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# If It Isn't Broke, Don't Fix It!

*Thomas Quaadman is the Executive Director for Financial Reporting Policy and Investor Opportunity with the U.S. Chamber of Commerce's Center for Capital Market Competitiveness.*

**Thomas Quaadman**

Improving corporate governance is all the rage these days. It seems we have a new proposal out every day. In evaluating these proposals we must ask if we are trying to atone for the past sins of the financial services sector, or are we going to shackle the engines that have driven the American economy to unparalleled heights?

For over 100 years, corporate governance in the United States has been regulated by the states. This has led to diverse corporate structures that have served the economy well and employed countless numbers of workers. Shareholders provide capital, boards of directors provide oversight and *management* runs the business.

Under this system, all of the parties involved must work together to increase the value of the company. If the relationship works well, everyone wins. If not, a shareholder can sell his/her shares, or where allowed by state law, replace management or board members. These laws vary by state thereby allowing corporate governance to be tailored to fit the stakeholder's needs.

Yet, in Washington, everyone seems to be tripping over themselves to ensure better corporate governance, not just for TARP companies, but for ALL companies. In May, Senator Charles Schumer (D-N.Y.) introduced the snappy sounding Shareholder Bill of Rights; next the SEC released a proposed regulation on shareholder access, and then Congressman Gary Peters (D-Mich.) proposed the Shareholder Empowerment Act. In addition to proposing new governance regulations for TARP companies, Treasury Secretary Geithner issued a statement of extensive executive compensation and corporate governance reforms for all companies which may soon be embodied in yet more congressional legislation. For TARP companies, the icing on the cake is that they now also have a Pay Czar to contend with.

While the proposals vary in substance and content, taken together, they propose the following federally mandated actions for all publicly traded companies:

- Say on Pay votes
- Shareholder access to the proxy
- Majority voting for Board members
- Separate the CEO and board chairman
- Create separate risk management committees
- Create independent compensation committees
- Regulate the compensation plans of certain executives

Some of these reforms have in fact been adopted by some companies reflecting the dynamism of corporate governance in America. If that's the case, what is wrong with these efforts?

*Plenty.*

First, let's remember some basics. Investors are not lemmings. That is, once they invest in a company, they are not powerless to protect their investment. Investors today, as they always have, retain the ultimate power in this relationship – the ability to sell their shares at anytime. Investors provide capital to companies on the basis that they trust the

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***Coming In August:***

**ADR In A Time Of Crisis**

*and*

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## Quaadman

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board of directors and management to use those resources to grow the company. This in turn will create a return on investment.

However, if shareholders lose faith in management, or if they feel that a company is going down a path that they dislike, they can withdraw their capital at any time. That is the ultimate vote of no confidence.

For the most part, these efforts are not about improving the corporate governance of poorly run companies, rather, it is to liberalize rules so that activist investors can avoid costly proxy fights and elect their own directors instead. Activist special interest investors, including some unions, have sought to use the proxy voting system as leverage to advance other agendas under the guise of improving corporate performance. But, in fact, their efforts do not have that result. The recent Navigant Consulting study, released by the U.S. Chamber of Commerce, *found no evidence* that the 166 shareholder proposals key-voted by the AFL-CIO improved stock prices over the short or long term. The last time I checked, the purpose of investing is to increase the value of your investment.

If directors and management have to spend their time fighting special interest agendas and complying with burdensome federally mandated corporate structures, they cannot manage a company. Sales will be lost, profits disappear, and jobs destroyed. One has to wonder about a pension fund that wants to play politics rather than increase retirement benefits for its members.

Indeed, the existing system has been working well and reforms have occurred in a steady and diverse way. Our state-law-based system has been a laboratory for experimenting with different approaches to corporate governance that have suited the challenges individual companies face. This system has evolved through a dialogue between management, directors, and shareholders, all without mandates from Washington.

There are many examples. A majority of the companies in the S&P 500 index now have majority voting, but not all 15,000 companies need or want it. Some companies have adopted say on pay, some have eliminated staggered boards, and others have strengthened the independence of their compensation committees. Some companies have decided to separate the chairman and CEO positions. However, we could name dozens of successful executives who have held both roles, including Sam Walton, Bill Gates and Warren Buffett. Delaware has even amended its corporate law, allowing companies to amend their by-laws and create shareholder access *if they so choose*.

Passage of measures such as the Schumer Shareholder Bill of Rights will create a body of federal corporate law that will eliminate the state-driven model that has existed since the start of the modern public corporation. A Washington-centric one-size-fits-all approach will destroy the variety that has allowed the American economy to thrive and be the most successful in world history.

Do we allow management, directors, and shareholders to choose the system that will drive corporate success, or do we let Washington outlaw successful approaches that have created untold billions of wealth and a countless number of jobs?

Slightly over 600 companies or firms have received assistance from the Treasury Department under TARP, most of which are financial institutions. Yet there are over 15,000 public companies that operate every day in the United States. That equates to over 96 percent of public companies having nothing to do with the financial crisis. For those 96 percent of companies, the issue is not better corporate governance, but how to re-inject liquidity into the credit markets. For those 96 percent of companies, the current governance system has worked well and allowed them to create trillions of dollars of wealth and millions of jobs. We shouldn't throw out the baby with the bath water.

The question is: are we making Main Street pay for the sins of Wall Street? If we are, we may radically hamper the ability of our economy to grow and prosper. Some of these proposals are based on corporate governance regimes from other nations, and emulation of new ideas isn't a bad thing. But when there is a proven record of success, why fix the model that isn't broken?

If we want to have a serious debate about corporate governance, we should have it. However, a real debate is about sound policies and not about sound bites. Let's instead look at possibilities for positive change: compensation plans that will allow companies to attract and retain talent during a difficult crisis, ending quarterly earnings guidance that forces a short-term managerial focus, improved disclosure, and a review of proxy voting participation as starters.

The U.S. Chamber of Commerce supports good ideas for governance reform if those proposals are proven to produce better outcomes for shareholders. We will fight to stop those proposals that advance special interest agendas and do nothing to improve corporate governance. Abusing shareholders during the worst economic crisis in 75 years isn't a path to recovery.

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## Health Care Reform

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they would be able to pursue discovery and survive a motion to dismiss by general allegations of wrongdoing.

Bear in mind that the defendant in a *qui tam* action isn't likely to know about it until the government has done at least some investigation. By the time a motion raising 9(b) could be made, it may be too late, and the plaintiff may have sufficient information to amend his or her complaint even in the face of a successful 9(b) defense. The additional discovery burden that would result from eliminating the requirements of 9(b) would be substantial.

**Editor: We also understand that both H.R. 1788 and S. 458 allow some government employees to bring *qui tam* cases based on information they learned as government employees.**

**Sepaniak:** Government employees regularly get access to our confidential information. We cooperate with them because we feel that it is in our interest and theirs to get to the bottom of any issue and, if we made a mistake, to correct it and to address any failures in our compliance system. If we knew that a government employee could use confidential information to file a *qui tam* case and profit personally, it would make the relationship far more adversarial. Changing the relationship in that way would be counterproductive since it would create an atmosphere of distrust which inevitably would increase costs.

**Editor: Both H.R. 1788 and S. 458 eliminate a defendant's ability to raise the jurisdictional defense of public disclosure/original source.**

**Sepaniak:** There's no question that, because of the greater access people have to information, there's a greater opportunity for relators to initiate these actions. Under current practice, the defense was really more of a deterrent than a bar. Even before FERA, the defendant in a *qui tam* action isn't likely to know about it until the government has done at least some investigation. By the time a motion could have been made, it may be too late, and the plaintiff may have sufficient information to amend the complaint. Also, the government would still retain this defense for purposes of dismissing the relator. The Department of Justice has not typically liked to share money with relators when given the opportunity. Prior to FERA, if we got a subpoena from the OIG/U.S. attorney, and he or she wanted to see all our records on a certain type of treatment or transfers for six years prior, I was already disadvantaged. I'd have to assign people to go through every record we have for that time period. Now, with electronic discovery, we have to capture all the e-mails and electronic communications. That's a full-time job for several people for a year just to respond to the subpoena. So that only adds to the problem.

**Editor: I noticed that the period of repose is lengthened by FERA.**

**Sepaniak:** Since any amended complaint the government files relates back to the date the relator filed, it could be on their desk for years. We wouldn't even know about it. The practices being reviewed could easily cover a decade. Most hospitals have an e-mail retention policy. The rules on e-discovery state that if you have a reasonable policy and you enforce the policy uniformly, you can't be held accountable for destroying e-mails that someone might later demand. However, there have been some substantial fines against companies that have destroyed e-mails that could have been discovered in litigation. Part of an effective e-mail retention policy is called "litigation hold." Once a claim is suspected, a "hold" is placed on the destruction of all e-mail and other documents that relate to that claim. However, the government could have claims in their drawer right now that relate to any hospital. They could be investigating them internally. A year from now they could ask to see all your e-mails, documents, and electronic backup. If you followed your policy and destroyed them, you may still have an upset U.S. Attorney, so it almost makes your e-mail retention policy ineffective.

**Editor: Steve, do you have any closing comments?**

**Sepaniak:** I am convinced that the cumulative effect of all the changes effected by FERA and contemplated by H.R. 1788 and S. 458 will cause a great increase in FCA actions brought against hospitals. The cost of e-discovery alone could be crippling. It is important to let policy makers in Washington know about the unintended consequences for hospitals. It seems strange that while Congress is so concerned about the rising cost of healthcare, it is proceeding down a path that will materially add to those costs.

## *Partners Notes*

### King & Spalding Expands International Arbitration Practice In New York Office

King & Spalding has continuing its expansion of its international arbitration practice with the arrival of Caline Mouawad as a counsel in its New York office. Ms. Mouawad brings to 14 the number of lawyers and consultants who have joined King & Spalding's international arbitration practice in the past 24 months. Last month the firm submitted an application to the Paris Bar Council in order to open an office in Paris, a key European venue for international arbitration matters.

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Paul D. Clement, former U.S. Solicitor General, has been elected to the board of directors of the National Chamber Litigation Center (NCLC). Clement is a partner in the Washington, DC, office of King & Spalding and head of the firm's national appellate practice.

* * *

Four King & Spalding partners are among 31 lawyers across the United States selected as top healthcare practitioners by Expert Guides in its 2009 edition of The Best of the Best USA. They are Dennis M. Barry, Gary W. Eiland, Glen A. Reed and Richard L. Shackelford.