

THE RACE TO CREATE A 21st CENTURY CORPORATE MODEL

We all have heard complaints that corporations are no longer functioning the way society has always hoped they would. Although we all likely agree on that, there is tremendous disagreement on what the solution to the problem might look like. No corporation acts in a vacuum, it needs a country to do so, and countries likewise need corporations. So, the symbiotic relationship between a country and the corporation (and other entities) needs to be re-examined on a regular basis to see what is working, and what needs to be fixed. Getting it right is more important now than any other time in history because the people and planet are not doing well. From income inequality to climate change, things have gotten worse. So new models need to be invented to solve new problems, or old problems that have gotten worse. So, let's take a look at some of the latest writers on the 21st century's biggest business challenge, viz.; creating a better 21st-century corporate model.

The three (3) approaches I would like to explore in this article are Leo Strine Jr., Corporate Governance model recently published in the ABA business journal entitled "Good Corporate Citizenship We Can All Get Behind?" Toward a principled Non-Ideological Approach to Making Money the Right Way." The second paper I want to discuss is entitled, "Rethinking the Social Contract Between State and Business: A New Approach to Industrial Strategy with Conditionalities" by Marianna Mazzucato, published in conjunction with the UCL Institute for Innovation and Public Purpose (IIPP). Lastly, the recently published standards by the ISSB entitled "IFRS S1: Sustainability Disclosure Standard General Requirements for Disclosure of Sustainability-related Financial Information" that was approved in June 2023. All three (3) papers approach the issue of corporate risk, responsibility, and opportunities from a different methodology. I submit all these are needed to solve the societal and business problems we find ourselves in today.

So let's begin by identifying what these major problems that need to be solved are. The five (5) problems identified at the Berle XIV symposium held in Los Angeles in July 2023, by the co-authors Leo Strine and Michael Klain, are as follows;

1. Worker powerlessness that results in inequality, fairness and social stability.
2. The corporate “externalities” theory that violate corporate accountability.
3. Corporate law facilitation of tax avoidance that results in the government capacity of not being able to address climate change and poverty.
4. The mismatch of regulatory constructs with the scope of the markets.
5. The political power of corporations and its negative effects on stakeholder protective policies.

I.

Given the above, let’s start with the first paper above, the Strine article entitled “Good Corporate Citizenship We Can All Get Behind“. The premise for Strine’s theory is that corporate law today in the United States is non-controversial in that corporations can pursue any lawful business by any lawful means and by any lawful activities. As such, the issue of whether a corporation can do something is very broad (within the limits of corporate statutes and common law of course). Secondly, under current corporate law, it is the Board of Directors that sets corporate policy and oversees management implementation of same within the context of their fiduciary duties. So given this two-part construct of what powers corporations have, and who exercises them within the corporation, the law is pretty settled. So, the only question is how shall a corporation use their power? This is where Strine has created what he calls his “Good Corporate Citizenship Model. So what is it, and how does it work? Let’s see.

So what is Strine’s vision of what he calls his “good corporate citizenship” model. For Strine, the solution can’t rely on just regulatory structures (i.e. rules and standards), but rather it must include creating corporate policies that take into consideration corporate rights concomitant with corporate limitations. As Strine asks “are we stuck with corporations that callously seek profit in a manner wholly abstracted from social context, and with none of the real world heart and soul concerns that animate sole proprietors and ordinary workers in their conduct? [Id. at 358] His answer is no because corporate By-Laws and policies are private law, so their elasticity enables them to address company specific solutions, within the broader rules of public law (i.e. hard

stops to errant policies.) His two-tier approach to corporate governance (at its floor level) basically embraces the Hippocratic construct of “first do no harm”. So in plain English what is the Strine policy? He writes: “[m]ake no mistake about it, we know our job is to deliver solid profits for our investors in a sustainable way, but also recognizing that by sustainable we mean sustainable. We are not going to seek profit the wrong way. Our shareholders don't just invest in us, they invest in the entire economy, and they pay taxes and need jobs. They live in the real world . . . [so] we will pay a living wage and benefits . . . and do so in all nations and regions where we operate. We will focus on safety and quality. . . We will try not to harm the environment or contribute to climate change that endangers our economy and well-being . . .”

So how does this work? Strine sets forth several board approved sample model policies to address corporations rights and duties. He divides them into direct interest vs. indirect interest policies. His draft direct interests (i.e. Tier 1) model policies take into consideration such matters as (1) ethical profits, (2) sustainability, (3) respect for stakeholders, (4) employee living wages and benefits, (5) safety and quality of its products, and (6) fair taxes, etc. for approval by the board. For so-called indirect interests, (“Tier 2”), Strine proposes they require a unanimous vote, such as “the entire board will approve any corporate policies in political and social issues, and will only address those more important to the company.” So Strine basically sets up two tiers of corporate interests, viz; direct interests versus indirect interests.

So how should Strine’s non-ideological model realistically work? Metaphorically speaking, for the first tier of corporate **direct** interests, directors should put their foot on the gas. For the second tier corporate **indirect** interests, directors should put their foot on the brakes. He argues that respected scholars in the legal field would agree that his model has, in legal parlance, a “rational basis” with appropriate “guard-rails” as he calls it. Strine refers to it as principled approach based on shared values. He then lists a dozen or so sample policies that fit his definitions and goals above. For example, one sample policy states; “[The company should avoid] environmental harm or any other harm that might unfairly shift cost from the company to its stakeholders or society”. Another policy states that “[i]f the company purports to take positions on external public

policy, its positions should result from a deliberative process of the Board of Directors based on the direct relevance of the policy question to the company, and not just reflect the personal view of the CEO without board backing.” Strine’s top list of director policies basically reflects the principles a specific corporation espouses (within the limits of corporate law) again on a two-tier basis, of whether the interest is direct or indirect to the overall company interests. Put another way, it would appear that Strine has premised his two-tier approach, on a sliding scale nexus-like basis, as to whether a company should, or should not, address and approve various suggested company policies.

So where do institutional investors fit in this model? Strine asserts that there should be a “corresponding framework to guide the stewardship role” of the investors. He then lists sample policies, such as to “identify reasonable expectations for portfolio companies to create sustainable value the right way”. For example, one investor policy is to “[d]emand corporations use the suggested guard rails [for corporations themselves] over political and social involvement.” Another Strine investor policy sample is “[c]hanneling engagement efforts toward those inward-facing issues – how is the corporation treating the people its conduct affects? . . .” So basically investor policy should track corporate policy.

In the end, Strine’s proverbial bottom line goal is that he wants both left and right sides to focus on encouraging corporations and institutional investors to “respect all corporate stakeholders in the pursuit of sustainable profit”. Simply stated, it’s about “making money the right way” so that “all Americans can get behind it, so it leaves no one out, and does not divide us.”

II.

The next approach on how to address the corporate and societal policy issues facing the country today was written by Marianna Mazzucato entitled, “Rethinking the Social Contract Between State and Business”. She is the founder of the UCL Institute for

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Simply stated, Mazzucato asserts that government funding must be conditioned on contracts and criteria that require public benefit from public investment to the maximum extent. This has not been the leading policy in the past decades (i.e. so-called free markets) that was less progressive, and focused simply on the government fixing market failures. The prevailing theory has been that the government was needed only for funding, but after that the government was to simply let the market be left alone, to do whatever the market does. So how did we get to this point?

To briefly digress, in the excellent book "Samuelson - Friedman - The Battle Over the Free Market" the author Nicholas Wapshott writes that in the 2008 crash, effectively the free market was no longer free. Financial institutions stopped lending. Credit markets froze, and financial businesses ground to a halt. As the author concludes "it was not exactly 1929 all over again, but the financial freeze of 2008 was to prove just as profound in its effect on the U.S. and world economy." Given same, in September 2008, Congress was asked to provide \$700 billion in emergency bank bailout funds to buy up troubled assets. When it voted against it (i.e. mostly Friedman free-market ideologues), "the Dow Jones plunged 770 points, the largest single-day fall in prices in Wall Street history." Chastened by the market verdict, Congress revisited their TARP decision and voted a second time a few weeks later, this time agreeing to fund the program in full on October 3rd, 2008. Below are some excerpts (and paraphrases) of what the author concludes from the facts he presented above. The financial freeze of 2008 undermined the logic of the rational-expectations school who argued that those who operate the markets know enough to avoid catastrophe. Why had there been no "rational expectation" of a financial freeze? [As the author stated]; ". . . America was to endure a painful, decade-long haul out of the ditch. Recovery was woefully slow. Friedman's championing of the free market had been hugely successful in his lifetime, but the financial freeze shook the commonly held belief that free-market forces, left to their own devices, would act to ensure the perpetual prosperity, full employment, and growth that Americans demanded. The same tone-deaf legislators who had voted down TARP led the charge against any federal government action that would hasten a recovery. There was

talk that bailing out companies presented a “moral hazard” that would encourage recklessness among financiers confident in the knowledge that the government would step in and save them at the last moment. But the principle that the government should keep out of the way and let the market do its worst had been shaken to destruction. In the heat of the crisis, no respected economist could be found to argue that it would be better to watch the economy fall off a cliff and wait for the market to provide a solution. Friedman's perennial prescription, to give the market time to cure itself, was not found wanting; it wasn't even considered.”

In Mazzucato’s paper she asserts that “conditionality”, as she calls it, in public-private funding, needs to be used to achieve the desired public policy objectives. She cites examples of five countries where this is being done right now. Put another way, so-called “private ordering” as a solution by itself will not suffice. A new era of detailed conditional public funding is needed to ensure the public is a stakeholder that benefits from the public-private partnership.

Sounds good, but how can this be achieved? The author submits that contract “conditions” are the best way to do so. By using such contract risk and reward shifting devices, namely, going from more of a defensive tool, to a strategic tool to address both risk and rewards, is the simplest way to do so. She cites procurement contracts as a way to address “greener supply chains, reinvestment of profits and better working conditions”. The four (4) contract conditions she lists to achieve these desired goals are as follows:

(1) Access Conditionality: This condition will allow companies equitable and affordable access to resulting products and services. Simply put, even though the government will be retaining various rights to the ultimate product or service, companies will be able to utilize the resultant product as set forth in the contract conditions.

(2) Directionality Conditionality: This condition is directed towards climate – friendly goals, by using green options. It also improves labor conditions by providing opportunities for jobs, measured by qualitative metrics (such as diversity and equity),

not just by the quantity of jobs. Both the issue of how the product is made (i.e. labor conditions, etc.) as well as the product's impact, will be taken into consideration in the contract conditions. So the “ends” and the “means” will be addressed on a “hands on” ethical basis.

(3) Profit-Sharing Conditionality: This condition requires profitable firms to share the royalties or equity with the government, and also may be incentivized to leverage their profits by acquiring government shares.

(4) Reinvestment Conditionality: This condition requires profits gained to be reinvested into productive activities in research and development for longer-term benefit. This will avoid financialization, and also create more alignment by the company with key government policy goals and support, so it creates both accountability and alignment.

The net result is a transition from, conventional industrial policy, to conditional industrial policy, that requires choosing those policies that initially focus on national and economic security, just as the DARPA and Bell Labs did in the past in the USA. The most recent legislation in the US, the author cites, is the CHIP Act which results in, as she states, “a powerful opportunity to inject Hamiltonian confidence into industrial policy through the use of a suite of stronger conditions. . .” She cites some examples, such as the prohibition of stock buybacks and shareholder dividends, to ensure the funding is aligned with public policy, broad societal goals, and to generate mutually beneficial partnerships, by sharing the risks and rewards from same.

III.

The third and final approach to solving today's five (5) major issues it's not a paper, but rather the IFRS S1: Sustainability Disclosure Standard that was approved by the ISSB in June 2023. It applies to resolving the climate-related industry standards that are useful to users. **The formation of International Sustainability Standards Board (ISSB)**

was done in 2021, under the umbrella of the IFRS Foundation in an attempt to harmonize sustainability reporting standards and the development of a long-desired ‘global baseline’. Following its 2022 draft of reporting standards for both general and climate-related disclosures, the ISSB published its first two Standards in June 2023, using as a baseline the pre-existing frameworks of both the TCFD (Task Force for Climate Related Disclosures) and the SASB (Sustainability Accounting Standards Board). The ISSB focuses on ‘single’ or financial materiality of how sustainability factors may affect a company’s financial performance.

So what is the IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information? Basically, this standard aims to support disclosures of financially relevant sustainability-related risks and opportunities (“SRRO”) that are useful to primary users of general purpose financial report, such as investors. Although it is broadly structured in a similar format to the Task Force on Climate-related Financial Disclosures (TCFD) framework, these parameters will now be applied to all material sustainability related risks and opportunities, not just climate risk.

The purpose of this article is to provide an overview of the approved IFRS S1 General Requirements For Disclosure (“GRD”) of Sustainability Related Financial Information, effective June 2023. The scope of these newly approved standards is to obtain financially-relevant sustainability information (as opposed to the GRI which covers all material) from an impact perspective. The ISSB aims to harmonize and consolidate sustainability reporting globally, improving the comparability and consistency of sustainability reports. In reporting to the ISSB, in conjunction with the GRI, reporting entities take a “double materiality” approach, ensuring that the reporting “speaks” to investors, and other stakeholder groups, such as customers and consumers.

In the approved IFRS S1 General Requirements For Disclosure (“GRD”) of Sustainability Related Financial Information, there are basically six (6) major sections in same, viz.:

- (1) Objective
- (2) Scope

- (3) Conceptual Foundations
- (4) Core Content
- (5) General Requirements
- (6) Judgments, Uncertainties, & Errors

In this article I will only highlight three (3) sections, namely, the Objective, the Scope, and the Core Content sections.

In the **Objective** section, the IFRS states that the objective of the GRD is to require an entity to disclose Sustainability Reporting “risks and opportunities that are useful to primary users of general purpose financial reports.” They cite as their reason that it is because the information is “useful [regarding] an entity’s ability to generate cash flows [that is] inextricably linked to the interaction between the entity and its stakeholders, society, the economy and the natural environment throughout the entity’s value chain”, namely an “interdependent system [of] resources and relationships”. The IFRS refers to same as an entity’s sustainability-related risks and opportunities (i.e. “SRRO” information). The rest of the standards relate to how an entity prepares and reports its SRRO financial disclosures with respect to various requirements for content and presentation of same.

In the **Scope** section, it simply states that this new GRD standards do not apply to those SRROs that are “not reasonably expected to affect an entity’s prospects outside the scope of this standard”. This also applies regardless of whether the SRRO statements are using IFRS or GAAP accounting standards. The terminology in the GRD is for public and private entities, as well as non-profit entities, although NPOs may need to amend the descriptions for particular items.

In the **Core Content** section, the four (4) specific areas the IFRS is primarily concerned with are the following:

- **Governance**
- **Strategy**

- **Risk management**
- **Metrics and targets**

So let's go through each one of these critical core subparts.

With respect to **Governance**, the IFRS objective is to obtain SRRO disclosures regarding an entity's "*process, controls and procedures* [it] uses to monitor, manage and oversee its SRRO". To do so, the disclosure must include both the governing body (e.g. Board of Directors) as well as its managers. Regarding the Directors, the SRRO information must include mandates, roles and related policies of the directors, their skills and competencies, how and how often they are informed about SRRO when overseeing its entities strategy, its discussion on major transactions, its risk management, and its setting targets and metrics. Regarding Managements' role in SRRO information reporting, the disclosure must include its controls and procedures to support SRRO efforts, and the integration of same.

With respect to **Strategy**, the IFRS objective is to obtain disclosures reports that must include SRRO information on an entity's *business model and value chain*, the impact on its strategy and decision making, its financial position, financial performance, and cash flows, and lastly its resilience. The information must also include its relationship to an entity's prospects, time horizons, its business model and value chain, trade-offs, and environmental impacts. The information must be both quantitative and qualitative, and contain any material adjustments and expected changes that enable users of general purpose financial requests to understand it. (There are several specific exceptions to the above that we will not discuss here, but the reporter must explain why it has not, or cannot, provide the SRRO information). Finally, the disclosure must assess the resilience of its strategy and business model in view of its SRRO.

With respect to **Risk Management**, the IFRS requires disclosures that show an entity's process to "identify, assess, prioritize and monitor" SRRO data, and the implementation of same into the entity's systems. The key question is how the entity uses the SRRO information throughout its organization, regarding its risk integration and opportunities.

With respect to **Metrics and Targets**, the disclosure of SRRO information must include the metrics the entity used to measure and monitor its SRRO information and its performance in relation thereto. The metrics must be those associated with the specific entity's business model in its particular industry. Such metrics shall include the period of performance, base period, milestones, trends or changes and any revisions. It shall set forth the metric required by an applicable IFRS standard, as well as ones the entity uses to measure and monitor the entities and risk and opportunities, and the entities performance in relation thereto. Likewise the entity must disclose information about the targets it has set to monitor progress towards achieving its goals, and as otherwise required by law. Such metrics shall include the period of performance, base period, milestones, trends or changes, and any revisions thereto.

CONCLUSION

So what is the point of creating a new 21st century corporate model to replace the 20th century version? The answer is because big problems, such as the national issues of sustainability and income inequality, pandemics, wars, etc. require a strong and resilient government that can handle these major issues. Those who simply see government as a mere backstop for "bail-out" economic programs are simply wrong, as the facts of the 2008 crash of the free market, and the COVID epidemic have shown. Good government is absolutely critical to solve cross-border issues. Calling the government the "problem" is just 1970's philosophical simplisism. Time to pivot to create a new 21st century corporate and economic model to replace it.

So the 3 questions are: (1) How should a 21st-century corporation act, (2) How should a 21st-century government act, and (3) How should 21st-century investors act? I propose a three-prong effort to do so, based on my thoughts on this paper.

First, we need to create a new corporate model. Call it "Good Corporate Citizenship" [Strine], or whatever you want, but it requires corporations to look beyond the financial simplisism of some of the past 50 years that created the major

“externalities” the public has had to endure at the expense of shareholders using zero-sum strategy gains.

Second, the government needs to create a new model for doing business with the private sector. Balancing a country’s budget begins with not giving away taxpayer finance research and development. There must be conditions attached to major technology transfers to allow the government to share in the rewards of the R&D being developed into products by companies. The days of “socializing risk and privatizing rewards” is over. The premise of the free market as being the best model was soundly discredited in the 2008 market crash and the subsequent Covid pandemic about ten years later. Good government matters, and so new public-private technology transfer models need to be developed, based on conditionalities for the transfer.

Lastly, a new financial model needs to be created to address sustainability risks and opportunities. For investors seeking to better understand what risk profile company has, it needs more disclosures of risk related data. And that data needs to be standardized, so that it can be compared to comparable data from other companies. Creating international standards requires international standard-setting institutions, such as the ISSB.

With 21st-century upgraded models for corporations, government, and investors, the issue of whether 21st-century problems can be solved becomes more realistically possible. All three systems need to be updated to address 21st-century problems. Time will tell, but as one of my law professors once said “there is almost always a simple solution to a complex problem, and it is almost always wrong.” Time to create a new model that deals with new complexities.

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