RETHINKING "POLITICAL" CONSIDERATIONS IN INVESTMENT

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Five years ago, Professor David H. Webber was invited to deliver an address both to our Delaware Law School community and to the Delaware Bench and Bar as Visiting Scholar in Residence of Corporate and Business Law. Webber's Speech, "Rethinking 'Political' Considerations in Investment," made several predictions about the rise of politicized investment which were quite prescient. As relevant today as when it was delivered, this piece explores the consideration of investment factors outside the traditional realm of shareholder profit maximization, both in its current state and in the future. Webber's analysis of how investors balance the role of capital accumulation with the special concerns of their members is addressed with objectivity and attentiveness. As "political" factors are on the rise in what seems every facet of our national landscape, it is increasingly important to address how such forces can impact markets and economies. On the occasion of its fifth anniversary, the Delaware Journal of Corporate Law has decided to publish the speech so it can be read by a broader segment of the corporate law community.

– Dante S. Pavan, Editor-in-Chief

[00:00:15]
INTRODUCTION: So we'll get underway. Welcome everybody. Thanks for being here. It's agreat pleasure to introduce our speaker. But a couple things to point out before we get to that. First of all, I want to thank former Chief Justice Myron Steele, who is our sponsor here at the Wilmington Club. And appreciate your hospitality very much. Good to have you here, too. I'm hoping to find some good questions to ask.

Also, want to thank Ellisa Habbart and Delaware Counsel Group for yet another year of sponsorship of this event, which I was trying to impress upon our guest, has been extraordinarily successful. We are very proud of the record of identifying up-and-coming young scholars, and watching them give their talks here, and then go on to great things in academia, and continue to influence the development of Delaware law and Delaware corporate and business law, in particular. So I have enjoyed this program. I've enjoyed thinking about whom to invite, and appreciate Ellisa's counsel in that, and sure we'll do very well again. One more administrative announcement. After the program, you are welcome to a reception downstairs. I encourage you to stay. If you've got to leave, I understand. But chance to hang around and speak to our guest,who I'll introduce now.

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David Webber, I found out this afternoon, is not a stranger to Wilmington. I'm told that he was a young associate at Patterson [00:01:58] I guess, and had the pleasure of being a participant in a bitterly contested two-week trial in front of then-Vice Chancellor Strine, not that that could ever be stressful. But so he's been to Wilmington before, and knows the drill. Which is not surprising,because he came to my attention as someone who had authored some very interesting works on the dynamics of shareholder litigation. And he's written on that subject, written about and taught about shareholder activism, a lot of the subjects that we hold near and dear. That is not, strictly speaking, his topic for today. And I'll let him introduce that topic.

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But before I sit down, I wanted to give him a token of our appreciation, which I pulled from yesterday mornings' *Wilmington New Journal,* if you didn't see it. David, it's got your picture here. And a little article about your background. So by all means enjoy it. Show it to your family. Tell them that you really were here. [laughter] Okay. And with that, I'll step down and invite Ellisa Habbart to—

ELLISA HABBART: Oh, there's nothing formal to say, only that I really appreciate the continued support of the Bar, and that Larry and I, not soon after this is done, we start thinking about the next scholar. So if you have come across any writings or persons that you think would be good for our annual event, please direct that information to us for our review.

INTRODUCTION: But without further adieu, live from Boston University Law School, David Webber.

[applause]

[00:03:42]
DAVID WEBBER: Thank you very much. I think I'll leave the article on the chair where it's safer from this bottle of water. But thank you. Thank you very, very much for inviting me. Larry, I want to thank you for inviting me, Ellisa, thank you as well. And thanks also to Carol and Flora for helping me get here. It's really an honor to be the Visiting Scholar in Residence in Corporate and Business Law here, to be invited to address this most distinguished Corporate Bar and Judiciary. And also, to follow in the footsteps of many of the scholars that Larry just referenced, all terrific people who I've gotten to know well in the academic circuit over the last few years. And with a definite penchant towards caring about doctrine and litigation and very real world corporate law issues, which I certainly appreciate and strive to emulate whenever I can.
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It's true, I've written a lot about shareholder litigation and shareholder activism, including a couple of articles, empirical papers, and institutional investor lead plaintiffs in Delaware M&A class actions. And I recently had a paper on plaintiff law firms in Delaware, with co-author Adam Badawi of Washington University in St. Louis School of Law. So, in addition to my having been a bag carrier on the trial here in front of then-Vice-Chancellor Strine, my focus has been on Delaware.

But I am pulling back the focus quite a bit, for purposes of the talk today. And I'm taking this as an opportunity to think through some of the bigger issues that I've been thinking about lately. In some ways, I've been making a conscious effort to try to step back and think through. You know, what are some of—Now, as I look out on being a scholar, and the scholarly space that I'll occupyfor the next 20-30 years, hopefully, you know, what seem like the big important trends going on now, that are likely to show up and manifest again and again? And what are the big, important developments going on right now?

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And there are, of course, any number that one could choose. But the one I wanted to talk abouttoday was the question of what are called, or what I would call political considerations in investment, right. And so having chatted about this a bit with some of my non-corporate law colleagues on the faculty at Boston University School of Law, you quickly develop an appreciation for just how hot-button and intense even the word "political" can be, and the many different things that it can mean. And what gets called political versus something else is itself a controversial subject to debate. So I'm going to cut that off right at the beginning, because I don't want to spend a lot of time debating what "political" is, and basically work back from a traditional kind of corporate law finance definition of it, and then work forward from there.

So the way I define what political investment considerations are, is they're almost any investment considerations that depart from classic investment calculations. So if you go back to finance 101, or you go back to a certain view of corporate law, right, what does a reasonable investor do? What does a rational investor do? Well, in making investment decisions, they try to figure out what the net present value of future cash flows is, discounted by their risk characteristics of the investment. And that's more or less how you go about making an investment, right. It's a rational calculation. The purpose of it is straightforward, to maximize returns to the portfolio, at least to do so consistent with whatever your particular risk profile may be. And then, of course, the great complexity, of course, comes in into, "Well, how do you do that? How do you do it well?" And much of finance, as an academic enterprise, is devoted that question.

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So for purposes of this talk, then, what I mean by politicize is sort of anything that departs from that basic investment focus, you know, on maximizing returns, maybe consistent with a diversified portfolio, depending on what the goals are, right. Any other rational reason why you might make one investment over another. Now, what I'm also not talking about is, you know, people who make investment decisions on the basis of what their astrologer tells them to do, or sort of everything that we would all agree would be a rational investment decision-making. Well, I assume. I'm making some assumptions here. Forgive me if I've ridden roughshod over one of your preferences. But I'm assuming that there aren't

a lot of people consulting astrological charts and making investments, at least not in this room.

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And so what I talk about, then, is that kind of, you know, politicized—something else that comesinto the investment decision. And so I talk about what I call multipreference shareholders, right. What's a multipreference shareholder? Maybe in contrast to a unipreference shareholder. Unipreference shareholder would basically be anybody who is really interested in that classic definition of maximizing returns consistent with whatever their risk profile is.

But if you look around the world to me, right now, particularly if you look at the explosive growth of sovereign wealth funds, the continuing and growing role, let's say, public pension funds and labor union funds are playing in corporate governance fights and shareholder activism. And some very interesting developments in the foundations. What we see is some interesting movement, at least, on what exactly these entities take into account when making investment decisions, arguably in ways that I think are changing the investment landscape.

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Of course, all of these entities—pension funds, sovereign wealth funds, and foundations care about portfolio performance. If that portfolio performance gets ignored, they go away and get smaller very, very quickly, and whatever other objectives they may have, they can't pursue if they aren't also tending to the portfolio. That having been said, if you look at each of these entities—I'm not the first to observe this—If you look at each of these entities, it's as if, in their DNA, if I could use that—in their DNA, we can identify that they have multiple interests that are necessary for them to act on and take consideration of, if they are going to sustain themselves in their mission, if they're going to sustain themselves, and even enhance their goals as an institution, right.

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So, when it comes to sovereign wealth funds, of course, we have this growing concern which was there from the beginning, and I think, in some ways, has been ignored a little bit recently, about how they might simultaneously pursue nationalist agendas. They might pursue the interest of the sponsoring nation-state, you know, rather than just sort of classic maximizing return behavior. Pension funds, this comes up all the time with

public pension funds, that they have an interest in the jobs of their members.

It came up, maybe most prominently, in recent years, in justifying the D.C. Circuit's decision inbusiness roundtable versus the SEC, to strike down the SEC's proxy access rule, for failing to adequately, in the court's judgment, failing to adequately do cost benefit analysis on so-called special interest shareholders, like public pension funds and labor union funds, that have interestsin their members' jobs, okay, and how that might affect their behavior as investors.

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And foundations. You know, foundations, of course, want to maximize their portfolio. But they also have the agendas for which they were created, that increasingly, they seem willing to pursue through the portfolio. And so actually, so at the outset, then, sovereign wealth funds, for example, have grown nine fold in terms of assets under management in the last 10 years. Pension funds have gotten more vocal. So have the foundations. And so part of what's going on here is that, as more of the market becomes invested into entities like these, we may expect to see pressures and shifts on a variety of legal doctrines, which are going to have to increasingly deal with these multiple preferences and how these shareholders go about pursuing them.

So yes, they may have very good reasons to maximize the portfolio. But there is two things that they might do, to pursue their other goals. One is, that yes, they're just going to maximize the value of the portfolio, in whatever way that they see best, most fit. But, alongside that, they're also going to use that portfolio to pursue other goals. Even, so for example, there is the investments of equal value rule, which has long been propounded by the Department of Labor in interpreting the fiduciary duties of pension trustees. Okay.

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And it basically says, if you're choosing between two investments of equal risk and profit potential, okay, as long as they're equal—huge asterisk next to that one, right? – But as long as they're equal, you could select one or the other for any reason under the sun, all right. You can choose between investment managers for similar reasons, which gives some leeway to bring in all sorts of other criteria in making investment decisions.

And then, to make an argument that's a little bit more controversial perhaps, arguably these institutions will be faced within moments when they might consciously choose to make an investment decision that is worse for the portfolio, because it advances some other interest. So that's pretty abstract. And let me put some real world examples on the table, to try to put some flesh on the bone here, all right.

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So here is one example I wrote about a couple years ago, in an article published in 2014, called "The Use and Abuse of Labor's Capital," which was published in the *NYU Law Review.* And it really is about public pension funds investing in privatizing investments, right. So there was a very interesting article in the *New York Times Magazine* a couple weeks ago about the role of private equity in privatizing all sorts of public services, right, private prisons, private public school service companies, private firefighting companies, private police companies, private bridges, and private tunnels, and on and on and on, right. So many of these functions that have classically been assigned to the public sector, are increasingly being privatized.

Setting aside entirely the public policy debates about whether that's a good thing, a bad thing, how we feel about it, etcetera, etcetera, a lot of that work is being financed, actually, by public pension funds. If you look— The latest figures I saw were something around 45 percent of all assets under management by private equity funds come from public pension funds, right. That's a very significant investment by public pension funds.

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And so the example I wrote about in this article a couple years ago was reported by Bloomberg News. And here are the facts. A custodian's union in Chelmsford, Massachusetts, which is in the same county where I live, custodian's union has its pension fund invested through a public pension fund in Aramark, a company called Aramark, okay, which was owned by a private equity pool, okay.

So they make this investment in Aramark. Not long thereafter, Aramark shows up in Chelmsford, underbids this custodian's union for the Chelmsford Schools contract, and then offers those custodians their jobs back. They had been making like \$20-\$25 dollars an hour. They get their jobs offered back for \$8-\$8.50 an hour, okay, very, very steep pay cuts for these workers.

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Now, again, I'm not addressing the broader issue about privatization one way or the other. But, it does raise some very interesting questions about fiduciary duties of pension trustees making such an investment, right. What does it mean if you take the retirement funds of, say, security guards who work in a public state prison, and invest it in the private prison, whose profits, to some extent, are dependent upon that security guard working for lower pay and lower benefits than right what the public security guard was doing, okay?

Now, under a classic understanding of—maybe not classic—Under a particular understanding ofthe fiduciary duty of loyalty to these pension trustees, the only question was, well, what's the value of this investment? And in fact, from what I understand, the investment did pretty well in Aramark. So in this Bloomberg News article, there was a similar thing that had happened in Louisiana, where post-Katrina, a lot of services were contracted out to Aramark and financed by a Louisiana pension fund, whose own workers had their jobs substantially cut back when the private entity showed up in town, right.

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And the Louisiana pension fund leader basically defended it and said, "Look, we just look at the performance for the fund, the returns to the fund, and that's the end of the analysis." And I sort of questioned that in this article, right, in pointing out, you know, look. First of all, if you're a pension trustee, right, even if you have a fund-first view; that is to say, all your job is, is to focuson the performance of the fund. Even if that's your whole view, right, when fewer people have those jobs and aren't contributing into the fund, and when the employer—say the state or the county, municipality, doesn't have to contribute as much because there aren't as many workers in the fund, it may be the case that maximizing investment performance, okay, is not actually what's most in the interest of the fund.

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And that's separated apart from a textualist argument about, is it really about the fund? This gets into ERISA, but I'll quote it briefly. I mean basically, what the standard said, is, you know, a trustee is supposed to invest, "solely in the interests of participants and beneficiaries, and for the exclusive purpose of providing benefits." That's the language. "Solely in the interests of participants and beneficiaries." And in 2008, the Department of Labor issued an interpreted bulletin that said, "What that

means is the fund," okay. What it means is, acting in the best interest of the fund, which I actually personally did not agree with, from just a question of sort of understanding the text, right. I mean if the language is participants and beneficiaries, etcetera, etcetera.

But my larger point that I would draw from that is illustrating precisely what I'm trying to talk about here, which is, right, these entities, we look at sort of just—I'm not even talking about the personal preferences of whoever is leading them. We all know that leaders are human. They have their own political ideological charitable preferences. That goes in one basket. I'm talking about advancing the interests of the institution, okay, through the portfolio, is complicated, in that it isn't obvious, actually, that maximizing returns is the best—is what most advances the interest. And that raises some very interesting questions of implications about, I think, the duty of loyalty in this context.

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I want to throw out, because part of what I'm trying to do is persuade you that this stuff is changing everywhere at the same time. I now want to throw out an example from a totally different realm, and indeed, a different part of the world, that I think advances my thesis about politicization, which is a very interesting episode that happened recently with the Russian Sovereign Wealth Fund and an investment Ukraine. I don't know if any of you may have seen anything about this. But there was an article in *The Economist* about it, and elsewhere.

So I'll tell it to you briefly, which is, in December 2013, the Russian Sovereign Wealth Fund made a very substantial investment in Ukraine, $3 billion dollar investment, very interesting transaction. Ukraine issued one bond. It issued this one bond through the Irish Stock Exchange, in a deal brokered by law firms that everybody in this room knows very well. And that one bond was earmarked to be sold to Russia—or excuse me, to the Russian Sovereign Wealth Fund, not the same thing, at least not in theory, right, as Russia.

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And, by the way, the interest rate, the return on investment was one-half the going market rate for Ukrainian bonds at that time, right. So here you have a situation. The Russian Sovereign Wealth Fund decides to make a very large investment in Ukraine, a very unstable part of the world, for half the going rate of return, okay. Already, it starts to look a little bit suspicious. And if we insist on keeping our investment blinders on, and I

think you know, there's many people out there who are very committed to the idea that sovereign wealth funds are only just investors all the time. That's the way to understand it, right, it's hard to understand the following, right.

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But what happens? What happens is, a couple months later, as many of us know, the Ukrainian Premier flees, Russia invades, and there were some very interesting provisions of this sovereign wealth fund transaction. One was that the second that Ukraine's debt to GDP ratio exceeded 40 percent, it was in default. And, in being in default, it's not only in default to Russia, but all of Ukraine's debt, okay, automatically got triggered in this default.

What was the effect of this? The effect of this—and I know this is getting far afield from how wenormally think about investment, the effect of it was, that Russia was able to entirely block IMF aid to the country of Ukraine. It had, under the IMF's own rules, okay. And this, I argue, had nothing to do—this was not an investment at all, frankly, all right. This was not about the Russian Sovereign Wealth Fund deciding, "Now would be a great time to park $3 billion in Ukraine, okay, for less than half the going market rate." The purpose of that investment was entirely something else. It was to advance the political agenda of Russia at that particular point in time, right.

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Now there are plenty of other examples that I can go through. But this, to me, is like another example, sort of increasing, sort of, politicization of investments. The Norwegian Sovereign Wealth Fund has been under pressure from one of its main political parties, and there's been domestic movements in Norway as well, to push for investments in Africa as a matter of socialconscience. And this brings in a whole other realm of discussion about socially responsible investing and all that goes along with that.

And then finally, one other point I want to—one other data point to put out there is about foundation shareholder activism. So there's one foundation that I have spoken to a few times now, that has the typical model of, well, they have their particular agenda, which involves environmental issues, it involves net neutrality, and things of that nature. And typically, what do they do? They do what most foundations do, which is every year give away four percent to fund whatever their particular interests are, right.

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But they have recently, among others, come to the conclusion, like why should we pursue our foundation agenda only through the four percent? We also have 96 percent of the endowment that's invested out there. And we can, through shareholder activism, continue to pursue our environmental agenda and other agendas, right, by meeting with companies and putting pressure and building alliances and engaging in forums of shareholder activism, etcetera, etcetera.

Well these are all from entirely different parts of the world, parts of the investment world, parts of the investment market. Foundations, sovereign wealth funds, public pension funds, okay. But to me, there is a common theme, which is that, in each of these instances, we can see institutions that would appear to have incentive to depart, if not actually departing, from classic portfolio maximizing investment activities, but making investment decisions that advance some other aspect of that institution's interests.

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Now what's interesting about this? I hope there's something interesting about this. Otherwise, we can go to dinner early. But look. I think if we look back—So first of all, I think—I started to say at the outset, do I think this kind of activity is going to totally displace markets and investors as we know it? Absolutely not. There's all sorts of countervailing pressures there. There's also a lot of people out there, you know, hedge funds, most mutual funds, individual investors, and others, who are you know, classic traditional investment criteria aren't going anywhere.

However, I do think that, as more assets get shifted into institutions like these, and never mind, even, the trillions of dollars that have committed, at least on paper, to the UN Principles of Responsible Investment, etcetera. There's reasons to be skeptical about, follow through on, etcetera. But when you have, I think, shifts in investor profiles, it's not long before you start to get—and we're past the point; we're already seeing it—all sorts of legal tensions, doctrinal tensions, institutional tensions, that I think are already coloring much of what we do, what the people in this room do, and what I expect to be doing for the next couple of decades, right.

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So some examples, right. In the 20th century, we saw a clear shift, a different kind of shift, but not all radically different, from a market comprised almost entirely of individual investors to amarket that, today, is dominated by institution investors, right. So today, something like 70

percent of the market is institutional investors, right. And individuals have really retreated into this kind of minority role in the market. We've all seen the tensions in this.

I mean I teach securities regulation. It's another area I've written in, right. You talk about the 33 Act and the 34 Act, those had in mind, for the most part, the protection of individual investors. Investor protection was the sort of primary goal of those statutes, right, and remains an important goal today. But, as institutionalization has grown, we've seen all sorts of shifts in the legal doctrine, formally, informally, that have changed the securities laws to accommodate those new realities.

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I listed a couple here. You know, the existence of qualified institutional buyers, right. These are,you know, once you get—once you're defined in the securities laws as a qualified institutional buyer, you are exempted from all sorts of the protections of the securities laws, right. You don't get as much protection. It's interesting that that framing makes it sound like a disadvantage. In many respects, it's an advantage. There are all sorts of securities offerings you can participate in,that others can't. You get all sorts of benefits in your ability to resell securities that other individuals and other institutions don't get.

How about the preference for institutional lead plaintiffs in Delaware shareholder litigation? Not to mention that at the federal level, right. We have now a system in place that places some— There's less emphasis on Delaware than – It's less cut-and-dry in Delaware than it is at the federal level. But it's still there. Cases like TCW and Hertz[?] and others, right, which developed this preference for institutional lead plaintiffs in Delaware class actions. Why? They're more sophisticated. They tend to have larger losses, which may give them more skin in the game, right. All sorts of reasons why.

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We look to the real world, and some changes to the institution, to the investor portfolio, and the law adjusts accordingly. Another example, what's happened to fiduciary duties, right? It used to be the prudent person standard, right, was one standard that we had. We've since migrated over to a prudent investor standard, which also has a way of accommodating diversification in asset allocation, right, and an accommodation, too, to institutional investors that are bouncing all sorts of interests, and making investment decisions.

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So each of these are examples of how one particular shift in investor profile has had all sorts of effects on legal rules, on statutes, on doctrine, etcetera. And so I would argue that these kinds of pressures, whether they be top-down political pressures on investment, like the example of the Russian Sovereign Wealth Fund, or even bottom-up ones, more populist ones, like the Norwegian example, or socially responsible investing, etcetera, that these pressures in the marketplaces are changing the way we think about—And, by the way, it's not just that these institutions are getting stronger, or are having more influence.

It's also that there's spillover effects. It affects the way everybody else sees what they're investing for, why they're investing, right. I mean increasing—You get these calls about boycotts, and counter-boycotts that we hear about sometimes, right. I mean this is not—We haven't always thought about investment in this way. It's true that investment has been—there's always been political elements to investment. And it sort of rises and it falls. But it seems, to me,that we are on an upswing again.

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And I think that means that there are a number of areas that are ripe for potential re-analyses, thatare ripe for potential tensions in the coming years. And so I'll finish up by talking about a few ofthese areas that I think are particularly susceptible to these pressures. One I've already touched on, which is the meaning and the scope of the duty of loyalty. And in particular, I'm actually talking about this less on the corporate side context than on the investment side context.

You know, there is this—there's a real interesting mismatch that I think hasn't mattered for muchof our history, but is mattering more and more, between the fiduciary duties that govern, say, boards of directors and corporate leaders, and the fiduciary duties that exist on the buy side, for trustees and investment managers, right. One, the latter, really comes out of a trust—the trust lawemployee benefits, ERISA, state pension codes line. And, where most of us spend most of our time, is on the corporate law line, which also comes out of trust law, but is developed along a different pathway.

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And the duty of loyalty, in the corporate context, doesn't mean the same thing as the duty loyalty in the investment management context. The duty

of loyalty in the corporate context, you know, self-dealing, we can deal with that in the corporate context. In the trust side context, it's verboten, right. There's no excusing it, right. It's you nullify it automatically.

So we have this situation, now, where you've got investors on the bottom. And you've got a trustee up here with one set of fiduciary duties. And you've got a corporate leadership on the investee side with a different set of fiduciary duties. And there may be more and more tension between them. And in fact, I would argue that probably the direction things need to go, although maybe this just reflects my own bias as a corporate law person, is it would seem to me that, over time, these employee benefits funds and pension funds are going to need to be turning increasingly to corporate law, to figure out how to navigate some of the conflicts and some of the issues that they're dealing.

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One simple example is sort of the business judgment rule, right. You have the business judgmentrule for a corporation. But, having looked at this stuff on the pension side, there really isn't a business judgment rule on the pension side. Now there are some courts that sort of say, "Well, we kind of sometimes have one, maybe, right." How much legal—How much comfort has anybody gotten from that kind of analysis, right? Not very much, that would give some leeway tocorporate leaders to make decisions, that it's not quite clear as much on the trust side.

Let me give you one other quick example. And I know my time is running out, which is you know, CalSTRS and other funds that divest—you know, CalSTR is the California State TeachersRetirement System, divested from gun companies after the Newtown, Connecticut massacre, right. They just, "We don't want to own this stuff anymore." Now, from a certain narrow investment perspective, and you know, I'm not a—I applaud what they did. I'm not opposed to it, right, to that divestment. But it is interesting to unpack it from sort of an investment analysis perspective. I mean unfortunately, the cynical reality is that, very often, after an event like that, there's a sharp uptick in gun sales, etcetera.

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I mean if you're really just focusing on certain kinds of investment criteria, CalSTRS has developed criteria—one of its risk factors is investing in products that are a harm to public safetyand public health. What's the investment rationale? The investment rationale is, well, these entities are going to be regulated in the future. And they're going to face lawsuits. And

they're going to face litigation. And so it's best to get out now. Okay, that's—Okay, that's potentially a valid investment analysis. I'm not directly going to argue with that one.

But, you know, many of us have a sense that this has also been long understood that under trust, the American Cancer Society doesn't have to invest in tobacco, right, because it sort of cuts directly against the grain of what the entity exists for, etcetera. Those are the kinds of issues, though, that I think this increased politicization magnifies and teases out more. And we're going to see more of that in the coming years, as issues like this come to a head.

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A final point would be about the definition of a reasonable investor for materiality purposes andsecurities, right. We understand in the TSC case, right, famous case defining materiality in the investment context, right, for purposes, right, in the presence of a duty to disclose information, right, what information does the corporation have to disclose, right? It's got to disclose the material information, the information that would assume actual significance in the mind of a reasonable investor, that would affect the total mix of information, etcetera, etcetera.

Well, you know, as increasingly investors want all sorts of different kinds of information, particularly pertaining to these other interests, potentially, jobs interests, environmental interests, etcetera, etcetera, right, what does that ultimately do to the reasonable investor standard in the face of pressures like that?

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Well, one possible reaction is, batten down the hatches. We are going to continue to insist that, you know, investors fit a particular profile. And I'm not saying that would be totally unprecedented. There are areas of law where you make choices like that. And you hold to standards like that. And, if people deviate from it, they deviate from it. But there are all sorts of reasons to do that. But I would argue that that's going to be increasingly difficult to do, as investor expectations change, as the actual investors with multiple interests gain more power andmore influence.

So to sum up, you know, these are a number of different examples. And I think my basic argument is that, if we look at the DNA of some of these institutions that are growing, and onlygoing to get more powerful, we can see that they have these multiple preferences built right into what they do, that there are more than one ways to answer interests through investment than just maximizing returns.

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And it's going to pose a challenge to regulation, to lawyers, to academics, to judges, to try to figure out, you know, how do we shift our doctrines? How far do we shift them? How much do we police them the way they are in dealing with these various pressures, much in the way that we have had to transition our law in the 20th century, from a world and dominated by individual investors, to a world that, today, is clearly dominated by institutional ones.

So with that, I think you guys are on the frontline. I would love to get your questions, comments,thoughts, challenges, anything to anything that I just said. Thank you.

[applause]

Q: Are you aware of any [00:37:12] Board of Directors chose less [?] than optimal business decision [00:37:19] pressure from the stockholder group? And if they would get away with that?

[00:37:24]
DAVID WEBBER: So let me answer that. You're talking about a corporate part? So the examples that I have at my fingertips are actually sort of pension boards, and boards of trustees. So let me—Okay. So on the trustee side, on the pension side, for example, a number of these pension funds and other entities have adopted policies like, for example, the Ohio Funds. They're not going to invest in any privatizing investments whatsoever. They're just not going to do it. They're not going to fund it. They're not going to do it.

Other entities, like CalPRS and CalSTRS have adopted these sort of—maybe half measures isn'texactly quite the word, but there are certain kinds of rules that they apply to invest, public, private partnerships, etcetera, etcetera. Private equity funds, there are private equity policies, etcetera. So many of these funds, for example, CalSTRS, in the gun company instance, has now negotiated separate new agreements as part of their being a limited partner in these private equityfunds, to enable them not to participate in certain investments, etcetera.

[00:38:40]
So I center this on the investment side, on the investor side, because I think that's clearly where the pressure is coming from. In terms of on the company side, you know, on the investee side, you know, I think that, first of all, it's not the kind of thing—On the investor side, you can create a policy. And you can say, "This is our policy, and this is what we're doing," right. I don't think anybody is going to come out and say that that's the reason that they're doing it.

But I'll give you one example. A company is investing—boycotting Israel. This is an example that's come up recently. There are a number of companies that have said, right—One CEO of a company in Egypt recently said that they were pulling out of the Israeli market for exactly this kind of reason. That's an example of a company that is responding to pressures like that. And, by the way, there are counter-boycotts now going on, along very similar lines, right, where Governor Cuomo in New York, and New York Pension Funds have now announced they're going to boycott any companies that announce that they are boycotting—right, okay.

[00:39:55]
So we're off to the races. I mean one—you know, one interesting project that I'm hoping to work on is Israel's launching a sovereign wealth fund next year. How are they going to—You know, what should they do about companies that are boycotting them? Should I invest in them to try to change that through their shareholder power? Or should they just counter-boycott? Or should they just ignore that?

So it's out there. Yeah, I think it's out there. And, you know, we'll see what happens, too, withpublic benefit corporations, and the extent to which you can see, you know—I mean Delaware recently adopted this statute that's going to—that explicitly allows for departures under public interest, etcetera. Do I detect some skepticism on your part as to how influential these powers will be?

Q: Yeah, you sure do. [laughter] So you think it will just go on? It's hard for me [00:41:00] the Board of Directors [00:41:02] specific investment that was not in our company's best interest, because some group of stockholders asked them to do that. And they expected all the other stockholders to say, "Oh, that's perfectly okay." [00:41:18] The stockholders approved it. That seems to be the trend recently. But, nonetheless, I just can't believe that that [00:41:27]

[00:41:28]
DAVID WEBBER: Well, I agree with you in that. I don't think it would ever play out that way. It's very hard to see it playing out that way, right, which is, we will, you know, we're goingto take investment decision X because such and such shareholder wants us to. And we don't think it's in the best interest of the—That's not going to happen, right.

[00:41:50]
If you go back to an article by Gilson and Milhaupt about sovereign wealth funds a few years back, I don't think anybody is worried about this on that level. But you know, some of the examples they talk through in that paper include potential trade secret disclosure, or technology,or even—Look. Look at the—How about, if a particular country's sovereign wealth fund makesan investment in your company, okay. And you are the CEO. And you have the choice of building that factory in China, or in Mexico, which doesn't have a particularly big sovereign wealth fund, as far as I know.

It doesn't seem implausible to me that decisions like that, at the margins, that these pressures at the margins begin to affect that kind of decision-making, right. I don't know if that requires a fullboard, right, to bring out all the big guns. But at the margins, I think you start to see distortions like that, or at least potential deviations from the traditional criteria.

Q: I think most everybody here understands pretty well how the [00:43:09] gets enforced in traditional corporate board context, right. I know next to nothing about how it gets enforced in the context of pension funds. And your example of the pension fund that has both current employees and retirees [00:43:29] interest on that privatization question, may have great interest.In that kind of case, if the trustees to the pension fund decide to pursue the non-wealth maximizing investment, or not to pursue the privatization, do the retirees have a loyalty claim?
And if they do, what do they do about it?

[00:43:55]
DAVID WEBBER: So one of the fascinating aspects of having—you know, coming from a securities and corporate background, and start to look into the investor side, the first thing you notice is the complete lack of litigation, almost total lack of litigation in that space. And for thoseof us who come, particularly in securities, where you feel like you can't take two steps without a regulation, a rule, you know, something—and never mind

10 cases that are on point, that world, it's a deafening silence. There are like—You can cover it all in four or five cases.

[00:44:32]
There have been a number of cases, so for four or five, that's still a number. There were some very interesting cases in the '70s about this in New York City, where the New York City Teacher Retirement Fund made a substantial investment in New York City bonds, at a time when the city was in deep trouble of potentially going bankrupt. And so the teacher fund swoops in with a big investment, and they got sued, for saying, "You're jeopardizing my nest egg with this investment." And ultimately, the trustees were vindicated in that suit. And they were allowed to—and the investment was allowed to proceed.

[00:45:19]
I'll tell you about a couple other cases that have come up along these lines. One went to the 11thCircuit. I think it was in the late '80s. And what happened is, the pension fund was making below-market rate loans, housing loans to their own members. And the Department of Labor sued them, saying, "You can't do that. You can't make a below-market rate loan to your membersbecause that's not good for the fund. You're deviating from value maximizing returns to the fund." And they came in with this particular read of the Duty of Loyalty, precisely that read, that says, you've got to—[00:45:59] return to the fund. And the 11th Circuit ruled against them and lost on that one. And basically looked at the process, what the Circuit was focused on the processof the trustees undertook in making that decision, and on and on and on.

And one other quick one, which was similar in San Diego, a weird set of facts—I won't go too far into detail. But the bottom line was, is that the trustees made a decision that hurt the fund but helped the jobs of their employees. Basically, San Diego, there was a screw-up. And San Diego had over-committed to its pension fund. And then basically came back to the pension fund and said, "If you don't"—I forget what the exact condition was. But they came back to the pension fund, and basically threatened that, "We're going to have to fire people unless you accept a lower contribution from us." That's what it was. And the trustees agreed to it, and they got sued by members for, "You know, you're hurting the fund."

[00:47:01]
So yes, they have a right to sue. They could bring a lawsuit. But it really hasn't happened very much. Maybe in part because—I don't know why. I

mean I wonder if—One thing I've been keeping an eye on is this recent spate of 401(k) cases. These are pretty new. There are now a number of lawsuits out there. This didn't happen a few years ago. Where law firms are out there,bringing suits against fiduciaries of 401(k) plans, typically for fees, excessive fees, tolerating excessive fees, things of that nature.

Sometimes you just need a bar that knows about this stuff, and goes out, and starts bringing these kinds of cases. But you know, there's no question that—I think people are paying more attention to this now. And I don't know if we're going to see some lawsuits. And, by the way, one point I just wanted to make clear about that Aramark example, I'm not suggesting that it should be a per se breach of the duty of loyalty to make such an investment in the first place, right.

[00:48:12]
The question, though, that's interesting is, you know, could it be part of the prep[?], you know. Some would say, it would be a breach of the duty of loyalty to even consider the impact on workers of this investment, to even take it into account, right. And so I would argue, well maybe there's a little more scope for doing something like that.

Q: This is PBGC is the Pension Benefit Guarantee Corporation

[00:48:43].
DAVID WEBBER: Not that I know of, on the fiduciary duty stuff. You know, it's very interesting, the way this all works at the federal level, because all sorts of different entities have authority. But actually, through some kind of deal, really between the IRS and the Department of Labor, going back a couple decades, the IRS defers to the Department of Labor. So this is really, at the federal level, this is really in the bailiwick of the U.S. Department of Labor. And it has been a back-and-forth.

[00:49:18]
So in '94, in the first Clinton term, they came out with an interpretive bulletin that allowed pension trustees, for the first time, to take into account—what's their phrase? It's effectively—It's not socially responsible investments. It's economically targeted investments, which basically mean that they can think about these other things, as long as they're not sacrificing returns. So once you've sort of reached sort of the returns threshold—Okay. Right. But we all see that, once you open that door, okay, in 2008, under Bush, they issued interpretive bulletins saying, "No, no, no, fund only." And in November of 2015, the Obama Department of

Labor revoked the '08 Bush interpretation, and deferred back to the '94 interpretation.

[00:50:14]
And this is probably more detail than you wanted. But, to add another layer of it, all of this is technically legally irrelevant to public pension funds, which are state-created entities, okay. So this is another—This maybe also ties into your point, Larry, which is like, there is so much legal uncertainty that paradoxically, I think, it generates in a way less litigation rather than more.

Because what happens is, the DOL's pronouncements don't have any actual legal authority overthe pension funds. Nevertheless, it sort of, in the culture of the lawyers who advise these entities, advise them essentially, "Your best bet—You know, focus on returns to the fund." And that's what they do, I think, or with some exceptions.

So you're in this very weird netherworld, where it's up to 50 state Attorneys General, and 50 state legislatures. And I actually did the dreaded 50 state survey on this a few years ago. And like20-some, 20-25 of them had basically close to identical language to ERISA. And some others departed. And some say, "We kind of follow ERISA, maybe." It's in the absence of a lot of direct legal authority, you get this, I think, conservatism in the sense of the legal advice they're getting. So in short, no, I don't think the PBGC is done.

Q: So you mentioned an example with the Teachers Pension Fund in California divesting itself from, I think it was firearm manufacturers. But that doesn't strike me as something where you would have unanimous support from teachers, because they have varying opinions, in short.

Some of them are very passionate about weapons. Is there a threshold amount, where the pension fund, for example, has to have—or at least believe in a certain amount of support, where they're going to start divesting? Or right now, is it just up in the air?

[00:52:17]
DAVID WEBBER: Yeah, that's fascinating. And I thought about that myself, because you know, it's like, this goes back to the point I was making at the end of the talk, about how, in some ways, I think what will happen, or needs to happen, is these entities are going to start looking more to corporate law and corporate forums, in terms of how they think and

grapple with stuff like this. So at least in the corporate context, you have some kind of a check-back with your shareholders in the form of annual voting, director elections, say on pay, whatever it may be. You know, you have some kind of feedback mechanism, a "How am I doing?" feedback mechanism to your shareholders, right.

[00:52:57]
That's separate, you know. And maybe that's not exactly how we think about fiduciary duty, typically. But it's there, right. And so I've wondered. I mean you could imagine, you know, ratification of decisions like that, or something along those lines. But [00:53:11] is like a matter of sort of law, is there some kind of known threshold? I mean, do they have to know that X number of their members approve? There's no such thing, that I'm aware of. No such threshold.

What you do have, and where that stuff gets sussed out, is in the duty of impartiality, where you can't favor one set of your beneficiaries over a different set of your beneficiaries. But gosh, you really have to be—to run afoul of that is hard, okay. I mean every investment decision is impartial. If you make an investment decision that has a 10 year time horizon, okay, that's goingto have differential effects for the people who just started contributing to the pension fund, versus the folks who are retired, right.

[00:54:04]
So there's all—there's always a multiplicity of interests. And therefore, impartiality is impossible to get to. But that strikes me as, you know, as an unanswered question, as of right now. And maybe you could—If you were a nervous trustee, what more might you do to insulate yourself? I think these—I know, I've actually spoken to groups of trustees like this. They're thinking about this stuff. I mean this comes up. And it just seems to me right for litigation, even though it hasn'tquite played out that way.

Q: So this isn't really a question, but a comment from, I think, the only person in the room who's not a corporate lawyer, but constitutional law lawyer. As I'm listening to this last dialogue, it's fascinating to think about, since this is all about political investments, the First Amendment decisions that deal with other people's money. And so there's two interesting strains. One is the Abood [?] strain, named after a famous case involving—and has involved an analogue to a California [00:55:22] the Keller[?] case. These were both Supreme Court cases, which deal with the extent to which, if you're forced to pay dues of some kind, you have a right not to have the entity you're paying the dues to use it for ideological purposes that you don't agree with.

So Keller involved the California State Bar. And the question is, could the State Bar take positions on political ideological issues? Or could it only use the money that the California lawyers were required to pay for sort of non-controversial justice issues? You know, access to justice, and that sort of thing. And the Abood involved the Teachers Union of Detroit with the same sort of notion. You can force me to pay dues for teacher stuff. But you can't necessarily use the dues to try to sustain Roe v. Wade or something like that.

And then, of course, in the corporate world, there's Citizens United, in which the Supreme Court essentially rejected the idea that there was some First Amendment problem with taking other people's money and using it for political [00:56:26] perspective. So there's a fascinating thing. Because I was listening to you, in terms of this problem from a corporate law perspective, listening to the extent there was any forced payment in any of these contexts. Like you've got [00:56:40] through the pension fund, or something like that. You could have some interesting First Amendment challenges to, "I only gave you this to maximize my return. I didn't give you this to take positions one way or the other on guns."

[00:56:57]
DAVID WEBBER: Well, you know, this Fredericks case, just as an interesting follow-up on that, that Abood decision was squarely on the chopping block earlier this year, in Fredericks. So Justice Alito had invited an opinion and said, "Maybe it's time for us to reconsider Abood." And the Fredericks case was that case. Nine California teachers, who had to—didn't have to contribute to the union's political fund, but still had to pay a fee to the union because of collective bargaining that the union did on its behalf, challenged that fee on those grounds, on First Amendment grounds. And it looked like it was going to five-four to strike down. And then we—You know, and then after Justice Scalia passed, that was—Abood was upheld in the four to four vote.

[00:57:51]
So yeah, I mean I just—Talk about another point of convergence. These issues are coming up on the investment side, more and more, for any number of reasons. More disclosure, organizations that are dedicated to thinking about this stuff. So I don't know. I think we'll be hearing more about it in many contexts.

[applause]

Thank you.

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