

## Proposed Corporate Law Reform: Legislative Proposals

Kent Greenfield & Daniel Greenwood

(<http://www.bc.edu/schools/law/fac-staff/deans-faculty/greenfieldk>)

(<http://www.law.utah.edu/greenwood>)

### I. Anti-Fraud Laws for Employees

Rationales:

- \* Already, a huge legal regime at both state and federal levels protects shareholders from untruthfulness.
- \* No federal law (and no state) makes it illegal for corporations to lie to employees.
- \* Truth is at least as important in labor market as in securities market.

For analysis, see: Kent Greenfield, *The Unjustified Absence of Federal Fraud Protection in the Labor Market*, 107 YALE L. J. 715 (1997). For a popular treatment, see: "Truth, or Consequences: If a Company Lies, Employees Should Be Able To Sue," THE WASHINGTON POST, Outlook Section (lead article), Sunday, June 28, 1998.

Text of proposed statute (based on federal Rule 10b-5, which makes it unlawful to engage in fraud in the stock market):

#### **[State] Anti-Fraud Act**

*1. It shall be unlawful for any corporation, partnership, sole proprietorship or other for-profit business enterprise doing business in [State] and employing people in [State]:*

- (a) to employ any device, scheme, or artifice to defraud,*
- (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or*
- (c) to engage in any act, practice, or course of business that operates or would operate as a fraud or deceit upon any person,*

*in connection with the offering or provision of employment, the negotiation of the terms of an employment relation, or the offering or continuing provision of employment benefits.*

*2. This provision may be enforced by private suits brought for damages or for equitable relief, or by suits brought by the Attorney General or his designee.*

NB: Federal ERISA law may present preemption problems, as least with regard to fraud in connection with pensions.

## II. Assert Rights of State to Govern Corporations Operating in the State

Rationales:

\* In most areas of law, a jurisdiction has the right and power to govern behavior within the jurisdiction, especially if that jurisdiction has a greater interest in governing that behavior.

\* In corporate law, however, the “internal affairs doctrine” says that the state that provides a corporation’s charter also provides the rules of corporate governance, even if the state of chartering (usually Delaware) has no other interest in regulating the behavior in question. This doctrine is not required by federal law or regulation, and is simply a convention that could be jettisoned at the discretion of any state.

For analysis, see: Kent Greenfield, *Democracy and Dominance of Delaware in Corporate Law*, 67 J. LAW & CONTEMP. PROB. 135 (2004); Daniel J.H. Greenwood, *Delaware and Democracy: The Puzzle of Corporate Law*, GWU Law School, Public Law Research Paper No. 55., 2003; Daniel J.H. Greenwood, *Democracy and Delaware: The Mysterious Race to the Top/Bottom*, 23 YALE LAW & POLICY REV. 381 (2005) (Greenwood articles available at <http://www.law.utah.edu/greenwood>).

Text of proposed statute:

### **The Defense of [State] Sovereignty Act**

*1. Abolition of the Internal Affairs Doctrine. The Internal Affairs Doctrine (regarding choice of law with respect to corporate law) is hereby abolished.*

*2. Notwithstanding any provision of the law of this or any other state, and notwithstanding the jurisdiction of incorporation of a corporation, it shall be the policy and law of the state of [State] to assert the law of corporations under [list State corporate law provisions] as the governing law over the internal affairs of any corporation that:*

- (a) is headquartered in [State]; or*
- (b) has 51% of its shareholders of record residing in [State]; or*
- (c) employs 51% or more of its employees in [State]; or*
- (d) employs more employees within [State] than in any other state or political subdivision of the United States; or*

*(e) by way of its activities, behavior, employment, investments, leadership, or effects on stakeholders or the environment, more significantly affects the interests of [State] to a greater degree than those of any other state.*

*3. In all cases not covered by Section 1, notwithstanding any provision of the law of this or any other state, and notwithstanding the jurisdiction of incorporation of a corporation, it shall be the policy and law of the state of [State] to apply its choice of law rules without regard to the “internal affairs doctrine” to any issue of corporate law regarding a corporation doing business in the state of [State].*

*4. Conforming changes. [RMBCA **Definitions:** "Corporation" or "domestic corporation" means a corporation for profit, which is not a foreign corporation, incorporated under or subject to this chapter.] **is hereby deleted and replaced with the following:** “Corporation” or “domestic corporation” means a corporation for profit incorporated under or subject to this chapter.*

### III. Assert Rights of State to Govern Major Decisions of Corporations Affecting State Citizens

This is related to Proposal II, but is broader in some ways and narrower in others.

For analysis, see: Kent Greenfield, *Democracy and Dominance of Delaware in Corporate Law*, 67 J. LAW & CONTEMP. PROB. 135 (2004).

Text of proposed statute:

#### **[State] Corporate Impact Act**

*1. Regardless of where such a corporation is chartered, and notwithstanding the law of any other state, the directors of:*

*(a) a corporation that employs 51% or more of its employees within [State] ; or*

*(b) a corporation that employs more employees within [State] than in any other state or political subdivision of the United States or other nation; shall consider the interests of the corporation’s employees in making decisions that have a material effect on the level of the corporation’s present or future employment. This provision may be enforced by private suits by affected persons brought for damages or for equitable relief, or by suits brought by the Attorney General or his designee.*

2. *Such a duty shall be deemed satisfied if the board of directors of said corporation includes at least one member who is elected by hourly-wage employees rather than shareholders, through a mechanism that is created by the board in good faith.*

#### IV. Limit CEO pay

Rationales:

\* Extreme inequality of wealth and income subverts the democratic process. No one in a republic should have enough money to purchase another person's service and loyalty.

\* Within the corporation, extreme differential of wages subverts the processes of corporate efficiency and decisionmaking, by separating CEOs from the institution they are meant to manage. High CEO pay defeats the "team building" that is essential to corporate success and leads to breakdowns of the flow of information in the corporation.

For analysis, see: Daniel J.H. Greenwood, *Enronitis: Why Good Corporations Go Bad*, 2004 COLUMBIA BUSINESS L. REV. 773 (2004); Daniel J.H. Greenwood, *Team Spirit: Doing Bad Things in the Cause of Good*, in WILLIAM MYERS (ed.), *EVIL, LAW AND THE STATE* (Interdisciplinary Press 2006); Daniel J.H. Greenwood, *Discussing Corporate Misbehavior: The Conflicting Norms of Market, Agency, Profit and Loyalty*, 70 BROOKLYN L. REV. 1213 (2005) (all available at <http://www.law.utah.edu/greenwood>).

Text of proposed statute:

##### **The Bob Cratchit Limitation of Tax Deductible Greed Act**

*1. Notwithstanding any other provision of [State] tax law, any payment or payments by a corporation or other business enterprise to any single executive, employee, consultant or person in excess of \$1 million shall not be deductible as a business expense to the extent of the excess of such payment(s) over \$1 million in any fiscal year, unless the requirements of Section 2 are met, and any such payment(s) shall be deemed a distribution of profits for purposes of corporate and personal income tax.*

*A. For purposes of this section, "payment" shall include salary, wages, bonuses, fringe benefits and all other compensation, whether in kind or in the form of cash, stock, stock options, deferred compensation to any person in the form of wages, bonuses, stock, stock options, or any other valuable consideration.*

*B. Deferred or restricted compensation and options and similar derivative securities shall be valued at the time of granting and deemed to be paid and received at the date at which granted and included in the accounts of the payor in that fiscal year. In addition, such compensation shall be valued at the time of exercise (in the case of options*

*and similar derivative securities) or actual receipt (in the case of restricted or deferred compensation) and the positive difference between the value at such date of exercise or receipt shall be deemed to be paid and received at that date and included in the accounts of the payor in that fiscal year.*

*C. Grants of restricted stock shall be deemed restricted compensation for the purposes of Subsection B.*

2. *Section 1 shall not apply if*

*A. the total compensation in every form paid to highest paid person in relationship with the payor in the relevant tax year does not exceed 20 times the total compensation paid to the lowest paid full or part time employee (or equivalent) of the payor, and*

*B. the payor maintains no benefit plan (including but not limited to retirement and medical benefits) that is applicable to highly paid employees (as defined in ERISA) and not applicable to non-highly paid employees, and*

*C. the payor accurately and publicly discloses (a) the ratio between its highest and lowest paid employees, (b) the total compensation received by its median employee, and (c) the percentage of its employees who earn less than 1.5 times the national poverty level for a family of four.*

## V. Abolish Corporate Double Bookkeeping

Rationales:

\* Accounting is an inexact process involving many judgments. When corporations are permitted, or even required, to keep separate books for tax authorities and shareholders, they will exercise their judgment to report the lowest possible profits for the former and the highest possible profits for the latter. This deceptive practice denies both sets of readers (and the general public) the benefits of an unbiased estimate by management of the corporation's success.

\* Honesty and dishonesty are habits inculcated by general practice. Corporate bureaucrats used to providing inconsistent numbers for different audiences may well internalize the notion that telling people what they want to hear regardless of the truth is acceptable behavior, leading to general breakdown of corporate decision making and actual fraud.

For analysis, see: Daniel J.H. Greenwood, *Enronitis: Why Good Corporations Go Bad*, 2004 COLUMBIA BUSINESS L. REV. 773 (2004) (available at <http://www.law.utah.edu/greenwood>).

Text of proposed statute:

### **Honesty in Accounting Act**

1. *Every corporation shall determine its profits in a single, consistent fashion in accordance with generally accepted accounting principles and in a fashion that fairly represents its financial position*
2. *There shall be a rebuttable presumption that it is fraudulent for any corporation to report different profits for different purposes or to different audiences.*
3. *Notwithstanding subsection 2, a corporation may report its earnings in alternative form when required to do so by law or good business practice, such as according to differing international and domestic accounting standards.*
4. *For purposes of [State] corporate income tax, the corporation's net income shall be deemed to be the higher of*
  - i. *The sum of profits as reported to shareholders plus any excess compensation disallowed pursuant to [CEO salary provision above] or*
  - ii. *Profits reported according to [State] tax law.*
5. *In the event that any corporation shall maintain more than one set of books or report its accounts in differing forms pursuant to section 3 or 4 or for any other purpose, each and every differing set of accounts shall be disclosed to the [State] tax authorities, to the corporation's shareholders and to anyone else entitled to view the corporation's books or accounts or receive its annual report, together with a reconciliation of the differences between or among them.*

## VI. Limit Corporate Political Interventions

### Rationales:

- \* Corporations are not citizens but tools of citizens.
- \* Corporate decisionmakers are usually required by law and market pressure to put aside their own views of what is good for the country and, instead, concentrate solely on maximizing corporate returns, even when they recognize that other values are more important.
- \* To harness corporations to the public good, the limits to the pursuit of profit must be set by the political process. Since corporations are required by law and market pressure to advocate for no limits to the pursuit of profit and to externalize their costs onto others, they are illegitimate participants in the political debate and should be barred from it.

For analysis, see: Daniel J.H. Greenwood, *Essential Speech: Why Corporate Speech Is Not Free*, 83 IOWA L. REV. 995 (1998) (available at <http://www.law.utah.edu/greenwood>).

Text of proposed statute:

### **Defense of Republican Democracy Act**

1. *It is the policy of the State of [State] that for-profit corporations act within the constraints of law and not evade legal regulation by lobbying or otherwise intervening in the political and regulatory process.*

2. *Because for-profit corporations are required by law and market pressures to pursue profits beyond the point at which citizens would decide that other values are more important, it is the policy of the State of [State] that for-profit corporations are not citizens of this state and are not adequate representatives in political processes of their members or participants.*
3. *No for-profit corporation shall spend, directly or indirectly, corporate funds to:*
  - a. *influence or attempt to influence any [State] election, referendum, legislation or proposed legislation, agency policy or rule making, interpretation, or*
  - b. *otherwise to lobby the State of [State] or any subdivision thereof, or*
  - c. *participate in any political campaign in the State of [State].*
4. *This provision shall not be applicable to any corporation the board of directors of which is elected on the basis of one human individual-one vote.*
5. *This provision shall not affect the right of the news media to report news or editorialize on any issue.*
6. *This provision shall not affect any right of any corporation to expend corporate funds to prosecute or defend any action in a court of law.*
7. *Breach of this provision shall be a breach of the duty of legality.*
8. *This provision may be enforced by private suits by affected persons brought for damages or for equitable relief, or by suits brought by the Attorney General or his designee.*