Is It Only About Profits?

The corporations-should-care-about-society movement reaches a crescendo with Elizabeth Warren's proposed bill.

BY DOUG RAYMOND

There's a growing and important debate about corporate governance, particularly viewed against the backdrop of significant criticism of recent corporate action (or inaction) around social media issues, the #metoo movement and other current controversies.

Sitting at the center of this is Sen. Elizabeth Warren, who recently introduced legislation (the Accountable Capitalism Act) requiring any U.S. company that has more than $1 billion in annual revenue to obtain a newly created federal charter.


Elizabeth Warren

The charter would be in addition to its state constituent documents (e.g., articles and bylaws) and would mandate significant changes in corporate governance.

In many jurisdictions, including Delaware, the board's primary obligation is to manage the business of the corporation "in the best interests of the stockholders." However, some jurisdictions take a more expansive view of the board's obligations and are expressly permitted to consider factors other than shareholder value in discharging their fiduciary duties.

For example, in Pennsylvania the board instead must act in the "best interests of the corporation," and may (but does not need to) take into account all "pertinent factors," including the interests of shareholders, but also the interests of customers, employees, suppliers, creditors and the communities in which the corporation operates. Pennsylvania also emphasizes a principle that has been judicially recognized in many jurisdictions — that short-term interests are not necessarily more important than long-term interests. Importantly, the board does not need to treat the shareholders' interest as paramount.

> The Accountable Capitalism Act would impose benefit corporation principles on all large companies, requiring businesses to create a general public benefit, and to consider the effect of a proposed action on all stakeholders who are materially affected – not just the shareholders.

These broader "constituency" statutes were originally adopted largely to assist boards in resisting hostile takeovers, but more recently have been cited to authorize a greater scope of corporate responsibility outside of the takeover context. An expanded version of this approach is reflected in the "benefit corporation," a relatively new form of business organization for which enabling legislation has been adopted in 34 states. *(See related BCorp article on page 34.)*

The benefit corporation concept reflects the perspective that businesses affect more than just their owners and have extensive impacts on other interests, including employees, customers, communities and the environment. These include environmental, social and political impacts that are not reflected in the costs typically recognized in running the business — for example, air or water pollution, work-related illnesses not covered by their employers, or the utilization of a social media platform for nondemocratic or repugnant messaging. The managers of a business, it is argued, must take into account the external, as well as internal, impacts when making decisions.

In most jurisdictions where benefit corporations have been authorized, the corporation must have a corporate purpose of creating a material positive impact on society and the environment. Its directors are not permitted merely to consider the interests of constituencies other than the shareholders. On the contrary, they are required to also consider the interests of other groups, without giving priority to the interests of any one group. These other groups include employees, customers, suppliers and communities where the corporation conducts business, and also "community and societal considerations, the local and global environment, and the ability of the benefit corporation to achieve its general and any specific public benefit purpose."

The Accountable Capitalism Act would impose some of these benefit corporation principles on all large companies, requiring businesses to create a general public benefit, and to consider the effect of a proposed action on all stakeholders who are materially affected, which include all the groups identified in the benefits corporation legislation, and is not limited to the interests of shareholders. (This legislation contains other interesting provisions, including restrictions on political spending and a prohibition on management selling shares for five years after they have been acquired from the company, or for three years following a corporate stock buyback. The bill also would give employees the right to elect no less than 40% of the directors.)

The broader "stakeholder" approach reflected in this legislation and in the growing benefit corporation movement has been criticized on the basis that if the directors are allowed to consider "all pertinent factors" their decisions are essentially unreviewable. These critics argue that in order to have accountability, there must be clear guidelines for reviewing board action, and as the shareholders own the business, why aren't they the best group to provide the measure? Moreover, say these critics, it is the shareholders who elect (and remove) the directors, not the employees or suppliers, so shouldn't their interests be paramount?

This criticism may miss the mark.

Unless the corporation is being sold or a director or a controlling stockholder has a conflict of interest (when very specific rules come into play in most jurisdictions), the board — even of a Delaware corporation — has significant flexibility when deciding what action is in the best interest of the stockholders. And the business judgment rule affords broad discretion to the board, and makes such decisions, if thoughtfully made, essentially unreviewable (except in a shareholder vote).

Because most boards already have this inherently broad discretion, the Accountable Capitalism Act and the discussion it provokes can serve as an important jumping off point for a board to consider and articulate the criteria directors will use in making significant decisions, including whether near-term profits should be paramount.

This discussion is particularly relevant in the current environment of intense public interest in and criticism of corporations' impact on climate change and

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commitment to sustainability; the role they are playing in political discourse and elections; pricing decisions for pharmaceuticals and other products; and the extent to which these businesses have been perceived as perpetuating sexual or racial harassment and discrimination.

Boards should, if challenged, be prepared to explain the basis on which they have made a controversial choice. This kind of discussion can help prepare the directors to make, and to justify, those difficult decisions. ■

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