The Merits of Cooperative Corporate Governance in the Digital Age

Meredith-Anne Kurz

Available at: https://works.bepress.com/meredith-anne_kurz/1/
The Merits of Cooperative Corporate Governance in the Digital Age

By: Meredith-Anne Kurz

“Competition has been shown to be useful up to a certain point and no further, but cooperation, which is the thing we must strive for today, begins where competition leaves off.”

–Franklin D. Roosevelt

I. INTRODUCTION

Employee cooperatives are business entities that give the employee-owner both economic and managerial interests in the company.1 A shareholder, in traditional terms, is an investor in the company, whose contribution is purely financial.2 A stakeholder may be an entity such as the surrounding community, employees and their relatives, and on a broader basis, the environment and the government.3 The relationship between shareholder and stakeholder, normally at odds, is reconciled within employee cooperatives, because the worker not only contributes labor, but also receives a share in the profits, often in lieu of a salary.4 Employees, arguably the most affected form of stakeholder, become owners as well as labor. Thus, it lessens, or even eliminates, the strife between the profit-oriented management and the worker looking for the most advantageous wages and benefits.

1 See Hansmann, “Employee Ownership of Firms,” THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW (1998). “An employee cooperative is a membership organization set up to market the labor and skills of its members through owning a business. It is owned by the members. Each member has one voting share. Its profits are allocated among the members on the basis of how much labor they put into the co-op, in co-ops, financial ownership is separated from share ownership, and each member has an internal account which holds his/her financial interest in the co-op.” See also John Logue, What is an Employee Cooperative? How does it work? An introduction for employee-members, OHIO EMPLOYEE OWNERSHIP CENTER, KENT STATE UNIV. (Jan. 2006), available at www.oeockent.org/library/doc/126/raw.


4 See infra, at 2-8.
The employee-owners are then able to strike a balance between profitability and accountability by electing their own board of directors and becoming managers themselves. The cooperative structure lends itself to democratic elections and governance, because each employee typically has one share in the company. Unlike the traditional corporation, a shareholder cannot control the company through ownership of a majority interest. The only way such a majority of votes is formed is through a coalition, similar to the structure of the U.S. government.

Employee cooperatives have flourished in niche markets such as agricultural and plywood industries, but have not received attention by traditional companies. That is, companies that rely on equity from passive investors and dedicate themselves to compensating shareholders. However, thanks to the omnipresence of technology, this Note proposes that employee cooperatives are possible across various fields and industries. The Internet has greatly shortened the distance between different areas of the world, and companies’ embrace of technology has allowed for more connectivity via telephone, videoconferencing, and email. A company with offices in several states or countries would be able to communicate on a daily basis with their colleagues and co-owners and as well as easily convene board meetings whenever necessary. This form of business not only encourages corporate social responsibility, but also ensures job security for the employee-owners. Once a part-owner of the company, the

---


6 The majority of companies fall into this category. Examples can be found in the manufacturing, retail, and technology industries, (i.e., Proctor & Gamble, Macy’s, and Apple).
employee not only feels invested in the output of the company, but is also an integral part of its success and thus is more likely to remain a permanent member of its management.  

The cooperative’s corporate structure is a hybrid of the partnership and corporation. Members are allotted shares in the profits (like in a partnership) as well as enjoying limited personal liability (as in a corporation), and remain relatively insulated from potential litigation and debt collection. The cooperative rebels against the traditional corporation’s dedication to profitability as a measure of success. Corporate social responsibility, or CSR, is now taking a more mainstream position. Many major corporations have social responsibility sections on their websites, signaling to the public their desire to contribute to communities beyond profits.

Employee cooperatives benefit from tax incentives and less regulation relative to traditional corporations. This Note analyzes the tax incentives and corporations laws to encourage the formation of employee cooperatives and conversions from traditional corporations to cooperatives. With the advent of increased connectivity through the Internet, there is a unique opportunity for the formation of cooperatives. Furthermore, community development between

---

7 See e.g., Management Structure, KENAN DEVAN HILLS PLANTATIONS CO. PVT. LTD., (last visited March 20, 2013). The cooperative’s management structure “includes relevant information…to enable the committees to function effectively to involve all levels of employees in the decision making process whereby a sense of ownership is fostered.”

8 Larry E. Ribstein, The Evolving Partnership, 26 J. Corp. L. 819, 840 (2001). “U.S. partnership law provides that partners share equally in profits and losses after paying non-partnership creditors. Indemnification by the partnership and contribution by individual partners reconciles partners’ loss shares with their vicarious liability for all partnership debts. Partnership statutes also deny partners interest and rent in addition to their profit shares except where they specifically contract to loan or lease property to the firm.”

9 Second, corporate shareholders are not, like general partners, personally liable for the firm's debts. Shareholders' limited liability does more than simply transfer risks to creditors--it can create wealth by facilitating freely transferable stock and therefore the development of informationally efficient stock markets. Commentators have considered limited liability to be an important justification for taxing and regulating corporations.” Larry E. Ribstein, Why Corporations?, 1 BERKELEY BUS. L. J. 183, 189 (2004).

10 See infra, ## (Corp. Soc. Resp.)

11 See infra, 19-20.
individuals across the world has been made possible with the advent of social media and the increasing availability of the Internet across the world. Employee cooperatives have been subject to economic analysis as of late, but have been largely ignored by legal scholars since the late 1990s. This gap in scholarship does not consider the effect that technology may have on the development of the form and its utility in times of economic instability to promote sustainability of businesses. Thus, employee cooperatives deserve new consideration as a business model that will offer stable employment and reliable productivity.

**CORPORATE SOCIAL RESPONSIBILITY: FUNDAMENTAL OBSTACLES**

In the scheme of corporate social responsibility, several types of companies have emerged. The first is a company that focuses purely on profit without consideration of any other factor of success. While many companies may be reluctant to admit that they are so organized, an example may be an investment bank, which is organized purely to arrange financial deals such as mergers and acquisitions. Another type is a company that focuses only on its social effects and shows no regard for profit, such as a non-profit corporation or charity, such as the Red Cross or the Salvation Army. The last breed is one that has evolved in recent years, and believes that CSR can enhance profits and thus publicizes its initiatives. An example of such a company is Ben & Jerry’s. Milton Friedman, a well-respected economist of the 20th Century, believed strongly that a corporation has no social responsibility except to its shareholders.

12 See, e.g., Mergers and Acquisitions, J.P. MORGAN http://www.jpmorgan.com/pages/jpmorgan/investbk/solutions/banking/advisory (last visited March 22, 2013). Investment banks also engage in trading securities on their own behalf and for the benefit of its clients’ top executives, which is not only a conflict of interest in some cases, but is also self-interest in its purest form. Stephen Gandel, *Is Proprietary Trading too Wild for Wall Street?*, TIME (February 5, 2010), http://www.time.com/time/business/article/0,8599,1960565-1,00.html.

Friedman translated “social responsibility” into fiscal responsibility. Shareholders, according to Friedman, should have no expectation of benefits except for return on investment. Social responsibility may be accomplished through responsible financial decisions, but the two are not necessarily synonymous. In contrast, many of the newer forms of corporate governance acknowledge the effect on those other than shareholders, such as the German system, and of course, employee cooperatives.

Shareholder primacy currently leads the pack of corporate structures as the most “successful,” when thinking purely in terms of the bottom line, but the recent economic crisis has shown that managers’ decisions can have drastic economic consequences. Under this schema, shareholders are presumed to value profits above all else. Shareholder primacy assumes that stakeholders, such as employees and the community, are “compensated” (though not necessarily

---

15 See id.
16 See infra pp. ___.
17 “Prior to 2008, many banks bundled subprime mortgages and sold them to unwitting investors, despite the fact that the bank knew the mortgages were worthless. The repeal of Glass-Steagall, which prohibited banks and investment banks from merging, allowed banks to engage in risky investments like subprime mortgage bundling with the FDIC ensuring all their cash reserves. Low interest rates led hungry asset managers to turn to higher-yield investments, since bonds were not profitable enough. Furthermore, credit agencies rated these investments as “AAA,” the highest possible rating, and fund managers relied on this information and failed to conduct independent research that would reveal just how risky the funds actually were. Change in SEC regulation and federal preemption of state anti-predatory laws encouraged this behavior. So much cash in the short-term impressed shareholders, and executives were awarded exorbitant compensation packages. In 2008, the financial crisis hit due to these factors. This scheme of selling mortgage-backed securities was due in part to managers’ overzealous nature when it comes to profit. They ignored the warning signs that indicated the investments were too risky and would jeopardize the entire world.” See Matthew Berger, Biting the Hand That Feeds: AIG and the Takings Clause, ___ J. OF INT’L BUS. & L. ___, Forthcoming Spring 2013 (citing Steve Denning, Lest We Forget: Why We Had a Financial Crisis, FORBES (November 22, 2011), http://www.forbes.com/sites/stevedenning/2011/11/22/5086/). “As we have seen, the board-centric model of corporate governance is currently under attack. The financial crisis of 2008 and the ascendancy of the Democratic Party in Washington have created an environment in which proponents of expanded shareholder corporate governance rights are making considerable progress. Even before the crisis hit, of course, there had been a number of efforts to extend the shareholder franchise, principally so as to empower institutional investors. The crisis, however, has given them new momentum.” Stephen M. Bainbridge, Director Primacy, 12 (UCLA School of Law, Law-Econ Research Paper No. 10-06, 2010).
economically) by contract. There is another school of thought known as board or director primacy, where the loyalty is to profits rather than stakeholders. This view assumes that shareholders do not value any form of altruism and does not consider that shareholders are far too removed from their investment to influence such behavior, aside from selling their shares. Stout suggests, “corporations run by directors who enjoy a range of authority to sacrifice profits in the public interest may end up serving investors’ interests—including investors’ altruistic, prosocial interests—better than corporations run according to the “standard model.”

Furthermore, there is a more progressive view that external concerns, such as the community, do not get built in to protections by contract. For instance, employees are compensated through contractual arrangements to perform work in exchange for a salary, even if there is no written contract per se. There are laws that attach to employers once they retain employees, forming certain boundaries that cannot be crossed. However, the cost to the community does not have such contractual protections. Environmental tolls that a factory may have on an area are only remedied with the involvement of an external entity, such as the government or the litigation process. Moreover, employees depend on the company to continue their employment to help support their families and pay for necessary costs such as healthcare, shelter, and food. Employees thus have much more invested than shareholders do, and have much more transaction costs at stake. For instance, if an employee must relocate in order to

---

19 In this model, the board of directors is not a mere agent of the shareholders, but rather is a sui generis body whose powers are “original and undelegated.” See Bainbridge, supra note 12 at 3. Sui generis is something “constituting a class alone.” Sui generis, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/sui%20generis (last visited March 31, 2013).
20 Id. at 20.
In 1970, Milton Friedman wrote in an influential *New York Times* article, “What does it mean to say that the corporate executive has a “social responsibility” in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers.” Friedman considered a corporation’s shareholders to be management’s “employers.” Therefore, in a traditional corporate structure, management’s progress is measured by the daily stock price, because no other qualitative measure is deemed sufficient. Friedman’s article thus considers corporate responsibility to be

---

22 The recent bankruptcy of Detroit has shown that the ruin of the financial crisis runs deep and will have long-lasting effects on stakeholders that relied on big business to keep themselves afloat. Matthew Dolan, *Record Bankruptcy for Detroit*, WALL ST. J., July 19, 2013, http://online.wsj.com/article/SB10001424127887323993804578614144173709204.html.
23 “As the workers depart in greater numbers than either their union or their employers anticipated, the exodus becomes more than a long ledger of altered lives. It is an accounting, of course, but an accounting of the most personal and poignant sort. Communities are fragmenting, families are relocating, and years of individual choices tethered to the notion of a certain kind of job in a certain kind of place are giving way to uncertainty, regret and loss of control.” Louis Uchitelle, *The End of the Line as Detroit Workers Know It*, N.Y. TIMES, April 1, 2007, http://www.nytimes.com/2007/04/01/business/yourmoney/01jobs.html?pagewanted=all&_r=0.
24 See Id.
26 Id.
an initiative that should be wholly ultra-viral but fails to consider the fact that social responsibility may ultimately support the “bottom line” in promoting holistic economic factors such as corporate culture, morale, productivity, and “goodwill.”

Ronald Green discusses Merck’s dedication to bringing medicine to treat river blindness which is found in indigent areas of Africa, the Middle East, and Latin America. He disagrees with Friedman’s position that a company’s most important responsibility is to its shareholders and instead offers a definition of “business excellence” which goes beyond the bottom line. He proposes,

Unlike Friedman, proponents of CSR do not see ethical commitments as a distraction from these objectives but an essential part of their pursuit. “Like the social responsibility position, it sees corporations as playing an important role in addressing social needs. But unlike this perspective, it refuses to see these activities as an obligation above and beyond managers’ fiscal responsibilities; it sees them as the essential part of business.”

Ethics, then, are an essential part of a corporation’s philosophy, and while Greene does not offer any practical solutions to creating an “ethical” business, he proffers that “modern business is all about ethics.” Merck’s decision to deliver the medicine to those developing areas, despite the fact that they knew it would not show a return, ultimately proved a contribution

---

28 See id. “Goodwill is an intangible asset that represents the extra value ascribed to a company by virtue of its brand and reputation.” Goodwill is valued on a company’s balance sheet. The goodwill, the bad and the ugly, THE ECONOMIST (Jan. 22, 2009), http://www.economist.com/node/12992559.
29 Ronald M. Greene, Responsibility and the Virtual Corporation, in Houck & Williams, supra note 1 at 37. Note, however, that Merck is not without its flaws. It was recently revealed that a suit against it began in 2010 alleging the pharmaceutical giant misrepresented the efficacy of its vaccines for the common illnesses mumps, measles, and rubella. It was also fined $1.6 billion since 2008 for failing to pay rebates owed to the government. See Kelly Kennedy, Drugmakers have paid $8 billion in fraud fines, USA TODAY, March 6, 2012, http://usatoday30.usatoday.com/news/washington/story/2012-03-05/health-drugmakers-fraud-fines/53372792/1.
30 See Greene, supra note __, at 40-42.
31 Id. at 46.
32 Id.
to Merck’s continued success as it cultivated relationships with stakeholders such as the World
Health Organization.  

Furthering the contrast to Friedman’s outlook, Bearle and Means wrote of the circuitous logic of the traditional corporation as early as 1933:

By tradition, a corporation “belongs” to its shareholders…and theirs is the only interest to be recognized as the object of corporate activity. Following this tradition, and without regard for the changed character of ownership, it would be possible to apply in the interests of the passive property owner the doctrine of strict property rights…By application of this doctrine, the group in control of a corporation would be placed in a position of ownership of the corporation for the sole benefit of the security owners despite the fact that the latter have ceased to have power over or to accept responsibility for the active property in which they have an interest. Were this course followed, the bulk of American industry might soon be operated by trustees for the sole benefit of inactive and irresponsible security owners.  

In a sense, then, the shareholders of a company will reap the benefits of profits and deny any responsibility for losses or destructive behavior, while the stakeholders must then clean up the mess, whether it is environmental or economic. Jackson suggested of the pair,

While they observed that power of the corporation began to resemble that of a sovereign state, the authors relied upon shareholders to ensure boards of directors did not self-deal or shirk in their duties. Thus, in a society rapidly turning into a consumer society, Berle & Means sought to make shareholders the foundation of the modern economic order. 

33 Id. at 44.
35 Id.
36 See Jackson, supra note 9 at 316.
Thus, the traditional corporation does not acknowledge the stakeholder’s interest except through a perverse form of adverse possession. Stakeholders are affected by management decisions to cut wages, relocate, and use harmful pollutants but have no decision-making power themselves. Legal remedies are often ineffective and in the case of environmental issues, must cause some actual damage before an injunction will be granted. For instance, recently Boeing decided to relocate one of its factories from Washington to South Carolina, a “right to work state,” because it feared its workers’ unions were too powerful. The National Labor Relations Board (NLRB) stepped in and filed a complaint against Boeing. However, the case was dismissed because the union that brought the complaint urged the NLRB to do so and the South Carolina plant is fully operational. The Washington-based union made a very favorable deal in Washington so as to balance the harm they face by competing with non-union workers. This does not, however, cure the harm that the nonunionized workers and their families face in South Carolina. Stakeholders are given all of the liability associated with any economic development, and very little of the benefits. The structure is paternalistic, but none of the safeguards against

37 Id.
40 74% of the union’s workers in the Washington plant voted to ratify a four-year contract extension that came with wage raises, job security provisions which are uncommon, and Boeing promised to renew its commitment to expanding in the Puget Sound area. Steven Greenhouse, Labor Board Drops Case Against Boeing After Union Reaches Accord, N.Y. TIMES (Dec. 9, 2011), http://www.nytimes.com/2011/12/10/business/labor-board-drops-case-against-boeing.html.
abuse are in place. In effect, the stockholder, as one with absolute ownership, should ensure that management is acting in a socially responsible way, but they lack the incentive to do so.\textsuperscript{41}

In practice, any attempt at corporate responsibility is an exercise in placating shareholders and meeting their expectation of economic return while balancing the social costs of a company’s actions. In a notable Newsweek article, R.J. Samuelson wrote,

The idea of the "good corporation" assumed that superior American management could easily blend two roles: the company as a fierce economic competitor, and the company as a welfare state for its workers. There seemed to be no conflict. Stable jobs and ample fringe benefits would make workers loyal, and loyal workers would make companies prosper.\textsuperscript{42}

As Samuelson implies, these ideals are unrealistic for American corporations with traditional structures, absent economic or tax incentives.\textsuperscript{43} This attitude is precisely why there is a need for a fundamental shift in corporate structure in order to incorporate social initiatives in business. It is somewhat of a “chicken or the egg” debate, as the willingness to accept corporate responsibility to stakeholders is philosophically incorporated into alternative structures such as employee cooperatives.\textsuperscript{44} However, with companies like the Tata Group, the ingrained sense of social responsibility in its mission fostered the creation of an employee cooperative.\textsuperscript{44}

Empirical studies of socially responsible companies have shown that they are just as economically successful, at times more successful, than ones that do not share the same altruistic philosophy.\textsuperscript{45} A study of CSR companies out of the Reputation Institute which measured trust,

\begin{footnotesize}
\textsuperscript{41} See infra pp. __.
\textsuperscript{43} See id.
\textsuperscript{44} Internal Cross Reference to section on the Tata Group
\textsuperscript{45} Moses L. Pava & Joshua Krausz, \textit{see supra} note __, at 15; Many companies known for CSR are “household names,” such as those indicated in the article cited in note __ [Forbes article below], as well as those recognized by
\end{footnotesize}
esteem, admiration, and good feeling, as well as the “seven dimensions of corporate reputation,” namely, governance, citizenship, financial performance, leadership, products and services, and innovation. Citizenship, governance, and the workplace are considerations that are shared with CSR-minded companies. The company chosen by most consumers was Microsoft Corporation, known for charitable contributions and community outreach. Scholars recognize this phenomenon as well. Nobel argues, “unless managers operate in a disciplinary framework that allows them to trade off profits in favour [sic] of third-party interests, other measures to increase responsibility are likely to have rather limited results.” Nobel also points out that social responsibility is no longer shunned by companies and ignored by the market, but valued. Thus, the subjective standard that accompanies customers’ preferences extends to CSR investing as well.

**Corporate Social Responsibility as Inspiration for Cooperatives and Cooperatives as a Form of Socially Responsible Company**


1. ‘Company’ is a good corporate citizen — it supports good causes and protects the environment;
2. ‘Company’ is a responsibly-run company — it behaves ethically and is open and transparent in its business dealings;
3. ‘Company’ is an appealing place to work — it treats its employees well.

47 Id.
48 Id.
49 Nobel, supra note 3 at 1261.
50 Id. at 1265.
An integral part of establishing employee cooperatives is the fostering of a sense of “corporate responsibility,” the subject of much scholarship, particularly in the 1990s. The difficulty lies in defining “corporate responsibility.” Is compliance with the law sufficient to allow the company to tout social responsibility? Charitable donations noted on the company’s 10k or mission statement? The plethora of scholarship has led to different opinions as to what corporate responsibility connotes. Much like the subjective standard among consumers about which companies are socially responsible, there is no concrete consensus among scholars as to a definition. The lack of cohesive definition suggests that more concrete concepts, such as the creation of an employee cooperative or hybrid cooperative structure, will lead to results not achieved through merely using the phrase “corporate responsibility.”

Nobel has suggested that internationally, “a consensus seems to exist that a corporation must consider the interests of all stakeholders (and not simply shareholders).” Stakeholders are those individuals affected directly or indirectly by a company’s actions, other than the company’s investors, including employees, surrounding communities, and the environment. The theory of stakeholder interests extends to groups such as “employees, customers, suppliers, nongovernmental organizations, [and] local communities…Legitimate objects of the corporation include not merely profitability but sustainable growth, equitable employment practices, and long-term social and environmental accountability.” Thus, the effect that a company may have

---

51 See e.g., IS THE GOOD CORPORATION DEAD? (John W. Houck & Oliver F. Williams, eds., 1996).
52 See id. at 25.
on its employees and those in the surrounding communities, which logically includes employees, is crucial to stakeholder theory.\textsuperscript{56}

A company’s employees are the most closely connected entities to the corporation, economically as well as socially. While economic ties are easier to analyze, social influences are amorphous, yet could possibly have a greater effect. In recent years, the collapse of the financial sector has made it increasingly evident that corporate culture may breed corruption arguably more readily than it may encourage community outreach.\textsuperscript{57} Milton Friedman’s theory of economic success being equal to corporate success is clearly extremely attractive to investors and any other philosophy is undoubtedly a “hard sell.”

The movement toward corporate social responsibility, however, is more concrete than ever before. An interest group called B Lab has created a program that allows companies who meet certain standards pertaining to its impact on the community, environment, and employees to be listed on a “B-Corp Index.”\textsuperscript{58} The companies are measured based on metrics to determine its “B-Impact score.”\textsuperscript{59} Once a score of 80 out of 200 points is earned, the company meets legal requirements (necessitating board and shareholder approval, in some cases), and amends its by-laws, the company can become a certified B-Corp.\textsuperscript{60} B Lab’s goal is to enact legislation in all 50

\textsuperscript{56} Id.
\textsuperscript{57} Grant Kirkpatrick, The Corporate Governance Lessons From the Financial Crisis, OECD Steering Group on Corporate Governance (2009); an infamous example the centripetal force of such greed may be seen in the Enron scandal. Enron went to great lengths to cover up the amount of debt they had undertaken through a series of complex transactions, which led the S.E.C. to begin an investigation into such fraud and ultimately to the criminal prosecution of many of the executives of Enron involved in the cover ups. \textit{See Behind the Enron Scandal}, TIME MAGAZINE, http://www.time.com/time/specials/packages/article/0,28804,2021097_2023262,00.html (last updated March 31, 2013).
\textsuperscript{58} B-CORPS, B-CORP INDEX, http://www.bcorporation.net/storage/documents/bcorp_index.pdf.
\textsuperscript{59} Id.
\textsuperscript{60} B-CORPS, HOW TO BECOME A B-CORP, http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp (last visited Feb. 17, 2013); “The benefits of the legal requirement:
states that creates a corporate entity called the “benefit corporation.” As recently as March 25, 2013, Delaware published a draft of a benefit corporation statute. The Delaware courts and laws are often consulted for precedent in corporation laws and serve as a model for many other states. A benefit corporation must create a public benefit, whether environmental or social, measured against by a third party. A Certified B-Corporation is a corporation that meets the requirements of the aforementioned interest group. A corporation need not be a B-Corp in order to be legally deemed a benefit corporation, but companies earn benefits from the interest group if

1. Give legal protection to directors and officers to consider the interests of all stakeholders, not just shareholders, when making decisions
2. Create additional rights for shareholders to hold directors and officers accountable to consider these interests
3. Limit these expanded rights to shareholders exclusively.


Legislation is pending in Delaware, seen as a great success because Delaware is home to more than 900,000 corporations and much of the seminal litigation comes out of either New York or Delaware. Laws have been passed in twelve states and twenty other states are in the process of passing legislation for benefit corporations. See Passing Legislation, B-CORPS, http://www.bcorporation.net/what-are-b-corps/legislation (last visited March 31, 2013). In New York, a benefit corporation is defined as: (a) Every benefit corporation shall have a purpose of creating general public benefit. N.Y. Bus. Corp. Law § 1706 (McKinney 2012).


General public benefit” means a material positive impact on society and the environment, taken as a whole, assessed against a third-party standard, from the business and operations of a benefit corporation.” N.Y. Bus. Corp. Law § 1702(b) (McKinney 2012); “Third-party standard” means a recognized standard for defining, reporting and assessing general public benefit that is:

(1) developed by a person that is independent of the benefit corporation; and
(2) transparent because the following information about the standard is publicly available:
(A) the factors considered when measuring the performance of a business;
(B) the relative weightings of those factors; and
(C) the identity of the persons who developed and control changes to the standard and the process by which those changes are made. N.Y. Bus. Corp. Law § 1702(g) (McKinney); “Specific public benefit,” includes:
(1) providing low-income or underserved individuals or communities with beneficial products or services;
(2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business;
(3) preserving the environment;
(4) improving human health;
(5) promoting the arts, sciences or advancement of knowledge;
(6) increasing the flow of capital to entities with a public benefit purpose; and
(7) the accomplishment of any other particular benefit for society or the environment.

N.Y. Bus. Corp. Law § 1702(e) (McKinney 2012).
they meet the standards for a Certified B-Corporation. Benefits include savings through partnerships with other B-Corp companies, attracting CSR-minded investors, participate in ad campaigns, and attracting talent through companies’ missions.

Ben and Jerry’s, an ice cream company, is the first subsidiary to become a certified B-Corporation. Unilever, the frozen treat company’s parent, is a Dutch conglomerate that sells food products, cosmetics, and pharmaceuticals internationally and has also embraced corporate responsibility. Ben & Jerry’s obtained “B Corporation” certification due to its dedication to stakeholders and its transparency in disclosing policies and financial documents. Ben & Jerry’s, acquired in recent years by Unilever, became the first wholly-owned subsidiary to become a certified B-Corp. B Lab’s website indicates there are over 600 companies with the certification, and is pressing for legislation in 39 more states that creates a new type of corporation, indicating dedication to stakeholder interests. There are certainly costs associated with becoming a Certified B-Corp and maintaining such certification, through audits and required policy changes. Annual costs for a large company can run up to $25,000 per year.

The principal reason for companies’ hesitancy is economic, as any regulation which requires

---

64 See PASSING LEGISLATION, supra note __. “Certified B Corporation is a certification conferred by the nonprofit B Lab. Benefit corporation is a legal status administered by the state. Benefit corporations do NOT need to be certified. Certified B Corporations have been certified as having met a high standard of overall social and environmental performance, and as a result have access to a portfolio of services and support from B Lab that benefit corporations do not.”


66 Ben & Jerry’s Joins the Growing B Corporation Movement, BUSINESS WIRE (Oct. 22, 2012), Factiva Database


70 Id.
improvements in technology and a decreased environmental “footprint” tends to increase costs of operation.\textsuperscript{71}

Moreover, there are certainly shareholders in the market who consider a company’s commitment to its stakeholders in their investment decisions. A magazine dedicated to the subject, Corporate Responsibility Magazine, has published a “blacklist” of those companies which show the least commitment to social responsibility.\textsuperscript{72} The list is measured by the level of disclosure of their social responsibility initiatives.\textsuperscript{73} Conversely, it has also established a rubric to determine the “100 Best Corporate Citizens,” which consists of, among other factors, employee benefits disclosure, diversity disclosure, human rights disclosure, and philanthropy.\textsuperscript{74} Furthermore, B Lab, the non-profit which created the B-Corp certification, instituted a new rating system called GIIRS.\textsuperscript{75} The system has been established to analyze the social and environmental impact of a company or fund, based on the ratings of its supporting portfolio companies.\textsuperscript{76}

Since the recession of the late 2000s, the call for corporate responsibility should be renewed, particularly with regard to employees and economic effects on communities surrounding a company’s locale. In 2007, the unemployment rate was below 5%. Since then,

\textsuperscript{73} Dirk Olin, \textit{Seeing in the Dark}, 3 CORPORATE RESPONSIBILITY MAGAZINE 3 (May-June 2012), http://www.thecro.com/content/seeing-dark.
however, the rate has been steadily rising, peaking at 10.10% in October 2009. 3.4 million foreclosures had been filed as of April 2012. Accordingly, a change must be made in order to stabilize this troubled economy. Employee cooperatives present a unique opportunity for CSR-minded investors to become directly involved in a socially responsible company. By definition, an employee cooperative is a responsible concern because shareholder and stakeholder are one and the same.

I. Structures of Corporate Governance

There are four principal structures of corporate governance that deserve consideration. The traditional corporation, which is also known as the American model in scholarship on corporate governance, provides a view of the structure which takes no consideration of stakeholders’ interests. The German System allows for employee representatives to sit on supervisory boards and works councils to set the policies of the company and must approve all business decisions. Thus, the German system is policy-based and employees are not entitled to any additional economic benefits. Employee stock ownership plans (ESOPs), in contrast, give employees an economic interest in the company in the form of a retirement plan. ESOPs are the product of tax incentives and are subject to much criticism with regard to worker productivity, for, “underlying the history of employee stock ownership is the notion that

---

79 See infra, pp. ___.
80 See infra, pp. ___.
81 See infra, pp. ___.
employee productivity may be improved by giving employees a stake in the company.”

Finally, employee cooperatives represent the most drastic departure from the traditional corporation. Cooperatives are distinctive in that they represent total worker ownership, and have been successful in some niche industries, such as farming and plywood manufacturing.

i. The Traditional Corporation

Milton Friedman famously wrote, “A corporation is an artificial person and in this sense may have artificial responsibilities, but “business” as a whole cannot be said to have responsibilities, even in this vague sense.” Corporations may enter into contracts, hire employees as their agents, bring suit and have it filed against them just like individuals. Furthermore, a corporation is created by its shareholders, and thus is traditionally “owned” by its

---

82 Michael E. Murphy, The ESOP at Thirty: A Democratic Perspective, 41 Willamette L. Rev. 655, 666 (2005). “[T]he ESOP remains highly tax favored. It enjoys the tax benefits available generally to qualified retirement plans: deduction of employer contributions to the plan, exemption of trust from taxation on earnings, and employee tax deferrals upon ultimate distribution of their individual accounts. In addition, the tax code allows employers to deduct payment of dividends to stock held by an ESOP and promotes the use of ESOPs as an estate-planning device for retiring business owners by allowing a deferral of gain on the sale of qualified securities to the ESOP trust.” Id. at 660.

30. CANAN, supra note 28, § 3.35.
32. See Charles A. Pillsbury, Note, Employee Stock Ownership Plans: A Step Toward Democratic Capitalism, 55 B.U. L. REV. 195, 206-07 (1975). These tax advantages presuppose a need to borrow money to purchase stock for a purpose such as facilitating the retirement of an existing owner or effecting an employee buyout. See Michael A. Conte & Jan Svejnar, The Performance Effects of Employee Ownership Plans, in PAYING FOR PRODUCTIVITY 143, 147 (Alan S. Blinder ed., 1990). The same net tax advantage may be secured by contributing stock to the ESOP in an amount equal to repayments on a loan unrelated to the purchase of stock. Id.
33. I.R.C. § 404(a)(9)(A), (B). For a detailed discussion of conditions and limitations on the employer deduction, see CANAN, supra note 28, § 3.37(A)-(B).
34. See
83 See Hansmann, supra note __, at 163.
84 Milton Friedman, supra note __.
shareholders through common stock.\textsuperscript{86} Shareholders appoint a board of directors, which is in charge of the managers, who are thought to have a fiduciary interest to the shareholders.\textsuperscript{87} This is known as “shareholder primacy,” and proponents of the theory do not consider stakeholders’ interests a substantial drawback.\textsuperscript{88} Managers are agents of the shareholders, and are responsible for their business decisions, while shareholders escape much of that liability.\textsuperscript{89} Shareholders, in turn, may bring legal claims against management, but are relatively insulated from the social and moral backlash that managers face.\textsuperscript{90}

Unlike shareholders, who have the right to legal remedies when their investment has been economically threatened, stakeholders have no such rights.\textsuperscript{91} Friedman’s view of what is good for the shareholders is good for the business is generally accepted today.\textsuperscript{92} Supporters of “shareholder welfare maximization” propose regulatory fines to offset any damage to the environment or communities in the area.\textsuperscript{93} They accept the conclusion that “participants in the corporation are better off, and the rest of us are at least no worse off, when social interests are protected through regulatory laws rather than by tampering with shareholder primacy.”\textsuperscript{94}

\begin{thebibliography}{99}
\item Id; Stephen Ellis & Grant Hayden, \textit{The Cult of Efficiency in Corporate Law}, 5 Va. L. & Bus. Rev. 239, 246 (2010).
\item Ellis & Hayden, supra note 23. “The board is limited to something less than total management. It (1) authorizes major corporate actions, (2) gives advice to corporate management, (3) assures that there are effective auditing procedures so that the board is adequately informed of the corporation's financial status, (4) reviews the corporation's investments at regular intervals to insure that they comply with all applicable provisions of law, and (5) monitors the performance of management, setting goals and measuring management's results against them.” \textsc{Edward Brodsky} & \textsc{M. Patricia Adamski}, \textit{Law of Corp. Offs. & Dirs.: Rts, Duties, & Liabs.}, §1:2 (2012).
\item Agency law
\item Einer Elhauge, \textit{Sacrificing Corporate Profits in the Public Interest}, 80 N.Y.U. L. Rev. 733, 756 (2005). \textit{See also Brodsky & Adamski, supra note 24, at §22:4, citing U.S. v. Dotterweich 320 U.S. 815, 64 S. Ct. 367 (1943)(holding criminal intent is not required to hold a corporate officer responsible for an action that is dangerous to the public, known now as the corporate responsibility doctrine).}
\item See Elhauge, supra note 27, at 749.
\item See Friedman, supra note 11.
\item \textsc{Frank H. Easterbrook} & \textsc{Daniel R. Fischel}, \textit{The Economic Structure of Corporate Law} 38 (1991), cited in \textit{id.} at 539.
\item Lee, supra note 24, at 539.
\end{thebibliography}
justification does not, however, consider the possibility that an employee is a stakeholder as well. Thus, the manager must carefully balance the interests of the shareholder and the stakeholder so as to both see an economic return and mitigate any social or moral damage which occurs in the process.\textsuperscript{95}

ii. **Employees in the Traditional Corporation**

The traditional corporation, along with American labor law, carries the mentality that employers and employees are necessarily adversaries and that one must sacrifice for the other.\textsuperscript{96} Employees organize to form unions in order to establish collective bargaining agreements, which are contracts that determine the terms and conditions of employment.\textsuperscript{97} Collective bargaining agreements further constrain the employee involved from exercising his individual freedom of contract.\textsuperscript{98} Disputes and allegations of unfair labor practices are brought before the National Labor Relations Board, which is a function of the National Labor Relations Act (NLRA).\textsuperscript{99} Thus, labor disputes under the American system are primarily resolved through litigation. Employees, then, are a force to be reckoned with by employers, and vice versa. This tension is a result of the mentality of managers, who do not view employees as stakeholders in the traditional structure, and thus do not promote their interests in making business decisions.\textsuperscript{100}

iii. **Partnerships**

\textsuperscript{95}See Elhaughe, \textit{supra} note 27.
\textsuperscript{96}Moses L. Pava & Joshua Krausz, \textit{see supra} note __, at 122.
\textsuperscript{98}See id.
\textsuperscript{100}See Jackson, \textit{supra} note 9.
Employee cooperatives contain an element of the traditional partnership. The Uniform Partnership Act provides a concise definition of a partnership: “A partnership is an association of two or more persons to carry on as co-owners a business for profit.”

The determinative factor of a partnership is often whether the purported partners share in the company’s profits. A partnership receives advantages under the tax code in many states because the partners are personally liable for partnership debts. Employee-owners in a cooperative also share in the profits of a company, but are not personally liable on the cooperative’s debts or in tort, absent an intentional harm on the corporation or a violation of criminal law.

iv. LIMITED LIABILITY CORPORATIONS

Limited liability corporations (“LLCs”) provide the most attractive structure for those firms that desire a tax advantage and protection from personal liability. The cooperative structure, when codified, bears a striking resemblance to LLC statutes. Section 401 of the New

---

101 UNIF. P’SHP ACT §6(1) (1914); See also UPA §101(6) (1997); “There are four apparently significant differences between the corporate and partnership standard forms. First, partners are liable directly or indirectly for the firm's debts while corporate shareholders have limited liability. Second, partnerships by default are managed directly by the partners rather than centralized in executives and directors as in corporations. Third, while corporate shareholders can, by default, freely transfer management rights, new partners by default can be admitted only by unanimous member vote. This reflects the potentially high costs of freely transferring management rights where members have unlimited liability, as well as the smaller benefits of free transferability in closely held partnerships as compared with publicly held corporations. Fourth, and most importantly according to Blair, partnerships by default are dissolved by the will or exit of any member, while the corporate entity survives member dissociation. On dissolution, in the absence of contrary agreement, the partnership's assets are sold and divided among the members or their heirs.” Larry E. Ribstein, Why Corporations?, 1 BERKELEY BUS. L.J. 183, 192 (2004).

102 UPA §18 (1914); See also UPA §202(3) (1997).

103 “All partners are liable (a) Jointly and severally for everything chargeable to the partnership under sections 13 &14. (b) Jointly for all other debts and obligations of the partnership, but any partner may enter into a separate obligation to perform a partnership contract.” UPA §15 (1914). “(a) Except as otherwise provided in subsections (b) and (c), all partners are liable jointly and severally for all obligations of the partnership unless otherwise greed by the claimant or provided by law. (b) A person admitted as a partner into an existing partnership is not personally liable for any partnership obligation incurred before the person’s admission as a partner. (c) An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner. This subsection applies not withstanding anything inconsistent in the partnership agreement that existed immediately before the vote required to become a limited liability partnership under Section 1001(b).” UPA §306 (1997).

104 See, e.g., IOWA CODE ANN. §497.33 (West 2012).
York Limited Liability Company Laws provides “Unless the articles of incorporation provide…[otherwise], management of the limited liability company shall be vested in its members who shall manage the agreement.” A membership interest is defined as:

a member's aggregate rights in a limited liability company, including, without limitation: (i) the member's right to a share of the profits and losses of the limited liability company; (ii) the member's right to receive distributions from the limited liability company; and (iii) the member's right to vote and participate in the management of the limited liability company.

Thus, a membership interest in an LLC is vested by statute in its members and includes the rights to share profits, obligation to share losses and the right to vote on the decisions of the company.

Similarly, cooperatives are structured so employee-owners have profit-sharing and voting rights. Cooperatives in New York are regulated by the Cooperative Corporations Laws, which provide with regard to membership: “Acceptance as a member in a worker cooperative shall be evidenced by a membership share, which shall be issued for a fee to be paid in such terms and conditions as are provided in the by-laws.” Furthermore, the statute guarantees management power for employee-owners: “a worker cooperative shall issue a class of voting stock designated as “membership shares.” Each member shall own only one such membership share, and only members may own such shares.” Thus, the rights of employee-owners are distinguished from shareholders of the cooperative, who cannot be issued the class of voting stock reserved for employee-owners.

However, the New York statute is severely limited in scope. The law allows cooperatives to be formed only primarily for purposes of “mutual help, not conducted for profit, for the

---

105 N.Y. LTD. LIAB. CO. §401 (McKinney 2013)
106 N.Y. LTD. LIAB. CO. §102(r) (McKinney 2013)
107 N.Y. COOP. CORP. LAW §88(1) (McKinney 2013).
purposes of assisting its members.” While these goals are ultimately the end result of a successful cooperative, the limitations of the statutory structure lie in these strictly worded purposes. In restricting the cooperative corporation to non-profits, it is not likely to expand its breadth to so-called “million dollar ideas” because the company will not be allowed to finance its operations through investors, nor will it be able to put sales revenue in its coffers. Massachusetts, in contrast, has no such limitation and allows cooperatives to be formed for any purpose.

v. THE GERMAN SYSTEM

In Germany, the “Codetermination System” is a government-mandated division of management which seeks to promote employee interests. Dinh has summarized the three chief features of the German system: “collective bargaining by industry unions, statutory works councils at the plant level, and employee codetermination on the corporation’s supervisory boards.” In contrast to American unions, German unions are very large and belong to even larger organizations called “federations.” The power really lies in the hands of the “works council,” who has the authority through the broad collective bargaining agreement reached

108 N.Y. COOP. CORP. LAW §13 (McKinney 2013).
112 Viet D. Dinh, Codetermination and Corporate Governance in a Multinational Business Enterprise, 24 J. CORP. L. 975, 978 (1999)(using as an example of the merging of the German and American systems the Chrysler-Daimler merger and concluding that for a multinational corporation, the German model is “ill equipped” to govern efficiently).
113 Id. at 978.
between industries and unions to bargain for rights of workers in individual companies and plants. Employee representatives, elected by their coworkers, sit on the works council, thus ensuring employee interests are promoted. This structure leads to greater bargaining rights for employees, as companies may not “opt out” of the works council and the perspective of the employee is incorporated in the company’s decision making process. Jackson posits, “German public companies orient themselves more towards long-term strategies that are better suited to serve all their stakeholders, including their employees and the surrounding economy. In comparison to their American counterparts, they are viewed as public and political entities serving larger social interests.”

The German system excels where the traditional system fails, first in considering employees to be stakeholders, and second, in considering their interests in business decisions. However, scholars believe that incorporating the German school of thought into the traditional corporate structure is unrealistic. The complex structure associated with large-scale unions and statutory councils is not compatible with the statutes already in place in the United States.

---

114 Id. at 978-80. (“The works councils are comprised of employee representatives chosen by their co-workers at individual companies. Representatives receive no payment and are proportionately elected by blue and white-collar workers. The councils have “the powers of information, consultation, codetermination, and direct autonomous management of some business actions.” In addition to providing a particularized annex to union-negotiated collective bargaining agreements, the works councils are consulted in all situations relating to: “(1) reduction of operations or closures of an entire plant or substantial parts of a plant; (2) relocation of an entire plant or substantial parts of a plant; (3) merger with other plants; (4) fundamental amendments to the organization of a plant, to the objective of the plant, or to the equipment used in a plant; and (5) introduction of completely new working practices and manufacturing processes.”). There is also ample opportunity for illegal practices such as bribery. "In Germany, executives at both Siemens and Volkswagen have been charged with bribing labor representatives on their companies' supervisory boards. German law requires that firms give as many as half of their supervisory board seats to labor representatives. Executives need the board's support to carry out their plans and strategies for the company, and some resort to bribery to get the cooperation they need." Richard L. Daft, ORGANIZATIONAL THEORY AND DESIGN 164 (2009).

115 Id. at 978-981.

116 See Jackson, supra note 36 at 311.

117 Id.

118 Id.; See also Dinh, supra note 41.
but the idea of incorporating stakeholder interests into business decisions should not be discounted in these turbulent economic times.

vi. Employee Stock Ownership Plans (ESOPs)

Employee stock ownership plans (ESOPs) were adopted first in the 1970s, where most or all of the firm’s employees become entitled to a share of the company’s profits, usually through a deferred compensation plan. ESOPs are essentially retirement plans, given “special tax treatment” under the Employee Retirement Income and Security Act of 1974 (ERISA) rather than an opportunity to buy company stock, which are known as “stock options.” ESOPs can also be used as a defensive mechanism to guard against unwanted corporate takeovers. While a form of employee “ownership,” the enrollees are generally not considered in business decisions. Thus their interests are ignored not only as stakeholders, but also as bona fide shareholders of the company. ESOPs are governed by ERISA and if it meets certain vesting and distribution requirements, participants have the right to diversify once they meet certain age and

121 See Employee Stock Ownership Plans, SECURITIES AND EXCHANGE COMMISSION,
http://www.sec.gov/answers/esops.htm (last visited Oct. 21, 2012); “ESOPs were invented by Louis O. Kelso, a lawyer and investment banker, who believes that the economy benefits from the “democratization of capital.” Proponents claim that ESOPs: “(1) foster economic democracy within the private sector; (2) increase productivity; and (3) create a more equitable distribution of wealth by giving employees a share of the capital assets of this country.” In the early 1970’s, Kelso convinced Senator Russell Long of Louisiana to promote ESOPs. Senator Long believed that companies would encourage employees to participate in ESOPs if ESOPs produced tax advantages, and he persuaded Congress to give ESOPs special tax treatment as part of the Employee Retirement Income Security Act of 1974 (hereinafter “ERISA”). In addition to the favorable tax treatment afforded ESOPs by ERISA, several states have also enacted statutes to encourage employee ownership through ESOPs.” Carol A. Glick, Labor-Management Cooperative Programs: Do they foster or frustrate national labor policy?, 7 HOFSTRA LAB. & EMP. L.J. 219, 242 (Fall 1989).
122 Margaret A. McLean, Employee Stock Ownership Plans and Corporate Takeovers, 10 PEPP. L. REV. 731, 733 (2013).
service targets, and employees have the right to sell the stock back to the employer at fair market value.\textsuperscript{123}

Furthermore, in the wake of the ENRON debacle and the bankruptcy of United Airlines, litigation surrounding ESOPs has discredited them.\textsuperscript{124} The Seventh Circuit determined that trustees of ESOPs have a duty to make prudent investments, even in light of contradicting instructions from fiduciaries in\textit{Summers v. State Street Bank & Trust Company}.\textsuperscript{125} Companies were attracted to ESOPs in light of tax advantages offered.\textsuperscript{126} The reason for an ESOP, however, is not to give employees “the thrills of gambling but a larger stake in the company's fortunes.”\textsuperscript{127} The Court found that the “employee-shareholders” involved are primarily risk-averse since they rightfully relied on the ESOP to support them, in part or in whole, after retirement.\textsuperscript{128} In dicta, the Court comments that ESOPs are not an efficient method to increase employee productivity.\textsuperscript{129} Judge Posner notes that the Court is not aware “of an argument for subsidizing the ESOP form, as the tax law does, rather than letting the market decide whether it has economic advantages over alternative forms of business structure.”\textsuperscript{130} A study at Cornell University suggests that while the results are not substantially conclusive, differences as to a

\begin{footnotes}
\textsuperscript{124} \textit{Michael J. Canan Gray Robinson, 1 QUALIFIED RET. PLANS} §3.25 (2011).
\textsuperscript{125} 453 F.3d 404 (7th Cir., 2006), citing “Fiduciary Responsibilities of Directed Trustees” (Field Assistance Bulletin 2004-03, Dec. 17, 2004). According to ERISA, the trustee of an ESOP, known as a fiduciary, has a duty of prudence, but has “no direct obligation to determine the prudence of a transaction” entrusted by the plan to another fiduciary. The Labor Department has interpreted this to mean in practice that a trustee may violate the fiduciary’s instructions when it is plain they are imprudent. \textit{Summers}, 453 F.3d at 406-07.
\textsuperscript{126} \textit{Summers}, 453 F.3d at 410. The Court noted “Why Congress thought it appropriate to stimulate the adoption of this business form by giving companies tax breaks rather than allowing the free market to determine the merits of the form is a separate question but not one we need answer in order to decide this case...” \textit{Id. See generally} Michael S. Knoll, \textit{supra} note 50, at 523-552 (discussing tax advantages to corporations as well as to individuals).
\textsuperscript{127} \textit{Summers}, 453 F.3d at 410.
\textsuperscript{128} \textit{Id.}
\textsuperscript{129} \textit{Id.} at 411-412.
\textsuperscript{130} \textit{Id.} at 411.
\end{footnotes}
firm’s “profitability, productivity, and compensation...are favorable to companies with employee ownership, especially among companies of small size.”

It is posited that the “Prisoner’s Dilemma,” in which the “individual incentive is to shirk even though all employees may gain if all cooperate in working harder,” is mitigated in a cooperative agreement.

Companies with ESOPs are usually closely held corporations (meaning, with a relatively small amount of shareholders) and employees do not have “control rights.” This aspect of ESOPs stands in direct contrast with the German supervisory system, in which employees are given rights of control within the company, but profits are not shared directly among the employees. Thus, ESOPs and the German system represent two alternatives to employee ownership, one economic and one policy-based. In combination, these theories of corporate employee governance form an employee cooperative, in which employees are both management and have an ownership stake in the business.

vii. Employee Cooperatives

Employee cooperatives, on the other hand, are employee-owned firms that are democratic in nature and allow each employee a vote in all major decisions, including election of a board, as well as a portion of the profits. Employee cooperatives are thus a combination of the ESOP

---

132 Id. at 61-62. The “Prisoner’s Dilemma” is defined as such: “Where N is the number of employees: if rewards are shared equally, each individual has an incentive to shirk because each employee will share 1/N of the gains from any increased effort.” Id. at 61.
134 Id.
and German systems, as in the former employees are afforded rights to earnings only, and in the latter, only the ability to make strategic decisions.\textsuperscript{135} The structure may be depicted as follows:

\[
\begin{array}{c}
\text{Worker-Members} \\
\downarrow \\
\text{Board} \\
\downarrow \\
\text{Elected by Members} \\
\downarrow \\
\text{Manager (Optional)} \\
\downarrow \\
\text{Elected by the Members and Directed by the Board}
\end{array}
\]

Each worker is allocated a vote, thus the notion of “one worker, one vote” is created.\textsuperscript{136} In forming a cooperative, the owners are able to structure the company so that the employees vote for day-to-day decisions themselves, or more practically for a larger cooperative, the employees elect a board that makes such decisions.\textsuperscript{137} In blurring this distinction, the “well-being of member-workers is a distinct and categorical goal.”\textsuperscript{138} This structure puts them in the position of shareholder, rather than merely stakeholder.\textsuperscript{139} Ideologically, the cooperative structure is democratic in governance and thus minimizes, and arguably even eradicates completely, the incentive for labor disputes and collective bargaining tactics.\textsuperscript{140} Thus, the

\textsuperscript{135} Hansmann, \textit{supra} n. 87 (Hansmann also mentions the Scandinavian approach, which gives employees between one and three seats on an executive board).


\textsuperscript{138} John Pencavel, \textit{Worker Cooperatives and Democratic Governance}, IZA DP No. 6932, 9 (2012).

\textsuperscript{139} See Nobel, \textit{supra} n. 30.

\textsuperscript{140} See Hansmann, \textit{supra} n. 87.
friction that employers and employees face in a traditional corporation due to employees’ lack of control of profits and managerial decisions is replaced by a sharing of the costs and burden of management, as well as the profits. However, a disadvantage of employee ownership lies in the reliance on “book value.” The employee-owner’s investment is thus limited to the retained earnings and losses of the company, and the individual sacrifices any additional value, such as goodwill.

Moreover, Hansmann suggests that while difficult to measure, ownership may provide an incentive to worker productivity. John Pencavel, a Stanford economics professor, has studied the mathematic models associated with productivity in worker cooperatives. While the computations are beyond the scope of this Note, he concluded that, in a study of plywood cooperatives and traditional mills in the Pacific Northwest during a recession, the two types of mills responded differently. Traditional mills reacted to a drop in demand by reducing the size of their labor force and the hours worked. In contrast, the labor force of the cooperative firm remained relatively static, but the hourly wages were decreased. Thus, he concludes, “in response to shocks in its environment, the capitalist firm adjusts quantities—employment, hours, other inputs, and output—while the co-op adjusts earnings per worker.” The cooperative provides more stable employment than the traditional firm. More employee-cooperatives thus mean lower unemployment and more stability in the economy.

---

141 See Pitegoff, supra n. 91 at 249.
142 Id. at 248.
143 Id.
144 See Pencavel, supra n. 92; Linda D. Phillips, Worker Cooperatives: Their Time Has Arrived, 40 COLO. LAW. R. 33, 33 (2011).
145 Pencavel, supra n. 92, at 8.
146 Id.
147 Id.
148 Id at 9.
Along with the democratic structure, there are tax incentives as well that come along with employee cooperatives. There are two probable alternatives for firms considering cooperative status—conversion from a traditional structure to a cooperative one, or establishing a new cooperative firm. In the case of conversion, the tax structure provides the greatest incentive.\textsuperscript{149} While this will be explored in greater detail, the government treats eligible employee cooperatives favorably in the tax code.\textsuperscript{150} Phillips notes:

A cooperative tax structure is similar to that of a partnership, but there are specific federal statutes that prescribe how a cooperative should be taxed if it is going to call itself a cooperative. A cooperative can receive favorable tax treatment under Subchapter T of the Internal Revenue Code (Code) if the company is operating on a cooperative basis. In general, this section of the Code allows a company to decrease its taxable income by not taking into account or deducting amounts paid to members of the cooperative as patronage dividends.\textsuperscript{151}

In contrast to the more stringent tax regulation governing ESOPs, employee cooperatives will allow tax incentives similar to that of partnerships, while also limiting liability similarly to a corporation. While they pose their own organizational difficulties, cooperatives will ultimately be the more advantageous option for employees and former management.

\textsuperscript{149} Id.
\textsuperscript{150} See 26 U.S.C. §1042(c)(2) (2006). The section requires an employee cooperative to meet the following criteria to be eligible:

The term “eligible worker-owned cooperative” means any organization—
(A) to which part I of subchapter T applies,
(B) a majority of the membership of which is composed of employees of such organization,
(C) a majority of the voting stock of which is owned by members,
(D) a majority of the board of directors of which is elected by the members on the basis of 1 person 1 vote, and
(E) a majority of the allocated earnings and losses of which are allocated to members on the basis of—
(i) patronage,
(ii) capital contributions, or
(iii) some combination of clauses (i) and (ii).

\textsuperscript{151} Phillips, supra n. 96.
In contrast, a firm considering establishing a cooperative “from scratch,” should turn to state incorporation laws. In New York, the applicable provision is the Cooperative Corporations Law. The policy guiding the law is as follows: “It is the declared policy of this state, as one means of improving the economic welfare of its people, particularly those who are producers, marketers or consumers of food products, to encourage their effective organization in cooperative associations for the rendering of mutual help and service.”

Alabama, Maine, Massachusetts, and Washington also have statutes establishing the legal structure of employee cooperatives. Massachusetts, for example, provides that a corporation may elect to be governed as an employee cooperative by stating such in its by-laws. To revoke cooperative status, a vote of two-thirds of the member-owners is required. The Massachusetts statute also prevents passive investors from joining an employee cooperative. An owner of a cooperative thus must be a part time or full time worker in order to own stock in the company. The employee-owner, however, also retains all the rights and responsibilities of a corporation under the general corporation laws.

Thus, there is support on the governmental level for worker cooperatives. Along with tax incentives, the government has the ability to facilitate corporate changeovers from a traditional

152 See generally N.Y. Coop. Corp. L. §§1-134 (McKinney’s 2012).
155 Ch. 157A §3.
156 Ch. 157A §4.
157 Ch. 157A §6(a).
158 Ch. 157A §6(b)(“An employee cooperative shall issue a class of voting stock designated as “membership shares”. Each member shall own only one such membership share, and only members may own such shares.”).
structure to a cooperative structure. The Internet, however, represents the most promising opportunity for expansion of cooperatives.  

The Internet has also been the business of cooperatives as well. Cooperatives have formed to allow customers in rural areas to have better and cheaper access to the Internet, in large part due to awareness cultivated over the Internet. Utility cooperatives are among the various types of cooperatives found in the United States. Utility cooperatives such as these often arise in communities where the closest corporation providing service refused to do so because it would not be profitable to do so. These cooperatives chiefly provide broadband and satellite service where residents would ordinarily be cut off from such resources. The National Rural Utilities Cooperative Finance Corporation (NRUCFC) is one example. The NRUCFC is a lender to electric cooperatives around the country, lending over $20.2 billion. The NRUCFC is traded on the New York Stock Exchange and was recently rated a “stable” investment by Moody’s. An organization such as this allows utility cooperatives to form and to be self-sustaining.

Moreover, the Internet provides a resource for those interested in starting cooperatives to learn the structure of the cooperative and how to become a legal cooperative in their state. A concise and complete database is necessary, however, to fully enable citizens from all fifty states

---

160 See infra, pp. XX-XX.  
163 Overview, NATIONAL RURAL UTILITIES COOPERATIVE FINANCE CORPORATION, https://www.nrucfc.coop/content/cfc/about_cfc/overview.html (last visited March 27, 2013).  
to start cooperatives without hiring an attorney or other expert. The incorporation process must be boiled down from a complex process to a matter of a few forms, just as registering a partnership or corporation has been simplified. The University of California’s California Center for Cooperative Development has published a guide to establishing a cooperative, which comprehensively discusses the structure of the cooperative and compares it to other business structures as well.\(^{165}\) The guide also includes sample forms and bylaws.\(^{166}\)

Worker cooperatives also lend themselves to community development.\(^{167}\) Many longstanding cooperatives owe their success to close-knit communities surrounding their work-life, in part because they are geographically isolated.\(^{168}\) While worker cooperatives may not have an immediate or dynamic effect on the development of the surrounding community, Pitegoff proposes,

> With a narrow frame, however, worker ownership can play a role in community economic development. The best practices in this regard combine cooperative enterprise with multifaceted strategies for building community resources and power. Many such efforts are not dependent upon the tax provisions that benefit ESOPs or worker cooperatives. Tax breaks come and go, but the underlying motivation and utility of placing worker ownership in the context of community development strategies is not a question of tax planning.\(^{169}\)

Thus, while governments may provide a monetary incentive for the creation of employee cooperatives in lieu of the complete dissolution of a company, the benefits go beyond economic

---


\(^{166}\) Id.


\(^{168}\) For instance, plywood and agricultural cooperatives, notoriously successful cooperatives, tend to be relatively secluded and away from urban areas.

\(^{169}\) Pitegoff, supra n. 107 at 250.
and tax breaks. For instance, KDHP, formed by the Indian conglomerate the Tata Group, has shown how employee cooperatives can provide invaluable resources for community development.

**CASE STUDY: KDHP CORPORATION, FORMERLY A SUBSIDIARY OF THE TATA GROUP**

Employee cooperatives have many characteristics of CSR-centered, profit-conscious companies, such as B Corps, as well as the infrastructure of a corporation providing financial stability to its owners. In looking at a case study of an employee cooperative carved out of a traditional corporation, it is apparent that the cooperative supports community interests and engages former “wage earning” employees in awareness of the success of the company as a whole, because they now share in the profits. In the United States, with relatively advanced education, this prospect seems entirely within reach. In a country where these resources are more difficult to obtain, especially in rural areas, a cooperative will lead to an improvement in financial independence and education where it is needed most.

For instance, despite political and economic hurdles in India, where it is headquartered, the Tata Group has accomplished a significant feat in establishing a cooperative for the employees of a subsidiary it planned to sell. In the course of divesting itself of the Tetley Tea Company, which the company acquired for $450 million in 2000, the Tata Group gave workers who opted for a voluntary retirement package the chance to become business owners. Rather than sell the plantations to rich landowners in the area, the company sold 17 of the 25 of the plots

---

170 See supra.

171 See INDIA, COUNTRY REPORT, PRS GROUP, 9 (JUNE 2011). According to this report on India’s business climate, India is ranked 9th among nations in a survey asking the respondents if they accepted a bribe in the last 12 months. 54% of the respondents reported accepted a bribe in the last year. Reportedly, corruption has occurred in land development projects, construction contracts, and telecom licensing.
to former employees of the company.\textsuperscript{172} The cooperative would ultimately be named the Kenan Devan Hills Plantation Company (KDHP).\textsuperscript{173}

The Tata Group has affirmed its commitment to equal opportunity employment, affirmative action, and community development. In its publication, the Tata Review, an article called “Social Kind of Justice” discusses its dedication to affirmative action within the context of Indian culture: “The Tata group’s affirmative action agenda is aimed at doing its bit to correct the discrimination blight as it applies to India, and that means the caste factor.”\textsuperscript{174} The initiative crafted is the 4E’s: education, employability, employment, and entrepreneurship.\textsuperscript{175} Sixty six percent of the Group’s holding company, Tata Sons, is held in trust by philanthropic organizations, thus securing its commitment to philanthropy.\textsuperscript{176}

KDHP’s mission is to benefit the “enterprise, the employees, and the community,” and to “give employees a better understanding of their role and importance in the working of the company.”\textsuperscript{177} It is evident that KDHP employees live in close proximity to the plantations and have developed a sort of microcosmic society that lends itself to cooperation. Thus, KDHP

\textsuperscript{173} Id.
\textsuperscript{175} Id.
\textsuperscript{177} KANAN DEVAN HILLS PLANTATION “MANAGEMENT STRUCTURE,” http://www.kdhptea.com/ManagementStructure.html (last visited Sep. 14, 2012). The management structure as a whole states, “To constantly improve productivity and quality in every activity of the company for the overall benefit of the enterprise, the employees and the community; To give employees a better understanding of their role and importance in the working of the company; To involve all levels of employees in the decision making process whereby a sense of ownership is fostered and To satisfy their urge for self-expression.” Id.
credits itself for its cooperative structure, and considers itself a “unique success story.”\textsuperscript{178} KDHP has indeed achieved success, employing over 12,000 people (most of whom are shareholders as well) and becoming the largest tea company in South India. The company has also revitalized the area, providing education and community outreach.\textsuperscript{179} These goals are similar to those of socially responsible corporations, such as benefit corporations and B-Corps.

For instance, building on the Tata Group’s tradition of philanthropy, KDHP emphasizes community outreach, education, and other initiatives for the benefit of its employees.\textsuperscript{180} KDHP provides free education through high school for the children of all employees, and actively recruits them when they graduate, ensuring continual employment in the region.\textsuperscript{181} The cooperative also provides free, comprehensive healthcare to its employees and their families, including health and hygiene education.\textsuperscript{182} Thus, the cooperative strives for well-rounded employees, including hosting social activities and sporting events, in addition to the basic care that most traditional companies provide (i.e., healthcare).\textsuperscript{183}

It is evident that KDHP is a successful cooperative that has helped its community develop and thrive as well. These attributes are embedded in the cooperative’s philosophy. Since the employees live and work in such a tight-knit community, there is a sense of interdependence, leading the employee-owners to independence from welfare and poverty. Since the advent of the recession, millions have lost their jobs because corporations have failed. While cooperatives are not “recession-proof,” having a group of owners who have not only labored, but also own, what

\begin{itemize}
\item \textsuperscript{178} \textit{Id.}; \textsc{Kanan Devan Hills Plantation “Uniqueness,”} \url{http://www.kdhptea.com/Uniqueness.html} (last visited Sep. 14, 2012).
\item \textsuperscript{179} \textit{Company Profile}, KDHP, \url{http://www.kdhptea.com/CompanyProfile.html} (last visited September 21, 2012).
\item \textsuperscript{180} Corporate Social Responsibility, KDHP, \url{http://www.kdhptea.com/Welfare.html} (last visited Nov. 18, 2012).
\item \textsuperscript{181} \textit{Id.}
\item \textsuperscript{182} \textit{Id.}
\item \textsuperscript{183} \textit{Id.}
\end{itemize}
they have produced, ensures that care will be taken in making any drastic changes to the business plan.

KDHP as a cooperative has also been successful in establishing initiatives that lead to members’ self-improvement and an overall improvement in healthcare and community resources. KDHP has shown the progress an employee cooperative can make in supporting stakeholders—the environment, the employees themselves, and the families of employees. Through the Tata Group’s commitment to stakeholders and community development, KDHP has inherited a legacy of helping the community. In part, no doubt, due to management by the Tata Group when KDHP was initially formed, KDHP has continued their tradition and has made admirable strides in the community.

Fostering Sense of Community Through Digital Media

The number of Internet users all over the world is increasing each year.\textsuperscript{184} The world has reached a point where technology truly knows no bounds, and people are increasingly connected, forming communities over the Internet with at times, even stronger bonds than in person. With this phenomenon, there is a unique opportunity for employee cooperatives to form

While some may argue that face-to-face communication is necessary to form the requisite connection to transact business, but consider the fact that people not only enter into business dealings over the Internet daily, but also form friendships and even romantic relationships through computer screens. Digital cooperatives are even less committal. The geographical obstacle is resolved, and all that is required is a group of employees with similar skills and interests. While many of the benefits that KDHP provides its employees and their families may be impossible (such as get-togethers, free healthcare, and social programs) due to logistic impediments, many activities are still possible, and even enhanced, with the proper technology. For instance, online education has made many strides in recent years. Workshops that advance employee-owners’ management skills may be offered online with an interactive

---

**Individuals using the Internet per 100 inhabitants, 2011**

*Commonwealth of Independent States*  
Regions are based on the ITU BDT Regions, see: http://www.itu.int/ITU-D/ict/definitions/regions/index.html
component so as to encourage the development of those skills as well as working relationships between the employee-owners.  

Furthermore, a digital environment allows for industries that traditionally are structured as corporations or office-based businesses to convert to a cooperative structure. Whereas cooperatives are typically most successful in agricultural pursuits in secluded areas, the internet allows for the possibility of expansion. Today, a community may be formed over waves of sound and light, and the bond between owners is strengthened through emails and video conferencing. Thus, an employee cooperative may form over the Internet and through traditional means.

CONCLUSION

Thus, employee cooperatives offer an opportunity for workers to participate not only in the profits, but also in community development throughout the world. Employee cooperatives support the interests of stakeholders and promote community interests, such as health care and education. As opposed to the traditional corporation that emphasizes shareholder primacy, employee cooperatives incorporate the philosophy of “benefit” or B-Corporations, tailoring business not only to the employee and other stakeholders, but also to a new kind of socially responsible shareholder. KDHP represents an example of an employee cooperative that originated from a socially responsible “parent” company, which strengthened its roots in building a community around the company. Employee cooperatives are rooted in such

---

commitment to the community. Unlike other forms of corporate governance such as the traditional (unionized) corporation, the LLC and partnership forms, the ESOP and the German system, the employee cooperative combines the interests of owner and worker. It lessens the risk of bribery and corruption within a company because of its democratic structure. With the Internet expanding across the world and shortening the distance between people living around the world from one another, there are renewed possibilities of starting a cooperative in more industries than ever before.