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Cheers and Boos for Employee Involvement: Co-Determination as Corporate Governance Conundrum

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Abstract

Employee involvement in a very general sense is by and large an accepted policy goal in the European Union. Its forms nonetheless vary considerably among

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Member States and sometimes include boardroom representation. Board composition, performance and incentive structures are core areas of the ongoing corporate governance debate in Europe and most other parts of the world. These two discourses are rather disparate. Recent EC legislation and jurisprudence do not proactively pursue an integrated approach. The following paper maps out overlapping areas of employee participation and corporate structure, explores some theoretical underpinnings for employee involvement from a contract-theory perspective and analyses issues specific to internationally engaged corporate groups. Finally, a transaction-based approach for modernisation of employee involvement is suggested. Preference is given to default rules that do not require employees to be represented at board level yet leave room for agreements to that effect. The plasticity of private law, the resilience of the corporate form and the governance-assisted employment relationship can defy petrification. Transaction-based employee involvement promotes a productive conjunction of corporate governance components consonant with the specific character of the employment relationship. An evolutionary approach to reform requires flexible legislation instead of deference to existing models. However, consensual model building needs proper enabling tools. Academic groundwork in private international law, contract, labour and corporate law is called for.

Keywords: co-determination, corporate governance, contract governance, corporate group, employee participation, human resources.

1. INTRODUCTION

A particular objective of the European Community and the Member States is to promote social dialogue between management and labour.[1] Board-level employee representation is a traditional structure in some national laws. The Regulation and Directive establishing a Statute for a European Company (SE) struggle with the wide range of models for workers' involvement in the Member States,[2] and pursue this objective to ensure that the existing participation in a company's

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[1] Arts. 2, 136-139 EC; Directive 2002/14/EC establishing a general framework for informing and consulting employees in the European Community of 11 March 2002, *OJ* L 80 of 23 March 2002, p. 29.

[2] Cf., 'Summary of Main Points', Davignon Group Final Report (13 May 1997): '… The Group's analysis of national systems shows that there are more differences than similarities … It is difficult to weigh their equivalence. The Group concludes that there is no "ideal system" and that general harmonisation is not possible.' Summary available at: <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/97/396>; Report available at: <http://europa.eu.int/comm/employment_social/labour_law/docs/davignonreport_en.pdf>.

management is preserved.[3] The EU Commission's Action Plan[4] to modernise company law and enhance corporate governance (influenced by Sarbanes-Oxley) has on its short-term list of actions many familiar topics from the international corporate governance debate, mainly with an emphasis on independent directors. As of February 2005, the Commission followed up with a Recommendation on the role of non-executive or supervisory directors.[5] Changes in private international law, triggered by recent decisions of the European Court of Justice,[6] may very well result in enhanced competition in the field of corporate law between Member States.

These developments are neither in sync nor in harmony with each other. However, they pertain to the same phenomenon: the internationally active and internationally financed corporation. This paper gives a short description of existing disparities, analyses some theoretical underpinnings and proposes a research agenda for more consistent strategies.

Participation of workers' representatives on the supervisory board, where they take one half of the seats, is an idiosyncrasy of German law much praised, despised and discussed.[7] Despite many empirical studies, evidence as to the

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[3] Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE), *OJ* L 294 of 11 October 2001, p. 1; Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, *OJ* L 294 of 10 November 2001, p. 22, Recitals 3, 7, 9, 18 and Art. 4(4). Critical of this preservationist approach and promoting more flexible solutions for the 10th and 14th Directives: K.J. Hopt, 'Europäisches Gesellschaftsrecht und deutsche Unternehmensverfassung', *ZIP* (2005) p. 461 at p. 464 et seq.

[4] Communication from the Commission to the Council and the European Parliament – Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, COM (2003) 284 final, available at: <http://europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0284en01.pdf>.

[5] Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, *OJ* L 52 of 25 February 2005, p. 51.

[6] ECJ, Case C-208/00 *Überseering* [2002] *ECR* I-9919 and Case C-167/01 *Inspire Art* [2003] *ECR* 10155.

[7] Board-level co-determination is not unique to Germany but never exceeds a ratio of one-third of board seats for labour in other countries; for other models, see M. Biagi, 'Forms of Employee Representational Participation', in R. Blanpain and C. Engels, eds., *Comparative Labour Law and Industrial Relations in Industrialized Market Economies*, 6th edn. (The Hague, Kluwer Law International 1998) p. 341; R. Rebhahn, 'Unternehmensmitbestimmung in Deutschland – ein Sonderweg im Rechtsvergleich', in V. Rieble, ed., *Zukunft der Unternehmensmitbestimmung*, Schriftenreihe des ZAAR No. 1 (Munich, Zentrum für Arbeitsbeziehungen und Arbeitsrecht 2004) p. 41; R. Rebhahn, 'Collective Labour Law in Europe in a Comparative Perspective', 20 *International Journal of Comparative Labour Law and Industrial Relations* (2003) pp. 271-295 (Part I) and (2004) pp. 107-132 (Part II); T. Baums

effects of this kind of co-determination is scarce. Research results are notoriously ambiguous; the confusion of causation and correlation is ever present.[8] There are too many variables, control groups in a technical sense of social science methodology are hardly available, statistics are under-defined and interviews are intrinsically prone to bias.[9] The delicate political compromise reached in Germany in 1976 is still being honoured to the extent that an open discussion of the pros and cons of boardroom co-determination is either avoided or heavily polarised.[10] The German Government Commission on 'Corporate Governance –

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and P. Ulmer, eds., *Unternehmens-Mitbestimmung der Arbeitnehmer im Recht der EU-Mitgliedstaaten*, *ZHR* Sonderheft 72 (Heidelberg, Verlag Recht und Wirtschaft 2004).

[8] Bertelsmann Stiftung and Hans-Böckler-Stiftung, eds., *Mitbestimmung und neue Unternehmenskulturen. Bilanz und Perspektiven* (Gütersloh, Verlag Bertelsmann Stiftung 1998), available at: <http://www.bertelsmann-stiftung.de/cps/rde/xbcr/SID-0A000F0A-F983D9A6/stiftung/Abschlussbericht1.pdf>; critical as to the scientific weight of this study: K.J. Hopt, 'Corporate Governance in Germany', in K.J. Hopt and E. Wymeersch, eds., *Capital Markets and Company Law* (Oxford, Oxford University Press 2003) p. 289 at p. 304 et seq.; M. Höpner, *Unternehmensmitbestimmung unter Beschuss. Die Mitbestimmungsdebatte im Licht der sozialwissenschaftlichen Forschung*, MPIfG Discussion Paper 04/8 (Cologne, Max-Planck-Institut für Gesellschaftsforschung 2004), available at: <http://www.mpi-fg-koeln.mpg.de/pu/mpifg_dp/dp04-8.pdf>; U. Jürgens and I. Lippert, *Kommunikation und Wissen im Aufsichtsrat. Voraussetzungen und Kriterien guter Aufsichtsratsarbeit aus der Perspektive leitender Angestellter*, study by WZB in cooperation with the Deutsche Führungskräfteverband (ULA) (Berlin 2005), available at: <http://www.wz-berlin.de/publikation/pdf/wm108/12.pdf>; further references to studies in K.J. Hopt, 'The German Two-Tier Board: Experience, Theories, Reforms', in K.J. Hopt, et al., eds., *Comparative Corporate Governance. The State of the Art and Emerging Research* (Oxford, Clarendon Press 1998) p. 227 at pp. 238-240.

[9] M.J. Roe, *Political Determinants of Corporate Governance. Political Context, Corporate Impact* (Oxford, Oxford University Press 2004) p. 76, gives an example of this kind of caveat. Quoting a study concluding that the law that increased labour representation from one-third of the board to one-half of the board for most large German companies cost shareholders about 15 or 20 per cent of their shares' value, Roe warns: 'To be sure here, since fully codetermined firms are larger firms, the authors cannot be certain whether they were measuring size effects or codetermination effects.' Methodological problems also arise when effects are attributed to boardroom participation without a look at shop-floor co-determination. See also W. Franz, 'Mitbestimmung in Deutschland: Mehr Wahlfreiheit und Flexibilität', *Zeitschrift für Arbeitsmarktforschung (ZAF)* (2005, forthcoming); Höpner, op. cit. n. 8, at p. 23; K. Pistor, 'Codetermination: A Sociopolitical Model with Governance Externalities', in M.M. Blair and M.J. Roe, eds., *Employees and Corporate Governance* (Washington, Brookings Institution Press 1999) p. 163 at pp. 170, 177, 181; specifically addressing shop-floor do-determination: T. Zwick, 'Employee participation and productivity', 11 *Labour Economics* (2004) p. 715.

[10] E.g., *Mitbestimmung International Edition 2004*, available at: <http://www.boeckler.de/cps/rde/xchg/SID-3D0AB75D-A305A1E2/hbs/hs.xsl/164_30877.html>: 'In Germany the corporate governance debate is being distorted to attack co-determination at board level'; R. Rogowski, 'My personal view: Employee involvement is good but board room co-determination has been a historical error' (2004), available at: <http://www.stern.de/wirtschaft/unternehmen/index.html?id=531082&nv=ct_mt>.

Corporate Management – Corporate Monitoring' was instructed not to touch upon co-determination; and its report of 7 July 2001[11] therefore does not contain any recommendations pertaining to workers' representatives on the supervisory board. The German Corporate Governance Code is based on current law. Consequently, the composition and size of the supervisory board are not questioned.[12] The recommendations of the Code for the supervisory board almost completely avoid special references to members representing the work force. One exception is s. 3.6 of the Code, which calls for separate gatherings of shareholders' and workers' representatives to prepare for meetings of the supervisory board. The recommendation flies in the face of the otherwise emphasised 'equality' of all members of the supervisory board by law[13] and by the Code. This and other recommendations in the Code cry out for critical debate. Only recently a more spirited discussion has set in.

The lack of open and discursive reasoning did not prevent a fierce defence of the German model of workers' participation in the Directive with regard to the involvement of employees in the European company (SE).[14] This complement to the SE Regulation is a compromise reached after a long struggle over a regime of employee involvement due to German intervention.[15] The Directive provides for an opting-out mechanism but raises very high barriers in terms of procedure and majority requirements. A German-based SE is not very likely to achieve an agreement that settles for less than half the seats for employees' representatives on the board. Thus, the SE is sometimes considered unattractive to begin with. Confronted with the decision where and how to incorporate or restructure, enterprises now have more choices and need not resort to the SE. After *Überseering*

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[11] T. Baums, ed., *German Government Panel on Corporate Governance. Summary and Recommendations*, English version available at: <http://www.ecgi.org/codes/documents/baums_report.pdf>; K.J. Hopt and P.C. Leyens, 'Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy', 1 *ECFR* (2004) p. 135 at p. 146.

[12] The German Corporate Governance Code (the 'Code') presents essential statutory regulations for the management and supervision (governance) of German listed companies and contains internationally and nationally recognised standards for good and responsible governance. It can be found at: <http://www.corporate-governance-code.de/index-e.html>.

[13] G. Hueck and C. Windbichler, *Gesellschaftsrecht* [Business Associations], 20th edn. (Munich, Beck 2003) § 24 n. 12 with further references; the separate meetings, however, have a tradition coming from the coal-and-steel co-determination model, Pistor, loc. cit. n. 9, at p. 171.

[14] See *supra* n. 6.

[15] S. Grundmann, *Europäisches Gesellschaftsrecht* (Heidelberg, Müller 2004) No. 1006 et seq., No. 1053 et seq.; F. Kübler, 'Aufsichtsratsmitbestimmung im Gegenwind der Globalisierung', in F. Kübler, J. Scherer and J. Treeck, *The International Lawyer. Freundesgabe für Wulf H. Döser* (Baden-Baden, Nomos 1999) p. 237 at p. 243; A. Schröder and M. Fuchs in G. Manz, B. Mayer and A. Schröder, eds., *Europäische Aktiengesellschaft* (Baden-Baden, Nomos 2005) Part A, No. 2 et seq.

and *Inspire Art,*[16] firms have opportunities to relocate in another Member State where they consider the corporate law more suitable or practical. Details are still disputed as, for instance, to what extent *Daily Mail* and *Centros* are still standing and allow restrictions for companies willing to move away from a Member State (as opposed to companies moving into a Member State).[17] Some argue that the German model of co-determination is of an overriding public interest, and this specific significance justifies restrictions in line with European case law on valid limitations to freedom of establishment (*Cassis* doctrine).[18] In tax law, Germany has a statute on the books that takes away the tax neutrality of cross-border reorganisations when the transaction reduces employee participation.[19] Even on the assumption that these protections of the German model hold up for the time being, they will not survive forever, as they are a kind of poison pill infringing upon the freedom of establishment. German-type co-determination has not been an export blockbuster, and in the long run nothing leads us to believe that it will sell well under conditions of competition of legal systems. Recent changes of co-determination laws adjusted some technicalities in application and voting procedures but did not touch upon the basic structure. When rewriting the law on co-determination of smaller corporations with a workforce of between 500 and 2000, the German Government avoided any attempt to apply German employee participation in the boardroom to foreign businesses as was suggested by some scholars and union representatives.[20]

However, an all-or-nothing approach would be too simplistic. Defending the current model without questioning its corporate governance impact is as uninspired as a call for the complete elimination of boardroom co-determination. Competing legal systems or, in our case, corporate laws are not a static four-corner box but subject to change and development.[21] Therefore, employee involvement is worthwhile revisiting from the perspective of corporate governance and

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[16] See *supra* n. 6.

[17] ECJ, Case 81/87 *Daily Mail* [1988] *ECR* 5483 and Case C-212/97 *Centros* [1999] *ECR* I-1459; Grundmann, op. cit. n. 15, at Nos. 129, 778, 841, 993; recently, ECJ, Case C-9/02 *Hughes de Lasteyrie du Saillant/Ministère de l'Economie*.

[18] Grundmann, op. cit. n. 15, Nos. 186, 187, for applicability in corporate law.

[19] Mitbestimmungsbeibehaltungsgesetz of 23 August 1994, BGBl. I, p. 2218, § 1.

[20] Drittelbeteiligungsgesetz of 18 May 2004, BGBl. I, p. 974.

[21] K. Pistor, Y. Keinan, J. Kleinheisterkamp and M.D. West, 'Innovation in Corporate Law', 31 *J. Comp. Econ.* (2003) p. 676, available at: <http://ssrn.com/abstract=419861>; K. Pistor, Y. Keinan, J. Kleinheisterkamp and M.D. West, 'The Evolution of Corporate Law. A Cross-Country Comparison', 23 *U. Penn. J. Int. Econ. L.* (2003) p. 791, available at: <http://ssrn.com/abstract=419881>; see also C. Kirchner, R.W. Painter and W. Kaal, 'Regulatory Competition in EU Corporate Law after *Inspire Art*: Unbundling Delaware's Product for Europe', 2 *ECFR* (2005) p. 159.

possible modernisation.[22] First, a starting point consisting of facts and legal analysis will be sketched. This outline assumes a common ground for academic argument without inferring that all the underlying questions of these assumptions are resolved. Then, some specific areas where co-determination is at odds with corporate governance and even its own original goals are mapped out. To approach more theoretical underpinnings, various forms of employee involvement will be classified according to its nature as an internal structure of the corporation or an external (contractual) relationship with the corporation. Finally, an agenda for modernisation according to current legal and factual requirements of the globalised business world will be drawn.

2. SOME COMMON STARTING POINTS

2.1 **Corporate citizenship**

Absolute shareholder primacy as well as a morally superior (romanticised), democratic, socially responsible and stakeholder-oriented model of the firm are extreme and ideological positions remote to the facts of real life. International corporations, modern corporate governance literature and codes of conduct take various constituencies into account. A reasonable amount of pluralism as to the interests the management of a publicly held corporation should serve is widely accepted. The roots of such pluralism are extremely diverse and path-dependent.[23] However, the legal outcome for managerial discretion converges in the acceptance of, e.g., sensible contributions to public welfare, humanitarian, educational and philanthropic purposes, on the one hand, and the quest for long-term and sustainable profitability and increasing shareholder value on the other hand.[24] This

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[22] A group of legal and management scholars, the Berlin Corporate Governance Network, presented suggestions for change at a conference held on 5 December 2003; cf., *Die Aktiengesellschaft* (2004) pp. 166-201. Other initiatives followed, e.g., Zentrum für Arbeitsbeziehungen und Arbeitsrecht (ZAAR): Rieble, op. cit. n. 7; WZB and ULA: Jürgens and Lippert, op. cit. n. 8; Federation of German Industries' Report of November 2004, available at: <http://www.bdi-online.de/BDIONLINE_INEAASP/iFILE.dll/XF1B13499DFA94B9B9979CDC72D2DF02F/2F252102116711D5A9C0009027D62C80/PDF/Bericht_BDA-BDI-Kommission_Modernisierung Mitbestimmung_11-2004.pdf>; see also C.H. Seibt, 'Privatautonome Mitbestimmungsvereinbarungen: Rechtliche Grundlagen und Praxishinweise', *Die Aktiengesellschaft* (2005) p. 413.

[23] P.A. Gourevitch, 'The Politics of Corporate Governance Regulation', 112 *Yale L. J.* (2003) p. 1829; Hopt, loc. cit. n. 8; Roe, op. cit. n. 9.

[24] Cf., American Law Institute, *Principles of Corporate Governance: Analysis and Recommendations*, Part II (1994) § 201; Hueck and Windbichler, op. cit. n. 13, at § 23, n. 15; C. Windbichler, 'The Public Spirit of the Corporation', 2 *EBOR* (2001) p. 795; Dow Jones Sustainability Indexes, available at: <http://www.sustainability-indexes.com>.

position is sometimes called an 'enlightened shareholder-value approach'. Stakeholders' interests vary tremendously and escape precise definition. Therefore, they provide dangerous escape routes for management when in conflict with shareholders' interests.[25] But shareholders' interests are not necessarily homogenous either. Institutional investors, blockholders, short-term speculators and individuals with moderate savings or managing considerable wealth do not necessarily agree on corporate policy, and divergent shareholder populations correlate with divergent sets of agency problems.[26] Such diversity of interests fosters coalition building among multiple parties that are not obvious at first glance, as for instance between a large blockholder and labour.[27]

The corporation and its management are embedded in a distinct economic, cultural and legal environment. Corporate governance codes of best practice correspondingly stress compliance with rules and regulations. In a global economy, that means first and foremost compliance with the legal order and norms of the country where establishments are located. A multinational corporation behaves competitively when it takes advantage of lower wage levels or the absence of regulation in certain areas, nevertheless complying with local laws there and keeping local internal and external integrity in the host country.[28] Such corporations are neither shirking nor engaging in dumping practices but can still be good corporate citizens paying taxes and bringing work to areas with high unemployment.[29] Unlawful and exploitative practices certainly exist and should be called to a halt. Such practices are a serious problem but are not to be confused with competition or, even, market economics in general. The distinction between general structure, individual wrongdoing and incentive structures for trespass is crucial for reasoned argument and is not provided by wholesale criticism of capitalism and globalisation.

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[25] C. Escher-Weingart, *Reform durch Deregulierung im Kapitalgesellschaftsrecht: Eine Analyse der Reformmöglichkeiten* (Tübingen, Mohr Siebeck 2001) p. 194 with further references; Hopt, loc. cit. n. 8, at pp. 237-238; Windbichler, loc. cit. n. 24, at p. 806.

[26] Hueck and Windbichler, op. cit. n. 13, at § 20, n. 15; H. Hansmann and R.R. Kraakman, in R.R. Kraakman, et al., *The Anatomy of Corporate Law* (Oxford, Oxford University Press 2004) p. 33; G. Hertig and H. Kanda, ibid., at p. 101.

[27] Pistor, loc. cit. n. 9, at pp. 177, 179; Cf. Roe, op. cit. n. 9, at ch. 6.

[28] Cf., M. Schmitt and D. Sadowski, 'A cost-minimization approach to the international transfer of HMR/IR practices: Anglo-Saxon multinationals in the Federal Republic of Germany', 14 *Int. J. of Human Resource Management* (2003) p. 409 at p. 415.

[29] The term 'social dumping' is often used in a political, non-technical sense for taking advantage of lower wage levels, e.g., in developing or transformation countries. The technical term 'dumping' in international trade law means to sell goods or services into foreign markets *below* cost in order to promote exports or damage foreign competition. In this respect, hiring labour at local cost is not 'dumping'. Cf., Art. 133(1) EC.

Not subject to compliance in a legal sense are internal codes of business ethics of multinational groups that sometimes extend beyond requirements of local law. Despite the variety of interests joining together in the public business corporation, many of the benefits for shareholders and stakeholders, especially for employees, do not conflict but converge. Good examples are the sustainable profitability of the enterprise (as opposed to short-term gains) and timely and accurate access to information for shareholders as well as employees.

This statement of convergence is not a presumption of encompassing harmony. Many conflicting interests still persist. The reduction of such conflicts to the old-fashioned antagonism of capital and labour, however, would be a serious mistake in the contemporary corporate environment. In the modern corporation, the separation of ownership and management is the typical governance structure, resulting in specific agency problems. Investors and managers should not be lumped together indiscriminately as 'capital'. Corporate law as well as corporate governance deal with the multiple agency problems among shareholders, between shareholders and management and between the corporation and creditors and other stakeholders such as employees.[30]

2.2 Valuation of human resources

Employee involvement is generally part of personnel management, no matter whether laws or collective agreements require structural recognition in participation models. Depending on the line of business, human resources, i.e., a skilled and loyal work force, may be the most valuable asset of the firm.[31] It would be poor business practice to neglect investment in human capital and disregard employees' discontent. Apart from this management perspective, it is a particular objective of the European Community and the Member States to promote social dialogue between management (not: capital!) and labour. So, at least, declares the introduction to the Directive establishing a general framework for informing and consulting employees in the European Community.[32]

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[30] Hansmann and Kraakman, loc. cit. n. 26, at p. 22; Pistor, loc. cit. n. 9, at p. 165. See also Arts. 138 and 139 EC which address the dialogue of '*management* and labor' [emphasis added].

[31] D. Sadowski, J. Junkes and S. Lindenthal, 'Labor Co-Determination and Corporate Governance in Germany: The Economic Impact of Marginal and Symbolic Rights', in J. Schwalbach, ed., *Corporate Governance. Essays in Honor of Horst Albach*, 2nd edn. (Berlin, BWV 2003) p. 147; with reference to accounting: M. O'Connor, 'Rethinking Corporate Financial Disclosure of Human Resource Values for the Knowledge-Based Economy', 1 *U. Pa. J. Lab. & Emp. L.* (1997-1998) p. 527.

[32] Directive 2002/14/EC, loc. cit. n. 1, at p. 29.

From the workers' side, their welfare may be defined by (high) wages including adequate return on efforts, i.e., firm-specific investment, benefits, stable employment, safety of the workplace, personal dignity and chances for individual development and growth. In other words, there is an interest in monetary value as well as in stability and quality. Incentives used in personnel management are based on such needs. But the convergence goes only so far and does not signal the absence of conflicting interests. Therefore, various legal strategies are in place to protect workers' interests. With due respect for the differences in the legal systems, it can safely be said that the phenomenon as such is ubiquitous. All protective legislation is based on the assumption that an individual agreement between employer and employee is insufficient to fairly govern the relationship. A short summary of such devices includes mandatory employment law (like anti-discrimination laws, laws against unfair dismissal or minimum wage laws), collective agreements and information and participation rights. Unless regarded ideologically, participation is overstated if taken as value-in-and-of-itself regardless of function.[33] Workers in each country have their own priorities: health care costs may be a top issue for workers in the United States, but workplace safety might be the top issue for workers in China. Wage levels and cost of living are specific to regions, therefore do not compare in abstract figures. Nonetheless, information and consultation play an important role in the multi-layered structure of protective rights and ensure, last but not least, that employers abide by the law of the land. Employee involvement may enhance the quality of managerial decisions and facilitate their implementation providing such decisions with the cachet of legitimacy. However, such results are by no means guaranteed and depend on multiple factors and conditions.

As already pointed out above, shareholders' interests are not homogeneous, and workers' interests are even less so. The work force of one plant may find itself in fierce competition with the work force of another establishment of the

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[33] For the concept of '*Wirtschaftsdemokratie*' (economic democracy) as a combination of political democracy with social constraints over the use of private capital in post-war Germany, see Pistor, loc. cit. n. 9, at p. 167. The editorial of the special issue 'Towards a civil economy: Participation proves its purpose' of the Magazine *Mitbestimmung International Edition 2004*, available at: <http://www.boeckler.de/cps/rde/xchg/SID-3D0AB75D-A305A1E2/hbs/hs.xsl/164_30868.html>, states: 'The shareholder value argument may continue to dominate the debate. But German trade unions remain obstinately convinced that the principles of democracy and participation, that have proved their worth as a way of organising states and societies, also make sense in the day-to-day world of business … Employees don't stop being self-confident individuals and citizens when they disappear through factory gates and office entrances in the morning…'. This paper will not discuss the difference between a state and an enterprise and the fact that citizens usually coordinate their economic activities by contract.

same multinational group.[34] International solidarity of workers may or may not be present; and there is no legal, economic or moral preference for commonality that can be taken for granted. Again, an antagonistic perspective of capital and labour cloaks crucial agency problems and issues of diverging interests among investors as well as among employees.

2.3 The corporate group as the normal form of organisation

The business actually conducted by a corporation is not identical with the corporation itself. The distinction between the corporate part and the operative part was an issue, e.g., in the lawsuit that Kirk Kerkorian initiated against DaimlerChrysler.[35] The universally adopted form of the corporate part is the group consisting of a (publicly held) parent company controlling a set of subsidiaries.[36] Usually, larger establishments are incorporated under national law as separate legal entities or even groups of entities. Local establishments of subsidiaries may be branches or, again, be incorporated themselves. Incorporation under local laws of the host country is very common. The managerial organisation of the business operation follows the lines of the legal entities only to a certain extent. Internal homogeneity or decentralisation are management prerogatives depending on many factors, predominantly costs.[37] Even if the administration of the group is very centralised and crosses all borders of legal entities, the entity-approach demands respect.[38] Corporate law provides off-the-shelf housekeeping rules for legal entities, not for groups of entities. Subsidiaries often have minority

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[34] Strong examples are competing plants in the automobile industry, e.g., General Motors' restructuring of its European activities, M. Bartmann, *Mitbestimmung International Edition 2005*, available at: <http://www.boeckler.de/cps/rde/xchg/SID-3D0AB75D-EE0995BC/hbs/hs.xsl/164_37819.html>. In countries with pluralistic union traditions, rivalry between unions comes on top of conflicting interests between factions of work forces and sites.

[35] *Tracinda Corp.* v. *DaimlerChrysler et al*., U.S. District Court for the District of Delaware, 7 April 2005 (2005 U.S.Dist. LEXIS 5830) at 53-54.

[36] Hertig and Kanda, loc. cit. n. 26, at p. 119; for a European approach to group law, see J.M. Embid Irujo, 'Trends and Realities in the Law of Corporate Groups', 6 *EBOR* (2005) p. 65; C. Windbichler, 'Corporate Group Law for Europe: Comments on the Forum Europaeum's Principles and Proposals for a European Group Law', 1 *EBOR* (2000) p. 265.

[37] Schmitt and Sadowski, loc. cit. n. 28, at p. 409.

[38] Dismissed too generally by P.I. Blumberg, *The Law of Corporate Groups – Statutory Law – General* (Boston, Little, Brown 1989) *passim*, and *The Law of Corporate Groups – Bankruptcy Law* (Boston, Little, Brown 1985); see also Pistor, loc. cit. n. 9, at p. 176: The German *Bundesverfassungsgericht*, in its opinion of 1 March 1979 on the constitutionality of the 1976 co-determination law (1 BvR 532/77, 1 BvR 533/77, 1 BvR 419/78, 1 BvL 21/78, BVerfGE 50, pp. 290, 339 et seq.) uses the term *Unternehmen* (enterprise, firm) rather than corporation (*Gesellschaft*), thus concentrating on the identity of the enterprise for which the corporation provides a shell.

shareholders whose rights are protected by limitations on majority discretion and other legal rules. If the parent company carves out a subsidiary by listing its stock, the listed subsidiary itself is subject to capital market law and corporate governance rules. A spin-off transaction accomplished by a stock deal is, in most cases, less complicated than an asset deal. That speaks for separate incorporation of relatively autonomous business activities. Tax law, as a rule, focuses on the individual corporation; consolidated taxation is the exception packed with qualifications. The same applies to insolvency law. With respect to personnel, the party to the employment relationship is normally the incorporated division, a legal person, as employer.[39] The employee has no legal ties with the parent or other legal entities unless this is expressly agreed upon or follows, abnormally, from piercing the corporate veil.[40] Finally, it is worth mentioning that the various corporate entities are represented by their own officers and directors, multiple appointments and interlocking directorates notwithstanding. The control of one company over another does not automatically confer agency powers, and legal recognition of group management is still a treacherous field.[41] Group structures reveal the dissimilarity of firm and corporation much more clearly than an analysis of the standalone enterprise.[42]

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[39] C. Windbichler, *Arbeitsrecht im Konzern* [Labour and Employment Law in Corporate Groups] (Munich, Beck 1989) p. 24 et seq., p. 68 et seq.; see also Qwest Code of Conduct: '… This Code sets forth policies and practices with respect to the conduct of all Qwest employees. It does not represent, and may not be interpreted as, an employment contract or other legally binding agreement between Qwest and any employee; nor does it create any contractual or other rights for non-employees or other third parties. Likewise, it creates no contractual or other rights between Qwest and employees. … Any reference to "Qwest" in the Code, policy and M&Ps is not meant to and does not change which entity is your employer. For instance, if you are employed by Qwest Services Corporation, the references here to Qwest do not make you an employee of Qwest Communications International Inc. or any other Qwest entity'. Qwest Code of Conduct, p. 28, available at: <http://www.qwest.com/about/media/presskit/companyFact/files/CodeOfConduct. pdf>.

[40] From a corporate law perspective, concepts like joint employer status or the criterion of *subordination juridique* in French law are either contractual or piercing by attribution (note: piercing the corporate veil is not restricted to liability); cf., in the United States, FLSA 29 U.S.C. § 203(d); *Lin* v. *Donna Karan International, Inc*., United States District Court, Southern District of New York, 6 Wage & Hour Cas. 2nd (BNA) 1142 (2001); for labour relations, see Blumberg (1989), op. cit. n. 38, at ch. 13; for France, cf., Cass. soc., 13 May 1969, *Droit Social* 1969, p. 512; 10 May 1973, *Bull. civ.*, V, No. 296; 15 June 1960, *Droit Social* 1961, p. 108.

[41] Embid Irujo, loc. cit. n. 36, at p. 65; Hertig and Kanda, loc. cit. n. 26, at p. 118 et seq.; Windbichler, loc. cit. n. 36, at p. 271 et seq.

[42] Corporate governance should therefore not automatically be equated with firm governance, and a corporate constitution is not necessarily the same as a firm's constitution. Cf., Sadowski, Junkes and Lindenthal, loc. cit. n. 31, at p. 149, on the one hand, and Pistor, loc. cit. n. 9, at p. 176, on the other.

3. THE CORPORATE GOVERNANCE CONUNDRUM

3.1 Boardroom co-determination and the agenda for improving board performance

The monitoring function of the board is high up on the agenda for corporate governance improvement in various contexts. The EC Commission's Action Plan[43] prominently recommends the confirmation of the collective responsibility of board members for financial and non-financial statements, the strengthening of the role of independent non-executive and supervisory directors and enhancing the responsibilities of board members. The Commission aims at fostering the efficiency and competitiveness of businesses and strengthening shareholders' rights and investor confidence. The Action Plan is meant to shape regulatory developments on an international scale, especially clearing up discrepancies with the Sarbanes-Oxley Act. Other corporate governance proclamations like the Financial Services Authority's Combined Code in the United Kingdom[44] and academic endeavours point in the same direction.

Employee-elected board members get in the way of this vision of an effective board. Workers' representatives do not qualify as 'independent directors' within the scope of s. 10A(m)(3)(B) of the 1934 Act as amended by the Sarbanes-Oxley Act. The SEC made use of the exemption authority granted in s. 10A(m)(3)(C). Rule 10A-3(iv)(C) exempts employees of foreign corporations elected according to home country co-determination laws from the independence requirement. This, however, does not declare labour representatives independent but releases foreign corporations from the stricter Sarbanes-Oxley obligations. According to the NYSE Corporate Governance Rules, listed foreign private issuers must disclose any significant ways in which their corporate governance practices differ from those followed by domestic companies. A commentary to this rule emphasises that 'this requirement is not intended to suggest that one country's corporate governance practices are better or more effective than another'.[45] This is a pragmatic approach since the NYSE does not want to be in the position of umpire in a competition of governance regimes. Neither the SEC exemption nor the NYSE Corporate Governance Rules justify further inferences as to the merits of co-determination.

With particular reference to the German two-tier system with a co-determined supervisory board, the relationship of the two boards with each other realistically

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[43] See *supra* n. 4.

[44] The Combined Code on Corporate Governance, available at: <http://www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf>.

[45] Sec. 303A, NYSE Corporate Governance Rules as of November 2004, available at: <http://www.nyse.com/pdfs/section303A_final_rules.pdf>.

needs to be seen in the context of shop-floor co-determination of works councils. Not only are works councils and representation on the board two completely different forms of employee involvement, albeit at least with least overlapping objectives, but, in practice the majority of employees' representatives are at the same time members or even chairpersons of works councils on several levels (establishment, undertaking or group).[46] Information, consultation and, in the case of hard co-determination rights, negotiations are transacted between management representing the corporation as employer, on the one side, and the chairperson of the works councils representing employees, on the other. The same players in the transaction scenario face each other in the hierarchical scenario of the internal organisation of the company, this time the employees' representative serves as a member of the supervisory board that appoints and oversees the managing board and, following the modern understanding of the role of the supervisory board in the two-tier system,[47] partakes in shaping the overall business policy. Frequent exchanges between management and employees' representatives in the day-to-day business routine create an environment suitable for coalitions, depending on the perspective labelled as consensual corporate culture, package deals or even back-scratching.[48] Shareholders' representatives on the supervisory board may have less information and less frequent contacts with management. And even if they are well informed and want to actively engage in close scrutiny of the management's work, open criticism in the presence of employees (as fellow board members) may be dampened by concern for management's leadership and clout *vis-à-vis* the workforce.[49]

Another common criticism of the co-determined board in action is the allocation of time in the boardroom. Although all members of the supervisory board are equally bound to promote the best interest of the firm as a whole, employees' representatives show a tendency to emphasise human resources topics even if the

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[46] See, e.g., supervisory board of DaimlerChrysler as disclosed in its 2004 annual report, p. 85, available at: <http://www.daimlerchrysler.com/Projects/c2c/channel/documents/628999_dcx_gb_2004.pdf>; Pistor, loc. cit. n. 9, at pp. 182-183.

[47] BGHZ 114, 127; German Corporate Governance Code, loc. cit. n. 12, at s. 3; Hueck and Windbichler, op. cit. n. 13, at § 24, n. 26.

[48] See Sadowski, Junkes and Lindenthal, loc. cit. n. 31, at p. 145, on the one hand, and J. Schwalbach, 'Effizienz des Aufsichtsrats', 49 *Die Aktiengesellschaft* (2004) p. 186 at p. 189, on the other; A. von Werder, 'Überwachungseffizienz und Unternehmensmitbestimmung', 49 *Die Aktiengesellschaft* (2004) p. 166 at p. 170. Pistor, loc. cit. n. 9, at p. 177: The 1976 model focused on how to ensure 'social governance' and largely ignored the implications for shop-floor co-determination. The daily give and take between management and *Betriebsrat* without adequate supervision may also have contributed to the intensification and petrification of shop floor co-determination. It produces, moreover, methodological difficulties in empirical research based on interviewing techniques.

[49] Schwalbach, loc. cit. n. 48.

issue, seen in the broader perspective of general policy and weight, does not deserve attention at the board level. Vice versa, attention is diverted from worthier concerns. A snapshot examination of this kind of boardroom episode is the famous bicycle shed v. multi-million-investment scene in *Parkinson's Law*.[50]

Anecdotal evidence shows various deformations in the functioning of the two boards. Even if not unduly generalised, the likelihood of such distortions under an agency perspective seems more plausible than, e.g., the win-win scenario painted by co-determination advocates.[51] Moreover, the interaction of board performance with other means of control – i.e., market forces supported by disclosure, anti-trust laws and take-over threats – is affected when part of the board is immunised against such other forces.

The deference given to board-level participation by the SE Regulation and Directive, therefore, is not in line with general European and other corporate governance policy. The promotion of employee involvement and social dialogue, on the one hand, and strengthening shareholders' rights and investor confidence, on the other, do not represent a 'fully integrated approach'.[52] As pointed out initially, the general policy towards employee involvement in the European Community convincingly refrains from attempts to harmonise the disparate systems.[53] That leaves the burden to adjust to changes in the business world and to meet modern corporate governance standards to the Member States. In the specific case of the SE, the contracting parties can, to a limited extent, shape their organisation to their taste. If they choose boardroom participation as the employee involvement model, they will have to put up with the corporate governance conundrum.

3.2 The national co-determination regime and the international group

German co-determination law takes boardroom participation very far. Within a purely national context, this may or may not have been a workable model.[54] For international groups, however, the German model leads to some peculiar consequences.[55] Some prominent examples may serve as illustration. DaimlerChrysler

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[50] C. Northcote Parkinson, *Parkinson's Law* (Boston, Houghton Mifflin 1957) p. 29.

[51] Cf. J.G. Backhaus, 'Company Board Representation', in J.G. Backhaus, ed., *The Elgar Companion to Law and Economics* (Cheltenham, Elgar 1999) pp.155-167; Sadowski, Junkes and Lindenthal, loc. cit. n. 31, at p. 144.

[52] The EC Commission's Action Plan, loc. cit. n. 4, at p. 3, points out that the objectives of fostering the efficiency and competitiveness of business and strengthening shareholders' rights and third party protection require a *fully integrated approach* [emphasis in original].

[53] See Davignon Report loc. cit. n. 2; Recital 5 of the Council Directive 2001/86/EC, loc. cit. n. 3.

[54] Backhaus, loc. cit. n. 51; Sadowski, Junkes and Lindenthal, loc. cit. n. 31; Roe, op. cit. n. 9.

[55] This remark does not assert that German-type co-determination prevents firms from incorporating in Germany. It obviously does not, at least not completely. The decision where to

AG is a stock corporation incorporated under German law, therefore subject to the German co-determination regime. DaimlerChrysler has operational subsidiaries, predominantly in Germany (ca. 180,000 employees) and the United States (ca. 170,000 employees), and is listed at the New York Stock Exchange, i.e., it is subject to American capital market law. The corporation has a two-tier board; half the seats, i.e., ten, on the supervisory board are taken by employees' representatives. Since the German co-determination law follows the principle of territoriality, only the German workforce is entitled to elect board members. Seven of the ten seats on the board are reserved for individuals actually employed by the corporation or its German subsidiaries. For the remaining three seats, the representative union (here: IGM, the German metal workers' union) has the right to nominate candidates, employed or not by DaimlerChrysler. The actual outcome of the elections, I would say, shows a mature way to handle a delicate problem. The metal workers' union nominated on its ticket the Vice President of the UAW[56] (Auburn Hills), who was elected by the German workforce. This is perfectly legal, the underlying gentlemen's agreement, however, will most likely not be enforceable. Upon nomination by IGBCE (the German chemical workers union), Ms Catherine Pinchault has a seat on the supervisory board of Bayer-CropScience AG, a subsidiary of Bayer AG; at Deutsche Telecom, the German union ver.di offered one of its three seats to the American CWA but the nominee did not get enough votes from the German workforce.[57]

Other internationally active groups headquartered in Germany with geographically dispersed operations, like Siemens or Allianz, do not have comparable arrangements. Their boards are becoming more and more internationalised on the shareholders' side but not on the employees' side. Why that is so, I can only speculate: I think that the history of DaimlerChrysler and the concentration of the non-German workforce at Chrysler provides for an important prerequisite for an arrangement. That is, the UAW is a genuine partner for negotiations, and the Germen workers are represented by a rather uniform union. If the international workforce is spread over the rest of the world, as it is the case with Siemens or Allianz, it would be difficult if not impossible for the German union(s) to settle

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incorporate depends on a host of considerations, especially the tax burden. Therefore, it is methodologically inaccurate to draw quick conclusions from the existence of DaimlerChrysler AG and others with respect to the effects of co-determination. Cf. *Tracinda* v. *DaimlerChrysler*, loc. cit. n. 35, at 41.

[56] International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). Many American unions carry 'International' in their names; however, their locals represent workers employed at US plants.

[57] Girndt, *Mitbestimmung International Edition 2005*, available at: <http://www.boeckler.de/cps/rde/xchg/SID-3D0AB75D-A305A1E2/hbs/hs.xsl/164_37825.html>.

on a partner and to motivate their constituency. We should not forget that the DaimlerChrysler arrangement costs the IGM one of its seats on the board.

By and large, the current German co-determination regime for international groups ensures only the representation of the German workforce. The supervisory board, as a consequence, is imbalanced in several ways and falls behind the 'democratic' qualities associated with co-determination.[58] Pragmatic solutions to ease the awkward results are very limited.

The oddity of the territorially limited co-determination regime has drawn academic as well as political attention. One suggestion to straighten this out, made in union circles, is to extend the right to appear on the ballot to persons employed not only in Germany but somewhere within the international group. Then, individuals employed by a subsidiary wherever in the world would be eligible for a board seat.[59] Given the proportion of 'inside' representatives and those on the union ticket, this model would save the German unions their seats (cf., the current DaimlerChrysler and BayerCropScience practice: Ms Pinchault and Mr Gooden have taken seats from IGBCE and IGM). The proposal has not been drawn out in detail. From an employment lawyers' point of view, e.g., the question may be asked whether an employee of a foreign subsidiary holding a board seat gets the necessary time off without loss of pay or is protected from retaliatory dismissal.[60] In this context, it is important to note that the employer is the subsidiary; the subsidiary has no legal obligation to support the parent company's co-determination model, neither in employment law, nor in labour law, nor in corporate law. And Germany (or any other country) lacks jurisdiction to impose protective laws on foreign subsidiaries incorporated under foreign law and employment agreements governed by foreign employment law, e.g., the doctrine of employment at will.

The suggested model does not touch upon nomination rights of foreign unions or even the right of workers employed abroad to participate in the board elections. Politically, this is understandable. Worldwide nomination and voting rights could shatter the power of German unions and leave a fragmented board that neither ensures workable employee involvement nor eases corporate governance inconsistencies. An idealistic approach that promotes a worldwide ballot for

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[58] See *supra* n. 33.

[59] Girndt, *Mitbestimmung International Edition 2005*, see *supra* n. 57; D. Hexel, *Mitbestimmung International Edition 2004*, see *supra* n. 10.

[60] For unjust dismissal laws, cf., in Germany SEBG (Law on Employee Involvement in an SE, BGBl. I 2004, p. 3686, § 42; protection for members of the special negotiating body in the United Kingdom: Statutory Instrument 2004, No. 2326, Part 3, ch. 8. ILO Convention 158 states in Art. 5(b) that holding office as workers' representative does not constitute a valid reason for termination. This rather weak Convention has been signed by thirty-one nations; the United States is not among them.

employees' representatives on the board of the parent company would have to deal with such political and functional reservations. Moreover, the legal model would have to work out the issues of private international law touched upon above. The candidacies and voting procedures need some legal shape and protection. The German legislature, or better, no national legislature, can provide that worldwide. Therefore, the proposition voiced sometimes to just extend the voting rights and have it all done by e-mail would be fine as a non-technical contribution to a newspaper but not as a serious suggestion for legal change.

Dutch law had, until recently, a formal co-optation system and special provisions for international groups.[61] In large corporations, the supervisory board appointed its own members. The shareholders' meeting and the works council only had nomination rights, and each of the two sides could veto an appointment planned by the supervisory board on grounds of unsuitability of the candidate. The difference of this procedure to election by the shareholders' meeting was, most likely, not as unique as it looked at first glance. *De facto* co-optation is very common in the selection process of board members; the shareholders' meeting practically acts as a ratification body only and the nomination process is dominated by the board. The Two-Tier Structure Reform Act of 2004 shifted the right to appoint members of the supervisory board to the shareholders' meeting; works councils have a nomination right for one-third of the board members. International holding companies incorporated in the Netherlands are exempt from the statutory two-tier regime when the majority of the employees of the company and of the group companies are employed outside of the Netherlands. The Dutch works councils shall have no undue influence on the management of predominantly foreign businesses. The exemption acknowledges the discrepancy between national workers' representation and international corporate activities. Some proponents for change in Germany promote such an exemption. However, the criterion of the number of employees outside the Netherlands is not persuasive beyond doubt; groups close to employing 50 per cent of their workforce domestically are subject to unwarranted pressures in their human resources policy. And the all-or-nothing approach of exemption is not compelling, either.

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[61] Cf., Burgerlijk Wetboek, Arts. 2:158-164 and 2:262-274; F.B.J. Grapperhaus and L.G. Verburg, *Employment Law and Works Councils of the Netherlands* (The Hague, Kluwer Law International 2002) pp. 59-60; E. Groenewald, 'Corporate Governance in the Netherlands: From the Verdam Report of 1964 to the Tabaksblat Code of 2003', 6 *EBOR* (2005) p. 291; Rebhahn (2004), loc. cit. n. 7, at No. 18; L. Timmerman and S.-J. Spanjaard, 'Arbeitnehmermitbestimmung in den Niederlanden', in Baums and Ulmer, op. cit. n. 7, at p. 85 et seq. Recent changes of the law (as of 1 September 2004) shifted the election right from the board to the shareholders' meeting leaving the nomination rights for one-third of the seats with the works council.

The Regulation and Directive on the SE, as secondary EC law, have the special advantage of harmonisation; procedures to establish the special negotiating body that represents the EC-wide workforce are in place in all Member States. The same applies to the European works council. This common denominator fails when employee involvement is to be taken beyond the European Union.[62] According to its design, the SE will most likely be a member of a corporate group. Employee involvement rules for the SE, as well as German law, take that into account, but lack provisions for differentiation as to the kind of relationship between corporations. The group is taken as a whole like in management science, where the group is often treated as a firm.[63] That makes sense in many instances but not always. To give only two examples: the listed subsidiary and the subsidiary held only for investment purposes without operational involvement. Both can hardly be treated as mere units of the parent company.

3.3 Competition of legal systems

After *Inspire Art*,[64] the legal environment for the competition of legal systems has improved tremendously. Whether a European equivalent to the Delaware effect will develop remains to be seen, however. The corporation laws entering the contest are the existing laws of the Member States to begin with. Additionally, the new European and global environment should be an incentive to consider changes in existing laws. As pointed out before, employee involvement deserves a broader debate than the defence or juxtaposition of existing models. This new discourse will only be productive if it is based on the current state of corporate governance conceptions and requirements in a world of international capital markets. A mere revival of social policy arguments exchanged in Germany leading to the 1976 co-determination law will not be fruitful, especially since that debate focused on minuscule variations in the design of the models under consideration instead of deeper structural and political understandings.[65] Even under the assumption that the 1976 law was a success and lived up to the highest expectations, the legal and economic environment has changed and adaptation seems inevitable. A third aspect is how innovation-friendly laws themselves are, i.e., how much room is given to contractual arrangements. One of the prominent features of Delaware law is the relatively high amount of default rules and the opportunities it gives for

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62 Cf., in Germany § 21(1) 1. SEBG, see *supra* n. 60.
63 Cf., *supra* n. 42 on the differentiation between firm and corporation.
64 See *supra* n. 6.
65 Pistor, loc. cit. n. 9, at p. 172 et seq.

custom-tailored corporations.[66] This third notion is in line with the preponderance for establishing procedures of employee information and consultation as well as participation in the SE primarily by means of agreement.

On the one hand, such agreements have to meet minimum standards; on the other, default rules determine to a certain extent the bargaining positions. To stay within the language of evolutionary theory, constraints are a prerequisite for development; by the same token, constraints may unnecessarily limit evolution, depending on their design. The latter may be the case for new models by agreement in the SE. Moreover, the production of new models can be costly. Experience shows, however, that contract-based employee participation is practiced, sometimes in a grey area of law, sometimes meticulously squeezed between rigid provisions of mandatory law.[67] Costs incurred by lack of practice and the need for continuing adaptation must be offset by advantages for all parties involved. An academic paper can hardly substitute for rich practical experience, but it can facilitate progress. Comparative references to existing examples of employee involvement in other countries are always valuable. The scholar may very well rummage through the toolkits of corporate, labour and employment, contract and private international law and help design building blocks for new workable models. The following sections outline some underpinnings for contractual solutions in general.

4. INTERNAL AND EXTERNAL GOVERNANCE

Given the tremendous diversity of rules and practices of employee involvement, and the similar diversity of theoretical explanations of the corporation, the firm, the group and the role of shareholders and stakeholders, I would like to focus first on a governance-oriented contractual analysis.

4.1 **Employees' internal involvement in the structure of the corporation**

The Council Directive supplementing the Statute for a European company with regard to the involvement of employees defines 'participation', as distinguished from 'information' and 'consultation', as the influence of the body representative of the employees and/or the employees' representatives in the affairs of a company by way of the right to elect or appoint some of the members of the

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[66] Pistor et al., 'Evolution', loc. cit. n. 21; similar effects may result from more generous recognition of dispure resolution by arbitration, Kirchner, Painter and Kaal, loc. cit. n. 21, at p. 195 et seq.

[67] Seibt, loc. cit. n. 22; Windbichler, op. cit. n. 39, at p. 541 et seq.

company's supervisory or administrative organ, or the right to recommend and/or oppose the appointment of some or all of the members of the company's supervisory or administrative organ.[68] This definition encompasses several models of participation found in various European jurisdictions. The German co-determined supervisory board clearly falls within the definition's first variation and is a corporate law device, i.e., corporate governance-based employee involvement. Given that delegated management with a board structure is a typical feature of the business corporation, the composition of the (supervisory) board is a core element of internal corporate structure.[69] As the group makeup is the predominant form of business organisation, German co-determination laws include the workforce of (national) subsidiaries in the constituency that elects the employees' representatives in the parent company's board.[70]

Therefore, an enquiry into the logic, advantages and disadvantages, cross-border practicability and susceptibility to agency problems of inside participation of employees is essential. Other forms of employee involvement are internal affairs of the firm as well, at least as seen from a customer's, creditor's or supplier's perspective. Technically, however, relations between the corporation's works council or other employees' representation are relations between two separate parties, which in the case of the *Betriebsvereinbarung* (works agreement) are clearly of contractual nature in a legal sense. Together with regulation and other legal and contractual constraints that shape the relationship between the corporation and its employees, such representation takes place outside the structure of the corporation itself. The distinction between governance-based and transaction-based employee involvement provides clarity when comparing businesses in other, non-incorporated forms like partnerships or limited partnerships. Such businesses are subject to shop-floor co-determination (*Betriebsverfassung*), collective bargaining and employment laws, but not to boardroom co-determination; they are under no legal obligation to have a board structure. The same applies to businesses carried on in incorporated form but too small to fall within co-determination laws. Employees' internal involvement in the structure of the corporation shares all the corporate governance issues as to board composition, independence, compensation,[71] terms, removal, and so forth.

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[68] Council Directive 2001/86/EC, loc. cit. n. 3, Art. 2(k).

[69] Hansmann and Kraakman, loc. cit. n. 26, at p. 11 et seq.; for the distinction between internal and external corporate governance, see also Hopt, loc. cit. n. 8, p. 289 at p. 292.

[70] Mitbestimmungsgesetz of 4 May 976, BGBl. I, 1153, § 5(3); similarly in the Netherlands, Art. 2:155(3) of the Burgerlijk Wetboek.

[71] Whether compensation of supervisory board members should include stock options or other incentive-oriented, variable elements is highly disputed; BGH opinion of 16 February 2004 – II ZR 316/02 rules out stock options for members of the supervisory board. For incentive-oriented compensation, see Schwalbach, loc. cit. n. 48. German labour representa-

4.2 Employees' contractual relations with the corporation

The employment relationship differs in many respects from the relationship that connects a shareholder with the corporation.[72] Workers receive payment for services rendered no matter whether their work proved productive or not. If discharged, they are in a position to offer their services to a different employer. An investor who lost his investment is never in the position to reinvest. In times of high unemployment rates, however, finding an adequate new occupation is difficult or even impossible. Nationally diverging systems place this burden, to a greater or lesser extent, on the worker, the employer or society in general. One of the remaining contractual problems that is usually not resolved is that the employeee's specific human capital investment is not recovered and that employees lack compensation for the decrease of general employability through firm-specific specialisation.[73] This is just a snapshot of a vast and complicated field.

The individual employment contract usually covers only a very limited range of topics and is more or less heavily regulated by legislation and case law. Rules on safety standards and social security are applicable to all categories of employment; the legal framework is mostly administrative law. Mandatory minimum standards of terms or work place safety are independent from the legal structure of the employer.[74] The employment contract has inherent 'hybrid' features.[75] The

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tives are bound by the articles of association of their union to pay the better part of their compensation into a fund.

[72] These differences are often neglected in a nexus-of-contracts analysis of the firm; cf., J.D. Cox and T.L. Hazen, *Corporations*, 2nd edn. (New York, Aspen 2003) pp. 39-44; M.A. Eisenberg, 'The Conception that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm', 24 *J. Corp. L.* (1999) p. 819; J.R. Macey, 'An Economic Analysis of the Various Rationale for Making Shareholders the Exclusive Beneficiaries of Corporate Duties', 21 *Stetson L. Rev.* (1991) p. 23; Windbichler, loc. cit. n. 24, at p. 805 et seq.

[73] See, e.g., the life-cycle model of wages according to M.L. Wachter and G.M. Cohen, 'The Law and Economics of Collective Bargaining: An Introduction and Application to the Problems of Subcontracting, Partial Closure, and Relocation', 136 *U. Pa. L. Rev.* (1988) p. 1349 at p. 1362, reprinted in S.L. Willborn, S.J. Schwab and J.F. Burton, *Employment Law Cases and Materials*, 3rd edn. (Newark, NJ, Matthew Bender 2002) p. 8; K. Van Wezel Stone, 'Policing Employment Contracts within the Nexus-of-Contracts Firm', 43 *U. of Toronto L.J.* (1993) p. 353.

[74] E.g., everybody working at a construction site has to wear a helmet and steel-capped boots, no matter whether the employer is a contractor or subcontractor or ancillary supplier, incorporated, publicly listed or a family business. See also P.L. Davies, *Introduction to Company Law* (Oxford, Oxford University Press 2002) p. 272.

[75] P. Behrens, 'Die Bedeutung der ökonomischen Analyse des Rechts für das Arbeitsrecht' [The Importance of Economic Analysis of Law for Labour Law], *Zeitschrift für Arbeitsrecht* (1989) p. 209 at p. 224; P. Bolton and M. Dewatripont, *Contract Theory* (Cambridge, MA, MIT Press 2005) pp. 486-498; I.R. Macneil, 'The Many Futures of Contracts', 47 *S. Cal. L. Rev.* (1974) p. 691 at p. 720 et seq.; I.R. Macneil, 'Contracts: Adjustment of Long-Term Economic

agreement is geared towards a relationship over a longer period of time but cannot foresee all future contingencies; it needs changes, additions and re-adaptations. Regular employment is a typical example of the incomplete (as opposed to: discrete) relational contract. Collective agreements and co-determination at the shop-floor level serve as tools for the necessary redefinition of rights and obligations over time, i.e., they are part of a sophisticated contract governance system.[76] Employment contract governance varies tremendously from jurisdiction to jurisdiction.[77] Some countries traditionally host reservations against cooperative approaches towards employer's relations with employees' representatives.[78] However, mechanisms to protect employees' interests by regulation or collective governance of employment relations are ubiquitous in all Western industrialised countries. Transaction-based employee involvement, therefore, is a well-stocked toolbox.

Shareholders, by comparison, have to rely on disclosure, the capital market and the governance structure of the corporation. This dissimilarity in relationship governance between shareholders and employees comes on top of the crucial distinction between creditors and residual claimants.

Relations Under Classical, Neoclassical, and Relational Contract Law', 72 *Nw. U.L. Rev.* (1978) p. 854; I.R. Macneil, 'Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus"', 75 *Nw. U.L. Rev.* (1981) p. 1018; O.E. Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations', 22 *J. Law & Econ*. (1979) p. 233 at p. 235 et seq.; J. Jickeli, *Der langfristige Vertrag* (Baden-Baden, Nomos 1996) p. 61 et seq., p. 77 et seq.; H. Kötz, *Europäisches Vertragsrecht* (Tübingen, Mohr 1996) p. 19 et seq.; R. Richter and E.G. Furubotn, *Neue Institutionenökonomik. Eine Einführung und kritische Würdigung*, 3rd edn. (Tübingen, Mohr-Siebeck 2003) p. 476 et seq.; E. Schanze, 'Symbiotic Contracts: Exploring Long-Term Agency Structures Between Contract and Corporation', in C. Joerges, ed., *Franchising and the Law: Theoretical and Comparative Approaches in Europe and the United States* (Baden-Baden, Nomos 1991) p. 67 at p. 100 et seq.; C. Windbichler, 'Betriebliche Mitbestimmung als institutionalisierte Vertragshilfe' [Co-Determination as Institutionalised Instrument to Complete Relational Contracts], in M. Lieb, U. Noack and H.P. Westermann, eds., *Festschrift für Wolfgang Zöllner* (Cologne, Heymann 1999) pp. 999-1009.

[76] To give a practical example: the individual employment contract describes the job as 'full-time'; the union agreement defines the 38-hour week as full-time employment; the agreement between the employer and the works council arranges the schedule to break up the (average) 38 hours into 8-hour shifts.

[77] For an excellent overview, see Rebhahn (2003), loc. cit. n. 7; also Biagi, loc. cit. n. 7.

[78] In the United States, the so-called Team Act that proposed an amendment to § 8(a)(2) NLRA (29 U.S.C. § 158) 1996 was vetoed by President Clinton, who gave in to union opposition; the amendment would have facilitated quality circles and other cooperative practices; J.G. Getman, B.B. Pogrebin and D.L. Gregory, *Labor Management Relations and the Law*, 2nd edn. (New York, Foundation Press 1999) p. 351; cf., also M.A. O'Connor, 'The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation', 78 *Cornell L. Rev*. p. 899 at p. 947 et seq.

Corporate management is responsible for handling employment relations within the applicable legal framework. That includes enforcement by administrative agencies, courts or arbitration. The discharge of the duties related to the workforce, human resources policy in general, is subject to all the benefits and drawbacks of the corporate decision-making process, its typical agency problems and problem-solving strategies.[79] More specifically, managers or the managing board are subject to (supervisory) board control, and that control includes the management of human resources. A poor corporate citizenship record and poor human resources management may indicate a lack of business acumen on the part of the incumbent management, likewise overly generous or back-scratching relations with labour. Implementing workable control of management is one of the principal corporate governance concerns.

Interestingly enough, more and more laws in the realm of corporate and capital market regulation include disclosure requirements and information rights for or pertaining to employees and their representatives. Examples include Article 8(2)(c) of the Council's SE Regulation[80] compelling the management to cover in a transfer proposal 'any implication the transfer may have on employees' involvement', and Article 8(3): 'The management or administrative organ shall draw up a report explaining and justifying the legal and economic aspects of the transfer and explaining the implications of the transfer for … employees.' National laws contain similar clauses.[81] Increasing disclosure obligations in capital market law are benefiting information interests of employees and their representatives, too. This is especially true for statements of business policy and other soft, projective or forward-looking information.[82] International Financial Reporting Standards and the US-GAAP call for more expectation-oriented financial statements compared to distribution-oriented accounting along the line of the German Commercial Code. Moreover, the Regulation on the application of

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[79] Hansmann and Kraakman, loc. cit. n. 26, at p. 22.

[80] Council Regulation (EC) No. 2157/2001, loc. cit. n. 3; see also Art. 6(3)(i) of Directive 2004/25/EC of 21 April 2004 on takeover bids, *OJ* L 142 of 30 April 2004, p. 12: 'The offer document … shall state at least: the offeror's intentions … with regard to the safeguarding of the jobs of their employees and management, including any material change in the conditions of employment…'.

[81] E.g., in Germany § 5(1) No 9 Umwandlungsgesetz, 28 October 1994, BGBl. I, 3210; § 11(1)(3) No 2 WpÜG of 1 January 2001, BGBl. I, 3822.

[82] Cf., for the United States, Regulation S-K Item 303, Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A); for Germany, § 29 BőrsZulV; § 15 WpHG; G. Hertig, R. Kraakman and E.B. Rock, 'Issuers and Investor Protection', in Kraakman et al., op. cit. n. 26, at pp. 199-201; Hueck and Windbichler, op. cit. n. 13, at § 27 n. 4; C. Windbichler, 'Die "kohärente und auf Dauer angelegte Gruppenpolitik"' [Coherence and Long-Term Consistency in Group Policy], in M. Habersack, et al., eds., *Festschrift für Peter Ulmer* (Berlin, De Gruyter 2003) p. 683 at p. 689 et seq.

international accounting standards[83] pertains to consolidated financial statements and addresses the group situation, i.e., the normal arrangement of doing business via publicly traded stock corporations.

The current tendencies in EC law do not generally advocate 'participation' as defined in the Council Directive supplementing the Statute for a European company.[84] In its introduction, the Directive points out in Recital 5 that '[t]he great diversity of rules and practices existing in the Member States as regards the manner in which employees' representatives are involved in decision-making within companies makes it inadvisable to set up a single European model of employee involvement applicable to the SE.' If and when participation rights exist within one or more companies establishing an SE, they should be preserved through their transfer to the SE. The Directive establishing a general framework for information and consultation[85] does not take a stand as to whether internal participation or transaction-based involvement is the preferable form. Hence, the policy questions raised by internal participation and current corporate governance developments are left to the Member States to be resolved.

5. TRANSACTION-BASED SOLUTIONS: AN AGENDA FOR MODERNISATION

5.1 **Boos for convoluted corporate boards**

Summing up some major concerns of the current corporate governance debate, it is safe to state widespread dissatisfaction with corporate board performance. Ways and means for improvement involve board composition, director's compensation, committee structure and other organisational instruments. The subject matter is far from settled. However, the state of the art in theory and (anecdotal) evidence shows that mandatory employees' internal involvement in the corporate structure is not helpful in resolving the agency problems arising from the separation of ownership and control and the demands of international capital markets. Instead, boardroom participation adds additional agency conflicts and makes incentive structures even less transparent than they already are. Purported lower costs as a result of better firm-internal information and smoother implementation of employee-legitimised managerial decisions is hard to prove empirically. Staunch defenders of the German model usually argue from the closely knit world of a single company in the local environment of national law including shop-floor

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[83] Regulation (EC) No. 1606/2002 of 19 July 2002, *OJ* L 243 of 11 September 2002, p. 1.
[84] Council Directive 2001/86/EC, loc. cit. n. 3.
[85] Council Directive 2002/14/EC, loc. cit. n. 1.

co-determination.[86] For the internationally active corporate group, nothing much is gained from this kind of scenario. Political entrenchment and historical background illustrate path dependencies and do not justify current and future structures.

The predominant enlightened shareholder value orientation in corporate governance, however, demonstrates that competitiveness of corporations does not contradict sensitive social and environmental performance.[87] Sustainability, long-term goals and corporate citizenship are in line with corporate governance objectives. The dissatisfaction with mandatory workers' boardroom participation is not identical with a position in favour of absolute shareholder supremacy. Neither is boardroom participation identical to efficacy of employee involvement. The problem is to find institutionalised channels for employee involvement that are compatible with corporate housekeeping rules. It should not make a difference for employee involvement whether the corporation has a one-tier or a two-tier board, a separate internal audit organ or an audit committee, is listed or a subsidiary, or controls other corporations.

From this perspective, an exemption from board-level co-determination for parent companies of international groups (the Dutch model) looks rather disingenuous as a solution. The same may be said of the approach the SE Directive has taken. The SE model, including its preference for employee involvement by agreement, is geared towards preservation of national models and stretches them across borders. There, the delicate interplay between local representation models (*Betriebsverfassung*) and corporate participation is taken too lightly. Employees of group-affiliated companies in countries with a more adversarial tradition in labour relations[88] are used to other forms of representation that do not correspond easily with cooperation in a co-determined board enhanced by shop-floor participation. The boardroom is not the right place for adding more interests to balance in a non-contractual, organisational way. The theoretical underpinnings of employees' involvement point towards contract governance, i.e., the collectively regulated employment relationship between individual and corporate employer. Participation in the structure of the corporation shrouds the difference between the firm and the corporate entity and group. The nexus of contract theory is useful in many respects to explain the firm. It is not helpful in addressing the issue of board performance.[89]

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[86] E.g., Backhaus, loc. cit. n. 51; Höpner, op. cit. n. 8, at p. 30 et seq.

[87] The EC Commission's Action Plan, loc. cit. n. 4, Introduction, p. 3.

[88] Cf., § 8(a)(2) NLRA and the problems associated with co-operative labour practices; Getman, Pogrebin and Gregory, op. cit. n. 78, at pp. 342, 351.

[89] Parts of American literature emphasise the need for protection of implicit contracts against ex-post opportunism and advance a stakeholder approach in corporate governance. See, e.g., M.M. Blair and L.A. Stout, 'A Team Production Theory of Corporate Law', 24 *J. Corp. L.*

5.2 Cheers for contract governance

The employment relationship is contractual in the legal sense of 'contract'. The parties to the contract are the employee and the employer. The employer is the corporation as a legal entity. Therefore, the internal governance structure of the employer is not a common topic of contractual provisions. Contract terms that police the structure of one party to the contract, as opposed to the behaviour of the party, are a rather rare exception practiced in certain areas.[90] The normal scenario would be an expansion of the contractual devices summed up above under 4.2. Collective representation, information and consultation, and collective agreements, are reinforcements of an otherwise weak contractual relationship. Moreover, collective means integrate the team aspect of employment relations that are neglected in a mere two-party contractual approach.[91]

As far as the subject matters that require employee involvement are concerned, the Directive establishing a general framework for information and consultation[92] sets a minimum standard without prejudice to the form (contractual or structural, see above). Other items and procedures may be added. German and Austrian laws, for instance, demand express consent of the works council to certain managerial decisions. This goes way beyond information and consultation. In countries with both strong shop-floor representation and boardroom participation, legal scholarship finds promise in pigeonholing what is shop-floor and what is boardroom co-determination (*betriebliche* v. *Unternehmensmitbestimmung*). However, this distinction is not a natural watershed. The quality and intensity of employee involvement does not depend on the splendour of board membership. The symbolic bearing of a board seat, however, may cloud the comparative value of the position.[93]

(1998-1999) p. 751; M. O'Connor, 'Labor's Role in the American Corporate Structure', 22 *Comp. Lab. L. & Pol'y J.* (2000-2001) p. 97. From a European management perspective, see Sadowski, Junkes and Lindenthal, loc. cit. n. 31, at p. 144: Firms as a pool of specific investors (capital and human capital). These perspectives gloss over the difference between 'firm' and 'corporation'. It seems, moreover, that the potential of contract governance on the employment level and the problems of board structure are underestimated.

90 An example for such an exceptional contractual arrangement may be found in German *Konzernrecht*, the domination contract (requiring shareholder approval) or, in US financing practice, covenants regulating dividend policy of a debtor company. The latter example comes with the reservation that dividend policy is a structural matter that may vary from jurisdiction to jurisdiction.

91 C. Windbichler, 'Das Arbeitsverhältnis als Austausch- und "Geschenkverhältnis"', in H. Hirte, K. Frey and R. Wank, eds., *Festschrift für Herbert Wiedemann* (Munich, Beck 2002) p. 673.

92 Council Directive 2002/14/EC, loc. cit. n. 1.

93 See above: the combination of shop-floor co-determination with boardroom participation…; in favour of symbolic rights: Sadowski, Junkes and Lindenthal, loc. cit. n. 31, at pp. 155-157.

The preference for contractual involvement with the corporation as partner over internal involvement in the corporation does not preclude arrangements for internal participation. The right of employees or their representatives to elect, appoint, recommend or oppose the appointment of members of administrative organs of the corporation, if contracted for, needs proactive harmonisation with corporate governance goals and a proper base in corporate law. The latter is usually ratification by the shareholders' meeting. Both requirements need elaborating and further research. The SE Regulation hints at least at the problem that certain forms of employee involvement do not fall within the realm of management prerogatives.[94]

5.3 Transaction-based evolution: plasticity v. petrification

According to Pistor et al.,[95] the resilience of the corporate form is a function of the adaptability of the legal framework to a changing environment. The current state of the law, in Germany at least, calls for modernisation, lest co-determination takes the way of petrification. Changes in the law, likely or not, could take a variety of forms, e.g., substitution by other binding models of co-determination and/or a (limited) contracting-out option. All changes in national law will automatically change the options available for the SE.[96] The variety of legal systems in corporate law, capital market law and traditions in labour relations make it very unlikely that a national law-maker will find a corporate governance-compatible, internationally inclusive, affordable and workable solution in one big sweep. Contracting-out options would empower corporate groups to experiment and therefore engage in an evolutionary process.[97] Such conversion from mandatory law to default rules fits into the broader picture of advanced corporate law that goes back to the basics, i.e., that makes mandatory only the core elements needed to permit registration as legal entity. Boardroom co-determination as part of corporate law should share this prospect towards more flexibility. Apart from the preservation aspect of the SE Regulation and Directive, the preference for choice in the articles of incorporation and agreements in the law governing the SE

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94 Art. 23(2) of Council Regulation (EC) No. 2157/2001, loc. cit. n. 3: Employee involvement in the SE shall be decided pursuant to Directive 2001/86/EC. The general meeting of each of the merging companies may reserve the right to make registration of the SE conditional upon its express ratification of the arrangements so decided; Seibt, loc. cit. n. 22, at pp. 417, 418; Windbichler, op. cit. n. 39, at p. 547.

95 Pistor et al., 'Innovation', loc. cit. n. 21.

96 Cf., Part 3 of the Annex to Council Directive 2001/86/EC, *OJ* L 294 of 10 November 2001, p. 22.

97 Pistor et al., 'Innovation', loc. cit. n. 21, at p. 7 et seq., argue that the innovative capacity of a legal system with a high amount of enabling laws is higher than that of a predominantly mandatory regime. For examples for innovative participation agreements, see Seibt, loc. cit. n. 22.

points exactly in that direction. The SE Regulation, for instance, forces the Member States to acknowledge the one-tier as well as the two-tier board structure, no matter what the national tradition may be.

5.4 Conclusion: an agenda for legal groundwork

As attractive as the call for agreements regarding employee involvement instead of regulation may be, the legal contrivances for such agreements are hardly in place. Enabling laws, in the sense that no immutable statute gets in the way of private actors' arrangements, are a necessary yet still insufficient precondition. Legal tools to set up transactional creations need shaping and sharpening.

Gentlemen's agreements and creative practices are of value for an evolutionary process. Even if such arrangements are not enforceable in the case of conflict, they may help establish accepted customs. Without disregard for the power of soft law, employee involvement is for the most part dominated by hard law control.[98] The SE Regulation and Directive and the respective implementing laws of the Member States, despite their welcome preference for contractual arrangements, show a propensity towards complicated and costly procedures. Such intricate rules notwithstanding, not all challenges of employee involvement in international groups are met (see under 3.2 above). The laws governing the SE can, therefore, only serve in part as a model. The quandaries pointed out in this paper highlight some critical points that need resolving if transaction-based evolution is to be successful on a more general basis. For German-based corporations, this is rather academic for the time being. There, co-determination laws are still absolutely binding, and opting out requires incorporation in another Member State (or, under not very likely circumstances, as an SE). However, if permitted by an amended law, contracting-out is more likely to engender change than opting-in opportunities in other countries.

To make a contracting-out option work, attention must be devoted to form and procedure, on the one hand, and possible content, on the other. It goes without saying that an agreement needs parties. On the employees' side, this is the question of proper representation. Most national laws provide for collective representation one way or another. For cross-border representation, the SE Directive and the Directive on European works councils demand the establishment of a special negotiating body. Legal literature sees quite some procedural excess here. Alternatives that draw more upon existing representation need exploring. Which employees shall be represented in what proportions should not

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[98] The practice of co-determination according to the German law of 1976 produced strong traditions that are not supported by the statute. One example is the separate preparatory meeting, see *supra* n. 13.

only turn on national distribution but also take into account the position of the employing company as member of a group.

All rights and privileges conferred upon employees with regard to involvement on the level of another corporation, i.e., the parent,[99] need to be in line with the applicable labour and employment law. Private international law conflicts loom where national forms of representation are overstepped. In European law, i.e., in the SE and for the European works council, the parent company has to bear the costs of group-wide employee representation.[100] This model follows German law and touches only lightly upon the impact on the relationship between employee and actual employer; it ignores the relationship between the corporations involved. Other jurisdictions attach importance to the independence of employees and unions by keeping financing separate. In Austrian law, the works council is financed by contributions levied on the employees; Italian law prohibited employer payments towards employees' representation and needed changing when the Directive on European works councils was implemented. The National Labor Relations Act in the United States declares employer interference with organising an unfair labour practice; co-operative management methods, therefore, are placed in a grey area.[101] They need to focus on management issues and stay away from employees' interests; employer-instigated representation has virtually no chance of legal implementation.[102]

On the employers' side, all corporations involved need proper representation, too. Conflicts arise when a subsidiary challenges its status or does not want to go along with the parent's policy for other reasons. Employee involvement is not designed to alter corporate control structures;[103] however, controversies about the existing structure may arise.[104] An agreement that provides for participation rights

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[99] See § 5 of MitbestG, loc. cit. n. 70; §§ 40(4)-(4b), 176 of the Austrian Arbeitsverfassungsgesetz of 14 December 1973; Art. 2:155(3) and Art. 2:265(3) of the Burgerlijk Wetboek of the Netherlands.

[100] Art. 4(1) and Art. 7 of the Annex to Directive 94/45/EC on the establishment of a European works council or procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees; Annex: Standard Rules Part 2(h) of Council Directive (EC) No. 2157/2001, loc. cit. n. 3.

[101] § 8(a)(2) NLRA.

[102] R.A. Gorman and M.W. Finkin, *Basic Text on Labor Law, Unionization and Collective Bargaining*, 2nd edn. (St. Paul, Minn., West 2004) pp. 257-270.

[103] Windbichler, op. cit. n. 39, at pp. 51, 300.

[104] ECJ, C-62/99 *Bofrost** [2001] *ECR* I-2579 and C-440/00 *Kühne & Nagel* [2004] *ECR* I-787; the latter ignores specifics of the group structure, and so does SE law. The United Kingdom, in its adaptation of the Directive on European works councils, provided for conflict resolution, including the scope of the group, by arbitration: Transnational Information and Consultation of Employees Regulations 1999, in effect since 15 June 2000. See C. Windbichler, 'Auskunftspflichten in der gemeinschaftsweit operierenden Unternehmensgruppe nach der Richtlinie über Europäische Betriebesräte', in M. Lutter, M. Scholz and W. Sigle, eds.,

within the corporate group needs internal implementation in the respective corporation. Board composition, nomination and veto rights regarding the appointment of directors are matters usually dealt with at the level of the articles of incorporation. The powers to manage the corporation on a day-to-day basis, or even the main strategic competences of a full board, do not include the shaping of the basic structure of the corporation. Shareholder ratification seems to be the remedy of choice. Again, the role of subsidiaries with minority shareholders should be addressed in this context, too.

The choice of possible topics that require information, consultation, veto opportunity or consent of employees' representatives can draw on a comparative overview of existing models. Additionally, the various tasks of the supervisory board should be screened for relevance under employee involvement criteria. Some issues may be much better placed in a dialogue with the managing board, senior executives or committees specifically devised for the respective corporation.[105] Existing laws are not helpful when it comes to changes in the group structure. Change of control is a well documented topic, not so the internal adaptations following a control change. Neither German co-determination laws nor the SE Regulation and Directive nor the Directive on the European Works Council contain structured models.

Academic groundwork can help in an evolutionary process to overcome the gap between co-determination preservation policies and corporate governance activism. As long as co-determination happens in the boardroom, and attempts to modernise the corporate board ignore that fact, the conundrum will persist.

Festschrift für Martin Peltzer (Cologne, Otto Schmidt 2001) pp. 629-643; C. Windbichler, 'Prozessspezifika unter besonderer Berücksichtigung des faktischen Konzerns' [Process-Specificities in Corporate Group Management], in P. Hommelhoff, K.J. Hopt and A. v. Werder, eds., *Handbuch Corporate Governance. Leitung und Überwachung börsennotierter Unternehmen in der Rechts- und Wirtschaftspraxis* (Cologne, Otto Schmidt 2003) p. 605 for further critical inquiries into information rights and group structure.

[105] Cf., the Chairman's Council 'created … to more accurately reflect the diversity and geographic reach of DaimlerChrysler's business', and 'the Automotive Council … [with the] objective … to explore opportunities for the three divisions to share equipment and plants', as reported in *Tracinda* v. *DaimlerChrysler*, loc. cit. n. 35, at 65.