Elizabeth Warren's Big Power Grab

Walter Olson

August 18, 2018

Sen. Elizabeth Warren of Massachusetts has introduced legislation that would radically overhaul corporate governance in America, requiring that the largest (over $1 billion) companies obtain revocable charters from the federal government to do business, instituting rules reminiscent of German-style co-determination under which workers would be entitled to at least 40 percent representation on boards of directors, placing directors under a fiduciary obligation to serve "stakeholders" as opposed to owners as currently, prohibiting political expenditures by corporations unless approved by at least 75 percent of directors and shareholders, and restricting directors and officers from reselling incentive stock within five years.

It's Been Tried. It Didn't Work.

"Let's be clear, none of these are new ideas," writes leading corporate governance expert Stephen Bainbridge of UCLA. "They are either academic utopian schemes or failed European governance models. There are very good reasons none of these dusty relics of eons of progressive corporate thought have made it into law." His series of posts picking it apart in detail begins here.

Our friend James Copland of the Manhattan Institute points out that Sen. Warren's proposal would pull down three main pillars of U.S. corporate governance: shareholder primacy, director independence, and charter federalism. Each has long been a subject of extensive research and debate, and the alternatives, European or otherwise, simply do not have as good a track record of supporting a dynamic economy that generates world-beating enterprises across a wide range of business sectors (as opposed to, say, the kind of specialty manufacturing at which Germany does well). Worker board representation, in particular, shapes incentives in ways that discourage important forms of risk-taking and reallocation of capital across sectors.

All of which helps explain why few startups would willingly accept Warren-style rules in drafting their by-laws. But there's a big additional problem in applying the rules, as Warren would, to existing companies that have already been capitalized under different assumptions: it

would in effect confiscate at a stroke a large share of stockholder value, transferring it to some combination of worker and "community" interests.

Government Expropriation by Any Other Name...

This gigantic expropriation, of course, might be a Pyrrhic victory for many workers and retirees whose 401(k) values would take a huge hit in exchange for new rights of uncertain value to install board members. Already, some early enthusiasts for the Warren plan are treating the collapse of shareholder value as a feature rather than a bug, arguing that it would reduce wealth inequality.

Whether or not it would accomplish that, it would test the restraints the U.S. Constitution places on the taking of property without compensation. Alas, the courts have been inconsistent about the extent to which they will recognize as takings, and provide a remedy for, legislative enactments that strip away much of the value of financial instruments or other property rights without expropriating fully 100 percent of their value. Cato over the years has been very much part of that legal debate, arguing for a strong interpretation of the Fifth Amendment's language: "nor shall private property be taken for public use, without just compensation."

Confiscatory proposals like Warren's make it more important than ever that we be prepared to defend this element of liberty in the courts.

Walter Olson is a senior fellow at the Cato Institute's Robert A. Levy Center for Constitutional Studies and is known for his writing on the American legal system.