

ISSN 1936-5349 (print)  
ISSN 1936-5357 (online)

# HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

## TOWARD FAIR AND SUSTAINABLE CAPITALISM

*A COMPREHENSIVE PROPOSAL TO HELP AMERICAN WORKERS, RESTORE FAIR GAINSHARING BETWEEN EMPLOYEES AND SHAREHOLDERS, AND INCREASE AMERICAN COMPETITIVENESS BY REORIENTING OUR CORPORATE GOVERNANCE SYSTEM TOWARD SUSTAINABLE LONG-TERM GROWTH AND ENCOURAGING INVESTMENTS IN AMERICA'S FUTURE*

Leo E. Strine, Jr.

Discussion Paper No. 1018

09/2019

Harvard Law School  
Cambridge, MA 02138

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This paper is also Discussion Paper 2019-11 of the  
Harvard Law School Program on Corporate Governance

## **Toward Fair and Sustainable Capitalism**

*A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing Between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future*

**By**

**Leo E. Strine, Jr.\***

**A New Deal For This New Century:  
Making Our Economy Work For All**

**October 3-4, 2019**

**New York University's  
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\* Chief Justice, Delaware Supreme Court; Adjunct Professor of Law, University of Pennsylvania Law School; Austin Wakeman Scott Lecturer in Law, Harvard Law School; Senior Fellow, Harvard Program on Corporate Governance; and Henry Crown Fellow, Aspen Institute.

The author is grateful to Kirby Smith and Reilly Steel for their excellent research and thoughts. This proposal would not have been possible to prepare without their diligence. Thank you also to Christine Balaguer and Margaret Pfeiffer for their excellent help, and to David Berger, Jill Fisch, David Katz, Ted Mirvis, Damon Silvers and Antonio Weiss for helpful discussions and comments that influenced the Proposal. All errors are on my own.

## **Fair and Sustainable Capitalism Proposal**

The incentive system for the governance of American corporations has failed in recent decades to adequately encourage long-term investment, sustainable business practices, and most importantly, fair gainsharing between shareholders and workers. That should not be so. This state of affairs exists in no small part because we have made public companies more and more responsive to the desires of the stock market, as represented by institutional investors with a demand for immediate returns. This has resulted in declines in gainsharing of corporate profits with workers, a large increase in stock buybacks, skyrocketing CEO pay, and growing inequality.

When looking for the causes of growing inequality and a corporate governance system that does not work for all, the usual subjects of criticism are the CEOs and boards of large companies, but very little is said about those who wield over 75% of shareholder voting power: institutional investors. Most stock today is owned not by mom-and-pop investors who directly hold stock in individual companies, but by institutional investors who control human investors' capital. The majority of middle-class Americans fortunate enough to be invested in the stock market are in a real way forced capitalists. These worker-investors must save for retirement through 401(k) and other tax-advantaged investments that require workers to turn over a portion of every paycheck to a family of mutual funds chosen by their employer. The institutional investors, not these worker-investors, get to vote the public company stock that mutual funds buy with human investors' capital.

Corporations will not give more thoughtful consideration to their employees and social responsibility—that is, our corporate governance system and economy will not change—unless the institutional investors who elect corporate boards also support doing so. Institutional investors have the most influence on corporations, and the imbalance in our corporate governance system can be fixed only by aligning institutional investors' incentives with the interests of their end investors: human beings saving for retirement and their children's college education. Even more important, human beings who most of all need American corporations to pay good wages and create good jobs.

The investment horizon of the ultimate source of most companies' funding—human beings saving for retirement and education—is long. That long-term horizon is much more aligned with what it takes to run a real business than the horizon of companies' direct shareholders, who are money managers under strong pressure to deliver immediate returns at all times. As diversified investors whose holdings track the overall economy, human investors do not benefit when companies offload the costs of their activities, such as carbon emissions and other pollution, onto others. And as human beings who breathe air, consume products, and depend on a good job for most of their income, human investors suffer as citizens when companies take shortcuts that harm the environment, defraud or injure consumers, or offshore jobs to countries with low wages and few worker protections.

Human investors owe most of their wealth to their job. This is true not only for the poorer half of Americans; [it is true of 99% of Americans](#). On average, Americans get 64% of their income from wages and another 15% from either retirement payments or other transfer payments. For the middle and upper-middle class, jobs are even more important, with wages comprising 70% or more of income. But the importance of work does not stop there. Those in the 80th to 90th percentiles get 75% of their income from working, and those in the 95th to 99th percentiles still get over 60% from their labor. As a result, human investors need companies to do business in a way that provides Americans with access to good jobs, sustainable wage growth, and a fair share of the wealth that businesses generate.

In short, human investors benefit from sustainable, long-term economic growth and gainsharing between shareholders and workers, but companies have increasingly failed to deliver on that promise. For about two and a half decades starting in the late 1940s, workers and investors shared in the wealth generated by a strong, growing economy. In the early 1970s, accelerating in the 1980s, and continuing since, [that social compact has frayed](#). Since then, worker productivity has risen by about 70%, but hourly pay has grown by only 12%. Meanwhile, corporate profits have hit [record highs](#). In other words, American workers are more educated than ever, more skilled, and doing more to create corporate profits than ever, but they have shared far less in the fruits of that labor.

To help redress this problem, workers must be given more voice within the corporate boardroom, and top managers and directors must give greater thought to how they treat their employees. Companies should have board-level committees that ensure quality wages and fair worker treatment. Labor law reforms should make it easier for employees to join a union and bargain over wages. Likewise, to hold companies accountable for how they treat their workers, how they treat their consumers, and whether they operate in an ethical, sustainable, environmentally responsible manner, the public and investors deserve better information from companies about their performance on these critical dimensions.

In addressing the decline in fair gainsharing with workers, we also cannot ignore the role of institutional investors in pushing for immediate returns and the poor incentives that pressure put on companies to take shortcuts that offload companies' costs onto others, harm consumers, and undercut Americans' access to quality jobs. In no small part because of retirement policy decisions by U.S. lawmakers, institutional investors have come to [dominate the governance](#) of large U.S. corporations. In the mid-20th century, individuals [held](#) the vast majority of U.S. public companies' stock; today, institutional investors own about [78%](#). And an increasingly small number of those institutional investors, which commentators have referred to as the "[Big Three](#)" or "[Big Four](#)," are especially dominant. These institutional investors effectively dictate U.S. corporate policy by voting in corporate elections and on management and shareholder proposals at annual meetings. Institutional investors elect companies' boards of directors. Institutional investors vote on whether to sell the company, back activist proposals, and support company executives' compensation levels. The power they exercise cannot be ignored as a factor in producing the decline in

fair gainsharing between workers and corporate shareholders. Ultimately, operating companies will not act in a more responsible manner unless the institutional investors who control them support them in doing so.

To ensure that operating companies act more responsibly toward their workers and other stakeholders, the institutional investors who are responsible for managing most human investors' money must vote with their investors' needs in mind. And for index funds especially, they should have to tailor their voting policies and recommendations to the fact that they cannot sell their shares and are invested for the long haul. To be fair, some institutional investors have started to consider environmental, social, and governance, or "ESG," factors. But if we want companies to operate in a socially responsible manner that creates sustainable profits, then all institutional investors who manage human investors' money need to factor EESG considerations into their investing and voting decisions, and emphasize the vital missing "E"—the interests of companies' employees. That is, institutional investors must align their voting policies with the interests of their worker-investors who need not just sustainable corporate profits, but also good jobs, clean air, and safe products.

If companies are spending too much on stock buybacks, taking environmental shortcuts, or failing to adequately compensate and invest in their workforce, that is likely because their stockholders—i.e., institutional investors—have exerted pressures on companies that encouraged this state of affairs. If the goal is to increase the gainsharing among corporations and their other stakeholders—workers, consumers, and society—that can be achieved only through aligning those doing the voting—institutional investors—with the interests of the flesh and blood human beings whose money the institutional investors manage and control. Creating this alignment is achievable, and can be done through modest changes to current laws and regulations that govern institutional investors.

Other complementary measures would also help to align incentives and promote sustainable, long-term economic growth that benefits all. To start, we must consider tax and accounting policy. That is, we must recognize the role of tax and accounting rules in creating incentives that encourage speculation and rapid portfolio turnover, rather than productive, sound long-term investing. As important, our nation has long-term economic challenges that must be addressed by public investment and incentives that can be implemented only if we have the funds to pay for them. Most notably, we have a huge infrastructure and basic research gap that is eroding our competitiveness and diminishing our quality of life. We also cannot be blind to the reality that we need to supercharge our efforts to address climate change and to set an example for the world. With real investments in basic research, cleaner, more efficient infrastructure, and worker training, we can create jobs in the United States, tackle climate change, help workers in carbon-intensive industries transition to jobs in emerging clean energy companies, spark innovation, and enhance the long-term international competitiveness of American companies. At the same time, by implementing good tax policy that addresses behavior

we want to have less of, we can use the savings to finance these investments in the future that create good jobs that cannot be sent overseas.

Finally, we must address legal changes that have given corporate elites an unfair advantage over working Americans and human investors, including Supreme Court and regulatory decisions that have undercut the effectiveness of labor unions, deprived Americans of their day in court and fueled a massive growth in unchecked corporate political spending.

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The bottom line is that America's corporations are not playthings. They create jobs, produce goods and services that consumers depend on, affect the environment we live in, and build wealth for human investors to save for retirement and their kids' education. That is, corporations are societally chartered institutions of enormous importance and value. Those who govern them ought to be accountable for the generation of durable wealth for workers, consumers, and human investors. A new accountability system that supports wealth creation within a system of enlightened capitalism—one that aligns the interests of institutional investors and corporations with those of the human beings whose capital they control—is needed. With some modest sacrifice by every interest that wields economic power, we can make our economy work better for all Americans. This Proposal to promote Fair and Sustainable Capitalism would take several steps to make that goal a reality.

**Enhancing Disclosure for Operating Companies on Employee, Environmental, Social, and Governance Matters to Promote Sustainable, Long-Term Growth and Gainsharing with Workers**

Reforming our corporate governance system starts with the operating companies that make products and create jobs. If companies do not focus on making sustainable profits by selling useful products and services, and treat their workforce well, our economy will not work fairly for everyone. And if institutional investors are going to support and expect companies to behave in a socially responsible manner—one that serves the interests of human investors as workers, consumers, and citizens, not just as investors concerned with short-term changes in the value of their stock portfolio—then they need the right information to hold companies accountable. As important, EESG disclosure is not just relevant for investors. It is vital for Americans as human beings who are workers, consumers of products, and breathers of air. Citizens deserve to have quality information about how the nation's most influential businesses are treating their workers and consumers, and respecting our environment, laws, and ethical standards. The Fair and Sustainable Capitalism Proposal therefore would:

- **Require large, socially important companies to annually report on their businesses' impact on workers, consumers, communities, the environment, and our nation.**
  - Before institutional investors can hold corporations responsible for providing long-term growth in a sustainable way that benefits employees, consumers, and the environment, institutional investors need quality information. The first step is thus to require companies to disclose more information about their businesses' impact on employee, environmental, social, and governance matters ("EESG," with an extra "E" for employees). To ensure that more disclosure requirements do not discourage companies from going public or encourage them to go private, any reporting requirement should not be based on whether the firm is publicly traded.
  - Under the Proposal, any company with more than \$1 billion in annual sales would be required to annually report information about its business's impact on workers, consumers, communities in which the company operates, other stakeholders, and the environment (including climate change). The Securities and Exchange Commission would develop rules, in consultation with the Department of Labor, the Department of Commerce, the Department of Justice, and the Environmental Protection Agency, to standardize disclosure so that it is useful to investors, workers, consumers, and other stakeholders, as well as regulators who protect the public. Reporting obligations would *not* be conditioned on whether the company's stock is publicly traded, avoiding the perverse effect of encouraging companies to go private or discouraging emerging companies from going public. These workable disclosure requirements would help both institutional investors and the public hold companies accountable for the impact of their businesses on stakeholders and society as a whole.
- **Require the boards of large, socially important companies to create workforce committees to address workforce issues at the board level.**
  - Union membership has drastically declined from its peak of around 28% of the workforce [in the 1950s](#) to less than 11% [today](#). With this decline, it has become harder for workers to collectively bargain for fair wages, training that assures them continued employment, and a safe and hospitable workplace. Meanwhile, in some other countries, such as Germany, workers have the right to be represented on the company's board of directors through so-called "codetermination," but foreign workers typically do not get the vote and it is not clear that codetermination fits with our economy. But many capitalist nations without codetermination require that each company has a workers' council or some other mechanism requiring ongoing consultation

with workers. The U.S. system stands out for its lack of corporate governance rules or other policies and practices that ensure companies will consider worker concerns. Combined with the drop in union representation, this failure may explain some of the decline in fair gainsharing between workers and companies that has occurred over the past several decades.

- To make sure that companies give careful consideration to worker concerns at the board level, the Proposal requires the Securities and Exchange Commission, the Department of Labor, and the National Labor Relations Board to jointly develop rules that would require the boards of companies with more than \$1 billion in annual sales to create and maintain a committee focused on workforce concerns. By requiring these committees at all large corporations, not just public corporations, more accountability would be imposed on large private companies, such as those owned by private equity firms, to treat their workforce fairly. These workforce committees would be focused on addressing fair gainsharing between workers and investors, the workers' interest in training that assures continued employment, and the workers' interest in a safe and tolerant workplace. These workforce committees would also consider whether the company uses substitute forms of labor—such as contractors—to fulfill important corporate needs, and whether those contractors pay their workers fairly, provide safe working conditions, and are operating in an ethical way, and are not simply being used to inflate corporate profits at the expense of continuing employment and fair compensation for direct company employees. Offering a middle-ground between the current system and “codetermination”-style worker representation, the committees would be required to develop and disclose a plan for consulting directly with the company's workers about important worker matters such as compensation and benefits, opportunities for advancement, and training. Finally, the National Labor Relations Act would be amended to ensure that companies can use dedicated committees to consult with their workers without running afoul of the Act's prohibition on “dominating” labor organizations, provided that the company doesn't interfere with, restrain, or coerce employees in the exercise of their rights to collective bargaining and self-organization. In essence, this would allow for European-style “works councils” without impeding union formation and representation.
- **Change accounting rules to treat investments in human capital like other long-term investments and require companies to disclose more information in narrative form about their human capital investments.**
  - Accounting rules currently treat human capital investments as a cost that is expensed immediately instead of a long-term investment that is expensed



over time. Given financial markets' focus on short-term results, this can lead corporate managers to underinvest in human capital. But investment in human capital is just as important as other long-term investments in plant and equipment and should be treated as such when being accounted for on a firm's income statement and balance sheet. Providing similar accounting treatment to human capital investments as other long-term corporate investments would encourage companies to invest in their workforces and diminish the incentive for activist hedge funds to campaign to reduce companies' spending on their workers just to increase short-term returns.

- To fix this problem, the Proposal would require the Securities and Exchange Commission to instruct the Financial Accounting Standards Board to revise generally accepted accounting principles to treat investments in human capital as capital expenditures like investments in plants, property, and equipment, and the Commission would develop rules requiring public companies to disclose in narrative form additional information about their investments in human capital.
- **Require companies releasing quarterly earnings guidance to make other necessary and appropriate disclosures.**
  - No rational person believes that corporations can deliver consistent, quarter-to-quarter earnings growth nor that corporations should be managed with that objective in mind, especially in light of the fact that most of their capital comes from human investors who are saving for the long run and therefore need sustainable growth, not bubble returns. Forward-looking quarterly earnings estimates provide little value to investors but continue to contribute to managing to the market in an unproductive way. And isolated issuer restraint is of little utility as competitive realities lead to a collective lack of discipline and wisdom because CEOs fear the loss of analyst coverage if they refuse to feed the market beast and their competitors continue to do so.
  - The Proposal would have the SEC promulgate rules requiring companies to disclose more information or adhere to other standards if companies are going to release forward-looking quarterly earnings estimates. Under the Proposal, the SEC must require any company that issues quarterly guidance to maintain, make public, and keep current a long-term plan for earnings growth and situate any quarterly guidance within the context of that long-term plan. By requiring companies to disclose long-term plans along with their forward-looking quarterly estimates, managers would be able to focus more on sustainable, long-term corporate growth and less on meeting the market's short-term expectations, and institutional investors would have a roadmap to hold corporations accountable for sustainable performance.

- **Make it easier for large corporations to become benefit corporations and commit to fair treatment of their workers, consumers, society, and the environment.**
  - Recently, the Business Roundtable made a promising statement recognizing that businesses have a responsibility to treat all their stakeholders well and to be socially responsible citizens. Skepticism exists about whether that statement is just talk. One concrete way business leaders can move from rhetoric to fairer treatment for workers, consumers, and the communities that their businesses affect is for the Business Roundtable to support having their corporations adopt the Benefit Corporation model. This model, which has been adopted by the leading corporate state of Delaware, requires, by use of the word “shall” and other means, that the corporation treat all stakeholders fairly, even in a sale of the corporation. The model is conservative in that the only constituency with a vote remains the stockholders, and thus their support for social responsibility is what keeps the board accountable. To move toward this sensible model, however, unreasonable barriers must be removed that require a supermajority vote or create a right to appraisal if a corporation is to opt into the Benefit Corporation model or if a corporation merges into an existing Benefit Corporation. There is no principled basis for this discrimination against Benefit Corporations, as the Benefit Corporation model contains all the strong fiduciary and statutory protections against self-dealing and unfair treatment available under corporate laws like Delaware’s. A majority vote of stockholders to move to Benefit Corporation model should be enough. And, if the Business Roundtable, institutional investors, and policy makers get behind this principled approach, entrepreneurs would have far less reason to argue for giving themselves stock with special voting power to protect other stakeholders, because a one-share, one vote model would exist that requires fair treatment of stakeholders.

### **Strengthening Institutional Investors’ Obligations to Promote Sustainable, Long-Term Growth and Serve the Interests of Human Investors**

Requiring operating companies to make EESG disclosures is a good start, but inadequate step. We cannot expect companies to focus on creating long-term sustainable value for workers, investors, and other stakeholders if those who elect the board and vote on management’s compensation are more focused on the next quarter than the company’s ability to generate durable returns. Because Americans must give their retirement and college savings to institutional investors, institutional investors now dominate the governance of public corporations. These institutional investors should be required to use their voting power in a way that is aligned with the interests of the worker-investors whose retirement and college savings money they control. Institutional investors should be expected to consider the need these worker-investors have for sustainable wealth creation,

and their interests as human beings who need our economy to produce good jobs that pay good wages and to generate wealth in a way that does not harm the environment or consumers.

But requiring institutional investors to account for the investment objectives and human realities of their worker-investors is not enough if they do not have information about the other investors—typically activist investors—making proposals to change a company’s strategic direction. Requiring these activist investors to disclose more information about their positions and the nature of their capital is therefore necessary for the corporate electorate to make an informed vote on these significant decisions. And finally, attention should also be paid to so-called “private funds,” such as hedge funds and private equity funds, which are often able to escape giving full disclosure to investors, despite taking money from pension funds that many Americans rely on for retirement and from universities and charities that advance important, publicly subsidized purposes.

The Fair and Sustainable Capitalism Proposal would:

- **Require institutional investors to consider their ultimate beneficiaries’ specific investment objectives and horizons, such as saving for retirement or education, as part of their fiduciary duties, and empower institutional investors to consider their ultimate beneficiaries’ economic and human interest in having companies create quality jobs, and act ethically and responsibly toward their consumers and the environment.**
  - To start, institutional investors’ fiduciary duties must be modified to both impose additional accountability and free institutions to consider their beneficiaries’ interests as human beings who are not just investors, but workers, parents, breathers of air, and citizens. Currently, the funds that Americans are invested in do not have to vote in a way that is tailored to the specific investment objectives of the funds and their investors. That is, instead of considering the particular investment horizon or financial needs of the investors in each fund, the funds in the same fund family (*e.g.*, BlackRock, Vanguard, Fidelity, etc.) all tend to vote the same way. But most worker-investors are rational index fund investors. And, an index fund will not exit until the portfolio stock leaves the index because its investment strategy requires it to hold all stocks in the index. Too often, index funds do not vote this unique stuck-in perspective. Rather, the index fund will vote the same way as the actively traded funds in the fund complex, regardless of the fact that the active funds do not hold their investments for the long-term, and regardless of key factors such as whether the issue on the table is a stock-for-stock merger in which the index fund holds both the acquirer and the target. This situation must change if corporations are to be responsive to the flesh and blood human beings who provide their capital. Requiring

institutional investors to consider the investment horizons and objectives of their ultimate beneficiaries will align institutional investors' voting behavior with the interest of the human investors whose capital they manage.

- Not only that, but proxy advisors remain highly influential in our corporate governance system. If institutional investors are going to vote with the interests of their ultimate beneficiaries in mind, then institutional investors must not rely on proxy advisory firm recommendations unless the proxy advisor's recommendations are tailored to the fund's investment style and horizon. This requirement would create incentives for proxy advisory firms to do better; and in particular, encourage them to develop voting recommendations and policies tailored to index investors, who are uniquely long-term and committed to sustainable wealth creation.
- Under the Proposal, large institutional investors who take human investors' money, including mutual funds and pension funds, would be required to consider the specific investment objectives and horizons of their ultimate beneficiaries, such as saving for retirement, saving for their children's education, or investing in a socially responsible manner, when making voting and other stewardship decisions. Specific obligations would be imposed on index and pension funds that would have to consider their investors' interests in sustainable, long-term growth and the diversified nature of their portfolios.
- As important, any covered institutional investor would be authorized to consider their ultimate beneficiaries' overall economic and human welfare, including their interests as workers, taxpayers, consumers, and human beings who live in the environment, in determining how to prudently invest their funds for sustainable, ethical portfolio growth. This plain and simple authorization for investment funds to consider EESG factors will eliminate any fear that institutional investors cannot take into account the moral and ethical factors that human investors can consider. This will help align institutional investors' voting and stewardship practices with the interests of the human investors who give these institutions money every paycheck.
- **Require institutional investors to explain how their voting policies and other stewardship practices ensure the faithful discharge of their new fiduciary duties and take into account the new information reported by large companies on employee, environmental, social, and governance matters.**
  - To ensure investors and regulators that institutional investors are voting and engaging with operating companies in a way that serves the interests of the human investors whose money they manage, the new fiduciary obligations

imposed on institutional investors should be accompanied by parallel disclosure requirements.

- Accordingly, the Proposal would require the Securities and Exchange Commission and the Department of Labor, in consultation with the Department of Commerce, the Department of Justice, and the Environmental Protection Agency, to develop rules requiring covered institutional investors to make annual disclosures explaining how their voting policies and other stewardship practices (i) address the Proposal’s newly imposed fiduciary duties; (ii) account for the information that the Proposal requires large companies to disclose about their worker, environmental, social, and governance impact; and (iii) address the specific objectives of the institutional investors’ ultimate beneficiaries. This required disclosure would also have parallels with the disclosure obligations imposed on operating companies.
- **Close loopholes so that activist hedge funds have to make a full and timely disclosure of their economic interests in the companies they seek to influence.**
  - If institutional investors are to effectively represent their beneficiaries’ long-term interests, they need up-to-date information about those making proposals affecting corporations’ business plans and corporate governance rules. Over the last two decades, the model of shareholder engagement has changed profoundly. In the past, shareholders commonly did not seek to pressure companies to take actions that changed fundamental corporate business plans and strategies in a way that affected other shareholders and, most important, employees. But today, shareholders—typically activist hedge funds—often seek influence to do just that. These shareholders pose substantial risks for other shareholders, especially long-term capital providers like the institutional investors who hold the retirement savings of worker-investors. These activists also affect the interest of company employees, whose livelihood can be put in danger by risky proposals to pump up immediate profits in an unsustainable way. It is up to the entire corporate electorate to consider the proposals of activists, but because the electorate cannot do so effectively without accurate and up-to-date information on activist investors’ incentives, economic interests in the companies they invest in, capital position, and holding periods.
  - Under current law, activist investors who seek to influence management—such as activist hedge funds—are already required to make a special “Schedule 13D” filing with the Securities and Exchange Commission once they acquire 5% of the company’s stock so that their interest in the company is known to other investors. But various loopholes have allowed activist

investors to avoid making full and timely disclosure of their interests. If institutional investors are going to rationally consider activist investors' proposed changes to a company's strategic direction, more information about the activists' economic interests and how they align with the interests of the company's long-term human investors is needed. If, for example, an activist is arguing for a company to cut its capital expenditures and pay a special dividend, but the activist is contractually required to sell its stock in three years because its fund must liquidate, the other shareholders are entitled to know about that. And because the current disclosure regime dates from the 1960s and was not designed to address the market developments that have allowed—through techniques such as derivatives and all-day trading—the aggregation of influential blocks of stock before the public markets know what is going on, the SEC's current rule must be changed to prevent activists from gaining creeping control without paying a control premium before disclosing their proposal to management and other investors. This will bring the United States current with other markets such as the European Union.

- To close the existing loopholes, the Proposal would require the Securities and Exchange Commission to revise its rules governing Schedule 13D disclosures so that: (i) the definition of beneficial ownership would include ownership of any derivative instrument that provides the opportunity to profit from an increase in the value of the subject security and any contract or device that allows the person to control the voting power of the equity security; (ii) any activist investor required to file a Schedule 13D would also be required to disclose any short interest or ownership of a derivative instrument that allows the investor to profit from a decrease in the security's value; (iii) any 13D filer would be prohibited from acquiring additional shares (or derivatives) once the investor crosses the 5% threshold (for large-cap companies) or a 10% threshold (for smaller companies) until a 13D has been filed and available to the public for 24 hours; and (iv) any 13D filer would be required to disclose any contractual or other arrangement that relates to the filer's commitment or ability to hold the subject security, including the ability of the filer's investors, if any, to redeem or withdrawal their capital. Additionally, the "investment-only" exception to the Hart–Scott–Rodino filing requirements would be revised for Schedule 13D and 13G filers so that Hart–Scott–Rodino filings do not function as a substitute for 13D and 13G filings for transactions that do not pose meaningful antitrust concerns.

- **Require an SEC study on the investor protection risks from private funds that are subject to only limited disclosure requirements.**
  - Under current law, hedge funds and private equity funds may solicit the investment of any “accredited investor” without providing meaningful or standardized disclosure about the fund’s or manager’s past performance or other risks. This accredited investor exception was originally intended as a sort of “Thurston Howell” exception, because that iconic figure from Gilligan’s Island comes to mind as the sort of rich person policymakers believed could proceed at his own risk. Put simply, the idea was that if hugely rich people wanted to risk their wealth, they could. That exception was never intended to allow funds on which ordinary Americans depend for their pensions, universities that educate our children, or key charitable institutions like the Red Cross and Boys & Girls Clubs of America to be able to put money at risk in investments not backed up by appropriate disclosures and standards of integrity. But today, pension funds, university endowments, and charities can qualify as accredited investors (and “qualified purchasers,” which are effectively “super” accredited investors, under the laws governing investment funds), thus ultimately exposing human investors to the risks that come with hedge fund and private equity fund investing. Nothing is intrinsically wrong with the private equity or hedge fund business model, but problems have arisen when pension funds that workers rely on for their retirement or charitable institutions endowed to provide critical social services invest in opaque private funds without adequate disclosure. These losses hurt workers and society and can require taxpayers to fill the resulting holes. Absent appropriate and reliable disclosure around past performance, the fees charged to all the funds’ investors, and the basic strategy and holdings of the fund, pension funds and charities too often entrust their beneficiaries’ hard-earned capital without enough information to prudently assess whether the investment is appropriate for their portfolio on both a risk-return basis and on a cost basis. Of course, disclosure should be tailored to the fund’s investments, e.g., hedge funds should not be required to disclose proprietary information about their trading strategies to the public. But pension funds and large charity endowments need enough reliable information to make informed investment decisions.
  - Under the Proposal, the Securities and Exchange Commission would be required to submit a study to Congress on the investor protection risks and benefits of private funds that are subject to only limited disclosure requirements, such as hedge funds and private equity funds. This study would have to include (i) an assessment of the adequacy of the disclosures that such private funds provide to their investors; (ii) an assessment of whether fund managers are adequately and reliably disclosing their

performance history; (iii) an assessment of the fees charged by these investment managers and whether certain classes of investors are paying more to access these investments; (iv) an assessment of how frequently fund managers offer superior investment terms to certain favored investors and whether disclosure about those favorable terms is available to other investors; and (v) an assessment of whether the universe of accredited investors and qualified purchasers is appropriately defined to include only sophisticated investors who can fend for themselves. The study would also include recommendations about whether additional regulation or legal authority is needed to address these concerns.

### **Reforming the Corporate Electoral System to Promote Sustainable, Long-Term Growth**

Reforms at the operating company and institutional investor level must be accompanied by reforms to the corporate electoral system. If we want institutional investors to wisely focus their voting decisions on sustainable corporate performance, we must reduce the continual mini-referendums occurring each year and the huge number of votes shareholders must cast each year, which encourages companies to manage to the changing whims of the stock market and institutional investors to outsource voting decisions to proxy advisory firms. With fewer but more meaningful votes, we can have a vibrant accountability system better focused on whether corporations are producing profits in a socially responsible manner. To that end, the Fair and Sustainable Capitalism Proposal would:

- **Change the “say-on-pay” voting system to promote more thoughtful voting by requiring companies to hold shareholder votes on executive compensation once every four years (or sooner upon any material change in executive compensation) and present shareholders with a four-year plan for each vote.**
  - One impediment to thoughtful voting is the substantial number of “say-on-pay” votes on executive compensation—[over 2,000 per year](#)—that institutional investors must cast at U.S. public companies every year. Because executive compensation should be designed to provide top executives with appropriate incentives to manage well and create sustainable long-term increases in corporate value, it is counterproductive that compensation arrangements should run on annual terms, with constant tinkering and changing of key provisions. Rather, compensation committees should bargain for and set employment contracts with a meaningful length over which to assess the contribution of management to the corporation. Likewise, if shareholders are going to be given voice in those arrangements, their voice should be exercised in a mature fashion consistent with the actual arrangements that will be binding on the corporation and with their sensible length. No one who cares about America’s worker-investors believes that



corporate executives should be paid based on year-to-year incentives. Rather, they should be rewarded for helping to create sustainable corporate profits, and their pay contracts should therefore be long term in nature. But instead of voting on long-term pay plans on a sensible schedule, say-on-pay votes are held annually, and likely because of the overwhelming number of these annual say-on-pay votes, academic research has found that institutional investors often [rely heavily on proxy advisory firms in their voting](#) on these resolutions (with [less than ideal](#) consequences). CEO pay continues to rise faster than the pay of company employees overall, and recent research bolsters the view that the current system of annual say-on-pay voting [isn't working](#) to close that gap.

- To mitigate these problems and allow more thoughtful voting by institutional investors, the Proposal would change the “say-on-pay” requirements imposed on public companies by the Dodd-Frank Wall Street Reform and Consumer Protection Act so that companies would be required to hold a say-on-pay vote every four years, or sooner if there is any material change in the terms of the executive compensation, based on a pay plan covering at least the next four-year period. The SEC would be required to establish a schedule so that approximately 25% of public companies have a pay vote each year, allowing for informed voting on a four-year track record rationally related to sustainable performance. Ultimately, this would result in more thoughtful voting by shareholders, helping to realize the vision that Congress originally had for say-on-pay votes.
- **Modify the SEC’s shareholder proposal rule to require proponents of economic shareholder proposals to have a genuine stake in the company and modestly increase resubmissions thresholds so that proposals that repeatedly fail by large margins are left off the ballot in future years.**
  - Some modest changes to the rules governing shareholder proposals could also encourage more thoughtful voting by institutional investors and increase the benefit to cost ratio of the corporate voting process. Although the SEC’s shareholder proposal rule likely plays a salutary role overall, some proponents—especially small-stakes proponents making economic proposals—have been less than thoughtful in deciding which companies to target for proposals, which recent academic research has found [burdens the system](#) with unnecessary and value-destroying votes. That finding is unsurprising: how actual end-user investors or corporate performance are aided by having hundreds of poorly targeted votes each year is difficult to understand. But what is certain is that institutional investors cannot rationally focus on all of them, limiting their ability to spend energy and attention on legitimate proposals that may benefit the corporation.

- These burdensome shareholder proposals are encouraged (or at least not discouraged) by law, which currently allows a shareholder holding as little as \$2,000 in the company's stock to make a proposal and have the company (and thus other shareholders and constituents like company employees) pay for the substantial costs of including the proposal on the corporate ballot and responding to it, generating too many proposals by shareholders with little stake in the company's future and thereby overwhelming the capacity of the investors voting on those proposals to meaningfully inform themselves as to the proposals' merits. This should not be so. In most states, candidates for public office are required to pay a reasonable filing fee tied to a percentage of the salary of the office they seek. And, California requires [a \\$2,000 filing fee](#) for ballot initiatives. It is reasonable and productive to ask the same of investors who seek to change the business plans or governance of a company. Requiring sponsors of economic proposals filed under Rule 14a-8 to pay a reasonable filing fee to bear a tiny fraction of the much larger costs their proposal will impose on the corporation, and therefore other shareholders and corporate constituents like workers, is a responsible method to better recalibrate the benefit–cost ratio of the shareholder proposal rule.
  
- Accordingly, the Proposal would require the Securities and Exchange Commission to revise its shareholder proposal rule so that shareholders seeking to make an “economic” shareholder proposal, such as a proposal requesting the removal of takeover defenses, at company expense would need to hold the *lesser* of \$2 million or 1% of the company's stock (with proponents having the option to aggregate their shares with any other shareholders willing to join in the proposal to satisfy the ownership requirement). This is an achievable number that shows that the proponents have a serious enough stake to justify the costs the proposal will have for others. It is like the requirement in states like California to get support from at least 5% of voters before a ballot initiative goes forward, but is by comparison far easier and less costly to achieve. Additionally, the Proposal would require a proponent of an economic proposal to pay a \$2,000 fee to have the proposal placed on the corporate ballot. These two requirements would *not* apply to environmental and social proposals; thus, for example, a proponent of a resolution encouraging the company to take action on climate change would be exempt from the new eligibility requirements. Finally, the Proposal would modestly increase the thresholds at which all proposals that fail to gain a meaningful share of the vote can be excluded in later years. Currently, a proposal that gets as little as 3% of the vote can still be included in later years; under the Proposal, a proposal would be excludable if it fails to gain 5% in the first year, 10% in the second year, or 20% in the third year. This clock would reset after five years. And this change would help investors

to focus more on assessing the merits of the proposals that are likely to actually gain wide support, and prevent idiosyncratic shareholders from repeatedly costing other shareholders and corporate constituents time and money over a proposal that has not garnered any substantial level of support.

- **Require shareholders attempting to change a company’s corporate governance—either by making shareholder proposals or soliciting proxies—to disclose their economic interest in the company.**
  - If institutional investors representing American worker-investors are going to rationally consider shareholder proposals or proxy challenges, more information is needed about those who are making these proposals. Investors cannot fully consider an activist’s proposal if the investor does not know whether the activist making the proposal has a genuine, long-term interest in the company’s sustainable profitability. Activist shareholders who seek changes in a company’s business plans or a breakup of the business have a huge impact on company employees and other shareholders. The institutional investors who hold the capital of working Americans should have better information to know if the activists’ economic interests are aligned with the interests of patient investors such as index investors and others who hold stock for the long run.
  - To that end, the Proposal would require those making shareholder proposals or soliciting proxies to disclose in clear and standard form their net beneficial ownership interest in the company’s securities. Disclosure of their beneficial ownership interest would include any short interest or ownership of any derivative instrument or any contract or device that allows the person to control the voting power of the equity security.

### **Updating Our Tax System to Reduce Speculation, Address Climate Change, and Promote Sustainable Growth, Innovation, and Job Creation**

In tandem with reforms to operating company disclosure, institutional investors, and the proxy system, our tax system must also be reformed to provide the right incentives for companies and investors to focus on promoting sustainable, long-term growth. Adoption of a sensible fractional trading tax on all securities transactions, including transactions by 401(k) investors, and capital gains reform to make eligibility for the preferential long-term rate dependent on actual long-term investment would help all investors focus more on sustainable returns. Not only that, but taxes like these discourage unproductive and destabilizing speculation of the kind that contributed to the financial crisis. In addition, tax changes applicable to hedge fund managers’ compensation can place everyone on the same playing field, ensure that the labor income produced by private equity and hedge fund

executives is taxed on the same basis as the sweat put in by other American workers, and help ensure that Wall Street pays its fair share of taxes. Not only that, but these taxes can help close a deficit that has widened after the passage of the Tax Cuts and Jobs Act of 2017 while also providing necessary funds for investment in infrastructure modernization, tackling climate change, cutting-edge research and development to secure America's position as a global leader in innovation and the industries of the future, and workplace training to ensure that American workers are ready to tackle this century's technological challenges and have quality jobs. To accomplish these goals, the Fair and Sustainable Capitalism Proposal would:

- **Change the holding period for long-term capital gains from one year to five.**
  - Currently, an investment needs to be held for only one year to be considered “long term,” which allows short-term investors to take advantage of the preferential low tax rate for genuine, long-term capital gains.
  - The Proposal would change this period to five years, thereby helping to promote long-term investment and discourage harmful speculation.
- **Establish a financial transaction tax.**
  - The Proposal would impose a very modest tax on most financial transactions, including the trading of stocks, mutual funds, bonds, and derivatives. This small tax would moderate excessive speculation, curb uneconomic high-frequency trading with no fundamental investment rationale that can contribute to financial system instability, encourage more thoughtful long-term investing, and discourage irrational fund-hopping by mutual fund consumers. All these incentives will help institutional investors as well as mutual funds better concentrate on stable investment strategies focused on sustainable growth—the kind that allows for fair gainsharing with company workers and provides funds for investors when they retire. Estimated to generate over \$2 trillion over 10 years, this tax should be used as a down-payment on important, long-term investments in sustainable growth. A financial transaction tax has been supported by leading economists such as Nobel Prize winner Joseph Stiglitz.
  - The rate for this tax would be 0.5% for equity securities, 0.1% for bonds, and 0.005% for derivatives.
- **Close the carried interest loophole.**
  - Under current law, some of the nation's wealthiest individuals—hedge fund and private equity managers—pay a lower tax rate than average Americans

because the bulk of their income is taxed at the preferential 20% long-term capital gains tax rate as so-called “carried interest,” rather than at the ordinary income tax rate of 37%, even though they are effectively being paid for their labor. Ensuring our system works for all also requires eliminating this unfair tax advantage hedge funds get over other human laborers. Closing this loophole would also diminish the ability of hedge fund managers to reap profits not shared with their investors and their targets’ other shareholders in the long-run, thereby shifting the activist hedge fund market directionally toward those fund managers able to generate value by contributing managerial expertise that creates durable value for the public companies in its portfolio. And because the Tax Cuts and Jobs Act of 2017 gave the majority of its tax breaks to wealthier Americans and increased the federal deficit substantially, closing the carried interest loophole is a fairer and more productive way to restore some equity to the Tax Code, while also helping to reduce the deficit or provide for other important national needs.

- The Proposal would close the carried interest loophole by requiring private equity or hedge fund managers’ compensation—in whatever form—be taxed as income, not as capital gains.
- **Create an Infrastructure, Innovation, and Human Capital Trust Fund.**
  - It is no secret that our nation currently lags in infrastructure and research spending, hurting the ability of American businesses to compete globally, and there has been bipartisan consensus that these problems need to be addressed.
  - To ensure that the funds raised by the financial transaction tax are used to promote sustainable development, the Proposal would transfer all the revenue raised by the financial transaction tax into a newly created Infrastructure, Innovation, and Human Capital Trust Fund. Congress could spend capital in the trust fund on only basic research and development, revitalizing our nation’s infrastructure in an environmentally responsible way that helps us redress climate change, and workplace training. In particular, as the United States transitions to less carbon intensive energy production, those in carbon-intensive industries will require help transitioning their high quality skills to the evolving skills needed to work with these new energy technologies. To that end, the funds in the Infrastructure, Innovation, and Human Capital Trust Fund could be used to provide training, support, and other assistance to help employees working in carbon-intensive industries transition to quality employment in industries generating energy in non-carbon intensive ways and to other emerging industries. This \$2 trillion investment over the next 10 years can help create

a sustainable, carbon-efficient transportation system and electrical grid, and aid the development of next-generation energy solutions, among other long-term, sustainable projects, while creating thousands of well-paying jobs that cannot be shipped overseas.

### **Curbing Corporate Power and Leveling the Playing Field for Workers, Consumers, and Investors**

Lastly, we must address three sets of challenges created in no small part by the United States Supreme Court, which have amplified corporate power at the expense of American workers, consumers, and human investors. In the 2010 decision *Citizens United v. Federal Election Commission* striking down the Bipartisan Campaign Reform Act (McCain-Feingold), the Supreme Court unleashed a massive growth in unchecked corporate political spending, which major institutional investors have so far been unwilling to address—even though the human investors whose money they manage do not invest their money so it can be spent by corporations on politics. And in a series of decisions blessing the increased use of forced arbitration, the Supreme Court has allowed businesses to deny workers, consumers, and human investors their day in court and has blocked the States from exercising their sovereign right to decide how best to enforce their own laws. Finally, in recent decisions such as *Harris v. Quinn* and *Janus v. American Federation of State, County, and Municipal Employees, Council 31*, the U.S. Supreme Court has added to the difficulties for American workers seeking to exercise in an effective way their right to form a union and collectively bargain. These adverse decisions came on top of existing statutory roadblocks to a majority of workers being able to seek greater gainsharing through collective bargaining.

Other proposals, such as the [Do No Harm Act](#), should also be enacted to address the amplification of corporate power, and diminution in the rights of working people to receive minimum federally guaranteed benefits of employment, condoned by *Burwell v. Hobby Lobby*. But, to address the problems identified above, the Fair and Sustainable Capitalism Proposal would:

- **Prohibit public companies from spending money on politics without the consent of at least 75% of their shareholders.**
  - Human investors do not invest their money for corporate executives to spend it on politics. We know this because this is not how institutional investors advertise to attract investors, and because human investors are as diverse as the nation and there is no rational reason to believe they have similar views on political issues. Corporate political spending also harms human investors seeking long-term sustainable earnings. Businesses that have to lobby and rent-seek to get ahead are less profitable. Not only that, but as most human

investors invest through index funds, any benefit that does accrue to one company through political lobbying is offset by harms to another and washes out for the index investor who holds the market. As important, worker-investors are taxpayers, and it hits the economic bottom line if businesses can externalize costs of ethical, sustainable ways of doing business to the public in the form of environmental harm that must be cleaned up or injured workers or consumers.

- To ensure that human investors' money is not being spent on politics without their consent, the Proposal would bar public companies from making any disbursement for a political purpose without first obtaining the consent, either for that specific disbursement or under a general policy allowing disbursements of that type, of at least 75% of their shareholders. This provision tracks a proposal by the late John Bogle, the respected founder of the index fund giant Vanguard.
- **Enhance fairness and restore State sovereignty over the enforceability of forced arbitration clauses.**
  - The United States Supreme Court has interpreted the Federal Arbitration Act to apply to a broad range of disputes to which it was not originally intended to apply, such as disputes between workers and their employers, thereby denying American workers and consumers their day in court by funneling them into secretive arbitration proceedings. This is especially problematic for consumer disputes that are important but not worth enough for a lawyer to take on the case unless consumers are allowed to join together in a class action. Moreover, this expansive interpretation of the Federal Arbitration Act—which has applied to not only lawsuits arising under Federal law, but also lawsuits arising under State law—has blocked the States from determining how to best enforce their own laws.
  - To stop the unfair application of the Federal Arbitration Act to disputes to which Congress never intended it to apply and restore State sovereignty so that the States can determine for themselves how their own laws should be enforced, the Fair and Sustainable Capitalism Proposal would amend the Federal Arbitration Act so that: (i) for employment, consumer, antitrust, securities, internal affairs, and civil rights disputes that arise under Federal law, forced arbitration clauses would be enforceable only if applicable Federal law other than the Federal Arbitration Act (such as the Fair Labor Standards Act or some other substantive law) makes them enforceable; and (ii) for employment, consumer, antitrust, securities, internal affairs, and civil rights disputes that arise under State law, forced arbitration clauses would be enforceable only if applicable State law makes them enforceable.

- **Reform the union election process by permitting card check elections to make it easier for workers to organize and collectively bargain with their employers.**
  - Reforming the corporate election process is a strong start on the path to increased gainsharing between workers and corporations. But to restore shared prosperity and create an economy that benefits all Americans, working Americans also need the ability to collectively organize and bargain with their employers. At least since the Reagan Administration, the ability of American workers to use the rights guaranteed by the National Labor Relations Act (“NLRA”) has been increasingly compromised. As a result, the leverage of American workers to obtain fair pay has been weakened, contributing to growing inequality and a decline in fair gain sharing between corporations and their workers. Labor’s declining influence has only been further eroded by recent decisions of the U.S. Supreme Court, such as *Janus v. American Federation of State, County, and Municipal Employees* and *Harris v. Quinn*, that treat labor unions in a disfavored manner in comparison to corporations in the area of political spending, and that have now gone further and denied unions the right to obtain fair payments from workers they advocate for in pay negotiations and protect from unfair discharge or demotions. The important reforms contained in the [Protecting the Right to Organize Act](#) should become law to address this diminution in worker voice. But an additional important step should be taken. Current law hinders workers’ ability to organize because even after a majority of workers signs a petition or authorization card supporting unionization (informally known as “card check”), a company can still demand a formal, time-consuming election during which the company can seek to erode the union’s support and delay collective bargaining. That is, even after a majority of employees support unionization, an employer can delay its formation and potentially avoid unionization all together by pressuring workers during the secret ballot campaign. Unsurprisingly, [studies suggest that unionization rates are higher when unions are recognized after a majority of workers sign a petition supporting unionization](#), and [union members enjoy higher wages and more robust benefits packages compared to non-union workforces](#).
  - If we are to improve the wages of American workers, the effectiveness of the NLRA’s promise to American workers needs to be renewed by granting unions obtaining a fair showing of majority support recognition and the right to bargain on behalf of the workforce for fair wages and working conditions.



## Acknowledgements

The Fair and Sustainable Capitalism Proposal was influenced by the scholarship and thinking of many distinguished elected officials, public servants, academics, and thought leaders. A debt of gratitude is owed to all of them for their research and thinking on making our economy work better for all. Among the many sources considered and consulted in the preparation of the Proposal were:

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