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## A New Standard for Governance: Reflections on Worker Representation in the United States

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\*J.D. Candidate, Fordham University School of Law, May 2020

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## Abstract

The contemporary state of corporate law in the United States is one that is skewed toward the archaic principle of shareholder primacy. This narrow conception of corporate purpose has resulted in governance mechanisms that tend to overlook the many stakeholders that are affected by, and, in turn, affect the bottom line of modern corporations. In the wake of the recently proposed Accountable Capitalism Act, this Note investigates the viability of adopting a system of mandated worker board representation—codetermination—in the United States. The Note employs a comparative analysis of the German and Swedish experiences with codetermination, and then evaluates the policy, efficiency, and legal arguments made by prominent scholars and experts in the field of comparative corporate law. This Note begins by examining the history of codetermination in Germany and Sweden. It then details several pertinent developments in United States corporate law and reflects on how these developments have affected the economy. Next, it introduces relevant arguments for and against codetermination that are rooted in economic and legal considerations. This Note then proposes a set of parameters for the adoption of codetermination in the United States—primarily maintaining a single-tier board structure and mandating a nationwide, industry-wide application. Finally, due to the unpredictability of transplanting foreign governance mechanisms, it calls for additional research and constructive debate on the topic.

**KEYWORDS:** Corporate law, corporate boards, board of directors, directors, corporate governance

# A NEW STANDARD FOR GOVERNANCE: REFLECTIONS ON WORKER REPRESENTATION IN THE UNITED STATES

*Julian Constain\**

## ABSTRACT

The contemporary state of corporate law in the United States is one that is skewed toward the archaic principle of shareholder primacy. This narrow conception of corporate purpose has resulted in governance mechanisms that tend to overlook the many stakeholders that are affected by, and, in turn, affect the bottom line of modern corporations. In the wake of the recently proposed Accountable Capitalism Act, this Note investigates the viability of adopting a system of mandated worker board representation—codetermination—in the United States. The Note employs a comparative analysis of the German and Swedish experiences with codetermination, and then evaluates the policy, efficiency, and legal arguments made by prominent scholars and experts in the field of comparative corporate law. This Note begins by examining the history of codetermination in Germany and Sweden. It then details several pertinent developments in United States corporate law and reflects on how these developments have affected the economy. Next, it introduces relevant arguments for and against codetermination that are rooted in economic and legal considerations. This Note then proposes a set of parameters for the adoption of codetermination in the United States—primarily maintaining a single-tier board structure and mandating a nationwide, industry-wide application. Finally, due to the unpredictability of transplanting foreign governance mechanisms, it calls for additional research and constructive debate on the topic.

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**INTRODUCTION**

Over a century ago, Otto von Gierke warned that the working class was “threatened to be deprived of their economic personality by the development of the capitalist large enterprise.”<sup>1</sup> While von Gierke uttered those words in a different context, the message could not be more befitting to the contemporary state of the U.S. economy.

U.S. corporate law has developed in a manner that continually expands the rights afforded to corporate entities which, in turn, incentivizes corporate ownership.<sup>2</sup> As a result, modern corporations exert

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1. Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, EMPLOYEES AND CORPORATE GOVERNANCE 164 (Margaret M. Blair & Mark J. Roe eds., 1999) (quoting Otto van Gierke’s 1868 writing).

2. See generally *The Rights of Corporations*, N.Y. TIMES (Sept. 21, 2009), <https://www.nytimes.com/2009/09/22/opinion/22tue1.html> [<https://perma.cc/9BWN-2T>]

an unprecedented level of influence on the global economy.<sup>3</sup> Their products are cemented into the U.S. psyche and have become integral features of the most intimate facets of the culture and, thus, the economy.<sup>4</sup> Corporate actions impact both stakeholders and society at large. For example, the opening of a new factory has a positive impact on a variety of groups—shareholders benefit from an increase in share value, the assets of new hires and their nuclear families multiply, and the local economy experiences a rise in activity.

Control over corporate decision-making, however, is reserved for shareholders and appointed directors.<sup>5</sup> Accordingly, the fate of the many stakeholders affected by corporate actions rests in the hands of a select few who often have different interests.<sup>6</sup> This discrepancy has not escaped the attention of contemporary legislators, as several have integrated corporate governance reform into their policymaking agenda.<sup>7</sup> One such example is Senator Elizabeth Warren’s Accountable Capitalism Act.<sup>8</sup> In an effort to address corporate accountability, Senator Warren proposed a system of governance in which worker representation—codetermination—would be mandatory and the fiduciary duties of corporate directors would be expanded to include stakeholders other than shareholders.<sup>9</sup>

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4M]; *When Did Companies Become People? Excavating the Legal Evolution*, NPR (July 28, 2014, 4:57 AM), <https://www.npr.org/templates/transcript/transcript.php?storyId=335288388> [<https://perma.cc/B92E-5CQB>].

3. Brian Roach, *Corporate Power in a Global Economy*, GLOB. DEV. & ENV’T INST., TUFTS U. 1 (2007) [http://www.ase.tufts.edu/gdae/education\\_materials/modules/corporate\\_power\\_in\\_a\\_global\\_economy.pdf](http://www.ase.tufts.edu/gdae/education_materials/modules/corporate_power_in_a_global_economy.pdf) [<https://perma.cc/4LVR-BJXL>].

4. *See id.*

5. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2016) (providing that “[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors.”).

6. *See* Fabian Brandt & Konstantinos Georgiou, *Shareholders vs. Stakeholders Capitalism* 36-37 (Spring 2016) (unpublished manuscript) (on file with the University of Pennsylvania Law School: Legal Scholarship Repository) (suggesting that some corporate directors protect a select group of stakeholders’ interests instead of the entire class of shareholders).

7. *See, e.g.*, Jonathan Ford & Jim Pickard, *The Four Key Proposals in May’s Boardroom Overhaul*, FIN. TIMES (Aug. 29, 2017), <https://www.ft.com/content/964a3d4c-8cc5-11e7-9084-d0c17942ba93> [<https://perma.cc/GUY9-V884>].

8. Accountable Capitalism Act, S. 3348, 115th Cong. § 5 (2018).

9. *Id.*

Through a comparative analysis of legal developments in Europe and the United States, this Note reflects on the legal and economic theories advanced by codetermination and, thus, evaluates its practical viability in the United States. Part I details the historical development of codetermination, which has occurred almost exclusively in Europe. Part II presents relevant arguments for the adoption of codetermination given its practicality, efficiency, and legality. Part III reflects on the goals that worker representation advances and, accordingly, suggests a course of action for its adoption in the United States.

## I. ORIGINS

Codetermination was first conceived and adopted in Europe, and continues to exist primarily there.<sup>10</sup> Germany was one of the first countries to consider implementing co-determination, having debated the topic at the country's first democratic assembly—the Frankfurt Parliament of 1848 and 1849.<sup>11</sup> As a result, the vast majority of codetermination research has been conducted in the context of Germany's experience with the system.<sup>12</sup> The most notable progress made outside of Germany has been in Scandinavia, where Norway, Sweden, and Denmark have each adopted a system of worker representation unique to their socioeconomic conditions.<sup>13</sup>

### A. GERMAN ORIGINS

German codetermination operates in two distinct ways. First, it exists at the shop level through workers' councils; second, it exists at the

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10. For a comprehensive list of participating countries and their respective worker representation systems, see WORKER PARTICIPATION, [www.worker-participation.eu](http://www.worker-participation.eu) (last visited Feb. 23, 2019) [<https://perma.cc/WK76-KZ78>].

11. Justin Fox, *Why German Corporate Boards Include Workers*, BLOOMBERG (Aug. 24, 2018, 10:00 AM), <https://www.bloomberg.com/opinion/articles/2018-08-24/why-german-corporate-boards-include-workers-for-co-determination> [<https://perma.cc/GB4U-H4K2>].

12. See *infra* Section I.A.

13. See generally Steen Thomsen, Caspar Rose & Dorte Kronborg, *Employee Representation and Board Size in the Nordic Countries*, 42 EUR. J. L. & ECON. 471 (detailing the history which led to the current system of worker representation in the Nordic countries).

corporate level through the representation of workers on supervisory boards.<sup>14</sup> The workers' councils address standard collective bargaining matters, while supervisory boards oversee companies' policy-based strategic decision-making.<sup>15</sup>

Some form of worker representation has existed in Germany for well over one hundred years.<sup>16</sup> As early as July 1891, the German legislature enacted laws allowing for the creation of workers' councils on a voluntary basis.<sup>17</sup> While the 1891 enactments only dealt with shop-level representation, representation soon rose into the upper levels of management. Germany first moved toward the current conception of codetermination in 1922, when the government passed legislation requiring that worker representatives be appointed to the supervisory boards of joint-stock companies.<sup>18</sup> In 1934, Germany's Nazi regime rescinded the laws because the ideologies on which they rested were at odds with those of the regime itself.<sup>19</sup>

Codetermination returned to prominence, however, after World War II and the rise and fall of fascism in Germany.<sup>20</sup> Politicians believed that the Nazi regime excelled largely due to its alliance with private capital, particularly the coal and steel industries.<sup>21</sup> To prevent the continued intertwining of politics and private capital, many thought the newly-

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14. See Pistor, *supra* note 1, at 165-66.

15. It is important to note that German companies operate with a dual-tiered board system, as opposed to the single-tiered system that is a staple in the United States. The dual-board structure consists of a supervisory board and a management board, which the supervisory board appoints and supervises. The supervisory board oversees the long-term policy and strategy of the firm, while the management board is in charge of the day-to-day operations. See Wolf-Georg Ringe, *German Versus Nordic Board Models: Form, Function, and Convergence*, 65 *NORDIC J. BUS.* 27, 30-31 (2016).

16. See, e.g., Ewan McGaughey, *The Codetermination Bargains: The History of German Corporate and Labour Law* 13 (London Sch. of Econ. & Pol. Sci. Working Paper 10/2015) (detailing the adoption and subsequent development of codetermination in Germany).

17. Gesetz Betreffend Abänderung der Gewerbeordnung [Law Concerning Modification of the Industrial Code], June 1, 1891, REICHSGESETZBLATT [RGL] at 159, § 134h (Ger.).

18. Gesetz über die Entsendung über Betriebsratsmitglieder in den Aufsichtsrat [Supervisory Council Act], Feb. 15, 1922, REICHSGESETZBLATT, Teil I [RGL I] at 209 (Ger.).

19. See McGaughey, *supra* note 16, at 30.

20. See *id.* at 34.

21. *Id.*

established political democracy should match an “economic democracy” that constrains the use of private capital.<sup>22</sup> This line of thinking, paired with the desire to maintain the economic powerhouses of the coal mining and steel industries (generally categorized in Germany as the Montanindustrie or Montan industry), resulted in the current regime of codetermination in Germany.<sup>23</sup>

The existing German codetermination legislation regulates two major factions of the market: the Montan industry,<sup>24</sup> and all companies outside of the Montan industry that employ more than 500 people.<sup>25</sup> Because the empirical data regarding Montan codetermination is both limited in scope and of questionable accuracy, this Note focuses on German codetermination as it exists outside of the Montan industry.<sup>26</sup>

The Works Constitution Act of 1952 (the “1952 Act”) introduced the current conception of German codetermination.<sup>27</sup> The 1952 Act mandated that companies—other than those in the Montan industry—with between 500 and 2,000 employees allow their workers to appoint one third of the

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22. See Pistor, *supra* note 1, at 167.

23. McGaughey, *supra* note 16, at 36.

24. The Montanmitbestimmungsgesetz [MontanMitbestG] [Codetermination Act of 1951], May 21, 1951, BUNDESGESETZBLATT, Teil I [BGBL I] at 347 (Ger.). This Act regulates the Montan industry and calls for an even split of shareholder and worker representatives on their boards.

25. The Works Constitution Act governed non-Montan industry companies that employ between 500 and 2,000 workers, while the Codetermination Act of 1976 governs companies with over 2,000 workers. See Betriebsverfassungsgesetz [BetrVG] [Works Constitution Act of 1952], Oct. 11, 1952, BUNDESGESETZBLATT, Teil I [BGBL I] at 681 (Ger.); see also Mitbestimmungsgesetz [MitbestG] [Codetermination Act of 1976], May 4, 1976, BUNDESGESETZBLATT, Teil I [BGBL I] at 1153 (Ger.). The 1952 Act was supplanted by the One-Third Participation Act of 2004, which mandates essentially the same conditions for the purposes of this Note. The One-Third Participation Act requires that German companies which employ between 500 and 2,000 workers must grant them 1/3 of their board seats. §§ 1 & 4 Drittelbeteiligungsgesetz [DrittelbG] [One-Third Participation Act], May 18, 2004, BUNDESGESETZBLATT, Teil I [BGBL I] at 974 (Ger.).

26. Experts argue two main reasons that the data is largely irrelevant for fiscal efficiency reasons. First, because the Montan industry was categorically affected, there was no control set of companies to weigh results against. Second, the research focused mostly on subjective reporting of workers’ self-esteem. See Pistor, *supra* note 1, at 169-70.

27. Betriebsverfassungsgesetz [BetrVG] [Works Constitution Act of 1952], Oct. 11, 1952, BUNDESGESETZBLATT, Teil I [BGBL I] at 681 (Ger.).



supervisory board.<sup>28</sup> Because the 1952 Act was limited in its application to firms of a certain size, it was not long before the legislature moved to expand the reach of codetermination requirements. The Codetermination Act of 1976 requires that all companies outside of the Montan industry with more than 2,000 workers allow the workforce to appoint one half of the directors who sit on the supervisory board.<sup>29</sup> This system is referred to as “quasi-parity codetermination” because, although employees make up half of the board, shareholders have the right to appoint the chairman, who has the authority to cast the tie-breaking vote in a deadlock.<sup>30</sup>

Despite the ability of shareholders to influence decisive tie-breaking votes, workers retain a considerable amount of influence over company policy through their board representatives.<sup>31</sup> This leverage is rooted in (1) their ability to influence the makeup of the board; (2) their increased access to information, which prevents shareholder representatives from abusing their power; and (3) their ability to withhold votes and essentially veto company decisions.<sup>32</sup>

It is important to note several characteristics unique to the German system. While a dual-board system consisting of both a supervisory board and management board is not unique to Germany,<sup>33</sup> it certainly is unexplored territory in the U.S. context, which has always consisted of single-tiered boards.<sup>34</sup> Because German shareholders and workers do not directly appoint the members of the management board, the board’s decision-making process is insulated from their control to a certain degree. Additionally, companies in the German market operate with a well-established system of collective bargaining, which sets a clear division between the subject matter debated by workers’ unions and that

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28. *Id.*

29. Mitbestimmungsgesetz [MitbestG] [Codetermination Act of 1976], May 4, 1976, BGBL I §§ 1, 7. (Ger.).

30. *Id.* § 29.

31. REINIER KRAAKMAN ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 90 (3rd ed. 2017).

32. *Id.* at 91.

33. See Thomsen, Rose & Kronborg, *supra* note 13.

34. Frank Chantayan, *An Explanation of American and German Corporate Law Norms*, 16 ST. JOHNS J. CIV. RTS. ECON. DEV. 431, 436-37 (2002).

which is debated by the codetermined supervisory boards.<sup>35</sup> The workers' unions negotiate typical core matters of collective bargaining outside of the company's enterprise on an industry-wide level.<sup>36</sup> These negotiations occur regularly, and bind companies in entire regions of the country.<sup>37</sup> On the other hand, the representatives on the supervisory board influence long-term policy matters, separate from those decided through collective bargaining.<sup>38</sup>

#### B. ADOPTION IN SCANDINAVIA

The Scandinavian countries are among the most pragmatic adopters of codetermination outside of Germany. Though each respective Scandinavian country has adopted systems with varying features, this Note focuses on the Swedish system, as it operates with what is effectively a closely controlled, single-tiered board structure—most similar to the United States.<sup>39</sup>

Scholars often attribute the origin of worker representation in Sweden to the rise of the Social Democratic Party (the “SAP”) in the early twentieth century.<sup>40</sup> Having remained largely in power from the mid-1930s through the mid-1980s, the SAP had a prominent impact on Swedish socioeconomic policy.<sup>41</sup> The party's socioeconomic agenda relied heavily on the belief that pure capitalism is not desirable, and instead, those in power should pursue an “economic democracy.”<sup>42</sup> The SAP envisioned “a stakeholder form of socialism that was more efficient than pure capitalism because it contained elements of rational planning that would eliminate the waste that irrational, short-sighted markets

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35. See Paul Davies, *Efficiency Arguments for the Collective Representation of Workers: A Sketch*, in *THE AUTONOMY OF LABOUR LAW* 383-84 (Alan Bogg et al. eds., 2015).

36. *Id.*

37. *Id.*

38. *Id.* at 385.

39. *Board Level Representation in Sweden*, EUROPEAN TRADE UNION INST., <https://www.worker-participation.eu/National-Industrial-Relations/Countries/Sweden/Board-level-Representation> [<https://perma.cc/M2LD-KFPU>] (last visited Mar. 6, 2019).

40. See Peter Hogfeldt, *The History and Politics of Social Ownership in Sweden*, in *A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD* 538-46 (Randall K. Morck ed., 2005).

41. *Id.* at 519.

42. *Id.* at 539.

create, like unemployment and volatile investment cycles.”<sup>43</sup> The SAP believed that the pillar of successful capitalism was a steady flow of investment that produced socially-beneficial, long-term growth.<sup>44</sup> As a result, policymakers should recognize that workers are not merely the means of production, but rather, private actors with valid socioeconomic needs whose fulfilment—or lack thereof—will have deep and lasting effects on society.<sup>45</sup>

Swedish labor policy in the mid-1900s was influenced heavily by the history of cooperation between the SAP and the capitalists that controlled the largest, most economically-relevant companies.<sup>46</sup> This level of cooperation first came to fruition in approximately 1938, when policymakers adopted two pivotal strategies.<sup>47</sup> First, the Saltsjöbadsavtalet accord afforded new protections to workers and cemented procedures meant to limit negative externalities produced by companies.<sup>48</sup> By stressing the common economic goals of large companies and their workers, a general spirit of cooperation developed.<sup>49</sup> Second, corporate tax reform granted free depreciation allowances for machines and equipment.<sup>50</sup> Because this policy mainly benefited large, capital-intensive companies, it furthered the spirit of cooperation between the SAP and capitalists.<sup>51</sup> These reforms and the cooperation that followed led to a period of socioeconomic prosperity dubbed the Swedish “Golden Age.”<sup>52</sup>

The policies adopted by the SAP were not without their drawbacks. While the policies benefitted large enterprises, they also stymied the formation of new companies and ignored the importance of small

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43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.* at 539-41.

47. *Id.* at 541.

48. *Id.*

49. *Id.*

50. *Id.* This was followed by an accelerated depreciation allowance in 1958, which was even more favorable to capitalists.

51. *Id.* For an analysis on how depreciation allowances benefit large companies, see Bruce Bartlett, *Depreciation's Place in Tax Policy*, NY TIMES: ECONOMIX (Sep. 10, 2013), [https://economix.blogs.nytimes.com/2013/09/10/depreciations-place-in-tax-policy/?\\_r=0](https://economix.blogs.nytimes.com/2013/09/10/depreciations-place-in-tax-policy/?_r=0) [<https://perma.cc/778U-S7DK>].

52. *See* Hogfeldt, *supra* note 40, at 545.

business.<sup>53</sup> Additionally, unequal working conditions became rampant even in the largest enterprises, which led to a long and bitter working strike in 1969.<sup>54</sup> Mounting criticism stemming from the 1969 strike, along with an economic depression triggered by an international oil crisis, led political incumbents to propose increasingly radical redistributive policies.<sup>55</sup> Though the SAP lost the 1976 election, the sociopolitical climate inevitably headed toward the economic democracy proposed decades earlier.<sup>56</sup> That same year, Sweden adopted the Codetermination Act of 1976 and, thus, took the first step toward their contemporary model of worker representation.<sup>57</sup>

The Act on Board Representation for Employees in Private Employment, codified in 1987 (the “1987 Act”), created what developed into the current system of worker representation in Sweden.<sup>58</sup> Under the 1987 Act, companies that employ over twenty-five people are required to allow workers to appoint two members to the board of directors.<sup>59</sup> Companies in certain sectors of the market with over 1,000 employees must allow on the board three worker representatives.<sup>60</sup> Although there is no specified percentage requirement of worker board members in Sweden like there is in Germany, recent studies have found that workers tend to make up approximately thirty percent of the board seats in Swedish companies.<sup>61</sup> Nevertheless, worker representatives may never constitute the majority of a company’s board of directors.<sup>62</sup> Local unions nominate the worker representatives, and the unions usually have collective agreements with the companies involved.<sup>63</sup> Although worker representatives can vote on most issues introduced to the board, they lack

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53. *Id.*

54. *Id.* at 545, n.12.

55. *Id.* at 545.

56. *Id.*

57. *Id.*

58. *See generally* LAG OM STYRELSEREPRESENTATION FÖR DE PRIVATANSTÄLLDA (Svensk författningssamling [SFS] 1987:1245) (Swed.).

59. 4 § Svensk författningssamling (SFS 1987:1245) (Swed.).

60. *Id.*

61. *See Board Level Representation in Sweden, supra* note 39.

62. § 4 Svensk författningssamling (SFS 1987:1245) (Swed.).

63. *See Board Level Representation in Sweden, supra* note 39.

veto power and cannot vote on issues that are part of collective bargaining done by the local unions.<sup>64</sup>

Finally, the Swedish system of corporate governance is marked by a “strict hierarchy between the different levels of command.”<sup>65</sup> The degree to which management is insulated under the German system does not exist and, thus, directors exercise strict control over management in Sweden.<sup>66</sup> Accordingly, the shareholders exercise close control over companies through their directors.<sup>67</sup> The close nexus of control prevalent in the Swedish system enables it to operate in a manner that functionally is equivalent to the single-tiered system of the United States.

### C. A FUTURE IN THE UNITED STATES?

Corporate law in the United States largely results from state-created legislation and case law.<sup>68</sup> The most widely accepted view of corporate purpose is that corporations are to be run for the pecuniary benefit of the shareholders.<sup>69</sup> It is not completely clear, however, how directors should pursue this pecuniary benefit. The Delaware General Corporation Law (the “DGCL”), widely considered an authority on U.S. corporate law, is relatively silent regarding corporate purpose.<sup>70</sup> Though the DGCL sets up boundaries for director power and liability, and indirectly imparts fiduciary duties, it does not define corporate purpose as creating a pecuniary benefit.<sup>71</sup>

In contrast, case law provides a more clear and nuanced definition of what a corporate purpose should be. In the oft-mentioned *Dodge v. Ford*, a Michigan court found that Henry Ford breached his fiduciary duty to

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64. *Id.*

65. *See Ringe, supra* note 15, at 33.

66. *Id.*

67. *Id.*

68. *See* Richard W. Jennings, *The Role of the States in Corporate Regulation and Investor Protection*, 23 L. & CONTEMP. PROBS. 193, 198 (1958).

69. *See, e.g.,* David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 183 (2013) (explaining that while some prominent scholars argue that companies may operate to pursue profits for stakeholders other than shareholders, the most widely accepted view is “that corporate boards are supposed to pursue profits for shareholders and that directors have neither the obligation nor the right to pursue other interests.”).

70. *Id.* at 185.

71. *Id.*

shareholders when he sought to reinvest profits into the company to increase wages and decrease prices, as opposed to issuing discretionary dividends.<sup>72</sup> Despite its prevalence in law school curricula, scholars often dispute the significance of *Dodge*, as Delaware courts have yet to cite it as authority on the issue of corporate purpose.<sup>73</sup> Alternatively, a line of now-famous takeover cases decided by the Delaware courts provides insight for how to define corporate purpose.<sup>74</sup>

In *Unocal v. Mesa*, the Delaware Supreme Court held that director power is derived from a duty to protect the “corporate enterprise, which includes stockholders, from harm reasonably perceived.”<sup>75</sup> Accordingly, in developing a reasonable anti-takeover plan, directors should consider the “inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on ‘constituencies’ other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange.”<sup>76</sup>

While the *Unocal* opinion gave the impression that directors could stray from shareholder primacy, the Delaware Supreme Court held otherwise in *Revlon v. MacAndrews & Forbes Holdings*.<sup>77</sup> *Revlon* clarified that the standard announced in *Unocal* did not authorize directors to make decisions for the sole benefit of stakeholders other than the shareholders themselves.<sup>78</sup> Though directors can act with other beneficiaries in mind, such actions are permissible only if they are “rationally related” to the benefits accruing to shareholders.<sup>79</sup> *Revlon* clearly demonstrates that shareholder primacy is at the center of Delaware law. Recently, the Delaware Chancery Court emphasized the idea of

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72. *Dodge v. Ford*, 204 Mich. 459, 507 (1919) (“A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.”).

73. Yosifon, *supra* note 69, at 188.

74. See discussion *infra* pp. 12-13.

75. *Unocal v. Mesa*, 493 A.2d 946, 954 (Del. 1985).

76. *Id.* at 955.

77. *Revlon v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1985).

78. *Id.* at 176 (finding that defensive maneuvers taken to protect creditors were inappropriate).

79. *Id.* (holding that “while concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the shareholders.”).

shareholder primacy as developed by the *Unocal* and *Revlon* holdings. In *eBay v. Newmark*, the court held that when a corporation is organized as for-profit, directors' fiduciary duties bind them to "promote the value of the corporation for the benefit of its stockholders."<sup>80</sup>

Though there is some ambiguity as to what constitutes value creation for shareholders, the reality is that modern directors are incentivized to enhance the monetary value of shares. Milton Friedman promoted this concept, staunchly endorsing the idea that the most efficient economy is one in which companies operate with the end goal of increasing profits.<sup>81</sup> Accordingly, directors making decisions on behalf of the company as fiduciaries must exercise the highest level of loyalty and care in the pursuit of advancing shareholders' interests, which are often primarily monetary.<sup>82</sup>

The general acceptance of shareholder value maximization has had a number of marked effects on the U.S. economy, beginning with an undeniable increase in the value of corporate ownership.<sup>83</sup> Empirical data reveals that, while share value has drastically increased, book value has remained relatively stagnant.<sup>84</sup> This is reflected in the average value of Tobin's Q, which historically has been measured at a value well below one in many developed countries, including Germany.<sup>85</sup> On the other hand, the U.S. average has been much closer to one since it took off in the mid-1980s, actually soaring and remaining above one for nearly a decade.<sup>86</sup> Thus, U.S. firms are providing higher shareholder value when compared to German and Swedish firms with similar book values.

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80. *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. 2010).

81. Milton Friedman, *The Social Responsibility of Business is to Increase Profits*, N.Y. TIMES MAG. 1 (Sep. 13, 1970), at 6.

82. See, e.g., Note, Christopher Yeager, *At Least Somewhat Exaggerated: How Reports of the Death of Delaware's Duty of Care Don't Tell the Whole Story*, 103 GEORGETOWN L. J. 1387, 1388-89 (describing how directors owe fiduciary duties of loyalty and care to their corporation's shareholders and must pursue, in good faith, the interests of the corporation and its shareholders rather than the directors' own interests).

83. See, e.g., FACUNDO ALVAREDO ET AL., WORLD INEQUALITY REPORT 87 (2018).

84. *Id.* at 86.

85. Tobin's Q is equivalent to a firm's market value divided by its book value. See Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 n. 150 (2005); see also Thomas Piketty & Gabriel Zucman, *Capital is Back: Wealth-Income Ratios in Rich Countries 1700-2010*, 129 Q. J. ECON. 1255 (2014).

86. Piketty & Zucman, *supra* note 85, at 1280-82.

The spoils of the increased value of corporate ownership, however, have been claimed almost exclusively by a select faction of the population.<sup>87</sup> Empirical research shows that the top ten percent of households own ninety-three percent of the outstanding shares in the United States.<sup>88</sup> Wealth inequality in the United States reflects these findings, as the average CEO of a large company now makes over three hundred times what the average worker makes—up from forty-two times in 1980.<sup>89</sup> Though this figure does not reflect the average stockholder, it illustrates the disparity in wealth distribution in the United States. Professor William Lazonick posits that this is a result of companies adopting “value-extracting” strategies, which involve cutting costs by all means necessary and distributing the freed-up capital to the shareholders through instruments such as stock buybacks.<sup>90</sup>

Mandatory codetermination has never been introduced in the United States. Though recent legislative developments have seen some jurisdictions permit corporations to incorporate and operate with the purpose of creating a net social gain,<sup>91</sup> the majority of companies in the United States continue to avoid operating with such a business model.<sup>92</sup>

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87. See Edward N. Wolff, *Household Wealth Trends in the United States, 1962 to 2016: Has Middle Class Wealth Recovered?* 53 (N.Y.U. Dep’t Econ., Working Paper No. 24085, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3082268](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3082268) [<https://perma.cc/D954-J6K3>].

88. *Id.*

89. *CEO-To-Worker Pay Ratio Ballooned 1,000 Percent Since 1950: Report*, HUFFPOST (Apr. 30, 2013, 10:01 AM), [https://www.huffpost.com/entry/ceo-to-worker-pay-ratio\\_n\\_3184623](https://www.huffpost.com/entry/ceo-to-worker-pay-ratio_n_3184623) [<https://perma.cc/Q2G8-QSK3>].

90. See William Lazonick, *Profits Without Prosperity*, HARV. BUS. REV. (Sep. 2014), <https://hbr.org/2014/09/profits-without-prosperity> [<https://perma.cc/54VL-R7US>].

91. See, e.g., DEL. CODE ANN. tit. 8, § 362. Corporations that operate for the purpose of creating a net social gain, as opposed to primarily creating value for shareholders, are referred to as “benefit corporations” or “b-corps.” GENERAL QUESTIONS, BENEFIT CORP., <https://benefitcorp.net/faq> [<https://perma.cc/GK32-FGBM>] (last visited Apr. 21, 2019).

92. Though some states like Delaware and New York permit this, very few companies have voluntarily chosen to operate in this way. This may be due to perceived drawbacks or simply a lack of experience with the system. Notable high-profile exceptions are Patagonia, Warby Parker, Ben & Jerry’s, and Etsy, which have decades of combined experience operating as public benefit corporations. For further discussion and analysis of high-profile U.S. companies operating for public benefit, see Mary Mazzoni, *3P Weekend: 12 B Corps Leading Their Industries*, TRIPLE PUNDIT (Dec. 9, 2016),



In August 2018, Senator Elizabeth Warren of Massachusetts introduced the Accountable Capitalism Act (the “Act”).<sup>93</sup> The Act, which is very similar to recent stakeholder protection trends emerging in Anglo-Saxon nations, proposes several shifts in corporate governance<sup>94</sup> to address mounting national concern over uneven wealth distribution, which many believe stems from the doctrine of shareholder primacy.<sup>95</sup>

The Act mandates the creation of an “Office of United States Corporations,” which would operate as a national registry to oversee corporations with over \$1 billion in annual profits.<sup>96</sup> While a federal registry seems benign on its face, it actually lays the groundwork for the substantive requirements of the Act.<sup>97</sup> All companies with over \$1 billion in annual revenue would be deemed “United States Corporations” and, thus, required to adhere to several requirements that radically depart from current norms.<sup>98</sup>

First, United States Corporations must operate with the purpose of creating a “general public benefit.”<sup>99</sup> When making strategic decisions, their directors must account for the interests of the workforce, the consumers, and the global environment.<sup>100</sup> Second, in order to make

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<https://www.triplepundit.com/2016/12/b-corps-leading-their-industries/> [<https://perma.cc/M642-ML4A>].

93. Accountable Capitalism Act, S. 3348, 115th Congr. (2018).

94. See, e.g., Matthew Yglesias, *Elizabeth Warren Has a Plan to Save Capitalism*, VOX (Aug. 18, 2018), <https://www.vox.com/2018/8/15/17683022/elizabeth-warren-accountable-capitalism-corporations> [<https://perma.cc/3XL8-MVJS>].

95. The last decade has seen a marked shift toward worker representation in political rhetoric. One of the key policies advanced by Theresa May in her run for office was mandated worker representation at board level. See *We Can Make Britain a Country that Works for Everyone*, CONSERVATIVES (July 11, 2016), <http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for> [<https://perma.cc/YEL6-BQ4E>]. Though she eventually backtracked on those plans, the policy struck a chord with other U.K. politicians such as Jeremy Corbyn, who is currently advocating for a nationwide mandate. See Ashley Cowburn, *Workers to Make up One Third of Company Board Members Under Labour, Jeremy Corbyn Vows*, INDEPENDENT (Sept. 23, 2018, 9:15 AM), <https://www.independent.co.uk/news/uk/politics/jeremy-corbyn-workers-boards-labour-conference-one-third-union-a8550946.html> [<https://perma.cc/M7DR-TH EJ>].

96. S. 3348 § 3.

97. *Id.* §§ 3-5.

98. *Id.* § 5.

99. *Id.*

100. *Id.*

political contributions of over \$10,000, United States Corporations would need the approval of at least seventy-five percent of both directors and shareholders.<sup>101</sup> Finally, the Act requires that workforce appointees make up at least forty percent of the board of directors.<sup>102</sup>

As the effects of such a proposal are largely unknown in the context of the United States, Part II of this Note details several prominent arguments with premises for and against the Act that have developed from the German and Swedish experiences with codetermination.

## II. CONSIDERATIONS FOR APPLICATION TO THE UNITED STATES

Legal and economic scholars have long debated the merits of both the German and Swedish models of codetermination.<sup>103</sup> This part presents prevailing views rooted in considerations of practical limitations, efficiency, and legal obstacles that would likely arise when applied to the United States.

### A. PRACTICAL LIMITATIONS

Practical limitations are based on arguments that challenge the structural prerequisites needed to implement codetermination. Because many of these arguments are presented as threshold questions, they are considered in piecemeal fashion where the remaining analysis is not impacted by their hypothetical resolution.

#### 1. *Mandatory vs. Permissive*

One of the most obvious practical limitations is rooted in the theoretical “race to the bottom.”<sup>104</sup> Justice Brandeis’ famous theory

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101. *Id.* § 8.

102. *Id.* § 6.

103. *See, e.g.,* J. Bautz Bonanno, *Employee Codetermination: Origins in Germany, Present Practice in Europe, and Applicability to the United States*, 14 HARV. J. LEGIS. 947 (1977).

104. *See* *Louis K. Liggett Co. v. Lee*, 288 U.S. 517, 558 (1933) (acknowledging the race to the bottom theory by stating “companies were early formed to provide charters for corporations in states where the cost was lowest and the laws least restrictive”). For further development of the theory, see William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663 (1974).

argues that regulatory states are in a constant race to the bottom, wherein the regulatory state with the most favorable treatment of corporations is the one that will get the most business.<sup>105</sup> Though the concept is used most commonly to describe Delaware's attractiveness for corporations, it is applicable in the federal regulatory context as well.<sup>106</sup>

Accordingly, as a practical matter, a national-level mandate of codetermined boards will result in an outflux of corporations.<sup>107</sup> That is, many companies may pursue opportunistic reincorporation to countries with more favorable treatment.<sup>108</sup> It is questionable, however, whether a substantial number of corporations would expatriate due to the costs associated with such swift, drastic action. If the United States enacted codetermination legislation and a U.S. company sought to reincorporate abroad, it would first need: (1) a majority vote from the codetermined board in order to bring the proposal to the shareholders' vote, and (2) shareholder approval for the reincorporation.<sup>109</sup> Additionally, foreign nations' treatment of corporate mobility differs significantly.<sup>110</sup> Depending on where a company seeks to reincorporate, directors of U.S. firms in Europe may face uncertainty regarding choice of law criteria, potentially requiring substantial modifications to governance protocols.<sup>111</sup> The reality is that the U.S. market will remain intact, albeit with an altered rulebook.<sup>112</sup>

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105. *Liggett*, 288 U.S. at 557-58.

106. *See, e.g.*, Anita Chan & Robert J S Ross, *Racing to the Bottom: International Trade Without a Social Clause*, 24 THIRD WORLD Q. REP. 1011 (2003).

107. This is based on the author's personal observations.

108. *See, e.g.*, Chan, *supra* note 106, at 1015-16.

109. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251.

110. *See* Christiana Panayi, *Corporate Mobility in Private International Law and European Community Law: Debunking Some Myths* 5-18 (Queen Mary Univ. London Sch. of Law, Research Paper No. 26, 2009).

111. *See* Federico M. Mucciarelli, *Freedom of Reincorporation and the Scope of Corporate Law in the U.S. and the E.U.* 6 (N.Y.U. L. & Econ. Working Papers, No. 257, 2011).

112. *See, e.g.*, Billy Melo Araujo, *Trade Deals, Labour Conditions and the Gap Between Talk and Action*, THE CONVERSATION (Sep. 28, 2017, 12:05 PM), <http://theconversation.com/trade-deals-labour-conditions-and-the-gap-between-talk-and-action-83730> [<https://perma.cc/BMY5-S47N>].

From a normative perspective, a mandatory approach may be the only way to effect change.<sup>113</sup> The reasoning is rooted in the “race to the bottom” theory.<sup>114</sup> If the government took a permissive approach by removing all federal law inhibitions and paving the way for individual states to pass such regulation, corporations would simply “take refuge” in states without a codetermination requirement.<sup>115</sup>

Though the internal affairs doctrine usually obliges courts to apply the substantive law of a company’s state of incorporation, some states instead apply their own substantive law to companies with significant business affairs within their jurisdiction.<sup>116</sup> One such example is California, which labels companies as quasi-foreign when a majority of the shareholders and business exists in California.<sup>117</sup> Companies deemed to be quasi-foreign are subject to the substantive law of California despite being incorporated elsewhere.<sup>118</sup> Though some states refuse to accept the California standard,<sup>119</sup> quasi-foreign classification remains an option for states to impose their own requirements on corporations that frequently conduct business within their jurisdiction.

Finally, some experts argue that the lack of voluntary codetermined firms in the United States is proof of its inefficiency.<sup>120</sup> These normative arguments suggest that firms adopt by default the governance mechanisms which maximize economic efficiency.<sup>121</sup> Accordingly, the absence of voluntarily codetermined firms in the U.S. market indicates some innate inefficiency that firms choose to avoid.<sup>122</sup> If codetermination

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113. See Clyde W. Summers, *Codetermination in the United States: A Projection of Problems and Potentials*, 4 J. COMP. CORP. L. & SEC. REG. 155, 168 (1982).

114. See Cary, *supra* note 104.

115. See Summers, *supra* note 113, at 157.

116. See Mucciarelli, *supra* note 111, at 38.

117. Cal. Corp. Code § 2115.

118. *Id.*

119. *Wilson v. La.-Pac. Res., Inc.*, 187 Cal. Rptr. 852 (Cal. Ct. App. 1982).

120. See, e.g., Michael Jensen & William Meckling, *Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination*, 52 J. BUS. 469, 473 (claiming that “the fact that this system seldom arises out of voluntary arrangements among individuals strongly suggests that codetermination or industrial democracy is less efficient than the alternatives which grow up and survive in a competitive environment.”).

121. *Id.*

122. See Davies, *supra* note 35, at 391.

truly allowed firms to become more economically efficient, the U.S. market would organically adopt it in order to exploit its benefits.<sup>123</sup>

## 2. Free Market Union Structure

While the substantive merits of union representation are beyond the scope of this Note, it is undisputed that both the Swedish and German systems of codetermination rely heavily on the structure of their unions as the backbone to support their respective systems of worker representation.<sup>124</sup> From a practical perspective, a unified system functions as the foundation for employees to convene, discuss the issues that are important to them, and act as the constituents that board representatives are meant to serve.<sup>125</sup>

The United States lacks a unified, comprehensive structure for union representation, in contrast to the Swedish and German systems.<sup>126</sup> In fact, studies have found the amount of workers represented by unions has dropped from roughly twenty percent to eleven percent since 1983.<sup>127</sup> Though larger firms statistically are more unionized than smaller firms, the best predictor of unionization is industry—the steel, electricity, and auto industries have historically been among the most heavily unionized.<sup>128</sup> Because many of the largest companies in the United States do not operate in the steel, electricity, and auto industries, a significant number of the largest U.S. companies are not unionized.<sup>129</sup> Accordingly, critics posit that establishing organized unions in the industries that lack

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123. *See id.*

124. *See Summers, supra* note 113, at 183.

125. *Id.* at 160, 162.

126. *Id.* at 160.

127. U.S. BUREAU LAB. STAT. (Feb. 9, 2017), <https://www.bls.gov/opub/ted/2017/union-membership-rate-10-point-7-percent-in-2016.htm> [<https://perma.cc/T7FA-8THV>].

128. Annalyn Kurtz, *Top 8 Union Jobs*, CNN MONEY (Dec. 12, 2012, 8:19 AM), <https://money.cnn.com/gallery/news/economy/2012/12/11/top-union-jobs/jump.html> [<https://perma.cc/FZ5B-69Q2>].

129. *See Table 3. Union affiliation of employed wage and salary workers by occupation and industry*, BUREAU LAB. STAT. (Jan. 18, 2019), <https://www.bls.gov/news.release/union2.t03.htm> [<https://perma.cc/MHT8-SQJ7>] (demonstrating that several industries are under-unionized including leisure and hospitality (2.9%), financial activities (2.1%), agriculture (2.2%), and wholesale & retail trade (4.3%)).

them is an indispensable prerequisite to the successful adoption of codetermination.<sup>130</sup>

## B. EFFICIENCY CONSIDERATIONS

Most of the debate regarding codetermination's effectiveness centers around whether it has achieved the proposed benefits in the respective countries which have adopted it in various forms. This Part presents a number of theoretical arguments for and against codetermination's effectiveness.

### 1. Influence on the Board

Critics have long questioned whether codetermination truly succeeds in giving workers influence in the boardroom.<sup>131</sup> First, there is the question of how board structure can affect worker representatives' ability to influence company policy.<sup>132</sup> The dual-board system employed by German companies is thought to decrease the amount of influence that shareholders have over management.<sup>133</sup> Because the management board acts as a "buffer" between the supervisory board and day-to-day operations, the influence maintained by worker representatives is limited to appointing management board members.<sup>134</sup> On the other hand, the lack of a "buffer" in the Swedish system allows for much stronger stakeholder control of management functions.<sup>135</sup>

Even if worker representatives have the ability to influence management, some scholars claim that a lack of expertise with long-term policy decisions typically deliberated at the board level prevents worker representatives from having the positive influence they intend to have.<sup>136</sup> Though earlier studies found that worker representatives tend to "specialize" in matters that do not have a direct bearing on their roles as

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130. See Summers, *supra* note 113, at 158-60.

131. See generally Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INT'L REV. L. & ECON. 203 (1994).

132. See Ringe, *supra* note 15, at 31-34.

133. See *id.* at 32.

134. See *id.* at 33.

135. *Id.*

136. See Pistor, *supra* note 1, at 189-90.

worker representatives,<sup>137</sup> a 2014 study found that worker representatives usually are qualified for their roles.<sup>138</sup> Notably, out of 229 worker representatives considered, not a single one was found to be less than qualified for their role.<sup>139</sup>

Under a game theory approach, Professor John Coffee argues that the introduction of worker representatives creates an unstable “multiplayer game” which results in a net decrease of control over management.<sup>140</sup> While the game previously consisted of a one-player paradigm, the added representatives create an unstable scenario where all sides will try to play off each other and, thus, “the locus of power and authority within the corporation is less certain.”<sup>141</sup> However, scholars often question the existence of this instability, as Germany has operated with the system for decades.<sup>142</sup> Coffee argues that as the multiplayer game is repeated over time, the parties involved create coalitions that result in long-term stability for firms.<sup>143</sup>

## 2. Increased Costs

Scholars posit that adopting codetermination will result in a net increase in operating costs.<sup>144</sup> Theoretically, this newly-established “heterogeneity of interests”—as opposed to the unilateral system of board and management—will increase both the costs of decision-making and the agency costs related to overseeing management.<sup>145</sup>

By having anything other than a unilaterally-operated board, firms will have to expend additional funds when making important decisions, since more interests need to be taken into account to get the necessary

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137. *Id.*

138. E. Han Kim, Ernst Maug & Christoph Schneider, *Labor Representation in Governance as an Insurance Mechanism*, (Eur. Corp. Governance Inst. Working Paper Series Finance, Paper No. 411, 2014), <http://ssrn.com/abstract=2399399> [<https://perma.cc/MF6J-YNVK>].

139. *Id.*

140. John Coffee, *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO. L. J. 1495, 1496 (1989).

141. *Id.*

142. *See* Pistor, *supra* note 1, at 180.

143. *Id.*

144. *Id.* at 178.

145. *Id.* at 177.

votes.<sup>146</sup> Even in systems without quasi-parity codetermination, worker representatives have the opportunity to “hold up” board proceedings by voicing their opinions, which takes up time and results in increased opportunity costs.<sup>147</sup> Such a diversity of interests is also thought to increase agency costs, as “it will be more difficult for a . . . board of diverse and conflicting interests to monitor management.”<sup>148</sup> Accordingly, mandatory codetermination may lead to increased agency costs for firms.

### 3. Effects on Firm Performance

While a number of studies extract empirical data regarding the effects of German codetermination on firm performance, the findings are varied and, oftentimes, conflicting.<sup>149</sup> The data supports the conclusion that both quasi-parity and non-parity codetermination<sup>150</sup> have had a modest, if any, impact on firm performance in the affected sectors and firms.<sup>151</sup>

The effects on worker authority and influence have been more pronounced. The previously mentioned 2014 study found links between quasi-parity codetermination and job security.<sup>152</sup> After periods of economic shock, firms with quasi-parity codetermined boards demonstrated a three-percent decrease in wage levels, but, more notably, a thirteen-percent difference in employment when compared to similar

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146. *Id.*

147. See KRAAKMAN ET AL., *supra* note 31, at 91.

148. See Pistor, *supra* note 1, at 179.

149. See L. Fauver & M.E. Fuerst, *Employee Representatives and Good Corporate Governance*, 82 J. FIN. ECON. 673, 689 (2006).

150. Quasi-parity codetermination refers to firms where half of the board is made up of worker representatives, while non-parity codetermination refers to firms for which less than half of the board is made up of worker representatives.

151. See *id.*; see also Bernd Frick & Erik Lehman, *Corporate Governance in Germany: Ownership, Codetermination, and Firm Performance in a Stakeholder Economy*, in CORPORATE GOVERNANCE AND LABOUR MANAGEMENT: AN INTERNATIONAL COMPARISON § 2.2 (Howard Gospel & Andrew Pendleton eds., 2004). But see Gary Gorton & Frank A. Schmid, *Capital, Labor, and the Firm: A Study of German Codetermination*, 2 J. EUR. ECON. ASS'N. 863, 885 (2004) (finding that equal representation has a negative effect on firm value because it decreases the market-to-book ratio of firms).

152. See Kim, *supra* note 138.



firms without it.<sup>153</sup> Parity-codetermined boards use their influence as an insurance mechanism, specifically when they agree to take on lower wages in exchange for higher job security.<sup>154</sup>

### C. LEGAL CONSIDERATIONS

#### 1. National Registry: Preemption and Constitutionality

From a practical perspective, scholars posit that a national registry is the most effective means to impose and enforce codetermination requirements in the United States.<sup>155</sup> Critics take issue with the constitutionality of wealth redistribution<sup>156</sup> and that the registry's requirements frequently would preempt state corporate law.<sup>157</sup>

Professor Stephen Bainbridge argues that empowering a federal registry to enforce nationally-mandated requirements on companies runs contrary to precedent set by the United States Supreme Court.<sup>158</sup> He posits that “a fair rule of thumb is that state law is concerned with the substance of corporate governance, while federal law is concerned with disclosure and a limited number of procedural aspects of corporate governance.”<sup>159</sup> Furthermore, he points to several instances where the Supreme Court held that state corporate laws are not preempted by federal securities laws.<sup>160</sup> These types of preemption arguments are questionable, as Congress has a

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153. *Id.* at 22, 25.

154. *Id.* at 33.

155. *See, e.g.*, Summers, *supra* note 113, at 160.

156. *See* Kevin D. Williamson, *Elizabeth Warren's Batty Plan to Nationalize . . . Everything*, NAT'L REV., (Aug. 16, 2018, 6:30 AM), <https://www.nationalreview.com/2018/08/elizabeth-warren-plan-nationalize-everything-woos-hard-left/> [<https://perma.cc/UPG5-6ZAA>].

157. Stephen Bainbridge, *A Critique of Senator Elizabeth Warren's "Accountable Capitalism Act" (Part 2): The Case Against Federalization of Corporate Law*, PROFESSORBAINBRIDGE.COM (Aug. 15, 2018, 11:11 AM), <https://www.professorbainbridge.com/professorbainbridgecom/2018/08/a-critique-of-senator-elizabeth-warrens-accountable-capitalism-act-the-case-against-federalization-o.html> [<https://perma.cc/J92T-4KDQ>].

158. *Id.*

159. *Id.*

160. *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987); *Burks v. Lasker*, 441 U.S. 471 (1979); *Santa Fe Indus. v. Green*, 430 U.S. 462 (1977).

broad set of powers to regulate commerce under the Commerce Clause of the United States Constitution.<sup>161</sup>

Conservative outlets have been quick to point out constitutional challenges that can be brought against the wealth redistributing goals of the national registry (and codetermination generally).<sup>162</sup> They argue that the wealth to be redistributed from shareholders to workers and other minority stakeholders would constitute a taking under the Fifth Amendment of the United States Constitution.<sup>163</sup>

Although a taking typically involves the government's physical confiscation or invasion of private property by the government, a taking of both real and personal property can also occur when a federal regulation overreaches.<sup>164</sup> These cases are referred to as "regulatory takings."<sup>165</sup> A key inquiry in takings jurisprudence is the level of economic destruction that directly results from the government's regulatory imposition.<sup>166</sup> Though courts usually consider compensation in cases with eighty-five percent or greater diminution in value, there is no guarantee that compensation will be awarded.<sup>167</sup>

It is worth noting that the German Constitutional Court (Bundesverfassungsgericht) upheld the validity of codetermination in

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161. U.S. CONST. art. I, § 8, cl. 3.

162. See Richard Epstein, *Elizabeth Warren's Surreptitious Socialism*, HOOVER INSTITUTION: DEFINING IDEAS (Aug. 20, 2018), <https://www.hoover.org/research/elizabeth-warrens-surreptitious-socialism> [<https://perma.cc/SSW5-J7P5>]; see also Walter Olson, *Sen. Warren's Confiscatory Corporate Governance Proposals*, CATO INSTITUTE: CATO AT LIBERTY (Aug. 17, 2018), <https://www.cato.org/blog/sen-warrens-corporate-governance-proposals> [<https://perma.cc/CHD8-SXTM>].

163. See, e.g., Carol D. Rasic, *Germany's Statutory Works Councils and Employee Codetermination: A Model for the United States?*, 14 LOY. L.A. INT'L & COMP. L.J. 275, 299 (1992). The Fifth Amendment of the United States Constitution provides that "private property [shall not] be taken for public use, without just compensation." U.S. CONST. amend. V.

164. *Pa. Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

165. *Id.*

166. *Rith Energy v. United States*, 247 F.3d 1355, 1362 (Fed. Cir. 2001).

167. See, e.g., *Brace v. United States*, 72 Fed. Cl. 337, 349 (2006); *Lucas v. S.C. Coastal Council*, 505 U.S. 1003 (1992). *Contra Yancey v. United States*, 915 F.2d 1534, 1542 (Fed. Cir. 1990) (finding that a diminution of seventy-seven percent was sufficient when the statute enacted adversely affected property that it was not aimed at regulating in the first place).

1979 when it faced what was essentially a taking claim.<sup>168</sup> The main issue in the proceeding was whether codetermination interfered with the interests of the company.<sup>169</sup> While the way a company is managed certainly affects shareholder value, the court held that the legislature, in pursuit of its socioeconomic goals, was justified in limiting certain rights of individuals.<sup>170</sup>

## 2. Conflict of Interest, Stakeholder View

A fundamental principle of U.S. corporate law is that corporate directors owe a fiduciary duty to their shareholders.<sup>171</sup> Given that directors are held to such high standards of loyalty and care toward shareholders, classifying workers as directors could cause a conflict of interest in the board room.<sup>172</sup> Worker-directors would find themselves in an “impossible position” because of the conflicting interests they would be bound to serve.<sup>173</sup> As appointed worker representatives, they would owe a duty to serve the interests of the workers, but as directors, they would owe a fiduciary duty to the shareholders.<sup>174</sup>

On the other hand, American legal scholar Clyde Summers asserts that arguments proposing such a conflict of interest are flawed because they rely on the “unarticulated premise that stockholders are the corporation, and undivided loyalty is owed to the stockholders.”<sup>175</sup> Though the classic view of corporate purpose is shareholder value maximization, there is a contemporary trend toward believing that corporations ought to consider the interests of persons other than shareholders.<sup>176</sup> If this shift in the conception of corporate purpose occurs,

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168. Bundesverfassungsgericht [BVerfGE] [Federal Constitutional Court] Mar. 1, 1979, Case No. BVerfGE 50, 290, para. 81. Scholars have not yet surmised as to whether a similar taking claim brought in the United States would be upheld. *See* discussion *infra* p. 29.

169. *Id.* at para. 69.

170. *Id.* at para. 202.

171. *See, e.g.,* Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928).

172. *See* Summers, *supra* note 113, at 169.

173. *Id.* (citing Philip Blumberg, *Implications of Representation Trends for U.S. Corporations*, HARV. BUS. REV. 46 (Jan. - Feb. 1977)).

174. *Id.*

175. *Id.* at 170.

176. *See* COLIN MAYER, FIRM COMMITMENT 32-42 (Oxford Univ. Press 2017).

the proposed conflict of interest ceases to exist, as board members would be bound to take on a more holistic view.<sup>177</sup>

The past few decades have seen a mounting interest around stakeholder-centered theories of corporate governance, many of which advance the idea that workers and other minority shareholders are worthy of consideration in the boardroom.<sup>178</sup> Generally, workers do not invest in companies in the traditional sense by acquiring stock.<sup>179</sup> They make firm-specific “human capital” investments, however, through the opportunity costs they take on by working for a specific company.<sup>180</sup> These human capital investments, which are largely undiversified, include relocating to remote places in order to work at factories, and learning how to use proprietary machinery or technology, among others.<sup>181</sup>

Accordingly, prominent legal experts posit that these firm-specific investments, which are so vital to the successful operation of companies, deem the interests of workers and other minority stakeholders worthy of consideration in the boardroom.<sup>182</sup> The Accountable Capitalism Act compounds this view by extending a fiduciary duty to workers, consumers, and other minority stakeholders.<sup>183</sup> By doing so, the Act indirectly eliminates the potential conflict of interest recognized by Summers.<sup>184</sup>

### III. SUGGESTIONS FOR TRANSPLANT

Because it is unlikely that companies would adopt a system of codetermination voluntarily, this Note argues that the only way to achieve a systematic widespread adoption of codetermination in the United States

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177. See Summers, *supra* note 113, at 170.

178. See KRAAKMAN ET AL., *supra* note 31, at 89.

179. *Id.* But cf. Richard Teitelbaum, *Stock-Based Pay on the Rise at Tech Companies*, WALL ST. J.: CFO J. (Apr. 20, 2016, 3:57 PM), <https://blogs.wsj.com/cfo/2016/04/20/stock-based-pay-on-the-rise-at-tech-companies/?ns=prod/accounts-wsj> [<https://perma.cc/X7YQ-JKXZ>] (explaining that stock-based compensation is on the rise in tech startups).

180. See KRAAKMAN ET AL., *supra* note 31, at 89.

181. *Id.* In countries such as Germany and Japan, workers also have firm-specific financial investments in the form of pension plans. See Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 966 (2013).

182. Cf. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 250 (1999).

183. S. 3348, 115th Cong. § 5 (2018).

184. Summers, *supra* note 113, at 169.

is through federal legislation compelling systems of codetermination.<sup>185</sup> Though worker representation may offer certain efficiency benefits, it is likely directly in conflict with directors' mandated duty to increase shareholder value.<sup>186</sup> The lower average of Tobin's Q in Germany and Sweden suggests that the introduction of codetermination regulation could lead to a decrease in the value of corporate ownership.<sup>187</sup> Thus, codetermination not only represents a significant transfer of power, but it promises a drastic redistribution of wealth.<sup>188</sup>

Moreover, it is crucial that such a mandate comes from the federal level, rather than using states as experimental vehicles.<sup>189</sup> Should individual states adopt mandatory requirements, companies could flee to reincorporate in states without such requirements.

By the same logic, some scholars argue that a federal mandate would result in many companies leaving the United States to reincorporate in foreign jurisdictions.<sup>190</sup> This argument is unconvincing, as it relies on short-termism and does not factor in long-term adaptation to legislative changes. In the long run, the market will adapt to these requirements as companies continue to operate and compete with this new set of rules. The Sarbanes-Oxley Act, enacted in 2002, is illustrative of a lack of reincorporation following sweeping regulatory changes.<sup>191</sup> Sarbanes-Oxley set in motion several sweeping regulatory changes, including mandatory independent audit committees and the establishment of director liability for accuracy of financial statements.<sup>192</sup> These requirements, though substantially different than their predecessors, are

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185. *Id.* at 157.

186. *Compare* Davies, *supra* note 35, at 388-89 (explaining how codetermined boards have led to increased efficiency at a firm-wide level), *with* *Dodge v. Ford Motor Co.*, 204 Mich. 459, 507 (1919) (holding that corporations must be carried out for the primary profit of stockholders), *and* *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010) (holding directors' duty is to "promote the value of the corporation for the benefit of its stockholders").

187. *See* discussion *infra*, section I.C.

188. *See, e.g.*, Yglesias, *supra* note 94.

189. *See* Summers, *supra* note 113, at 168.

190. *See* Cary, *supra* note 104.

191. Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

192. *Id.*

simply part of the current legislative landscape.<sup>193</sup> A worker representation requirement would be no different.

The lack of a comprehensive union system is a valid concern for nation-wide application.<sup>194</sup> There seems to be no way to completely avoid the logistical and overhead costs associated with applying worker representation to non-unionized industries.<sup>195</sup> Instead of categorically imposing the requirement on all companies with over \$1 billion in profits, the relevant legislation could integrate a set of tax incentives to increase unionization in industries which are not presently unionized. Though this option would give companies a buffer period to roll out the regulatory changes, the extent of the costs that such a shift places on companies is unknown. In sum, it seems that some sort of union or quasi-union structure is desirable in order to successfully phase in worker representation in the United States.<sup>196</sup>

Because so much of this debate turns on efficiency, the results from contemporary empirical studies conducted in Germany particularly are persuasive.<sup>197</sup> While there are many valid and convincing arguments suggesting losses in efficiency measures when boards are codetermined, it is worth noting that the relevant German studies did not find any significant decreases in traditional measures of firm value.<sup>198</sup> Therefore, codetermination succeeds in empowering the work force to pursue goals that they value, while also allowing shareholders to benefit from corporate ownership.

As Senator Warren's Act prescribes, maintaining a single-board structure is likely the most efficient option for the United States.<sup>199</sup> A switch to a dual-board system ultimately would be an unnecessary endeavor because the technical distinction between board structures tends to blur in practice and the degree of control exercised over management is largely attributed to the discipline achieved in the corporate

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193. See Stephen Wagner & Lee Dittmar, *The Unexpected Benefits of Sarbanes-Oxley*, HARV. BUS. REV. (Apr. 2006), <https://hbr.org/2006/04/the-unexpected-benefits-of-sarbanes-oxley> [<https://perma.cc/N576-DBL4>].

194. See Summers, *supra* note 113, at 160-63.

195. *Id.*

196. *Id.*

197. See Fauver, *supra* 149, at 689; see also Frick, *supra* note 151.

198. See Frick, *supra* note 151. In this case, firm value stood for profitability, which is defined as cash flow over total assets.

199. See S. 3348, 115th Cong. § 5 (2018).

hierarchy.<sup>200</sup> A system with a close nexus of control is preferable in newly-adopting countries because it ensures that workers receive the baseline level of influence the system promises.<sup>201</sup>

The majority of proposed legal challenges either are poorly developed or completely miss the mark.<sup>202</sup> While it is true that federal law has previously been found not to preempt state securities law, this does not preclude the application of worker representation *per se*.<sup>203</sup> To begin with, there has been a recent shift toward the expansion of federal regulatory power in relation to corporate governance.<sup>204</sup> Moreover, the preemption doctrine is rooted in the concept that “matters that can be adequately handled by states should be left to them; matters that cannot be so handled should be undertaken by the federal government.”<sup>205</sup> Be that as it may, this is clearly a matter that cannot and has not been adequately handled by states.

While critics would surely bring taking claims against the government under the Fifth Amendment, their likelihood of success is relatively low. In order to be compensated for a regulatory taking, a claimant must clearly demonstrate a particular level of economic destruction resulting directly from the government’s regulatory imposition.<sup>206</sup> At this point, any proposed challenge is merely speculating at the level of “destruction” that imposing codetermination would cause. Even if such an imposition resulted in a marked diminution in value, courts have been hesitant to grant relief in taking claims even when the diminution in value has exceeded ninety percent.<sup>207</sup>

The arguments under the stakeholder theory acknowledge one weakness in the regulatory changes proposed in Senator Warren’s Act. A fiduciary duty ought to extend to employees in order to avoid conflicts of interest while also affording them protections as largely undiversified investors of human capital. Legislation, however, should err on the side

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200. See Ringe, *supra* note 15, at 34; Summers, *supra* note 113, at 160-63.

201. See generally Ringe, *supra* note 15.

202. See Epstein, *supra* note 162; see also Olson, *supra* note 162.

203. See Epstein, *supra* note 162.

204. See generally, Robert B. Thompson, *Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue*, 62 L. & CONTEMP. PROBS. 215 (1999).

205. Chief Justice William Rehnquist, Address at the American Law Institute Annual Meeting (May 11, 1998), in LEGAL TIMES, May 18, 1998, at 12.

206. *Rith Energy v. United States*, 247 F.3d 1355, 1362 (Fed. Cir. 2001).

207. See, e.g., *Brace v. United States*, 72 Fed. Cl. 337, 349 (2006).

of caution and avoid extending these duties to other minority stakeholders. From an efficiency standpoint, minority stakeholders, like the environment and consumers, are better protected through regulations and contract, respectively.

### CONCLUSION

Codetermination represents a drastic departure from the current principles and ambitions that dominate contemporary U.S. society. If policymakers decide that codetermination is the appropriate path for the United States, any legislation should be federal and compulsory, and a unitary board structure maintained. While expanding a fiduciary duty to all stakeholders may be theoretically sound, the reality is that aside from workers, most other stakeholders are best protected by other means.

Though decades of European experience provide some insight into the possible economic effects codetermination could have in the United States, it would be unrealistic to expect an identical result, and unwise to rely solely on a statistical analysis of its effects. Instead, we should focus on the type of socioeconomic values we want to cultivate. By establishing parameters which favor principles of economic democracy, mandated worker representation is a means to further the interests of stakeholders other than corporate shareholders.

Because the effects of this sweeping legislative proposal are largely unpredictable, it is clear that they should be addressed through further research and constructive debate.