AHLA WEEKLY
10/25/2019

Nonprofit Health Care, Social Responsibility, and the Accountable Capitalism Act

By Michael W. Peregrine and Robert C. Louthian, McDermott Will & Emery

The nonprofit health care sector should become informed about, and be prepared to join the evolving debate on, what the actual purpose of a corporation should be, and new principles of corporate accountability. This includes the possible application of the proposed Accountable Capitalism Act (Warren Proposal) to the largest nonprofit health systems (either directly or by implication/drift).

The ultimate resolution of this debate could have a profound effect on the organizational mission, director fiduciary duties, board composition, strategic planning, and the extent of federal regulation of nonprofit health care. The corporate general counsel can provide valuable assistance to the board and management in their consideration of the key issues.

The current debate on corporate purposes was prompted by various corporate social responsibility initiatives, including those promoted by Blackrock CEO Lawrence Fink. It received a major thrust by the August 19 release from The Business Roundtable of its "Statement on the Purposes of the Corporation" and it has manifested itself most practically in political process, with various corporate accountability proposals offered by several progressive Presidential candidates. The most consequential of these is the Warren Proposal, which would have the effect of federalizing the corporate governance of large corporations.

Corporate Social Responsibility and Accountability Initiatives

The basic theme of corporate social responsibility (CSR) is that a company should serve a wider societal purpose beyond (but in addition to) the company's economic performance. This theme is grounded in a perception that government is no longer capable of fully addressing future needs of society (e.g., on issues such as retirement and infrastructure; automation and worker retraining; and the environment). Private corporations are thus being asked to "fill the gap" and help respond to these concerns. While recognition of tax-exempt status under Section 501(c)(3) of the Internal Revenue Code already requires a demonstration of sufficient community benefits, these benefits are separate and distinct from the CSR and accountability initiatives set forth in the Warren Proposal and the Statement on the Purposes of the Corporation.

Thought leaders such as Blackrock's Mr. Fink articulate a connection between financial performance and social purpose, and call for a new model of corporate governance that includes a continuous involvement with the company's long term strategy.

The Business Roundtable's Statement is framed as a commitment from its signatories (CEOs of 181 major corporations) to lead their companies for the benefit of all stakeholders: customers, employees, suppliers, communities, and shareholders. Specifically, they commit to (i) deliver value to customers; (ii) invest in employees; (iii) deal ethically and fairly with suppliers; (iv) support the communities in which they work; and (v) generate long term value for shareholders, "who provide the capital that allows companies to invest, grow in and innovate." The Statement reflects a concern that "the American dream is alive but fraying," and a commitment to "push for an economy that serves all Americans."

Renewed Emphasis on Corporate Accountability

The progressive political movement extends CSR to matters of corporate accountability, describing the practice of shareholder primacy as the "root cause of many of America's fundamental economic problems." Emerging legislative proposals seek greater "accountability" from the corporate sector. These proposals incorporate concepts such as the federalization of large corporations; statutory board diversity quotas, corporate "public benefit" requirements, and the right of employees to select a portion of a corporation's board directors. And by their literal reading, they do not appear to exempt charitable corporations from their provisions. Even if not expressly included in the ultimate CSR legislative proposal, nonprofits should remember how their exclusion (for the most part) from Sarbanes Oxley did not totally insulate them from the bill's reach as many of its provisions aimed at for-profit corporations effectively "drifted" over to the nonprofit sector and became expected practices.

Of the various CSR proposals, the most detailed and potentially impactful is the Warren Proposal. This proposed legislation was originally introduced in August 2018, and is expected to shortly be re-introduced by Senator Warren (D-MA) and Congressman and Assistant House Speaker Ben Ray Lujan (D-NM). This controversial legislative proposal is intended to address concerns that corporations have become overly focused on maximizing return to shareholders at the expense of all other societal needs.

Federal Charter. A key element of the Warren Proposal is the requirement that corporations with more than $1 billion in annual revenue obtain a federal charter. In the Warren Proposal's current form, it does not appear limited to public companies. Thus, literally taken, it would apply to nonprofit health systems with annual revenues in excess of $1 billion.

General Public Benefit. The terms of this charter would require directors of chartered companies to consider not just the interests of shareholders, but those of employees, customers, and the communities in which those corporations operate. Specifically, a U.S. corporation must have the purpose of creating a "general public benefit," meaning a material positive impact on society resulting from the company's business and operations, taken as a whole.

Employee Directors. The proposal also provides that at least 40% of the corporation's directors must be selected by employees, under rules to be established by the U.S. Securities and Exchange Commission (SEC). (Senator Bernie Sanders' corporate accountability proposal incorporates a higher percentage of employee directors). Notably, state attorneys general would be authorized to submit petitions to the new Office of United States Corporations to revoke a charter based on a history of egregious and repeated illegal conduct and a failure to take meaningful corrective action. Senator Warren comments that this proposal is based in part on concepts reflected in the benefit corporation model that 33 states have adopted.

Analysis

Board and executive leadership of large nonprofit health systems should take close note of evolving trends concerning corporate social responsibility and corporate accountability, the social and economic factors that are motivating them, and the potential they have to be manifested into either governance best practices or federal law. This is especially the case with respect to the Accountable Capitalism Act and nonprofit health systems with over $1 billion in annual revenue.

These CSR/corporate accountability trends provide a significant prompt for nonprofit health care systems to re-evaluate the scope, sufficiency, and flexibility of their own purposes statement (especially as it relates to their strategic initiatives). Those systems should also monitor the extent to which public companies in the health care sector implement CSR principles, and the possibility that such activities may further blur the important distinction (for tax-exemption purposes) between the for-profit and nonprofit health care delivery models.

The nonprofit health care sector has an important stake in the current debate on the purposes of the corporation, and in the political discussion of corporate accountability. Corporate leadership should not dismiss these developments as limited to public companies as that would be strategic error. Indeed, these developments reflect more fundamental concepts about the future of the corporate model and its relationship to society and regulation, that are not limited to form of entity, organizational orientation, or tax status.

Mr. Peregrine and **Mr. Louthian** are members of the Health Industry Practice Group of McDermott Will & Emery and are resident in the firm's Chicago and Washington, D.C. offices, respectively.