Chapter 16

Commonwealth Companies: A Path to Restoring Workers' Rights and Economic Democracy

Tom Croft and Annie Malhotra

> Democracy is, among other things, the ability to say "no" to the boss. But a man cannot say "no" to the boss, unless he is sure of being able to eat when the boss's favor has been withdrawn.
>
> Aldous Huxley, *Themes and Variations*[1]

For over three decades, progressive investment policy leaders have been saying that the owners of workers' capital—the workers themselves—must act to prevent the misuse of their hard-earned retirement savings and other assets by financially harmful short-term Wall Street schemes. In *Working Capital: The Power of Labor's Capital*,[2] we labeled that harmful process "collateral damage."[3] In this chapter, we present our view that shareholders and stakeholders alike have an imperative to make corporate management more accountable and to move toward what we call a "commonwealth company" framework. We call for workers to take stronger action in their roles as shareholders (who own a large chunk of the capital markets) and as stakeholders (who are crucial, after all, to the success of any enterprise) to invest responsibly and reclaim their power to participate in the governance of companies. As a result, they would be better able to protect the beneficiaries of pension investment.

We begin by explaining the meaning of the commonwealth framework for companies and the importance of a balance between shareholder value and stakeholder rights within that framework. To illustrate the importance of this discussion, in Section 2: Destroying Company Value, Destroying Workers' Rights, we relate two separate events that reveal how worker shareholders and stakeholders have been ignored and disparaged. Then in Section 3: Toward Commonwealth Companies, we outline new pathways for moving toward the growth and development of commonwealth companies. In Section 4: Regaining Control of Workers' Capital and Voice, we discuss how workers in their roles as both shareholders and stakeholders can help change the status quo. Based on this discussion, Section 5: Strategy and Policy Recommendations presents our proposals for actions that would ensure worker shareholders can protect their rights and move toward a broader balance for shareholder and stakeholder value. Finally, we present our conclusions in Section 6 from the perspective of democratic values.

Section 1: The Nature and Importance of Commonwealth Companies

The commonwealth framework is another way of describing a company that subscribes to "codetermination." Codetermination is a legislative framework in many countries of Europe under which workers are elected by their peers to the governing boards or supervisory boards of companies. By allowing elected employee representatives to join shareholder representatives on corporate boards, codetermination gives workers a voice and provides them with the opportunity to improve corporate governance, accountability, and oversight. Additionally, codetermination gives employees the ability to elect representatives to works councils, through which they can participate in other levels of corporate decision-

making. Works councils are joint labor-management systems that facilitate shop-floor participation and represent workers' interests to management on operational issues and long-term strategies.

Germany is often cited as having the most robust codetermination system in place. Instead of an all-encompassing single board of directors, German companies generally have a supervisory board composed of worker and shareholder representatives, a management board composed of company executives, and a works council.[4] As Rainald Thannisch, policy officer at the Department of Co-determination of the Executive Board at the Confederation of German Trade Unions, has said, "From the trade union point of view, co-determination plays a key role in the debate on sustainable company development and management pay."[5] More generally, he has explained, in Global Union conferences, that co-determination creates the conditions—especially in global companies—for democratic control of economic power. It is important to note that true codetermination does not include employer-driven "company unions" that have been created in the U.S.

Studies have found that codetermination and works councils "lead to higher wages, less short-termism, greater productivity, even higher levels of income equality."[6] These outcomes are the opposite of what happens in shareholder-centered work systems.[7] Under the commonwealth framework, ethical and corporate governance failures can still occur—as seen in Volkswagen's emissions scandal in which the company's attempts to introduce a works council was perversely shot down in the U.S. (a case that will be discussed later in this chapter). Nonetheless, codetermination has been shown to improve governance outcomes

along with productivity and company strategy. Most importantly, by giving workers a stronger voice in the governance and management of the companies that employ them, codetermination allows for a long-term stakeholder orientation over short-term shareholder capitalism.

In recent decades, the concept of the commonwealth corporate framework has spread from Germany to many countries in the European Union. Australia and Britain have also taken up the idea. Since 2017, there has been an explosion of developments with regard to codetermination, including proposed federal legislation in the U.S., collectively-bargained efforts, shareholder resolutions, corporate statements, and academic and policy research. For example:

- In the U.S., Senators Tammy Baldwin, Bernie Sanders, and Elizabeth Warren—the latter two are 2020 Democratic presidential aspirants—have introduced federal legislation to require companies to seat workers on corporate boards in a manner analogous to German and Euro codetermination structures. Other senators and members of the U.S. House of Representatives have signed on, with many Americans supporting the idea as well.[8]
- A majority of OECD and European Union countries have laws in some form that the right of workers to vote for board representation.
- A similar push is happening in the U.K., which recently passed a new Corporate Governance Code.[9] All U.K.-listed companies must comply with three corporate governance alternatives—in order to make management more accountable—or

explain why they do not. Options include appointing worker directors, designating an existing non-executive director to engage with the workforce, and setting up advisory panels. The Trade Union Congress (TUC) has argued for worker directors, and a few firms have appointed workers.

- A Canadian Supreme Court decision in 2008 cleared the way toward more stakeholder-shareholder balance (*BCE Inc v 1976 Debentureholders*, 2008 SCC 69 (CanLII), [2008] 3 SCR 560).[10] In its decision against a hostile takeover by an Ontario pension fund, based on the charge that the buyout would have left the target company deep in debt, the Court backed a ruling that "helped shift more responsibility to directors, and made it clear that acting in the best interests of the corporation allows directors to consider the interests of a broader range of stakeholders."[11]
- Through collective bargaining, unions have pushed for decades to win seats representing workers on boards. Following the precedent set by Autoworkers Union (UAW) President Douglas Fraser's stint on the board of Chrysler (announced three days after the U. S. government's 1980s bail-out of that company), in the mid-1990s the United Steelworkers (USW) bargained for seats on the boards of USX Corporation, Bethlehem Steel Corporation, and other firms. Today, the Autoworkers, Machinists, and Pilots have seats on Daimler AG, United Continental Holdings, Delta Airlines, and Navistar International.
- Union and worker shareholders, including the Change to Win Federation (CtW), have proposed resolutions demanding that Alphabet Inc. (Google's parent), Walmart

Inc., and Microsoft Corporation each seat a non-management employee on their boards. These proposals have come after increasing unionization and worker agitation efforts at the large "techs," including a global walkout by 20,000 Google employees demanding changes in how the company treats its workers, resulting in Google ending its forced arbitration rule.

- On August 19, 2019, the U.S. Business Roundtable announced the release of a new "Statement on the Purpose of a Corporation" signed by 181 CEOs who committed to lead their companies "for the benefit of all stakeholders—customers, employees, suppliers, communities, and shareholders."[12] The announcement was said to have come after many of its leaders pushed back on the long-held theory that the *only* purpose of a company is to maximize shareholder value. Some analysts, rightly skeptical of the Roundtable's motives, also noted that public opinion has been turning against corporation wrong-doing (especially since the massive frauds exposed during the financial market crisis that cost working families $4 trillion in lost retirement funds and $12 trillion in lost household wealth).
- A steady stream of new academic and policy research on codetermination has come forward from prestigious thought leaders, including former Chief Justice of the Delaware Supreme Court Leo Strine,[13] Lenore Palladino, Susan Holmberg, the Roosevelt Institute (see https://codeterminationfacts.com); Ewan McGaughey, Senior Lecturer, King's College, London[14]; Euro union researchers and friends[15], and others.
- The idea is also politically popular. In a recent poll by Data for Progress (https://www.dataforprogress.org/), in which Senator Tammy Baldwin (D-WI) made

the case for stakeholder governance, 52 percent of likely 2018 voters supported "establishing worker representation on companies' boards of directors." Another 25 percent were unsure. Overall, employee governance had net positive support in 100 percent of states and congressional districts.

We welcome this onrush of economic democracy ideas. In our work, we endorse these diverse paths toward a stronger role for worker stakeholders in American companies. However, rather than pitting stakeholder rights against shareholder values, we argue that corporate governance should reflect a balance between them. We argue for an evolution toward a stakeholder society that includes worker shareholder rights and recognizes, retains, and respects the long-term value of responsible shareholder action.

Section 2: Destroying Company Value, Destroying Workers' Rights

To illustrate the importance of this discussion, we offer two distinct stories of how the stakeholder and shareholder roles of working people and unions have been ignored and disparaged while irresponsible investors and corporations have destroyed companies, company value, and workers' rights.

Canton, Ohio. In June 2014, Timken Steel, a leading, profitable and modernized manufacturer of steel and bearings was forced to split into two companies following a shareholders' campaign. The breakup was led by the California State Teachers' Retirement System (CalSTRS), a signatory to the UN's Principles for Responsible Investment (PRI). The breakup was in fact the product of a strategy by Relational Investors, an activist hedge fund founded by protégés of corporate raider T. Boone Pickens. The split was forced in order to

"unlock value" and provide financial benefit for shareholders, including the CalSTRS pension fund.

However, multiple news accounts relayed the fears of the Timken family, workers, and local citizens that the breakup was unnecessary. The company was a good community neighbor whose workers were represented by the United Steelworkers (USW). Timken was well structured, had low debt, and a healthy pension fund. It is notable that soon after the split, Relational Investors sold its interests and walked away with a profit of $188 million gained in just over two years as a shareholder.[16]

Since the break-up, stock prices for the split companies have continued to fall, from the $49 range in September 2014 to around $6 in November 2019 for Timken Steel, a loss of over 87 percent, and from the $68 range in June 2014 (an all-time high) to around $53 in November 2019 for Timken Company.[17] So, despite opposition from Teachers' Union trustees on the CalSTRS board and from the USW, the decision to split the original company enriched short-term players, resulted in the loss of long-term share value, destroyed synergies (as feared) making the divided companies less competitive, and will probably continue to make the companies vulnerable to hostile takeovers in a challenging economic environment.

Chattanooga, Tennessee. In February 2014, the United Auto Workers (UAW) lost, by a close margin, a crucial organizing vote at a Volkswagen (VW) automotive plant. A second vote in June 2019 had the same result. The VW Corporation, based in Germany, pledged

neutrality in the organizing campaign, and through their works council structure had committed to establishing a codetermination system at the VW plant.

The loss was a setback for workers, who had been bombarded by a massive, third-party anti-union campaign waged by U.S. Senator Bob Corker (Republican), the Governor of Tennessee, and the local Chamber of Commerce.[18] As a result of the loss, the Chattanooga plant is VW's only plant worldwide without a works council. After the UAW won a subsequent election in a smaller unit at the plant, VW turned against the union as the massive VW emissions scandal was unfolding.[19]

The above examples are proxies for the systemic short-termism plaguing America's corporations, pension funds, and capital markets. It is no secret that workers' capital, the pension assets and savings of everyday working people, represent the largest shares of global financial stock, including companies like VW and Timkin. At the end of 2018, pension assets were valued at US$40.1 trillion across 22 major pension markets globally. The U.S. pension assets market—at US$24.7 trillion and representing 120.5 percent of the nation's Gross Domestic Product (GDP)—is the largest among the global markets.[20] Isn't it perverse, then, that workers' assets are so often deployed in ways that go against their long-term well-being? In *Working Capital,* Dr. Tessa Hebb, one of the thought leaders in responsible investing, described this dichotomy succinctly: "The earnings that workers defer for a secure retirement inform financial decisions that, in turn, determine the quality of employment and the character of goods and services they enjoy. Yet the institutions and individuals that

manage pension funds often pursue narrow goals whose consequences undermine workers who provide the savings they tend."[21]

As we pointed out in *The Responsible Investor Handbook*,[22] the increasing misalignment of incentives between the owners and managers of corporate wealth, coupled with the decline of unions, has resulted in greater separation between the long-term interests of the beneficiaries of retirement funds and the shorter-term interests of the advisors who oversee and manage those assets. The result has been:

- the investment of pension assets into approaches that ignore long-term risks and focus instead on market timing and short-term gains;
- a preference for quick, short-term profits for shareholders and unsustainable bonuses for CEOs at the expense of sustainable, long-term value creation that benefits core stakeholders;
- the loss of worker representation and voice in the management of the workplace;
- the dual crisis of job insecurity and the malignant use of temporary contract employees;
- stagnated wages (even as productivity and corporate profits have soared) and rising income inequality; and
- little accountability for the negative environmental, social, and governance (ESG) impacts often generated in the pursuit of short-term gains.

The tectonic changes in the American corporate landscape, marked by an epic struggle between labor and capital, have led to the dominance of a corporate business model in the

U.S. that *solely* prioritizes the maximization of shareholder value—a focus on short-term profits over long-term strategy. As economist William Lazonick has pointed out, this model has resulted in value extraction rather than value creation.[23] (See Lazonick's work in Chapter 6 of this book, "The Investment Triad and Sustainable Prosperity.")

As a leading indicator of the model's failure, wages have failed to keep pace with productivity gains, a brutal process for working people that has been underway since 1973.[24] This divergence is illustrated in Figure 16.1 by its "Drunken Y" pattern: compensation gains tightly tracked productivity growth in the early post-war years, then fell progressively behind.

Figure 16.1:

Disconnect between productivity and a typical worker's compensation, 1948–2014

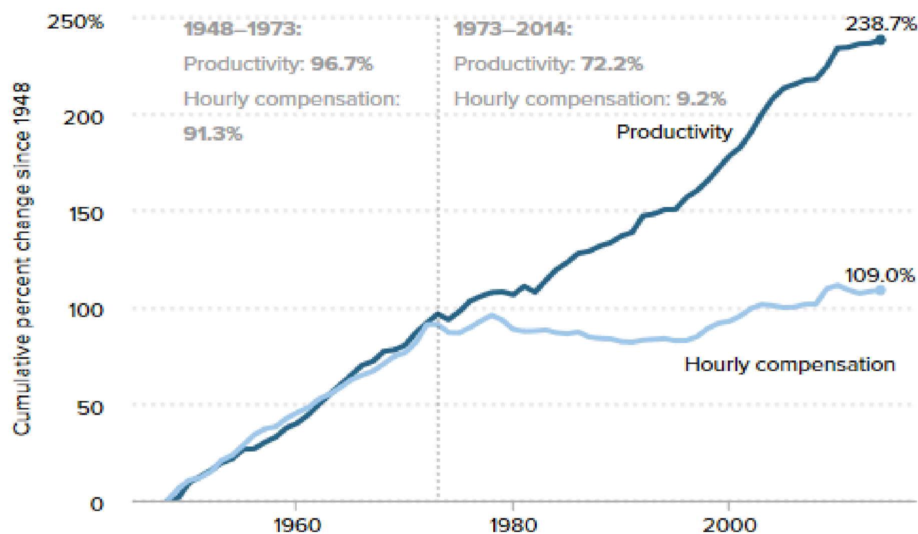

Chart Data

Note: Data are for average hourly compensation of production/nonsupervisory workers in the private sector and net productivity of the total economy. "Net productivity" is the growth of output of goods and services minus depreciation per hour worked.

Source: EPI analysis of data from the BEA and BLS (see technical appendix for more detailed information)

Coincident to the stall in workers' income has been a retreat in business investment, according to the Center for American Progress. Profits have been rising while business investment has been falling since 2000, which has slowed productivity. However, there's also been a dramatic decline in union density since the late 1970s, in large part driven by anti-union federal and state policies, according to Ewan McGaughey.[25] These are two trends, among others, that explain the erosion of the middle class and the rise of income inequality. They also represent the betrayal by corporate and political leaders of the post-WWII social compact between unions and the private sector that led to the greatest prosperity in modern U.S. history.

In order to alter this destructive pattern. America must reverse our alienated, monarchical corporate work culture and move toward a "commonwealth" company framework, one that respects its employees, provides increased human capital investment, and empowers and embraces long-term engagement with workers.

Section 3: Regaining Control of Workers' Capital and Voice

In their roles as both shareholders and stakeholders, workers can help change the status quo, reclaim control over their own capital, and regain their voice. As shareholders, workers' pension funds can have a positive influence on the behavior of investee companies through shareholder activism. Such activism can range from private engagement with companies (such as behind-the-scenes consultations, letters, meetings, one-on-one communication) to formal proposals presented at annual shareholder meetings. Through shareholder proposals, labor, public and worker pension funds, socially responsible

investors, and their allies have been winning major corporate governance campaigns to elect more diverse boards of directors, question CEO pay, review mergers and acquisitions, and promote more transparent and accountable corporate management. They have forced corrupt corporations to alter behavior and become more accountable, and they have tackled non-financial environmental, social, and governance (ESG) issues such as human rights, diversity, sustainability, and pollution.

Through their activism, pension trustees and other fiduciaries have demonstrated that they can bring attention to and support those issues that are expected to contribute to the long-term interests of workers and beneficiaries, or that at least will have no adverse effects. However, while many industrialized nations globally have put stronger responsible investment policies in place, the U.S. has lagged. To improve the U.S. position, in the U.S. Department of Labor (DOL) Interpretive Bulletin 2015-01 (IB 15-01) the Obama Administration supported the inclusion of ESG factors as, "'proper components' of a fiduciary's economic analysis," and not just "collateral considerations or tie-breakers," as had been the case with the use of Economically Targeted Investments (ETIs) in the past.[26] This historic ruling also made it easier for pension funds to offer ESG options to plan participants within 401(k) plans.

Furthermore, the DOL's Interpretive Bulletin 2016-01 (IB 16-01) encouraged pension funds to take a proactive approach to corporate issues, rather than merely respond to proxy solicitations. It stated: "The existence of financial benefits associated with shareholder engagement is suggested by the fact that a growing number of institutional investors are

now engaging companies on ESG issues…. Other market developments further substantiate the financial benefits from shareholder engagement."[27]

The Trump DOL 2018 Field Assistance Bulletin did not reverse the 2016 bulletin, but it applied more "high-level guardrails" (and perhaps confused investors). According to CorpGov.Net, "The analytical architecture of IB-2015 and 2016 remains unchanged. ESG factors are an appropriate component of a prudent investment decision provided they are financially material and that shareholder engagement in connection with economically relevant issues is consistent with fiduciary practice."[28]

We argue that workers, unions, and pension funds, as the core stakeholders of America's businesses, should exercise their immense collective influence to include stronger social commitments within their investment policies. Such influence can enable funds to shape the work practices of investee companies positively, including how investee companies treat their workers. As the Global Trade Unions have repeatedly emphasized, trustees, in keeping with their fiduciary duty, "should promote—and do not weaken—workers' fundamental rights to freedom of association and collective bargaining."[29] By furthering a range of sustainability issues, including accounting for a company's intangible assets such as its human capital, worker stakeholders in their role as shareholders can advance social and environmental rights while also securing better performance outcomes for their pension investments.

In addition to the more publicized investments of socially responsible funds that focus on the "E" and "G" of the ESG framework, more investors are giving higher priority to the

needs and roles of working people through their investments, thus raising the profile of the "S" in ESG. This change is due in part to a heightened awareness that many Wall Street investors had not just ignored workers' rights, but had not held management accountable in highly publicized business failures that led to worker deaths and injuries, such as the Massey Coal explosion (killing twenty-nine miners); rampant gender and racial discrimination and harassment (as in the case with Uber); and the never ending parade of corporate sabotage and value-stripping (such as the recent cases of K-Mart and Toys-R-Us, leading to bankruptcies and mass layoffs). The obligation to fiduciary duty requires pension trustees not only to enable workers to achieve their financial goals for retirement, but also requires fiduciaries to respect workers' rights and champion a long-term, responsible, and activist approach to the management of workers' assets. We will revisit the "S" in our discussion of human capital management initiatives (HCM) later in this chapter.

Of course, activist shareholders must take care to avoid running afoul of Securities and Exchange Commission (SEC) rules. The Commission's controversial "ordinary business rule" exception, which prevents initiatives that interfere with company operations, has stopped many important shareholder initiatives in their tracks. However, it is evident that investors who don't include ESG matters in their investment decisions, instead ignoring non-financial (yet material) investment considerations, risk violating fiduciary duty. Shareholders should push for corporate governance measures that recognize workers' rights and address the treatment of workers more aggressively. As activist scholar Marlene O'Connor pointed out in her prophetic discussion of the need for human capital management disclosures and shareholder-stakeholder balance, the hallmark of fiduciary law is disclosure.[30] Responsible

investment advocates should push to have ESG investment considerations embedded into and disclosed as part of fiduciary duty.

Section 4: Toward Commonwealth Companies

Below, we suggest strategic pathways for moving toward the growth and development of commonwealth companies, i.e., firms that practice responsible governance rules, respect worker stakeholders, empower workers to participate in decision-making, and "share the wealth" with the core stakeholders. These pathways include:

1. reclaiming the investment of workers' capital for the long term and for the benefit of workers and their beneficiaries through responsible investment strategies;
2. using responsible activism in corporate governance and pushing for worker-friendly agendas based on pension investments;
3. balancing shareholder wealth creation with stakeholder rights, which can contribute to long-term value creation;
4. demanding better human capital management practices and disclosure;
5. reinstating workers' voices and rights through unions, codetermination, and new work systems such as work councils.

We will now discuss each of these pathways in turn and discuss how they lead to a balanced shareholder and stakeholder approach.

1. Reclaiming workers' capital through responsible investment strategies

Generally, pension plans are organized as trusts, with a board of trustees that is responsible for the oversight and investment of pension fund assets.[31] Trustees are the primary stewards of the plan's assets and are the ultimate decision-makers in relation to the plan's investments.[32] They have a fiduciary responsibility to invest plan assets prudently, impartially, and cost-effectively, in accordance with governing laws and documents. Most importantly, they must act with loyalty, i.e., solely in the best interests of the plan participants and their beneficiaries.[33]

Pension trustees have a duty to protect and grow the plan's funds for the trust's participants and beneficiaries. Workers and their family members depend on these assets held in trust to meet their financial goals in retirement. However, trustees who oversee the management of pension funds encounter practical challenges such as weak governance structures, increased capital market complexities, oversized influence of investment managers and external consultants, and a multitude of changing regulations. Sometimes they have succumbed to short-termism and an institutional herd mentality, suffering "disrupted attention to the fiduciary duties of loyalty and impartiality."[34]

We encourage pension trustees to re-align their governance and investment strategies with the long-term interests of the beneficiaries of their pension funds by incorporating responsible investment practices into the decision-making process for investing plan assets.[35] What is responsible investing? It is "the integration of certain non-financial concerns in the investment process" to help generate competitive financial returns in the long-term

alongside positive environmental and social impacts. These concerns are collectively referred to as ESG issues.[36]

We hold that responsible investors, with their longer-term focus, ESG-based holistic risk assessment, and shareholder activism, are better equipped to preserve and grow retirement capital while maintaining intergenerational equity. This concept of intergenerational equity represents the idea that "growth should occur whilst ensuring a certain level of economic, social and environmental security for future generations"—emphasizing important and inherent links between the goals of workers' capital and those of responsible investing.[37]

By re-aligning their governance and investment strategies with the long-term interests of beneficiaries, trustees can regain control of their fiduciary responsibilities and better influence the future of workers' capital. In so doing, trustees can also ensure that "their decision-making processes balance allocation of capital between near-term needs and future wealth creation and consider the potential transfer of risks between participant generations."[38]

Investors and unions, both globally and nationally, are supporting and re-affirming trustees in this reassessment of their fiduciary duty. Leading the charge for investors is the PRI, a growing global coalition of pension funds and other institutional investors, unions, consultants, and asset managers who are signatories to the Principles of Responsible Investment. PRI members have pledged to incorporate ESG considerations in their

investment decisions. Together, the coalition stands as an influential group of aspiring responsible investors representing nearly $80 trillion in assets.[39]

Similarly, the Global Trade Unions, with over 200 members from 25 countries, seeks to promote the long-term responsible investment of pension assets.[40] Closer to home, the AFL-CIO, the largest federation of unions in the U.S. with 56 national and international unions as members, has also urged wider adoption of responsible investment practices by pension plans.[41]

2. Using responsible activism in corporate governance

> Nothing concentrates the mind of a corporate executive quite so sharply as a pointed inquiry from a large investor or outside director.
>
> Reich, former Secretary, Department of Labor[42]

Questions of governance influence everything about how a company is run. Governance involves many different actors who have a stake in the ownership and control of companies, including shareholders, management, corporate boards, workers and their unions, and other key stakeholders. Good corporate governance, as CalPERS has noted, is about making "the boss" accountable.[43] It allows for proper incentives for the board and management to pursue objectives that are in the interests of the company, its shareholders, and other stakeholders.

The U.S. Department of Labor, in addition to minding traditional board governance concerns, updated and reformulated corporate governance objectives to include:

> ...the nature of long-term business plans including plans on climate change preparedness and sustainability, governance and compliance policies and practices for avoiding criminal liability and ensuring employees comply with applicable laws and regulations, the corporation's workforce practices (e.g., investment in training to develop its work force, diversity, equal employment opportunity), policies and practices to address environmental or social factors that have an impact on shareholder value, and other financial and non-financial measures of corporate performance.[44]

As the Organization for Economic Cooperation and Development's (OECD) 2004 report on Principles of Corporate Governance states, "The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for investment decisions."[45] In the aftermath of the 2008 financial crisis, bad corporate governance practices were placed front and center in the minds of investors.

To prevent a repeat of that crisis, the Trade Union Advisory Committee (TUAC) to the OECD asserted that corporate governance principles should not accept the status quo standards that contributed to the 2008 crisis. Instead, they should aim for aspirational governance standards to achieve the long-term interests of the company and its stakeholders.[46] TUAC's proposals to strengthen corporate governance principles and practices included the following fundamental principles:

- giving workers a voice through the right to information, consultation, representation and negotiations;
- ensuring greater transparency in the investment chain;
- promoting the responsible use of shareholder rights;
- promoting board independence and diversity;
- providing checks on executive pay.[47]

Most importantly, it is necessary to undertake responsible activism that is in the interest of all key stakeholders, not just shareholders. Workers' pension funds should not be engaging in the type of negative, speculative "value-unlocking" activism engaged in by CalSTRS, Relational Investors, and other raiders. As Suzanne Berger, a professor of political science at M.I.T noted, "In the microcosm of Timken, you can see the larger forces playing out in manufacturing in America. It's not classic greed, like 'Barbarians at the Gate.' But we've set up financial markets in a way that's injurious to long-term investment and industrial companies…where California teachers have to protect their pension funds by hurting manufacturing in Ohio."[48]

There is much evidence to support the value of responsible corporate governance initiatives for shareholder profits. For example, findings from two large meta-studies revealed that in aggregate, good corporate governance principles lower the cost of capital and are correlated positively with improved operational and stock market performance.[49] Further, active responsible investment approaches (such as proxy voting), along with the integration of material ESG factors in the valuation of securities had a positive impact on corporate behavior and performance as compared with passive approaches."[50]

3. Balancing shareholder wealth creation with stakeholder value creation

The move toward a commonwealth framework for corporations includes the need to find a balance between shareholder value and stakeholder rights. In her book, *The Divine Right of Capital,* Marjorie Kelly predicted the implosion of a corrupt global corporate leadership, correctly pinning the gigantic meltdown on systemic organizational hubris and speculation on a mass scale. Kelly, in 2001, was not talking about the banks that drove the sub-prime financial markets collapse of 2008, but the 2000–2001 dot-com recession and an earlier group of corporate corruption scandals that, by the end of 2001, included the Enron bankruptcy and self-demolition. To make her case, Kelly argued for a new "stakeholder politics" of the corporation and of society by drawing on the philosophical tradition represented by Jefferson, Paine, Lincoln, and even Adam Smith. One of the biggest fans of this outlook was business journalist Bill Greider, who observed in the book's Foreword: "The opening question that hovers over American politics and smothers public life is this: Do corporations have too much power in our society?"[51]

Despite the progress that has been made in responsible investment, CSR, and ethical business management, we agree with Kelly that corporations have become "feudal estates." As economist William Lazonick points out (in Chapter 6 of this book and elsewhere), corporate managers and shareholders have increased executive bonuses, stock buybacks, and other measures that reduce workers' pay and benefits, workforce training, and R&D, thus bleeding corporate innovation.[52]

Except where there are strong unions, conscientious owners, or employee-owned firms, workers are generally treated like serfs, with few or no rights. Labor-generated shareholder actions, while often calling on firms to comply with the International Labour Organization's (ILO) core labor standards, generally have been less successful advancing resolutions that focus on the workplace or that call for more democratic, high-performance work practices.[53] Moreover, shareholder motions in the U.S., in contrast to Europe, are non-binding.

We argue that workers' pension funds in America have a greater responsibility to use their rights as shareholders to insist on policies at investee companies and in the capital markets that respect working people and empower workers to be more engaged in their industries. As described earlier in this chapter, in European countries that have a dualistic model of corporate structure (as in Germany, Austria, and the Netherlands), the workers' voice is empowered through codetermination, works councils, and stronger unions. Unlike in the U.S. where market forces dictate the employment model, EU worker protection is institutionalized through regulation. Consequently, worker shareholders in the EU generally are more passive in their engagement with companies.[54] In addition, in Europe the concept of corporate social responsibility (CSR), a variant of responsible corporate governance, "differs a great deal from the American understanding because many social issues that are part of the original CSR social approach, such as employee participation, education, and healthcare, are regulated by law in European countries."[55]

In contrast, unions in the U.S. do not have legally embedded rights through codetermination. Consequently, in addition to collective bargaining, the stewards of

workers' capital have had to make a stronger, earlier push toward exercising their shareholder rights as well. As a result, U.S. union and public pension funds generally have been aggressive in launching proxy campaigns and shareholder engagements with companies.

Agency theory is used to explain the relationships between corporations and their shareholders and stakeholders. This theory assumes that shareholders, as rational investors with residual claims on a company's profits, incur a *higher* investment risk than other stakeholders, such as workers. Consequently, shareholders have the right, according to agency theory, to assert total control over their agents and corporate boards, so they can demand maximum financial returns.

Under the "nexus of contract" theory, a firm is, in essence, the center of relationships ("contracts") between the firm's key principles and/or their agents, including shareholders, directors, and employees. Based on this theory, it is believed that the interests of workers, customers and suppliers, and communities (such as planning or environmental concerns), can be dealt with more efficiently through contracts and/or through extra-corporate regulation. So, "theoretically," employees are "fully capable of bargaining for contractual protections in addition to those made generally available through labor and employment law."[56]

Of course, the nexus theory, like the theory of efficient markets, breaks down upon closer inspection.[57] The rise of corporate dominance in the U.S. economy and public affairs, the increase in deregulation since the Reagan era, and the related decline of labor unions

have meant that individual workers and communities have no comparable "power" to force negotiations. Companies are not required to (and so generally will not) enter into voluntary contract negotiations with individual workers or communities as partners.[58]

By contrast, stakeholder theory holds that workers and other stakeholders of companies also make firm-specific investments and incur risk, and that core stakeholders should be considered in investment decisions. Labor economists observe that employees, as stakeholders, tend to develop long-term attachments to corporations under implicit contracts and make long term human capital investments in firms. In fact, shareholders can sell their stock shares much more easily than employees can find another job.

Workers also hold a role as worker shareholders who have invested in their companies through pension funds and other retirement plans. Moreover, it is important to recognize the efforts of responsible activists who have a longer-term focus and promote ESG-based holistic risk assessment. Therefore, there is a need to balance shareholder value with stakeholder rights, an approach that creates value for all stakeholders. Indeed, American labor and its pension allies view value creation as long-term stakeholder value creation. Accordingly, they signed on to the Aspen Principles, which assert that companies and investors should "recognize that firms have multiple constituencies and many types of investors, and seek to balance these interests for long-term success."[59]

While we firmly support ethical and progressive shareholder activism, we would be remiss to ignore the rising list of authors who pinpoint shareholder primacy as a driver in the rise of short termism and financialization, the demise of innovation, and the destruction

of many corporations: shareholders like CalSTRS in the case of Timken. As John Kay, author of the Kay Report, asserts: "Markets and corporations serve citizens when, and only when, they are embedded in the societies of which they are part."[60]

4. Demanding better human capital management practices and disclosure

Earlier, we described a growing canon of performance studies that have demonstrated the financial benefits of responsible investing and good corporate governance. There has been less interest, historically, in researching and understanding the "S" in ESG, which includes critical issues such as union representation, worker participation, good wages, and workers' health and safety. According to the evidence, respecting workers, providing good wages, training, and other benefits, and engaging with workers yields increases in productivity.

As TUAC notes, in addition to the active participation of pension plans in corporate governance, there are also many complementary workplace practices that protect workers' rights, engage empowered workers, and facilitate productivity and higher bottom line results. These include:

- undertaking responsible employment relations;
- supporting greater workforce participation and ownership;
- engaging in workforce training and knowledge sharing;
- employing empowerment and diversity strategies.[61]

Investors are slowly becoming interested in a broader framework that places more importance on workers as major stakeholders of industry, and they describe this broader

field as human capital management (HCM).[62] As defined by one investor group, HCM includes, but is not limited to, "hiring and retention, employee engagement, training, compensation, fair labor practices, health and safety, responsible contracting, ethics, desired company culture, and diversity, both with respect to a company's direct employees and to the employees of vendors throughout the company's supply chain."[63] Some analysts also include employee engagement, workforce participation, and broader work systems in the sphere of HCM. Others recognize the collateral importance of sharing ownership, profits, and productivity with employees of firms. Despite a terminology issue that some have with the naming of this field, human capital management has become widely accepted as a key component of corporate strategy.

A Harvard Law School IRRC Institute study conducted in 2015 surveyed the literature on human capital, reviewing empirical studies that examined the relationship between Human Resource (HR) policies and financial outcomes such as return on equity, return on investment, and profit margins. The majority of the ninety-two studies reviewed found positive correlations between training and HR policies with investment outcomes. The authors concluded that there is "sufficient evidence of human capital materiality to financial performance to warrant inclusion in standard investment analysis."[64] Beyond employee training, this report confirmed that companies are more competitive when their work systems are designed well and function effectively to make the most of employee talents and skills by stimulating worker engagement and commitment on the job.

In order to protect and enhance their investments, shareholders are increasingly incorporating HCM analyses into their overall evaluation of a company's ability to deliver long-term sustainable value. These investors believe that firms with strong HCM policies and practices may be at a competitive advantage, and conversely, firms that have illegal or poor HCM practices are exposed to risk of failure. However, despite the importance of HCM, corporate reporting requirements for HCM are virtually nonexistent. Where reporting does exist, the data cannot be compared across similar companies or industries because of a lack of standardization in reporting. The Human Capital Management Coalition, representing an influential group of institutional investors holding over $4 trillion in assets, is seeking to change this state of affairs.[65] Among its many initiatives to further elevate HCM as a critical component in company performance, the Coalition has submitted a petition to the SEC asking it to demand HCM disclosure for public companies.

In addition, sustainability rating agencies, which have increased dramatically in number in recent years, play an important role in shaping the demands placed on companies regarding sustainability disclosures and practice. Global Unions, through its Committee on Workers' Capital (CWC) and its Taskforce on Sustainability Ratings, has begun a multi-year dialogue with a group of sustainability rating agencies to promote its "Guidelines for the Evaluation of Workers' Human Rights and Labour Standards."[66] The Guidelines are meant to improve the methodology used by the rating agencies to provide accurate snapshots of company strategies regarding the provision of decent working conditions and workforce empowerment—factors that are tied to long term performance.

These efforts toward disclosure will drive best practices, which may yield a more motivated, productive, and innovative workforce, and thus reduce personnel costs. Firms that ignore HCM are likely to have higher personnel costs, more disruption, and embarrassing operational, reputational, and legal risks. The Coalition notes that HCM failures have even resulted in disastrous losses of life. Such disasters have been accompanied by share value reduction at firms such as Massey Coal and BP.

5. Reinstating workers' voices and rights through unions, codetermination, and new work systems such as works councils

As TUAC notes:

> …various mechanisms exist across OECD and G20 economies to ensure workers' voices in the governance of the firm. These rights are recognized and upheld by several ILO conventions and by the OECD Guidelines for Multinational Enterprises (MNE). The most fundamental form of contractual governance consists of collective bargaining between senior management and worker representatives... But other important mechanisms to participate in company decision-making also exist, such as works councils and board-level employee representation.[67]

Although the UAW lost the 2014 union vote at VW's Chattanooga plant (as described earlier), an unexpected outcome from the loss was the commitment in 2015 on the part of IG Metall (the German union that represents workers in VW Germany) to partner with the UAW. The purpose of the partnership was to explore the introduction of a works council in

the U.S. to represent blue-collar and white-collar workers.[68] There does not appear to have been much progress on this front as of yet. Still, it is a positive benchmark, one easily replicated by other union alliances, towards giving workers a voice in corporate decisions affecting their well-being.

Most studies examining the productivity of firms that have works councils found a positive correlation between the two. In one report, the author reported that, on average, establishments with a works council were 6.4 percent more productive. Other reports confirmed this conclusion if there was also a collective bargaining relationship.[69] Previous initiatives led by the AFL-CIO and the European Trade Union Congress as part of the negotiations for the Trans-Atlantic Trade and Investment Partnership demanded that the treaty require trans-national firms operating in the U.S. to replicate the dual union/works council structures under which they operated in Europe.[70]

Section 5: Strategy and Policy Recommendations

To ensure that worker shareholders can protect their rights and that we can move toward broader balance for shareholder value and stakeholder rights, we offer the following strategy and policy recommendations.

Broadly adopt shareholder rights to push firms to be more accountable and responsible to all stakeholders.

Capital stewards should invest in responsible firms by screening (selecting or excluding) companies for investment based on their ESG practices. Stewards should demand the integration of ESG considerations into corporate investment decisions, and they should advance responsible corporate governance strategies through shareholder engagement,

proxy votes, and other tools. These efforts can improve corporate governance practices, and by extension, the long-term value of their funds' assets.

Shareholders and public investors should prioritize investment in firms that adopt good human capital management practices. Diligent activists also should engage with the boards and management of firms around stakeholder issues to disclose and improve HCM practices. Action should be taken to support the HCM Coalition Petition to the SEC to require HCM disclosure from U.S. firms. These endeavors would boost fair wages, benefits, and working conditions, increase workforce training, and facilitate more broadly shared profits. In addition, investors should demand that sustainability ratings firms adopt and utilize the Committee on Workers Capital "Guidelines for the Evaluation of Workers' Human Rights and Labour Standards."

Further, labor shareholders should explore new work systems, including a broad array of existing U.S. workforce participation strategies and industrial democracy practices (some considered part of HCM), as well as Euro-style dual union/works council systems.

Finally, workers, capital stewards, and shareholders should engage with the boards and management of firms, or conduct shareholder proxy campaigns if necessary, to demand that companies seat worker-directors and practice communication, consultation, and codetermination with workers and their representatives—the three key elements of legitimate works councils.

Given the growing role of external asset managers in owning today's industries, Limited Partners (the investors) in private equity investment structures can also push their

General Partners (the managers) to adopt similar practices with their portfolio companies. After all, some of the most progressive company policies, such as worker board seats, diversity, employee shares, profit sharing, and labor-management collaboration, have been put in place as a condition of enlightened private capital and impact investors.

Fight for Worker Stakeholder Representation on Boards

Workers should have a statutory right to representation on corporate boards. Both the UAW and USW have experimented with board representation, as we mentioned, having bargained collectively for this provision with several of the largest industrial corporations in the U.S. While this process has been inconsistent, with labor's board representatives sometimes isolated by management and other board members, it has allowed for more information sharing with corporate management and discussion with other board members.

As McGaughey has noted, worker voice is embedded in American tradition and would expand economic prosperity.[71] In 1919 and during the 1920's, Edward Filene, owner of the Filene's retail store chain that originated in Boston, adopted a House-Senate-Cabinet model of governance, known as the Leitch plan, which included workers on boards. Twenty other companies followed. In the 1970s, Unions began bargaining for board seats, and after mixed proxy and bargaining attempts by unions at GM, UAL, Illinois retailer Jewel, ATT, the Providence and Worcester Railroad, and Anheuser-Busch, the UAW finally succeeded at Chrysler. Despite a history of fierce political opposition from the courts and federal administrations, these scattered battles have led to worker-directorships.

Demand Federal Legislation

It is clear that legislation requiring substantial worker board representation or codetermination would be far more effective than relying on case-by-case collective bargaining agreements. Warren's proposed Accountable Capitalism Act, which has garnered the support of one-third of Senate Democrats, calls a range for 1/3 to 40 percent of non-managerial employees to represent workers on corporate boards. The proposed legislation by Baldwin and Sanders are similar in intent.

We know from collectively bargained experiences that workers need more than one or two seats to be effective. How many seats are enough? Since 2/3 of EU countries have adopted worker codetermination laws, there are a wide set of options to examine.[72] "Although one-half of the board might be the logical answer if the claim is accepted that both labor and capital play an equal role in the success of the corporation, a range of proportions may be appropriate, as long as worker directors must have sufficient representation such that they can exert power in decision-making."[73]

Demand State Legislation and Revisit State Constituency Statutes

Since two-thirds of all corporations are incorporated in just three states—Delaware, New York, and California—these states, which lean Democratic, and others could choose to enact state legislation to require that corporations seat workers.[74] California, after all, passed a law that requires its publicly held corporations headquartered in California to include women on their boards.[75]

McGaughey has asserted that there are no Constitutional or federal law barriers to enacting such a state law. There are precedents here as well. McGaughey also noted that "then Massachusetts Governor Calvin Coolidge signed what is probably the world's oldest codetermination law (outside universities) still on the statute books today. Under the Massachusetts Laws, manufacturing companies can voluntarily enable employees to elect board members." [76] This law likely also accommodated the Filene Company. While this law is voluntary, the state laws could be made mandatory.

Since the corporate takeover and merger wave of the 1980s, the majority of states have adopted so-called "constituency statutes," giving boards of directors broad latitude to take account of stakeholder interests in corporate decision-making. "The statutes, which allow companies to prioritize the interests of 'stakeholders'—often employees—rather than just shareholders, tend to allow businesses more time to bring innovations to market, rather than forcing those companies to prioritize quarterly financial results at the exclusion of new products and new activities."[77]

Since there is a legitimate fear among labor-oriented corporate governance advocates that some directors and managers will use constituency statutes as a shield for self-dealing and to avoid responsible corporate governance measures, we might want to revisit the constituency statute framework. Progressive stakeholder statutes should guarantee that boards are accountable, monitored, and allow responsible governance initiatives to prevail. Governors and legislators can pass legislation, as Illinois did in 2019, that all pension funds and public investors invest with ESG criteria (or, as in the case of Ontario, mandate ESG

disclosure).[78] They can further enact rules that companies adopt information, consultation, and codetermination rights for workers, their core stakeholders.

As states are still the laboratories of democracy, working people and communities need all the tools they can find to prevent destructive hostile takeovers, illogical and often unprofitable mergers and acquisitions, exuberant offshoring, and irrational break-ups (think Timken).

Amend trade deals to stakeholder company adoption.

In the coming years, there will be a number of efforts to reform international trade deals. While supporting the push from labor and civil society for more democratic and transparent terms for all country partners, we acknowledge the important precedent, as was sought in the case of the Trans-Atlantic Trade and Investment Partnership, to require that overseas firms operating in the U.S. adopt dual union/works council structures, especially given the productivity results that are apparent in firms utilizing the German model.

Section 6: Conclusion—Shareholder and Stakeholder Activism in Perspective

To put the issues surrounding codetermination in perspective, it is important to consider them from the perspective of democratic values. A question with deep roots in our society, with origins in the writings of C. Wright Mills, is this: "Why does American democracy end when we step outside the ballot box?" Later, seizing on Mill's writings, the New Left of the 1960s lit a fire under an American ideal of economic democracy, pushing it into schools, neighborhoods, and factories. They proclaimed that students, residents, and workers should have more of a say in these social spaces. According to Noam Chomsky,

economic democracy is simply this: participants in economic institutions (e.g., factories, stores, and universities) decide on the policy of the institution.[79]

We can point to early actions taken by worker stakeholders and shareholder activists to move toward a more social and inclusive, participatory, bottom-up democracy. For example, in 1949 the Association of Independent Telephone Unions used their share ownership in AT&T to bring fellow shareholders' attention to the unilateral decision by management to cut pension benefits.[80] In the 1970s, the Amalgamated Clothing and Textile Workers Union (ACTWU) brought the unsavory employment practices of the southern textile firm J. P. Stevens to light at the company's shareholder meetings. As a result of its efforts, the union won representation for more than 3,000 of Stevens' workers. The campaign was also portrayed in a 1979 hit movie *Norma Rae*. Such legacies have had a lasting impact.

There are thousands of companies utilizing interesting alternative ownership models in the U.S. and abroad, such as co-ops and employee-stock owned firms (ESOPs), that share profits with workers and in some cases provide meaningful worker participation. In the U.S., ESOPs with significant worker ownership shares include about 6,000 companies that collectively employ some three million employees, according to Chris Mackin of Rutgers University. (To read more of Mackin's views, see Chapter 16 of the book, "*Property not Pay: Restoring the Middle through Ownership*.") As we pointed out in the *Handbook*,[81] many unions such as the Steelworkers, Machinists, and UFCW have employed defensive worker buyouts starting in the 1980s to salvage larger at-risk firms.

There are also newer ethical business models that target social purposes and benefits. B-Lab (https://bcorporation.net/) offers B Corporation certification to companies that have been chartered in many states and several countries. Among their aims is the integration of the principles embodied in ESG and elevation of the roles of worker stakeholders. There are over 2,500 B Corporations in over 50 countries, representing 130 industries. B Corporations, which include in their ranks popular brands such as Patagonia, Seventh Generation, and a number of breweries, proclaim their commitment to "a living wage for all workers, a boardroom with the same mix of people as the factory floor, and business that works for everyone."[82] There are other innovative efforts that we do not have space to recognize here, such as the work of impact investors who give priority to enabling workers to share in ownership.

While a systemic stakeholder company approach does not preclude such brave and hard-fought models, we need to acknowledge the inherent limits in a brutal financialized, capitalist, global economy. In the case of the USW ESOPs, for example, most of the firms eventually closed, as workers did not have the capital to overcome major downturns, global competition, and unfair trade practices. Moreover, most alternative business models are voluntary—even with favorable state incentives—so they have limited application to the people who toil daily in our factories, stores, and marketplaces.

A bridge to economic democracy can be built by the promotion of the broader interests of workers and all stakeholders: investors, customers, suppliers, and the greater community, rather than solely maximizing shareholder value. Businesses are publicly chartered, though

the public rarely has a voice in whether a company has violated that charter. As a society, we need to rein in bad actors and lift up the concept of commonwealth companies that make profits for shareholders and also share the wealth with their stakeholders—especially employees. To do that, we need a consistent, integrated web of national and state laws and business rules that look more like those of our friends in Europe.

As Marlene O'Connor noted in 2001, there are convergences not only in global corporate ownership (with more European firms operating in the U.S. and U.S. firms merging with European firms) but also in fiduciary and shareholder law that call for a reconsideration of how business is conducted in the U.S. Over the last two decades, these trends have only become more prevalent.

Leo Strine, in his remarkable October clarion call, asked for workers' capital advocates to add an additional "E" (for employees) to ESG, and proposed that workers be appointed to board committees to focus on fair treatment of workers in both home companies and in the supply chains. He argued,

> US public corporations are not playthings. They create jobs, produce goods and services that consumers depend on, affect the environment we live in and build wealth that help Americans lead more secure lives. They are societally chartered institutions of enormous importance and value. Those who govern them should be accountable for the generation of durable wealth for their workers and ordinary investors.
>
> We need a new system that supports sustainable and fair wealth creation within a system of enlightened capitalism. It should align the

> interests of institutional investors and corporations with those of the workers whose capital they control. With some modest sacrifices by every interest that wields economic power, we can make the economy work better for all Americans.[83]

Political pendulums swing, and it's time to swing back to economic democracy.

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Notes on the Contributors

Tom Croft is the Managing Director of Heartland Capital Strategies (HCS) and Executive Director of the Steel Valley Authority (SVA). He is co-author, with Annie Malhotra, of the *Responsible Investor Handbook: Mobilizing Workers for a Sustainable World* (Routledge Publishing, 2016). Mr. Croft's previous works include *Up from Wall Street: The Responsible Alternative* (Cosimo Books, 2009); "Targeted Responsible Investments," a chapter in *The Next Generation of Responsible Investing* edited by Tessa Hebb (Springer Publishing, 2011); "Helping Workers' Capital Work Harder: A Report on Global Economically Targeted Investments (ETIs)," a report commissioned by the Global Unions Committee on Workers' Capital (CWC), International Trade Union Confederation (ITUC) (2009); and "Collaboration Between Labor, Academics and Community Activists to Advance Labor/Capital Strategies," a chapter in *Money on the Line: Workers' Capital in Canada* edited by Isla Carmichael and Jack Quarter (Canadian Centre for Policy Alternatives, 2003). Heartland previously commissioned *Working Capital: The Power of Labor's Capital* edited by Tessa Hebb, et al. (Cornell University, 2001).

Annie Malhotra is co-author of the *Responsible Investor Handbook* with Thomas Croft. Currently Heartland Capital Strategies' Research Director, she began her career at a leading asset management firm where she gained deep exposure to fundamental, value-based, long-term investment principles and philosophy. Later, Ms. Malhotra led the development of an online financial platform whose aim is to democratize access to capital for micro, small, and medium-sized businesses and not-for-profit organizations—taking the platform from idea to implementation. Ms. Malhotra also consults in the areas of sustainability, impact investing, and responsible investment. She has completed the Canadian Securities Course (CSC) and is a Chartered Financial Analyst (CFA).