

INCORPORATING LABOR

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Early in her article, Professor Marleen O'Connor points out the remarkably narrow focus of U.S. corporate law. This focus is on the relationship between shareholders and upper management. Shareholders are viewed as the "owners" of the corporation and these owners are seen as delegating management authority or the venture to a board of directors. Among the matters that corporate law concentrates on are issues such as the mechanisms through which governance authority is delegated and exercised; how much authority is retained by the shareholders; how the shareholders can challenge the exercise of the delegated authority; and, how such authority can be overridden. The operation of any corporate enterprise, of course, involves and affects many more groups than just the shareholders and members of the upper management. These other groups include employees, mid- and lower level managers, creditors, suppliers, customers, governments and the local communities. The members of these groups (some more than others) often have key roles to play in decisions regarding the running of the corporate entity. The puzzle, therefore, is why U.S. corporate law ignores them. O'Connor's article focuses on the aspect of the puzzle relating to one of these groups, that is, labor. As things stand today, the relationship of employees with the corporate venture is considered a matter of either labor law or employment law. The thrust of O'Connor's article is the argument that labor has an important part to play in the governance of corporations and that this role needs to be recognized within corporate law. Her appropriately titled article, "Labor's Role in American Corporate Governance Structure," argues for the need for the role of labor to be recognized within the corporate law framework and puts forward a set of proposals for how that incorporation can be effectuated.

O'Connor's arguments are both interesting and provocative. As she and the other authors for this symposium point out, both the

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German and Japanese corporate law systems provide labor a far greater role than does the American system. Put differently, and given the ability of corporations from these countries to be able to compete on equal footing with (and sometimes outcompete) their U.S. counterparts, this suggests that a greater governance role for labor will not bring with it all the inefficiencies that many in the United States often assume. In her article, O'Connor does not spend time discussing the evidence from Japan and Germany (or elsewhere). Not only is there already a large and rich comparative literature on this subject, but there are other articles in this symposium that address the latest developments on that front. Instead, O'Connor's paper moves directly into her proposals for how labor can and should be incorporated into the existing U.S. corporate law framework. The article also sets out O'Connor's observations about how the U.S. labor force, through its shareholdings in pension funds and stock ownership plans, is already playing an important and productive role in corporate governance.

This comment focuses on two of O'Connor's proposals for incorporation of employees as a more integral part of the governance structure. Specifically, these arguments are: (a) that the law should recognize a fiduciary duty owed by the corporation to the workers and (b) that the law should require that corporations disclose information on workplace practices and human capital. In conclusion, I flag an interesting set of observations that O'Connor makes, which relate to the role that employee shareholders already play in corporate governance.

Before proceeding, a few words of background on O'Connor and her scholarship. For some years now, O'Connor has been on the forefront of pushing for greater attention to the role of labor in corporate governance. Her articles on the need for an expanded role for labor form an integral part of the growing subset of corporate scholarship that argues for the increased role of stakeholders in corporate law (this scholarship is often referred to as "Progressive Corporate Law" or "Communitarian Corporate Law").¹ The scholarship by the Progressive Corporate Law scholars such as O'Connor has done a tremendous amount to energize and generate debate in a field that was beginning to seem to be the exclusive

1. For a collection of articles by some prominent "progressive" scholars, see *PROGRESSIVE CORPORATE LAW* (Lawrence E. Mitchell ed., 1996). A sign of the growing prominence of progressive corporate law scholarship is that in 2002 alone, there were at least two law review symposia devoted to the topic (one at George Washington Law School and the other at Tulane Law School).

preserve of scholars with a neoclassical law and economics perspective (the “Chicago School”). More specifically, O’Connor has raised a number of issues—including the question of how to tackle human capital disclosure issues—that form a key part of these debates.² As a junior scholar in the field, it is a privilege to have an opportunity to comment on a paper by someone such as Professor Marleen O’Connor.

As the reader will see, however, I am not fully persuaded by O’Connor about the need to expand existing laws to incorporate labor. I am more of the view that the corporate laws give shareholders too much and may do well to shrink the laws on that front (especially those regarding fiduciary duties).³ That said, I do think that the U.S. conception of what corporate law is (particularly, in how we teach the subject) is far too narrow and can be usefully expanded to include the roles other groups who already participate in the governance of corporations. For example, I think it is scandalous that most corporate law classes altogether ignore the role of debt finance. Similarly, I am in agreement with O’Connor when she points out that labor already plays an important and productive role in corporate governance. The same or similar arguments can be made for almost all of the other “stakeholder” groups. There may or may not be a need to expand the existing corporate laws to include stakeholders, but there is a need to expand our conception of what constitutes corporate law.

I. FIDUCIARY DUTIES TO WORKERS

O’Connor’s primary reform proposal for corporate law is that workers should be owed fiduciary duties. The rationale is that the presence of these duties will provide a protection against opportunistic conduct by management. For example, take the case of Company A where management is considering moving a production plant to a new location where labor is cheaper. This looks to be an ordinary business decision, but let us say that the company had been

2. Among Professor O’Connor’s recent articles are: *Rethinking Corporate Financial Disclosure of Human Resource Values for Knowledge-Based Economy*, 1 U. PA. J. LAB. & EMP. L. 527 (1998); *Organized Labor as Shareholder Activist: Building Coalitions to Promote Worker Capitalism*, 31 U. RICH. L. REV. 1345 (1997); *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993).

3. Some of my ideas on the subject are set forth in Mitu Gulati, William Klein & Eric Zolt, *Connected Contracts*, 47 UCLA L. REV. 887 (2000). For a critique, see Stephen M. Bainbridge, *Director Primacy: The Board as Nexus of Contracts* (unpublished paper prepared for the 2001 Sloan Conference at the Georgetown University Law Center).

in financial trouble a few years earlier and that management had obtained a wage cut from labor by making the argument that this was necessary for the firm's long term survival. Here, the decision to move the plant looks to be opportunistic and in bad faith. To the extent that parties in a business relationship fear opportunistic behavior, they will be less likely to enter into that relationship. From a social optimality point of view, therefore, opportunistic behavior should be deterred.

The question, however, is whether the law is the best tool to deter such behavior. The law can often be a blunt instrument. Legal obligations produce lawsuits and those lawsuits can often be frivolous, give rise to unneeded delays, and result in inaccurate decisions. If there is an alternative mechanism to a legal protection, it is possible that the parties themselves might prefer it. In the case of organized labor, reputational sanctions are a possible alternative. Organized labor is generally a repeat player with company management and is therefore well informed on corporate practices. This does not mean that companies will not ever act in opportunistic ways, but it does mean that there is already likely to be a significant deterrent mechanism at work. To the extent that there are contexts in which labor does not believe that the reputational markets will work (perhaps with a small company or one that is moving its operations to another country), it can negotiate for specific and narrow protections in these contexts.⁴ In her article, O'Connor does not discuss reputational markets, but she does say that there are significant barriers to labor negotiating specific contractual protections against opportunistic behavior. But what are those barriers? In the case of a well-informed repeat transactor, such as organized labor, not only should the reputational markets work reasonably well, but the barriers to negotiating contractual protections should be low.

Individual employees in a non-organized context, however, are a different matter. Here, there are likely to be all sorts of problems both with depending on a reputational market and on negotiating individual contractual protections. Fears of negative signaling, inadequate information, budget constraints, etc.; the list of potential

4. For a brilliant treatment of nonlegal sanctions and their relationship to the law, see David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 375 (1990). On the relevance of reputational sanctions to the labor market, see JAMES N. BARON & DAVID M. KREPS, *STRATEGIC HUMAN RESOURCES: FRAMEWORKS FOR GENERAL MANAGERS* (1999). Another article on the subject is Samuel Estreicher, *Reputation at Work* (unpublished paper presented at the 2000 Conference on Behavioral Law and Economics at New York University Law School). I have only seen an early draft of this article, but it promises to be both interesting and illuminating.

sources of market failure can go on. But even if we think that the law should imply protections against opportunistic conduct, what does this have to do with corporate law specifically? The need to protect against opportunism in the employment relationship presumably applies to a much broader class of employers than corporations. Hence, to the extent there needs to be an implied term that protects against opportunistic behavior by employers, wouldn't it be better to locate this protection in employment contracts rather than in corporate law? In addition, there is the question of why employees need "fiduciary duties" of the type that are owed to shareholders. A long line of cases tackling the shareholder-corporation context has shaped the contours of these duties. It seems likely that the problems of opportunism in the employer-laborer context are going to be quite different and the fiduciary duty caselaw from the shareholder-corporation context will not apply easily. I am sympathetic to the notion that it would be socially beneficial for the law to imply protections against opportunistic employer conduct for at least a subset of employees, but I am not persuaded that corporate law is the place for this protection.

II. DISCLOSURE OF HUMAN CAPITAL MATTERS

O'Connor's second major reform proposal is that the disclosure of human capital matters be required. This disclosure could be either a function of the fiduciary duties discussed above or could be mandated by the federal securities laws. Under the securities laws, many companies are already required to make detailed disclosures regarding their financial positions. Details about a company's human capital assets, the argument might be, are often just as important, if not more important, in enabling an investor to predict a company's prospects for the future. In her paper, O'Connor does not make the investor welfare argument (although I do not think that she will disagree with that point). Her interest in having mandatory disclosure of human capital matters has to do with the potential benefits this will have for labor. O'Connor does not fully spell things out, but her argument appears to be that mandatory disclosure of human capital practices and penalties for false statements and omissions will result in labor having better information. Better information will enable labor to better evaluate and compare companies and that, in turn, will force companies to improve their human capital practices.

On the point that the details of a company's human capital assets can often be extremely important to investors, I have no quarrel. In

today's knowledge economy where the primary asset of many companies is their human capital, it is hard to imagine too many quarrels on this point. How a company hires employees, its promotion and wage practices, its training programs, its absentee and retention rates, etc., are all likely to be crucial determinants of future economic prospects for many companies. As noted earlier, better disclosure of labor practices will also benefit labor, as workers will be able to better evaluate companies. This seems to be a good thing from a labor point of view. Further, from a social optimality point of view, everyone gains because both labor and financial capital will be better allocated.

The 400-pound gorilla that remains in the corner is the question of whether the law should mandate that these matters be disclosed, given their importance to investors and laborers. The answer to that question depends on the costs of mandating such disclosure and whether the information in question is already reaching the market through alternate mechanisms. A standard argument made by the opponents of additional mandatory disclosure is that if this information is important to investors, one would see companies voluntarily disclosing it. Companies that do not provide full and accurate disclosures will suffer in terms of their ability to raise capital from investors and will be driven out of the market. Alternatively, one could see opponents arguing that companies are likely already disclosing this information while competing with each other in the market for labor. Once again, the argument is that companies that do not provide full and accurate disclosure will face a higher cost to attract labor and lose out in a competitive market. The bottom line with both arguments is that there is no need for an expensive system of legally mandated disclosures because market pressures are likely to already induce the optimal amount of disclosure. O'Connor's response, presumably, is that the market forces are not working.

If I were to hypothesize, I would say that O'Connor is correct in that market forces are not producing anywhere near the optimal amounts of human capital information about companies. For example, my five years of research on law firms has told me that lawyers and law students know remarkably little about the human capital practices of the organizations that they work in or are considering working in. Furthermore, the firms themselves do little to make their internal processes more visible. If anything, the focus of the firms is on hiding their true practices. What this suggests is that

the labor market forces are not working well in producing voluntary disclosure, at least in this one context.⁵ Yet, law firms are not publicly traded companies with Wall Street analysts studying their every move. In other words, the market pressures of the public markets are not at play on law firms. Public companies in the United States already complain that they face large expenditures in satisfying the existing disclosure requirements and dealing with lawsuits about problems with the disclosures. With the disclosure scandals at Enron, World Com, Tyco, and Xerox, these complaints have become muted in recent days. Still, if new human capital disclosure obligations are going to be imposed, they need to be justified with careful empirical research and not guesses of the type that I just made. O'Connor's article performs the vital task of opening the debate on an important question. My hope is that there will be others who find this question interesting enough to do the necessary empirical work to further explore the question.

III. CONCLUSION: THE GOALS OF LABOR AND CAPITAL

One hurdle that often stands in the way of proposals to expand the obligations of corporations to include the interests of labor is the assumption that the interests of labor inevitably conflict with those of capital. Not only is it difficult to evaluate the performance of management when it is serving conflicting interests, but the situation gives management more room to act in self-interested ways. In the final portion of her paper, O'Connor points to recent research by scholars such as Randall Thomas and Stewart Schwab on the behavior of labor-shareholders.⁶ What this research suggests is that labor-shareholders often exercise their voting power and influence in ways that are generally consistent with the welfare of shareholders as a whole. While this research is still in its infancy, the preliminary results point to the intriguing possibility that the interests of labor and capital might not be in as much conflict as has been traditionally assumed. Indeed, as in the case of human capital disclosure, these interests may even be complementary. There are also other related questions that

5. See David B. Wilkins & G. Mitu Gulati, *What Law Students Think They Know About Elite Law Firms*, ___ U. CIN. L. REV. ___ (forthcoming 2002); David B. Wilkins & G. Mitu Gulati, *Reconceiving the Tournament of Lawyers: Tracking, Training, Seeding, and Information Control in the Internal Labor Markets of Elite Law Firms*, 84 VA. L. REV. 1581 (1998); David B. Wilkins & G. Mitu Gulati, *Why Are There So Few Black Lawyers in Corporate Law Firms? An Institutional Analysis*, 84 CAL. L. REV. 493 (1996).

6. See Stewart J. Schwab & Randall Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998).

are worth exploring, such as the increased role that organized labor is playing these days in the legislative processes relating to the making of corporate and securities laws.⁷

As things stand today, it is unlikely that either the proposal for recognition of a corporate fiduciary duty to workers or for mandatory disclosure of human capital matters will go anywhere. There are too many skeptics who think that the status quo works well. Yet, papers such as Professor O'Connor's offer invaluable contributions as they raise questions that produce debate and further investigation, the long-term result of which may well be beneficial change.

7. I am grateful to Don Langevoort for making this point to me.