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## **The Crisis of Confidence in American Business: Corporate Accountability or Business As Usual**

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Workers and their families are the real victims of the corporate greed and abuse gripping American business. We pay with our jobs and our retirement security when corrupt corporate insiders are allowed to pillage the companies they lead. The American labor movement, therefore, has a special responsibility to fight corporate abuse and restore genuine social accountability to American corporations by organizing workers, as employees, shareholders and citizens.

For over a year, we have witnessed a seemingly unending series of corporate scandals. The sudden and spectacular collapse of Enron, one of the largest and most celebrated American companies shocked the nation. The conviction of Arthur Anderson, among the nation's most prestigious accounting firms, confirmed the depth of the problem. And the drumbeat of accounting scandals at Global Crossing, Tyco, Worldcom, Adelphia, Waste Management, Halliburton, Dynergy, Computer Associates and many others has demonstrated the enormous scope of the problem and its systemic roots.

The almost daily revelation of new acts of corporate abuse and malfeasance has thrown into question the integrity of the American economic system. American business is suffering its most serious crisis of confidence since the Great Depression. Polling results consistently show the decline in public confidence in employers, corporations and their leaders. A recent poll sponsored by the AFL-CIO showed that only 18 percent of respondents expressed confidence in CEOs as a group.

Earlier episodes of economic failure and corporate abuse have powered far-reaching reforms. The predations of robber barons led to anti-trust legislation in the early 20<sup>th</sup> century. And economic failure and corporate excesses in the Great Depression led to the New Deal reforms that fundamentally recast the rules under which American companies operated for fifty years. What is still uncertain, however, is whether we use this "post-Enron moment" to effect authentic corporate reform or whether the resistance of corporate insiders and their political allies will prevail and restore business as usual in corporate America.

On the one hand, the public demands fundamental corporate reform. On the other, public outrage at new revelations of corporate abuse seem to be on the wane, even as public skepticism of corporations remains at historic highs. Important reforms, however partial and halting, have been won with the passing of accounting reform legislation in Congress, new rules governing corporations and capital markets at the Securities and

Exchange Commission and new requirements of firms listing their shares on the New York stock exchanges. At the same time, the appetite for further legislative action seems to be weakening, as the resistance from corporate interests grows.

Today, we face the challenge to reform corporations and capital markets. But authentic and thoroughgoing corporate reform will require more than simply waiting for our elected leaders to act. To realize the potential of the post-Enron moment requires that we aggressively organize American workers to demand reform to defend our jobs and our retirement security. It also requires that we pose fundamental questions concerning the nature of the corporation and its social mission; that we carefully diagnose the maladies that compromise that mission and deform the corporation; and that we formulate appropriate reforms in the ways in which corporations are organized, regulated and governed. Most of all it requires that we aggressively organize workers to expose ongoing corporate abuse and fight for the reforms we need.

### **The Social Mission of the Corporation and the Roots of the Crisis**

The modern publicly traded corporation is the dominant form of business enterprise in the American, as in the global, economy. Together with the markets in which they operate, corporations are the foundation of the American economy and the key to ensuring the prosperity of the American people.

Properly regulated and governed, the corporation is an extraordinarily powerful institution for the creation of wealth. Indeed history has seen no more effective and efficient means for creating the wealth on which society depends. However, improperly regulated or weakly governed, the corporation becomes an insiders game and the corporation is transformed into an engine for the redistribution of income instead of the creation of wealth.

The social mission of the corporation is the creation of wealth, not the enrichment of shareholders or other corporate constituents. Corporate constituents -- shareholders, managers, workers, creditors and suppliers -- all contribute productive assets to corporations' success and all expect to receive income in return.<sup>1</sup> The private interests of corporate constituents, including shareholders, may be to make money, but the corporation remains accountable to society for the creation of wealth.

Properly regulated and governed, the social mission of the corporation is aligned with the legitimate private interest of shareholders and other constituents to make money. Improperly regulated and governed, a wedge is driven between the social purpose of the corporation and the private interests of shareholders. The corporation is transformed from a wealth creating institution into an engine of income redistribution in the favor of insiders. A few insiders become rich, but at the expense of the social accountability of the corporation and the public trust on which its success ultimately depends.

What we witnessed at Enron, WorldCom and the others was a pattern in which corporate money flooded the coffers of elected officials to create regulatory black holes where they could operate out of reach of public authorities. Corporate insiders then used their

privileged knowledge and position in compromised governance structures to manipulated conflicts of interest in regulatory and governance systems to enrich themselves at the expense of employees, shareholders, taxpayers, communities, the environment and even the future of the companies themselves.

### **Conditions of Corporate Accountability<sup>ii</sup>**

Corporate accountability requires a number of political, social and economic conditions that can only be assured through a combination of effective regulation of corporations and capital markets and strong structures of corporate governance.

Only government can establish the laws and regulations necessary for corporate accountability -- rule of law, macro-economic balance and effective regulation of product, labor and capital markets to limit the market power of individual companies. In the wake of recent scandals we can see the regulatory failures in the California energy markets that Enron manipulated; in the deregulation of the telecommunications and the financial services industries.

However, corporate accountability requires more than effective regulation. It also requires sound mechanisms of corporate governance. Corporate governance concerns the relations among the shareholders, the board of directors and senior management of corporations. Sound corporate governance assures that the interests of managers are aligned with those of the company and its constituents and guides the strategic allocation of productive assets and the formation and execution of effective business and competitive strategies.

Central to assuring effective corporate governance is a CEO who is compensated fairly and in relation to the company's performance. Perhaps most of all, sound governance requires a board of directors that is diverse and independent of management and loyal to the company. Boards need to be real watchdogs, and not lapdogs for CEOs. And in governance systems like the U.S. where workers participate only as shareholders, it is essential that they have the rights and the ability to elect independent directors and have voting power on important governance issues.

As Enron, WorldCom and other failed companies show, governance fails when executives are improperly compensated; when boards of directors are dependent on management and/or when shareholders have no effective power over senior management.

Corporate social responsibility and an ethical business culture are also important elements of corporate accountability, but they are no substitute for effective regulation and sound governance. Indeed corporate social responsibility and an ethical business culture are only possible when corporations are effectively regulated and governed.

### **"No More Business As Usual": A Labor Led Campaign for Corporate Accountability**

Workers suffer most when corporations are socially unaccountable. However, it is not just workers who suffer from unaccountable corporations. So do other shareholders whose investments are diverted to enrich corporate insiders. So do consumers who suffer from unsafe and poor quality goods and services. So does the environment when corporations externalize their costs by overusing scarce natural resources or by polluting the air and water, just as workers suffer when corporations externalize the costs of providing a safe and healthy work environment. So do taxpayers who must pay more than their share of the cost of government because unaccountable corporations have shed their fair share of the tax burden. So do communities who are forced to provide unjustified subsidies to influence the location decisions of corporations. So even do conscientious corporate managers who want to serve as stewards of society's productive assets, but cannot because of the competitive pressures of product markets, the financial pressure from capital markets and the conflicted mechanisms of corporate governance.

The American labor movement must organize workers to lead a broad social movement to restore accountability to American corporations. We must join with allies among consumer groups, taxpayers groups, the environmental movement, consumer groups, and with citizens in communities across America to restore integrity to the American corporation. And we must reach out to other shareholders and conscientious business executives who want to invest in and lead socially accountable corporations.

Representing workers as employees, unions organizing and bargaining with corporations as employers still represents the most important source of power in holding corporations accountable. This is also the case with union programs to directly engage employers through bargaining relationships to "block the low road and pave the high road" in corporations' business and competitive strategies.

Representing workers as shareholders, unions are organizing workers' capital and are one of the largest and most powerful of shareholder groups to hold corporations accountable. Workers' capital – pension funds and savings – is the largest source of investable resources in the country. Workers' capital owns 26 percent of the shares of all publicly traded companies. The capital stewardship programs of the AFL-CIO and its affiliates are focused on organizing this power and focusing it on holding corporations accountable through shareholder activism.

Representing workers, as citizens, unions and our allies need to formulate a coordinated legislative, regulatory and political program that makes the corporate accountability issue an asset in our political work and that builds legislative and regulatory support for elements of a corporate reform agenda. The limited reforms that have emerged to date in Congress despite the enormous public awareness of the problems with corporate regulation and governance suggests the need to develop a higher profile for corporate accountability in our political work.

- **Putting Workers First: Organizing at Enron and WorldCom**

In the immediate aftermath of the collapse of Enron, the American labor movement, working with the churches and community groups in Houston, mobilized to help the workers whose lives were disrupted as they lost their jobs and retirement security. The

Houston central labor council set up a worker assistant center where Enron employees could get adjustment assistance, referrals to community resources and even food and clothing.

Working with Reverend Jesse Jackson, the AFL-CIO sponsored buses to bring Enron workers to Washington to seek help from their elected officials. The heroic Enron workers who traveled to the nation's capital represented a cross section of the company's workforce. Every demographic group was represented -- men and women of all age groups, African Americans, Latinos, and whites. There were parking lot attendants and office workers as well as managers. These workers came to tell their stories, to seek the severance benefits they were due, to demand an investigation to understand what happened to a company which they all had admired, and to fight for the reforms necessary to protect workers from the corporate abuse they had suffered.

These heroic workers, the real victims of the collapse at Enron, played an essential role in dramatizing the crisis in corporate accountability and launching the congressional investigations that propelled the early corporate reform initiatives. They spoke of their experiences with unchallengeable authority and the urgency of their situations demanded immediate action on the part of elected officials. They testified before the many congressional hearings that were held and were interviewed by every national media outlet.

The AFL-CIO organized a series of town hall meetings in twenty cities where these workers could meet with workers from other companies on the issues of corporate accountability and retirement security. The Houston Enron employees did not have defined benefit pension plans. Like most non-union workers in the U.S., their only retirement security depended on worker savings plans, defined contribution 401-K plans. And, like so many other workers, their 401-K plans were loaded with Enron stock. When Enron collapsed, so did the value of their retirement plans. They visited with workers whose retirement plans were even more concentrated in the employers' stock. Unionized Enron workers who lost their 401-K assets also accompanied them but still had their defined-benefit pension plans to fall back on. Also along were unionized public sector workers whose pensions were weakened by their investment in Enron and would have to pay to replenish these funds at the bargaining table. These conversations were invaluable for raising the awareness of the importance of Social Security and defined-benefit pension plans in the retirement security of American workers and the meetings drew enormous attention from local media.

The AFL-CIO provided legal support for the Enron workers in seeking the severance benefits they were due but were denied when the company sought bankruptcy protection. In bankruptcy, the claims of workers usually fall to the back of the line, preceded by the creditors represented on the bankruptcy committee. When the Enron workers visited the headquarters of the investment banks on the creditors committee to discuss with their employees why their companies did not support the Enron workers, a number of the investment banks agreed to support the petition of the Enron workers to increase the severance payments they were due. At the end of the day, the bankruptcy court approved the payment of over \$60 million to the Enron workers, money they badly needed but would not have had were it not for their ability to organize effectively to demand it.

When WorldCom collapsed, the AFL-CIO also provided legal support to those workers and tens of millions of dollars more moved to the workers as their demands moved to the front of the line. The federation also established a website for workers losing their jobs to collapsing telecommunications companies to help them organize and find help in pulling their lives back together. WorldCom workers gained the full severance payments they were due. Cara Alcantar, who recounts her experience in an accompanying article in this issue of *New Labor Forum*, was a young WorldCom worker who helped organize these efforts.

Workers, most of whom were not union members with little experience with collective action, were learning the importance of organizing.

- **Fighting for Corporate Accountability, Company-By Company**

In the wake of the collapse of WorldCom, the largest in U.S. history, the reform movement got new life and partially overcame the resistance to reform from vested corporate interests. Nevertheless, the labor movement and its allies could not simply wait for desperately needed reform. We challenged corporate abuse and fought for reforms company-by-company.

A good example was the confrontation with Stanley Works, the hand tool manufacturer headquartered in New Britain, CT. When Stanley Works proposed to re-incorporate in Bermuda to escape its tax liability to the U.S. workers confronted them in the community and in the capital markets. A shareholder proxy fight led by workers' pension funds demanded that the company abandon plans to abandon the country and the community. When a large rally was organized in New Britain last August, led by the Machinists and the local labor movement and attended by the states elected officials and covered extensively by the media, the company cancelled a second shareholder vote and withdrew its proposal to reincorporate to Bermuda.

Two days later, a busload of Machinists traveled to Boston to join with the labor movement and allies there to confront Fidelity, the largest mutual fund company in the U.S. Fidelity had supported Stanley Works management in their proxy fight to reincorporate offshore. And like all mutual funds, Fidelity refused to disclose to its investors how it votes its proxies. This is an enormous problem for workers' shareholder actions since the mutual fund industry owns 25 percent of all publicly traded companies and they almost always support management. The mutual fund industry suffers an undisclosed conflict of interest in that, although they have a responsibility to the people whose money they manage, they also earn enormous fees by managing the pension and savings plans of corporations. In order to be selected by corporations to manage their plans, they too often agree to vote with management in proxy contests, even when it is not to the benefit of Fidelity investors.

The labor movement in Boston held a large rally and threatened to march on Fidelity's headquarters unless the company agreed to disclose how it votes its proxies so that they could be held accountable to investors. Fidelity agreed to talks, but did not agree to disclose.

- **Corporate and Capital Market Reform**

Richard Trumka, who led the rally and met with the CEO of Fidelity, knew that in the post-Enron environment, which demands openness and transparency, Fidelity's position was untenable and that one way or another and that Fidelity would ultimately relent.

The AFL-CIO immediately petitioned the Securities and Exchange Commission (SEC) to enact a rule change to require all mutual funds to disclose their votes in proxy contests. Supported by SEC staff, the commissioners voted unanimously to support the rule change and thus began a 90-day period for public comment. The SEC received over 7000 comments overwhelmingly in support of the proposed rule, the largest number of comments in the history of the agency. The comments came from unions, workers funds and allies from all over the world. Meanwhile, central labor councils organized demonstrations at Fidelity offices in 20 cities to demand transparency and accountability from the mutual fund industry.

Despite determined opposition of the mutual fund industry, led by Fidelity and Vanguard, the SEC adopted the proposed rule change. Mutual funds, an enormous and comprised player in fights for corporate accountability will now be required to come clean about how they vote in proxy contests.

This reform, among the most important since the collapse of Enron, will allow workers to hold the mutual fund industry accountable and will enable workers' capital to be even more effective in representing the interests workers have as shareholders in genuine corporate accountability.

### **Looking Forward**

The experience of the labor movement in connecting the struggles of workers and communities in New Britain with capital market contests at Stanley Works and Fidelity is but one example of the ways the labor movement will need to combine our representation of workers as employees, shareholders and citizens to power the reform of corporations and capital markets which we so desperately need.

Organizing workers as employees and building strong unions to countervail the power of corporate insiders is the single most important task of the labor movement. Without strong unions there is no hope of holding corporations accountable to society and ensuring that they serve their mission of creating wealth. Strong unions are also necessary to assure that the wealth that corporations create is equitably distributed and that prosperity is broadly shared.

Whether or not we are able to require that worker representatives gain a formal role in the governance of corporations as in many European countries, workers as shareholders must be empowered to play a central role in corporate governance as shareholders.<sup>iii</sup> Our fiduciary responsibility to the beneficiaries cannot be served without active stewardship of the five trillion dollars of workers' capital.

The labor movement is already responsible for over 30 percent of all shareholder resolutions filed in publicly traded corporations. Workers' capital has doubled the

number of resolutions filed in the current shareholder season. The over 380 resolutions filed so far have focused on the important themes of the post-Enron moment: Executive compensation, board independence and diversity, off-shore re-incorporation and worker rights and workplace practices. We have also fought to extend the rights of shareholders to require that shareholder resolutions be made binding on management and to require that the companies' proxies be open to union nominated directors.

For example, union funds are sponsoring resolutions at Coca-Cola on stock options and international worker rights; at General Electric on executive pensions; at Walmart on employee health care coverage and board independence; and at Sprint on golden parachutes for executives.

At Tyco, union funds are fighting for re-incorporation of the company back into the U.S. It was only after Tyco re-incorporated in Bermuda to escape their tax liabilities that the plundering of the company by Dennis Koslowsky and others really got under way. The labor movement is also sponsoring Congressional legislation to deprive all such companies of the tax advantages of such unaccountable behavior. Union sponsored resolutions at Tyco are also seeking to separate the positions of board chair and CEO, the indexing of stock options and requiring shareholder approval for golden parachutes.

At Unocal, the international labor movement will be supporting a shareholder demand for the company to respect international labor rights. Unocal is deeply involved with the brutal, anti-worker military regime in Myanmar accused of forced labor, rape and even murder in connection with the company's oil and gas project there. Last year a resolution demanding respect for worker rights won an historic 34.8 percent of all shareholder votes.

As we engage more and more companies on corporate accountability themes we will also continue to press the Congress for legislation to bolster retirement security and corporate accountability. We will petition the SEC for new rules to rein in executive pay and strengthen shareholder protections in our securities laws. And we will seek higher standards for companies in the listing requirements of the major stock exchanges.

Workers, as employees and retirees, are the real victims of corporate abuse. Workers and their unions must be the principal agents of corporate reform. The attention of the media to corporate abuse may wax and wane, but for workers the Enron moment will be as long as it takes to enact authentic corporate reform. Workers know that there will be no real reform without organizing and without continuing struggle.

Corporate reform, like all reform, is not a spectator sport.

## An Agenda for Corporate Reform

- **PUT WORKERS FIRST.** Workers should not bear the brunt of corporate malfeasance and their retirement security priority. The claims of workers who lose their jobs should have first claim on the assets of companies destroyed by corporate misconduct. These include severance claims as well as unpaid wages, benefits, pension and 401-K contributions. The ill-gotten gains of corrupt corporate insiders must be captured and returned to the innocent victims of corporate abuse. Corporations must assume their share of responsibility for the retirement security of the workers who devote their careers to build company success. Guaranteed defined benefit pension plans must be restored for America's workers. Workers' savings plans, including 401-Ks, should not be irresponsibly loaded up with company stock. Workers should elect trustees of their retirement funds.
- **HOLD CEOs ACCOUNTABLE.** Stock options have corrupted America's corporate leaders and do not serve the long-term interests of shareholders or companies. Where options are used they should be expensed and indexed to company performance. Better still, executives should receive shares instead of options so they bear risks of their work as well as reap the rewards. CEOs should be prohibited from selling any options or shares they receive during their tenure with the corporation. Corporate traitors that re-incorporate offshore, and abandon America should be stopped immediately, not rewarded with further tax cuts. Shareholders should have full democratic rights in determining who leads our companies. CEOs should no longer have access to company funds to run candidates for their boards while worker funds have to spend their own money to elect independent directors. Company boards must be independent and diverse if they are to be accountable. Giant mutual funds should disclose how they vote their proxies and stop supporting cozy corporate boards and rubber-stamping insider abuses.
- **PUT INTEGRITY BACK INTO CORPORATIONS.** Conflicts of interest among accountants and financial analysts, the aiders and abettors of corrupt corporate insiders, must be eliminated. Accounting reform legislation passed last week in Congress is a strong start. Congress should also prohibit Wall Street analysts from being involved in any way in the investment banking side of their firms. We should end the civil immunity aiders and abettors of securities fraud now enjoy – and make the accountants, lawyers and bankers who draw up the fraudulent documents pay for the damage they do. Finally, we need a national commission to study regulation and oversight of investment and commercial banks and the concentration of financial power in the wake of the repeal of the Glass-Steagall Act.
- **END CORPORATE CORRUPTION OF POLITICS.** We must eliminate the corporate corruption of our nation's politics. We must get corporate money out of our politics and finance our elections with taxpayer money. Only when government is accountable to the American people instead of business, can we get the reforms needed for real corporate accountability.

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<sup>i</sup> It is common, particularly in Europe, to refer to shareholders, managers, creditors and others as “stakeholders,” usually defined to include any party who affects or is affected by corporations. We prefer the term “constituents” and to include only those parties that contribute productive assets to corporations’ wealth-creating activities. The point is not to diminish the significance of stakeholders who are not constituents, but to more accurately describe the stakeholders who should be involved in corporate governance in contrast to those to whom the company should be socially responsible.

<sup>ii</sup> “Corporate accountability” (CA) is a term of art intended to distinguish labor’s notions of how the behavior of corporations should be shaped from the different, but more familiar, “Corporate Social Responsibility” (CSR). In contrast to CSR (at least in the Anglo-American usage), corporate accountability is intended to suggest that corporations are accountable to “the company and its shareholders” of course, but also to society and our government, under whose laws corporations are organized, regulated and operate.

CSR standards usually apply to the effects of corporate behavior on non-core aspects of corporations’ business – treatment of employees, environmental impact, community relations and even corporate philanthropic undertakings. Corporate accountability includes many of these concerns, but aims directly at the core social mission of the corporation – the creation of wealth.

CSR is a subjective standard to serve as guidance to enlightened company policy and the conscientious behavior of executives. In contrast, standards of corporate accountability require more objective means of implementation – law, regulation and effective governance mechanisms. Accordingly, and perhaps most important, CSR is advanced as an explicit substitute for law and regulation, whereas corporate accountability requires law and regulation to make possible enlightened company policy and the conscientious executive action. Corporate accountability is not intended to replace the standards of CSR nor the enlightened company policies or conscientious executive action necessary to implement them. On the contrary, only in socially accountable corporations, can the important concerns of CSR be fully realized.

<sup>iii</sup> Under American law, the only corporate constituent with a formal role in corporate governance are shareholders. Unlike co-determination systems of corporate governance in many European countries, workers as employees have no formal role in the governance systems of American companies.

Crude economic rationales for the American requirement of a corporate governance role for shareholders, and the absence of such a required role for workers, is the “ownership” claim that shareholders stake on the corporations whose shares they hold.

More sophisticated economic rationales for the required role of shareholders in governance stress their distinctive role of bearing the “residual risk of the enterprise.” Shareholders benefit only when the corporation is successful in its various business enterprises because only then will there be a profit after paying for the contracted services of other corporate constituents. This residual risk entitles shareholders to “residual control rights” in the corporation, which can best be achieved by providing them a role in the governance process of the corporation. This allows shareholders; through their role in electing board members, oversight over the strategic decisions of senior management, which ultimately determine whether the corporation is successful. Importantly, under this economic theory, it can be argued that workers as employees also bear “residual risk” related to the firm-specific knowledge, which they contribute to corporations’ success. Workers as employees, therefore, have the same claim as shareholders to a formal role in corporate governance. Workers’ participation in corporate governance is not now on the agenda in the United States, although it is a matter of law in many European countries and a matter of active discussion in many transition and developing economies currently in the process of reforming their economic institutions.