

FLUID RELATIONSHIPS IN TRANSITIONAL TIMES: A COMMENT ON EMPLOYEES AND CORPORATE GOVERNANCE

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The nature of work is not static, nor is the structure of relationships through which people perform work for others. That employment relationships vary greatly and are far from immutable is relevant to the role that employees and their interests may play in the institutions that determine a corporation's strategic direction and general business plans. In this brief comment, I focus on only a few of the interesting points raised by the principal papers. I suggest that discussions about corporate governance in relation to the interests of employees should consider changes in the nature of relationships, not all of them relationships of employment, through which work is done. In the United States, changes in the structure of work relationships may enhance, not weaken, justifications for retaining the status quo, in which employees as such do not play a formal role in corporate governance and directors must, subject to applicable law, exercise their discretion to enhance corporate profit and shareholder gain.¹ In any event, these changes are of an order of magnitude that should redefine the frame of reference for analyzing the relationships between employees' interests and corporate governance.

My starting point is that we live in an era of relentless change in technology and in social and economic circumstances, in which the impact of economic activity often overruns national boundaries. Transactions intermediated through capital markets may carry widespread consequences for businesses and people, regardless of their physical location. Additionally, the content of work has changed: much work now involves using discretion in interactions

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1. See PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (1994). Directors may act consistently with this standard by taking action that will not result in an immediate and particular profit and that is justifiable only over the long run, including action that will benefit the corporation by enhancing employees' morale. *Id.* cmt. *f.*

with other people and in manipulating symbols, in contrast with work defined by tasks that principally require the physical manipulation of material objects. The demographics of the contemporary workforce reflect major shifts as well, including fuller participation by many more women, as well as the impact of employment-driven migration from one nation to another.

Mutability also characterizes the relationships through which many people participate in the workforce. Shifts away from a widely followed standard employment relationship as the norm raise regulatory issues that vary with particular jurisdictions and that are beyond the scope of this brief paper.² Nonetheless, it is significant that the shift away from a standard employment relationship is a broad phenomenon that is not localized to a particular country.³ It is also significant that the shift has occurred in countries that differ in how corporate law and governance treat employees and their interests.

In the United States, Japan, and Europe, proportionately less work is done under the auspices of conventionally defined employment relationships than appears to have been the case two decades ago. One indicium is the proportion of work done under the auspices of temporary employment relationships. In the United States, employment through help-supply services grew from 0.6% of the total private economy in 1982, to 2.7% in 1998. This rate of growth surpassed even the rate of growth of employment in data processing and other work with computers.⁴ Temporary employment tracks tentative economic times, buffering employers against the need to reduce the permanent workforce if hoped-for business growth is not sustainable.⁵ Temporary employment relationships also enable employers to audition employees for longer-term employment and to rely on screening services provided by the temporary service.⁶ European commentators likewise note the increased significance of

2. For a broad-ranging discussion of implications for employment law, see Paul Davies & Mark Freedland, *Labor Markets, Welfare and the Personal Scope of Employment Law*, 21 COMP. LAB. L. & POL'Y J. 231 (1999).

3. On implications of the shift and possible explanations in the German context, see Ulrich Mückenberger, *Non-Standard Forms of Work and the Role of Changes in Labour and Social Security Regulation*, 17 INT'L J. SOC. L. 381 (1989). Mückenberger notes that the "atypical" practice of part-time work "is actually by no means 'atypical' for a certain part of the workforce, i.e. working women. . . ." *Id.* at 382.

4. See U.S. DEP'T OF LABOR, REPORT ON THE AMERICAN WORKFORCE 18 (1999) (hereinafter AMERICAN WORKFORCE REPORT).

5. *Id.* at 18-19.

6. *Id.* at 23-24. More employers (30.9%) gave auditioning as the reason for using temporary services than cited the need to staff for special projects (27.6%) or for peak periods (23.4%).

“casualized employment” in all forms, including on-the-job training contracts for younger workers and contracts for fixed terms.⁷ A contributing factor may be financial incentives created by mandatory employer contributions to social security schemes for long-term employees. For example, in Germany, between 1.1 and 3.3 million employees hold “minor” jobs requiring less than 15 hours of work per week below stated wage levels, which are not subject to social security contributions. Most holders of “minor jobs” are women.⁸

Moreover, the working lifetime of many employees is likely to include sequential relationships with multiple employers. In the United States, the average person born between 1957 and 1964 holds 9.2 jobs from age 18 to age 34. Within these years, the average person holds an average of 5.6 jobs between ages 18 to 24, an average of 3.0 jobs between ages 25 to 29, and an average of 2.4 jobs between ages 30 to 34.⁹ The average person in this age cohort was employed during 75% of the weeks between ages 18 and 34, with women spending 68% and men 83% of weeks employed. Over 87% of men and women experienced at least one period of unemployment, with the incidence of unemployment falling with increased age.¹⁰ For all workers in the United States, median tenure with their current employer was 3.5 years as of February 2000.¹¹ Median tenure increases with age; the median tenure of workers aged 45 to 54 is over three times that of workers aged 25 to 34. From 1983 to 1998, the proportion of men with 10 or more median years of tenure decreased across all age groups, while the proportion of women with 10 or more years of tenure increased.¹² European commentators recognize that the extent of long-term unemployment in some countries requires rethinking policies based on the traditional conception that the prospect of unemployment presents “a small risk in a linear career.”¹³

Even in Japan, in which achieving employment stability has been a defining practice within corporate governance, atypical employment

7. See Alain Supiot, et al., *Beyond Employment: Changes in Work and the Future of Labour Law in Europe* 11 (2001) (report prepared for European Commission).

8. *Id.* at 74. These numbers do not include workers who hold a principal job as well. Including them would account for another 500,000-2,000,000 jobs. *Id.*

9. Bureau of Labor Statistics, U.S. Dep't of Labor, *Number of Jobs Held, Labor Market Activity, and Earnings Grown Over Two Decades: Results from the Longitudinal Survey Summary* (news release, Apr. 25, 2000) (statistics come from a longitudinal survey begun in 1979, of 9,964 men and women), available at <http://stats.bls.gov/news.release/nl.soy.toc.htm>.

10. *Id.*

11. See Bureau of Labor Statistics, U.S. Dep't of Labor, *Employee Tenure Summary*, (news release, Aug. 29, 2000), available at <http://stats.bls.gov/news.release.tenure.htm>.

12. *Id.*

13. See Supiot, et al., *supra* note 7, at 32.

has increased over the past decade from 20.2% to 26.2% of the workforce.¹⁴ Organized labor in Japan has begun to accept modifications to the long-established seniority-based wage structure as a cost of preserving the commitment to long-term employment. In Japan, as in the United States, union density continues to decline.¹⁵

Changes in structures through which work is performed may be facilitated by and encouraged by changes in capital markets. Raghuram Rajan and Luigi Zingales argue that finance became more available in recent years as a consequence of technological, regulatory and institutional changes that increased the amount and quality of data available about prospective users of capital and made financial markets more competitive.¹⁶ The greater availability of finance enables more new projects to be developed outside the aegis of existing firms, thus facilitating the creation of new firms. Moreover, greater transparency in financial markets increases scrutiny of the use that all firms, established as well as newly formed, make of the funds and other assets available to them.¹⁷ Additionally, a firm's ability to attract capital from external sources depends on its attractiveness to prospective investors, relative to other available investments.¹⁸

As a consequence, to attract or retain external capital, corporate managers may "downsize" the ranks of employees when work can be done at lower cost by outsourcing it. Work does not disappear when

14. See Takashi Araki, *A Comparative Analysis: Corporate Governance and Labor and Employment Relations in Japan*, 22 COMP. LAB. L. & POL'Y J. 67 (2000). See also Ryuichi Yamakawa, *New Wine in Old Bottles?: Employee/Independent Contractor Distinction Under Japanese Law*, 21 COMP. LAB. L. & POL'Y J. 99 (1999).

15. See Araki, *supra* note 14 (reporting union density in Japan of 21.5% as of 2000). In the United States, as of 2000, 13.5% of the workforce belonged to unions. See Bureau of Labor Statistics, *Union Members in 2000* (news release, Jan. 18, 2001), available at <http://stats.bls.gov/news.release/history/union21.01182001.news.htm>. Four out of ten governmental-sector workers are union members, but only one out of ten private-sector workers. *Id.* Union membership in the United States peaked at 32.5% of the workforce in 1953, and, by 1995, had declined to 14.9%. See John B. Judis, *Labor's Love Lost*, NEW REPUBLIC, June 25, 2001, at 18. In the last five years, union membership among private-sector workers fell by 252,000. *Id.*

16. See Raghuram G. Rajan & Luigi Zingales, *The Influence of the Financial Revolution on the Nature of Firms*, 91 AM. ECON. REV. 206 (2001).

17. *Id.* at 208 (effect of financial revolution was to help sever "the link between assets in place and growth opportunities. If insiders could now convince both the corporate bureaucracy and outside shareholders of the merit of new internal projects, they could probably also convince outside financiers to fund the projects as separate ventures.").

18. See Michael Bradley et al., *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROBS. 9, 78 (1999) (positing that ability to attract capital, especially foreign capital, is an underlying structural reason for increased prominence of shareholder welfare within organizational structures). Capital market constraints on managers of Japanese companies are evident during recessionary times, when obtaining external finance from equity and debt markets is crucial. See Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL. J. CORP. L. 189, 216 (2000).

it is outsourced to an external provider; the external provider itself may itself represent an attractive focus for investment. Indeed, European commentators point to the rising incidence of outsourcing and subcontracting relationships as an explanation for why a large number of jobs have shifted from large to small and medium-sized firms.¹⁹

Capital markets aside, these changes in the structure and duration of work relationships reflect many other underlying circumstances. For example, workers themselves may be more mobile and some workers may be in a strong position to seek out better opportunities. As technological change has increased the skill level that many jobs require and varied the mix of required skills, more workers may know more that is readily transferable from their present employer into another context for work.²⁰ Changes in labor markets may mimic changes in other markets: The major increase in work done under the auspices of temporary employment services has been characterized as the “labor equivalent of just-in-time production factors in the motor vehicle manufacturing industry,” reflecting another instance of flexibility and cost-reduction in an era of greater competitiveness.²¹ A person who works for a sequence of employers, interspersed perhaps with intervals of self-employment or further education, has diversified her personal portfolio of human capital in a manner and to a degree that is unlikely within a single relationship of lifetime employment.

Unsurprisingly, governmental responses to these changes differ. In France, employees who are dismissed must be offered “conversion agreements” that provide continued remuneration for a period, an assessment of the employee’s qualifications, plus training. If many workers are dismissed, their employer must have a plan to do what it can to offer a new internal placement.²² The Japanese government, recognizing that lateral mobility has increased, has taken measures to encourage labor markets external to firms,²³ supplementing internal labor markets, which are highly developed as a consequence of a sustained policy of avoiding dismissals at all costs.²⁴ Within the

19. See Supiot, et al., *supra* note 7, at 11. In most European Union countries, most jobs consist of employment by “small” firms with fewer than 50 employees and “very small” firms with fewer than 10 employees. *Id.*

20. On the impact of technological change on skill levels and skill mixes, see AMERICAN WORKFORCE REPORT, *supra* note 4, at 40.

21. *Id.* at 6.

22. See Supiot, et al., *supra* note 7, at 49-50.

23. See Araki, *supra* note 14.

24. *Id.*

United States itself, state law differs on the basic question of whether an employee's agreement not to compete with an employer following the cessation of employment is enforceable. By statute in California, in contrast with the majority common-law rule in most states, covenants to compete are not enforceable.²⁵ The California statute assures an employee that a likely source of new employment cannot be foreclosed by a former employer (even pursuant to the employee's prior agreement) and lends official endorsement to job-hopping and greener-pasture-seeking.²⁶

Changes of this magnitude in the structure and duration of work relationships raise several questions that are relevant to the role of employees and their interests in corporate governance. For starters, the widespread nature of these changes suggests that their causes and consequences operate independently of how corporate governance treats employees' interests within particular regimes of law and established business practices. Part-time and short-term employment are observed phenomena in Germany, as well as in the United States, despite the long-term presence in Germany of legally mandated institutions to represent employees' interests in corporate governance.²⁷

Major shifts in the structure of work relationships may also make management a more complex endeavor because lines of authority may multiply or become blurred. For example, once work is outsourced, those who do the work may be employees of a separate firm.²⁸ Management also becomes more challenging when employees and other providers of services realize the contingent nature of their ties to those whom their work benefits. Lack of trust in an employer can

25. See CAL. BUS. & PROF. CODE § 16600 (West 1997).

26. The California rule may also facilitate innovation by enabling "knowledge spillover" when employees move from one firm to another within the same industry. California broadly protects a former employer's interest in its trade secrets by prohibiting former employees from using or disclosing them. However, employee migration from firm to firm may transport other information that does not constitute a trade secret. This process may facilitate innovation, particularly in an industry in which technological progress is cumulative. See Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575 (1999). Gilson notes that Route 128, situated in Massachusetts, which enforces covenants to compete that are reasonable in scope and duration, lagged well behind Silicon Valley by the mid-1990's in creating and exporting electronic products, despite an initial lead in the 1960's. *Id.* at 586. Over the intervening three decades, Route 128's firms had traditional and highly integrated structures, whereas the denizens of Silicon Valley were characterized by "non-linear career patterns" and influenced by the experience of visibly successful entrepreneurs who thrived outside older firms.

27. See generally Dieter Sadowski, Joachim Junkes & Sabine Lindenthal, *The German Model of Corporate and Labor Governance*, 22 COMP. LAB. L. & POL'Y J. 33 (2000).

28. See Davies & Freedland, *supra* note 2, at 244 (discussing multilateral nature of nonstandard work relationships).

lead to disabling results, for example, when successfully surmounting a crisis requires greater effort from all.²⁹ Additionally, even when work is done outside an authority relationship established by employment, goodwill may often help to resolve circumstances that explicit contractual specifications do not fully address.

Many factors are relevant to an employer's effectiveness in surmounting these challenges. One approach is to structure the relationship's financial aspects to align the parties' interests more closely. Within relationships of employment, a noticeable trend over the past decade in the United States is the use of variable measures of remuneration tied in some way to the performance of an individual, a group, or the firm itself.³⁰ An employer's ability to use this strategy is, of course, not unlimited. If labor is in relatively short supply, the structure of remuneration may require that an employer give greater weight to the goal of attracting and retaining employees with the skills requisite to meeting its business needs.³¹ Another approach assigns participation rights to representatives chosen by employees. Studies of works councils in Germany suggest that their effectiveness may be a consequence of scale, such that works councils appear not to produce any efficiency advantages in plants with fewer than 100 employees, perhaps because more direct forms of participation are available in smaller plants.³² However, basic labor law in the United States limits the available range of mechanisms that facilitate employee participation.³³

Large-scale changes in the structure of work relationships also call into question how to define employment and the interests of employees for the purpose of specifying the interests that a corporate governance regime should be designed to protect. Structures that systematically afford representation and protection for the interests of long-term employees may also systematically disfavor the interests of those who perform work outside a structure of long-term employment

29. On the importance of trust relationships in explaining how organizations function successfully, see Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001). See also Gregory Jackson, *Comparative Corporate Governance: Sociological Perspectives*, in *THE POLITICAL ECONOMY OF THE COMPANY* 265, 279 (John Parkinson, Andrew Gamble & Gavin Kelly eds., 2000) (noting that especially when contingencies of labor contract cannot be specified in advance, "effective authority requires legitimacy to promote the goodwill of the subordinates to follow the spirit rather than the letter of the rules.").

30. See U.S. DEP'T OF LABOR, REPORT ON THE AMERICAN WORKFORCE 82 (2001).

31. *Id.* at 83 (predicting that forecast labor shortages early in the new century may lead to new balance between compensation measures designed to align pay to organizational goals and measures necessary to attract and retain skilled workers).

32. See Sadowski, et al., *supra* note 27.

33. See Araki, *supra* note 14.

for a single employer. This latter category includes, but is not confined to, many women and young people. It is open to question whether long-term employees in conventional employment relationships are reliable proxies for the interests of all who do work for others. If the interests to be protected are those of people who perform work, not simply those who do so within a particular relational structure, it is open to question how corporate governance structures might best be re-oriented. In particular, the context within which work is done may migrate from one firm to another under the auspices of an outsourcing or subcontracting relationship. A governance orientation that focuses on retaining work within the originating firm may not serve the interests of those who would do the work if it is outsourced or subcontracted.

Moreover, if a workforce is inevitably mobile, many of its members may best be served by policies and practices that recognize the high likelihood of change over time in any individual's work relationships. Although education and training are key, an individual's financial condition may be a source of either comfort or distress when transitions occur in work relationships. The availability of unemployment insurance in some form eases transitions, as do funds that an individual has saved. A vested interest in a pension plan should also be a source of comfort.³⁴ If the investment that the pension plan interest represents is controlled by someone other than the individual employee, ERISA requires that investment and management decisions be made with a singular focus on the interests of the plan's participants and beneficiaries in retirement income.³⁵ Courts have interpreted this standard to forbid the use of assets in a union-sponsored plan to provide incidental benefit to the plan's beneficiaries, but primary benefit to the union's members in the creation and preservation of jobs.³⁶ Thus, in considering whether to

34. As of 1997, 50% of full-time employees in medium and large establishments in the United States were participants in defined benefit pension plans, whereas 76% were defined-benefit participants in 1982. However, as of 1997, 57% were participants in defined contribution plans, an increase from the 33% who were defined-contribution participants in 1983. See AMERICAN WORKFORCE REPORT, *supra* note 4, at 195, Table 45.

35. See 29 U.S.C. § 1104(a)(1), which provides that subject to other provisions in the statute, a fiduciary of a pension plan shall "discharge his duties with respect to [the] plan solely in the interests of the participants and beneficiaries. . . ."

36. A pre-ERISA example is *Blankenship v. Boyle*, 329 F. Supp. 1089 (D.D.C. 1971). See also *Donovan v. Walton*, 609 F. Supp. 1221 (S.D. Fla. 1985), *aff'd per curiam sub nom Brock v. Walton*, 794 F.2d 586 (11th Cir. 1986) (multi-employer plan designed to subsidize jobs for union members in construction trades from assets of pension fund through below-market-rate mortgage loans to union members; court holds ERISA not violated because statute, 29 U.S.C. § 1108(b)(1), permits loans to plan participants and beneficiaries if loans are adequately secured, available to all on reasonably equivalent basis and bear a reasonable rate of interest).

2000]

FLUID RELATIONSHIPS

157

undertake exercises in shareholder activism, it is important that pension fund trustees bear in mind that the plan's participants and beneficiaries vary in employment status and interests, while all may benefit from focusing on improving the plan's investment returns and the financial performance of companies represented in the plan's investment portfolio.³⁷ Likewise, employees who leave firms owning stock in their now former employer may not systematically differ as investors from the firm's other shareholders; their interests may best be served if the firm's directors exercise their discretion to maximize profit.

Our times are interesting precisely because so much that was once absolute now seems open to change and redefinition, including the nature of work and of employment. Distinctions—including the division between those who do work and those who provide capital—are now much less categorical. National boundaries are relatively fixed, but increasingly irrelevant to much economic activity. The frame of reference for assessing corporate governance should reflect these changes.

37. Not all may agree that trustees of union pension funds must justify shareholder activism on this criterion. On shareholder activism by union pension funds, see Marleen O'Connor, *Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97 (2000).

