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Bill Takes Aim at Directors, Corporate Governance

By Jennifer Williams-Alvarez September 17, 2018

Companies in the United States and their directors are fixated on one thing, according to Senator **Elizabeth Warren** (D-Mass.): maximizing shareholder returns to the detriment of other stakeholders in the company. To address this, Warren recently introduced a bill that would require directors to consider all major stakeholders, not just shareholders, when making company decisions.

As is, the bill is unlikely to become law, sources say, but Warren's proposal to overhaul the way certain companies in the United States operate highlights some of the major issues currently facing companies, and according to some, it may have an impact on corporate governance discussions and decisions made within companies.

And it may also serve as a critique of boards of directors, says **Douglas Chia**, executive director of the governance center for **The Conference Board**. "She basically wants to strip [those at the decision-making table] of certain powers that they have or impose certain requirements on them," he says. "That's a direct criticism of corporate boards."

Warren's bill, the Accountable Capitalism Act, would require companies with more than $1 billion in annual revenue to get a federal corporate charter that mandates that directors consider interests of all major stakeholders. The bill also stipulates that at least 40% of all directors would be elected by employees and at least 75% of directors and shareholders would have to approve political expenditures.

> **The Accountable Capitalism Act**
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> (1) CONSIDERATION OF INTERESTS—In discharging the duties of their respective positions, and in considering the best interests of a United States corporation, the board of directors, committees of the board of directors, and individual directors of a United States corporation—
>
> (A) shall manage or direct the business and affairs of the United States corporation in a manner that—
>
> (i) seeks to create a general public benefit; and
>
> (ii) balances the pecuniary interests of the shareholders of the United States corporation with the best interests of persons that are materially affected by the conduct of the United States corporation...
>
> *Source: S. 3348, Sen. Elizabeth Warren (D-Mass.)*

In a *Wall Street Journal* op-ed, Warren said that, while companies once recognized obligations to several stakeholders, that idea was replaced by the view that directors are required solely to maximize shareholder returns. She also criticized equity-based compensation, which she argued feeds into the desire to focus too much on shareholder returns.

“For the past 30 years we have put the American stamp of approval on giant corporations, even as they have ignored the interests of all but a tiny slice of Americans,” Warren wrote in the *Journal.* “We should insist on a new deal.”

Governance Overhaul?

The ideas underlying Warren’s bill are not necessarily novel, but in a blog post published not long after she announced it, **Martin Lipton**, a founding partner of **Wachtell, Lipton, Rosen & Katz**, speculated that the proposal would have a definite impact. Lipton, who pointed back to his post when asked for an interview, likened Warren’s proposal to previous efforts by **Ralph Nader** to require federal incorporation of companies.

“Warren’s proposal should not receive any more support than Nader’s,” wrote Lipton. “However, like Nader’s proposal led to significant changes in environment regulation, Warren’s will likely lead to major changes to the relationship between corporations and the institutional investors and asset managers who control them.” Lipton added in a second post that, while he is a proponent of stakeholder corporate governance, he believes federalization of large companies is “too high a price to pay.”

But not all expect sweeping changes. **William George**, senior fellow at **Harvard Business School** and director on the **Goldman Sachs Group** board, says he imagines a more muted impact focused on discussion of the issues.

In particular, the bill highlights a concern that companies are too focused on short-term goals, which George agrees is detrimental to a company. Countless hours are expended in the name of quarterly filings, distracting management from longer-term goals, he says, and so this and other recent events, such as President **Donald Trump**’s tweet announcing that he’d asked the **SEC** to consider an end to quarterly reporting, will the discussion.

Meanwhile, some say the proposal is likely to have no impact, whatsoever.

“Not only does the bill have no chance of passing, its likelihood of having any impact on corporate governance is close to zero,” **Lawrence Cunningham**, a law professor at **George Washington University** who regularly advises and serves on corporate boards, writes in an e-mail. “[A]nd it’s a good thing too,” he adds, pointing out that a federal corporate chartering system would bring with it the risk of “infecting corporate life” with federal politics and lobbying.

Regardless of the impact of the proposal, sources agree that more regulation and, in particular, the Accountable Capitalism Act, is not the answer to the issues laid out by Warren and others.

For one, George contends that federalizing corporations would be an “enormous mistake.” What’s more, he says that having employees elect a certain percentage of directors would create a two-tiered board in which directors elected the traditional way largely operate, and make decisions, separately from the rest of the directors. George says he previously served on the board of a French company with a similar structure, and “it was a façade.”

“It doesn’t work at all,” says George, who previously served as chairman and CEO of **Medtronic**. “I believe very strongly that every board director must represent the company and its shareholders. I do not think that we should have representative directors.”

George acknowledges that focusing exclusively on maximizing shareholder returns to the detriment of other stakeholders is the “death knell for a company.” But, he says, successful companies already make full stakeholder concerns a priority.

This would make sense, given the attention focused on the idea that company decision makers should be driven by more than shareholder returns. In his letter to chief executive officers earlier this year, for instance, **BlackRock** CEO **Larry Fink** noted that that companies “must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate," otherwise they will "lose their license to operate from key stakeholders."

And in fact, as Warren points out in her op-ed, more than 30 states have authorized so-called "benefit corporations," which require directors and officers to consider the impact of their decisions on stakeholders such as employees and customers, as well as on shareholders.

The key difference between what states have done and Warren's bill is choice, **Haskell Murray**, associate professor of management and business law at **Belmont University**, points out in an e-mail. For years, there has been more of a focus on companies' social responsibility, and whether or not future governance changes stem from Warren's proposal, ongoing movements or some combination of the two, Murray notes the Accountable Capitalism Act is giving the concept of social business an elevated platform.

Murray adds, however, that his concern is the bill may also "make the social business movement more partisan." He points to a recent *Forbes* article from **Jay Coen Gilbert**, co-founder of B Lab, who, in reaction to Warren's proposal, wrote that in the 34 states that have authorized benefit corporations, both Republican and Democrat governors have signed the legislation into law.

Allowing businesses to opt in (as is the case in the 34 states), versus mandating governance changes for certain companies, may make all the difference. "While the social benefit movement has leaned left overall, I think the support that benefit corporation legislation has received on the right rests on the fact that it is a free market solution to social ills," Murray writes. "Under existing state benefit corporation law, the socially-focused governance model is voluntarily adopted. In contrast, Senator Warren's proposal is mandatory for the covered large companies."