

February 8, 2006 – Testimony on “The Responsible Business Corporations Act” HB 3118

Honorable Committee Members:

I. Introduction – Who is testifying?

I am Deborah Groban Olson, a Detroit attorney. At the request Rep. Marcus Oshiro, I provided a “Stakeholder Governance Corporation Act” model (SGCA) proposal that could be incorporated into and substitute for parts of HB 3118, the “Responsible Business Corporation Act” (HRBCA). I now welcome the opportunity **to testify in favor of HB 3118 and suggest replacing Sections 1, 2 and parts of Section 6 with the SGCA language and consider revising the tax benefits in Section 10.**

Since 1981 I have specialized in creating and representing employee owned companies and labor unions faced with business restructuring issues, including sales of assets and plant closings. (See www.esoplaw.com.) I’ve worked as a consultant for state and regional economic development agencies on employee ownership feasibility studies.

I am also the executive director of the Capital Ownership Group (COG) (www.capitalownership.org). COG is an international network of professionals, academics and activists operating an on-line conference center, think tank and library from Kent State University’s Ohio Employee Ownership Center. Its aim is to abate the negative effects of globalization through broad-based ownership.¹

II. Why globalization makes it important for Hawaii to create a new type of company?

States and communities need new responses to problems created by the globalization of business. People are much less mobile than capital.

One of the COG network’s strategic objectives, determined in 2002 by its participants from developing and developed countries, was to develop and popularize the Fair Exchange (FE) concept. FE is a promising strategy for minimizing the effects of globalization on communities. FE encourages governments, employees and communities to utilize standard business investment principles in their dealings with businesses, particularly when providing subsidies or concessions. HRBCA and SGCA are efforts to provide pro-active means for non-money

¹ COG has 20 working groups with over 600 participants from 6 continents and has responded to over 6.8 million information requests from people in 173 countries through a web-site navigable in English, Spanish, Russian, and Chinese. The organization has sponsored several international conferences and, since 1999, has been funded by such foundations as the Ford Foundation, the German Marshall Fund of the U.S., the Alfred P. Sloan Foundation, the European Union Fund, Corporation for Enterprise Development, the Carey Center for Democratic Capitalism and the MLG Foundation.

investor stakeholders to help shape the company's direction in ways beneficial to the community.

States charter companies to provide incentives for private parties to join together to create wealth. States provide limited liability, perpetual existence, access to courts, and enforcement of contracts. States and local communities provide companies a variety of infrastructure services, and often job training, tax abatements, etc. Creation of businesses can be very beneficial for communities. But, a key problem underlying this assumption, my COG work and my labor/employee ownership practice, is that global corporations now exist outside the jurisdiction of any single government body. Their strategies, needs and loyalties are based on global competition and not loyalty to the communities where they do business. With their mobile capital, they can and do, get myriad assistance from all levels of government based on the dual claims that: 1) providing such benefits will bring jobs and economic growth; and 2) if our community does not provide such subsidies, a rival one will. Yet many company-promised benefits are not fulfilled.

Governments need new strategies and tools to contend with the community impact caused by the downward spiral of wages, benefits, safety and environmental rules (race to the bottom) created by highly mobile capital.

Like employee ownership, Fair Exchange, Capital Stewardship, or creation of a national pension and health insurance system, the Hawaii Responsible Business Corporations Act or Stakeholder Governance Act is such a strategy. Governments, unions and workers need to use these and other new tools to protect the Hawaiian and U.S. standard of living. Otherwise, that standard of living will be pulled down to a global lowest common denominator.

Both HRBCA and SGCA provide benefits to companies that agree to open their decision making process to stakeholders such as employees and the community, so that the needs of these constituencies, as well as those of investors will be considered.

Companies can incorporate in any state or country they choose, and can usually get permission to do business anywhere else. No state yet has the bargaining power to create many new requirements of all companies in its jurisdiction, without losing them. So, if Hawaii wishes to attract companies with an HRBCA or an SGCA law, that law must: 1) provide attractive incentives and benefits; 2) not decrease company efficiency; 3) easily accommodate different types of businesses; and 4) avoid language that unnecessarily makes businesspeople feel defensive. Below I shall analyze HRBCA and the proposed SGCA law based on these criteria and suggests ways to combine them.

II. Analysis of HRBCA and SGCA based on the above criteria

a. What's in a name? *Consider changing Section 1 of the HRBCA to the SGCA or something else.*

“Responsible Business Corporation Act” as a name implies that those not taking this designation are irresponsible. Business organizations and their friends may object to the entire bill because they cannot get past the name. By contrast “ Stakeholder Governance

Corporation” is a sufficiently different sounding creature that it will not get that reaction. I base this on my experience with employee owned companies and how the general public, the business world and the press perceive them. Any company can choose to become employee owned, whether it is a small percentage of ownership or 100%. That some companies are employee-owned is not an inherent criticism of other forms of ownership, in the same way that a C corporation, an S corporation, a cooperative, a partnership or a limited liability company do not inherently criticize each other. They simply serve differently groups with different needs or philosophies. Employee ownership took off in the U.S. after employee stock ownership plans (ESOPs) began providing companies, lenders and sellers with significant tax benefits in the 1970’s and thereafter. Many business owners were initially suspicious that employee ownership would cause chaos. Others were tempted to try ESOPs because of the tax benefits. Once there were many examples of very successful employee owned companies, ESOPs became popular in the business world for both their tax benefits and their methods of increasing profits and productivity. (For statistics on this see <http://www.nceo.org/library/corpperf.html>).

A “Stakeholder Governance Corporation” will be viewed more like a limited liability company, as a business entity option among many others. However, if stakeholder involvement makes these companies more efficient or competitive, others will take notice and choose this corporate form.

b. Creating a new law that allows companies to experiment with stakeholder governance on their own terms – and rewards concrete positive behavior

The HRBCA broadens the definition of corporate interests to require that corporate directors consider long as well as short term best interests of the corporation, its shareholders, employees, customers, suppliers, creditors, and the public interest, but limits liability of directors if they act in good faith on these interests. It requires the company board to give various stakeholder groups regular advisory opportunities. It requires the corporate board to contain 20% employee representatives and 20% representatives of the public interest. It protects the company from hostile takeovers, gives them an SRC designation they may advertise and exempts them from Hawaii business income taxes. It requires a voice from non-financial stakeholders but no financial participation. It has many good features, but it does not fundamentally give non-financial stakeholders an economic stake.

The HRBCA’s Sections 3, 4, 5, 6(a), (f) and (g), 7, 8 and 9(a) and (c) on the duties, education of, and liability protection for company directors, and the forum for stakeholder input, should be included in any SGCA law adopted. Its Sections 10 and 11 could be used instead of the incentives suggested in the SGCA proposal. However, the HRBCA tax break is not tied as directly to specific behaviors as are the benefits under SGCA. So under SGCA companies that provide more social benefits get more rewards.

The SGCA proposal approaches changing corporate behavior differently than HRBCA. SGCA is tied more fundamentally to the creation and allocation of wealth created by all the parties. It is based the employee ownership community’s experience in building acceptance of employee ownership. SGCA provides more flexibility and options for companies. It provides companies a sliding scale of obligations and corresponding benefits proportional to the amount and type of benefits the company provides to stakeholders beyond their financial investors. So that, as with many employee owned companies, the owners can test the waters with a toe before they plunge in. But, once they plunge in, they get substantial benefits and are subject to account for their

right to retain those benefits. Early adopters will have a grace period in which they will get the tax benefits while they organize as an SG company.

As an employee ownership attorney I am skeptical that a minority voice without a material stake, such as that provided by the HRBCA Sections 6(b- e), will be taken as seriously by all parties as one involving sharing of economic benefit and loss. In an SG company, the parties create a Declaration of Stake Allocation (DSA), which requires them to quantify the investment being made by employees and the local community. It then provides for allocation of stock and governance in proportion to those investments. The relative value of inputs of capital, labor and infrastructure may vary over time and be adjusted accordingly through the DSA process.

In an SG company, entrepreneurs are not asked to place on their board a representative of an environmental group. Instead the specific benefits the company provides to the biosphere (by creating green buildings and amassing or selling CO2 credits) are rewarded with tax credits or deductions. It provides unemployment compensation and workers' compensation tax credits to companies that provide representatives of their hourly or union employees at least 1/3 of the board seats. It allows companies to pay part of their taxes in stock if both the company and the taxing authority agree.

The attached SGCA proposal provides several legislative options that could be included in the HRBCA or as an alternative. (Specific proposals are attached hereto.) They are:

- 1) A law permitting any company to have “**Community Fiduciary Rules**”: permits a company to create a board of directors comprised of stakeholder representatives who may be chosen by, and owe primary responsibility to, specific constituencies in addition to the stockholders. It permits its corporate charter to provide that directors are acting as proper corporate fiduciaries when they consider the impact of corporate decisions on employees, communities and the environment as well as shareholders. It provides that fiduciary liability is owed to the specific named constituencies as well as to the shareholders generally, but is not expanded to other unnamed claimants, beyond the reach of current corporate law. This would allow companies to adopt HRBCA Sections 4,5,7,8 and 9. This model need not receive any special financial incentives from the State, but could protect against hostile takeovers.
- 2) A law creating a **Stakeholder Governance (SG) Company**: defines stakeholders; enumerates their rights to participate in an SG Company; provides a method for the State to determine if such standards are being met; and provides economic benefits to companies that meet these standards. An SG Company should be allowed to utilize the C, S or LLC corporate formats if it can do so and also meet the SG requirements. This would incorporate HRBCA Sections 3,4,5,7,8 and 9. But it would change the Section 2 definition of “Stakeholders” to Section A in the Attachment to this testimony and would change Section 6 to include the language in Sections B-F of the Attachment to this testimony.
- 3) A law creating a **Shared Ownership (SO) Company**: that may receive 15% of the tax incentives provided to a full SG Company if at least 30% of its highest class of voting and dividend paying stock is owned by Qualified SG stakeholders. An SO company could get (on a sliding scale) up to 50% of the SG Company tax benefits if it became 100% owned by Qualified SG Stakeholders. Unlike an SG company, and SO company

need not have all the stakeholder governance provisions, it is simply sharing ownership with Qualified SG stakeholders. So, for example, a company with a 30% ESOP could meet these requirements without creating an SG governance structure.

- 4) The SGCA proposal calls for an SG Review Board to approve SG status (or give the company a specific list of compliance requirements if not initially approved) to ensure fairness and that tax benefits go to companies that comply with the law's intent.

Thank you very much,

Deborah Groban Olson

**Attachment to Testimony of Deborah Olson on the
Hawaii Responsible Business Corporations Act**

Outline of Stakeholder Governance Company Act (“SGC Act”)

A. SG Company Stakeholders Defined:

Stakeholders are those who contribute to the wealth created by a business, including those who merely absorb costs involved in creating that wealth. They are defined as:

- 1) Capital investors
- 2) Employees and contractors who generate/ enable products, services or sales and all types of business skill (entrepreneurs, marketing, sales and management). Employee stakeholderhood may not be weighted in favor of “highly compensated employees” (HCEs). *The HCE provision could fashion rules based on ERISA’s penalties for plans that provide excessive benefits to highly compensated employees.*
- 3) Intellectual capital & innovation providers
- 4) Infrastructure providers and representatives of the effluent neighborhood (facility site local governments)
- 5) Biosphere – environmental impact beyond immediate effluent neighborhood

B. SG Corporate Structure and Charter

- 1) The various stakeholder interests in an SG Company generally coincide, but when they conflict, an SG Company provides means to efficiently govern the enterprise and work out these issues. This legislation allows a range of corporate governance structures to accommodate different businesses and definitions of constituencies within its framework.
- 2) An SG Company shall have a board of directors including representatives of its stakeholder constituencies selected by those constituencies through a democratic process wherever practical. The SG Review Board shall provide model bylaws outlining such democratic processes, but will accept any other company created selection process they deem to serve the purposes of the SG Act.
- 3) SG stakeholder constituencies *shall include* at least providers of:
 - i. Capital (financial, real estate and intellectual);
 - ii. Labor (skilled and unskilled);
 - iii. Community infrastructure and receipt of effluent.

- 4) An SG Company may configure the above-mentioned constituencies to provide more precise stakeholder representation (such as separate representatives for union and management employees or financial and intellectual property investors, etc.) Where a single person resides in more than one constituency s/he may have a voice in each relevant constituency.
- 5) SG stakeholder constituencies *may include* other constituencies provided these are so determined by the Board of Directors and approved by the SG Review Board (*described below in section C.*)
- 6) An SG Company's Charter shall provide stakeholder representation on its board of directors and allocate its stock based on its **Declaration of Stake Allocation (DSA)**. Its DSA shall describe the basis on which it determines the proportion of stock and governance allocated to each designated constituency. A DSA should allocate stock and governance based on a projection of the amount of company wealth attributable to each constituency; and should provide a basis for recalibrating DSA as the respective impacts of each constituency on the company's wealth changes over time. The SG Review Board shall provide model DSA language. But an SG Company shall be permitted to provide its own DSA, provide it complies with the intent of the SG Act as determined by the SG Review Board.
- 7) The impact of any business on the biosphere, beyond its immediate environs, is very difficult to measure. Therefore, the biosphere's interests are represented in this law by means of environmental tax incentives rather than specific board representation.
- 8) Obtaining an SG Charter
 - i. In order to enable experimentation with SG structures, any SG Company chartered before December 31, 2010, (hereinafter referred to as an "Early SG") shall have the following privileges during that period:
 - ii. Upon filing an application for an SG corporate charter, an Early SG may begin to operate as a normal business and shall have a one-year grace period to organize its stakeholder board and fulfill its other SG requirements, and shall be eligible during that year for all SG Company Tax Incentives.
 - iii. At the end of its first year of operation, an Early SG shall file a special SG Annual Report with the SG Review Board. Said SG Annual Report shall outline the stakeholder governance and structure and share allocation adopted in its DSA and any other special SG required disclosures.
 - iv. The SG Review Board shall decide whether the Early SG Company complies with the intent of the SG Act and is thus eligible to continue receiving SG tax benefits. If the Board finds any deficiencies, it shall provide the company a specific list of compliance requirements that, if fulfilled within 60 days, will entitle it to retain SG status.
 - v. Once a company has received its initial SG status compliance approval from the SG Review Board, it shall file regular corporate annual reports. However, every 5 years it shall file a special SG annual report and have its SG status re-examined by the SG Review Board. An SG Company that has obtained compliance approval from the SG Review Board shall be called a "Qualified SG Company." In addition, during the non-SG Review years, any qualified Stakeholder, may petition for a special SG Review Board examination of the Company's SG compliance.
- 9) Board members elected by stakeholder constituencies have a fiduciary duty to serve the best interest of the corporation and all its stakeholders to the extent that it does not contravene the best interests of their constituency. They must use their best efforts to run

the corporation to serve the best interests of all the stakeholder constituencies, but shall hold the interest of their stakeholder constituency as their primary responsibility. *(The HRBCA fiduciary standards should be included in the SGC Act. Particularly Sections 5, 6(a), (f), (g) and 7 - 9.)*

C. Appointment and Powers of SG Review Board

The Speaker of the House, the President of the Senate and the Governor shall each nominate one member of the SG Review Board who must also be approved with the advice and consent of the Hawaii Senate, to serve for a 5 –year term. The SG Review Board shall interpret the SG Act and oversee the SG Company qualification process, creating the necessary forms, rules and procedures to enable and ensure true stakeholder representation and ownership in companies that receive Qualified SG status. In any instance in which SG status is denied, the Board shall provide a written statement of actions the company must take to obtain SG status. The SG Review Board will be staffed by the Hawaii Department of Taxation. *(I can provide examples of potential DSA guidelines and democratic stakeholder constituency election processes upon request.)*

D. SG Corporate Tax Incentives –

One hundred percent (100%) of the following tax incentives shall be available at to any Qualified SG Company or Early SG Company. A Qualified SO Company may obtain (on a sliding scale based on ownership percentage) up to 50% of these benefits.

(Sections 10 and 11 of HRBCA could be substituted here instead of the specific benefits mentioned below, but it would be a less precise tool. The specific percentages in the sections below are examples and not based on any financial impact analysis. The legislature might want to start out a bit less generous and increase the benefits upon analysis of actual experience.)

- 1) CO2 Credits – any profits made by an SG Company that sells CO2 credits shall not be subject to any Hawaii taxes, including but not limited to corporate income tax.
- 2) Any SG Company that builds, or leases a LEED certified structure, shall pay no more than 50% of the assessed real estate taxes on that structure and the real estate on which it stands, to any government body in the State of Hawaii.
- 3) Any SG Company that includes on its board of directors at least one representative from a jurisdiction in which it has a business facility, shall pay no more than 50% of the assessed real estate taxes for any real estate owned or leased in that jurisdiction.
- 4) Any SG Company that provides for at least 1/3 of the seats on its board of directors to be filled by non-HCE employee-elected or collective bargaining unit elected representatives; shall pay no more than 75% of the unemployment compensation taxes normally assessed a similarly situated non-SG business and no more than 85% of its normally assessed worker’s compensation taxes.
- 5) An SG Company may, **with the consent of any jurisdiction** in Hawaii, pay up to 25% of its taxes to that jurisdiction in SG Company securities, provided that there is an independent valuation of those securities meeting the standards of IRS Rev. Proc. 59-60 and the ERISA definition of “adequate consideration”.
- 6) An SG Company that: a) makes a physical product and b) demonstrates to the satisfaction of the Hawaii EPA that it takes full responsibility for its products’ life-cycle by reclaiming to nature its post consumer waste; c) is eligible for a tax credit against its Hawaii income taxes. The tax credit is equal to 50% of the reclamation cost certified by the Hawaii EPA.

E. SG Company Special Contractor Status

Qualified SG Companies shall receive preference in bidding on government contracts in Hawaii, as SG Companies are determined to be as Hawaii Community Investors.

F. Qualified SG Company Stakeholder Rights

- 1) SG Company Stakeholders have the right to vote on all shareholder issues, including voting for the board of directors (although voting on some of these director seats may be limited to specific stakeholder constituencies).
- 2) Voting of SG or SO stock shall be on the basis of (a) one participant, one vote or (b) one share, one vote.
- 3) SG or SO company stock appraisals are made available to SG constituents upon request for copying cost.