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New Ways in Corporate Governance: European Experiments with Labor Representation on Corporate Boards

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NEW WAYS IN CORPORATE GOVERNANCE: EUROPEAN EXPERIMENTS WITH LABOR REPRESENTATION ON CORPORATE BOARDS

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A. *The Problem*

Corporate governance has been discussed in Europe for over 150 years.[1]

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1. On developments during the first half of the nineteenth century, see Hopt, *Ideelle und wirtschaftliche Grundlagen der Aktien-, Bank- und Börsenrechtsentwicklung im 19. Jahrhundert,*

Indeed, in the 1840's, when the first Corporation Act was enacted in Prussia, three troubling features of the corporate organization form had already been discerned: (1) the vulnerability of small investors who lacked the influence and sophistication to control the corporation; (2) the risk to creditors and the public created by the limited liability of the corporation, especially when combined with inadequate funds and poorly controlled management; and (3) the power that big corporations could amass economically, by monopolizing markets, and politically, by exerting influence on public opinion and government.[2]

Today these features of the "modern" corporation — separation of ownership and control; the lack of "personal" responsibility vis-à-vis creditors and the public, who bear the consequences of corporate decisions and corporate failure; and the ubiquitous presence of corporate power in what has been called a "corporate society" — have been examined from both a theoretical and an empirical viewpoint in the United States as well as in Europe.[3] Yet, in spite of an endless number of reform proposals and a good number of actual corporate law reforms,[4] the problem of corporate governance remains acute. Indeed, the development of more complex corporate structures, such as groups of companies,[5] and the appearance of transnational enterprises[6] has exacerbated the problem. Legislators and courts in

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in 5 WISSENSCHAFT UND KODIFIKATION DES PRIVATRECHTS IM 19. JAHRHUNDERT: GELD UND BANKEN 128 (H. Coing & W. Wilhelm eds. 1980). On the period between 1860 and 1920, see Horn, *Aktienrechtliche Unternehmensorganisation in der Hochindustrialisierung (1860-1920). Deutschland, England, Frankreich und die USA im Vergleich,* in RECHT UND ENTWICKLUNG DER GROSSUNTERNEHMEN IM 19. UND FRÜHEN 20. JAHRHUNDERT 123 (N. Horn & J. Kocka eds. 1979) [hereinafter cited as N. Horn & J. Kocka] (German with English summary).

2. *See Instruktion, die Grundsätze in Ansehung der Konzessionierung von Aktiengesellschaften betreffend, vom 22.4.1845,* 1845 MINISTERIAL-BLATT FÜR DIE GESAMTE INNERE VERWALTUNG IN DEN KÖNIGLICH PREUSSISCHEN STAATEN 121 (concerning the practice under the Prussian Corporation Act of 1843); R. von Mohl, *Die Aktiengesellschaften, volkswirtschaftlich und politisch betrachtet,* 1856 DEUTSCHE VIERTELJAHRS-SCHRIFT pt. 4, at 1, 38, 52.

3. *See, e.g.,* A. BERLE, JR. & G. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932); L. GOWER, J. CRONIN, A. EASON & LORD WEDDERBURN OF CHARLTON, PRINCIPLES OF MODERN COMPANY LAW 49-57, 494-95 (4th ed. 1979) [hereinafter cited as L. GOWER]; E. HERMAN, CORPORATE CONTROL, CORPORATE POWER (1981); E. MESTMÄCKER, VERWALTUNG, KONZERNGEWALT UND RECHTE DER AKTIONÄRE 78-89 (1958); R. WIETHÖLTER, INTERESSEN UND ORGANISATION DER AKTIENGESELLSCHAFT IM AMERIKANISCHEN UND DEUTSCHEN RECHT 270-338 (1961).

4. *See* L. GOWER, *supra* note 3, at 28-30, 39-57 (discussing English reforms); 2 J. HAMEL, G. LAGARDE & A. JAUFFRET, DROIT COMMERCIAL 1-16 (G. Lagarde 2d ed. 1980) (French); 1 H. WIEDEMANN, GESELLSCHAFTSRECHT: GRUNDLAGEN 24-34 (1980) (German).

5. *See, e.g.,* M. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 213-315 (1976) (as to the U.S.); 2 LEGAL AND ECONOMIC ANALYSES ON MULTINATIONAL ENTERPRISES: GROUPS OF COMPANIES IN EUROPEAN LAWS (K. Hopt ed. 1982) [hereinafter cited as Hopt] (as to Germany, England, France, Belgium, Switzerland, Sweden, and the European Communities); F. WOOLDRIDGE, GROUPS OF COMPANIES (1981) (as to Britain, France, and Germany).

6. On the historical development of the transnational enterprise, see the series of contributions in *Multinational Enterprises,* 48 BUS. HIST. REV. 277-446 (1974); *see also* Hawrylyshyn, *The Internationalization of Firms,* 5 J.W.T.L. 72 (1971). On the legal policy problems, see B. GROSSFELD, PRAXIS DES INTERNATIONALEN PRIVAT- UND WIRTSCHAFTSRECHTS: RECHTSPROBLEME MULTINATIONALER UNTERNEHMEN (1975); Tunc, *Multi-national Companies in French Law,* in LAW AND INTERNATIONAL TRADE: FESTSCHRIFT FÜR SCHMITTHOFF 375

several European states are very conscious of the corporate governance problem, but their responses to it have been dissimilar.

B. *The Different Reform Strategies in European States*

European states appear disillusioned with attempts at achieving better corporate governance through increased shareholder democracy.[7] This is hardly surprising, since, apart from the problem of the lack of sophistication exhibited by a broad stratum of the shareholding public, the cost-benefit balance for small shareholders of investing more effort in participation and control is clearly negative.

Furthermore, although several European states have posited the need for fundamental corporate law reform,[8] the likelihood of achieving anything more than piecemeal reform remains speculative. Although an exception is found in Switzerland, where revision of the corporation law is going on slowly but steadily,[9] Switzerland's unique tradition in the area of corporate governance explains this departure from the norm.[10] Thus, in the absence of convincing designs for new corporation law, most European states experiment with rather concrete reform strategies, and in the process exhibit their different theoretical views of the corporate governance problem.

When grouped according to the control mechanisms chosen, the most common of these reform strategies is to enhance use of the liability device. The immediate targets of this device are management and the board of directors. In most European countries, the duties and liabilities of manage-

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(Fabricius ed. 1973); Vagts, *The Multinational Enterprise: A New Challenge for Transnational Law,* 83 HARV. L. REV. 739 (1969).

7. *See, e.g.,* H. WIEDEMANN, *supra* note 4, at 352-53; *see also* M. EISENBERG, *supra* note 5, at 19, 56-63 (as to the U.S.).

8. As to Great Britain, see L. GOWER, REVIEW OF INVESTOR PROTECTION (1982) (The Gower Report was produced by a commission set up under the Secretary of State for Trade to advise on the need for new legislation.). As to Germany, see the report of the Enterprise Law Commission, a group set up by the Federal Ministry of Justice: BUNDESMINISTERIUM DER JUSTIZ, BERICHT ÜBER DIE VERHANDLUNGEN DER UNTERNEHMENSRECHTSKOMMISSION (1980) [hereinafter cited as the Enterprise Law Commission Report]. The Enterprise Law Commission worked from 1972 until 1979, producing a report of over 1000 pages. However, because it was composed of members of various factions and interest groups, it has remained divided over nearly every major problem. For a critical evaluation of its work, see Kübler, *Unternehmensorganisation zwischen Sachverstand und Interessenpolitik,* 10 ZGR 377-92 (1981). Total revisions of the corporate law have been enacted in Germany in 1965, in France in 1966, and in the Netherlands in 1970-1971.

9. Botschaft über die Revision des Aktienrechts vom 23. Feb. 1983, No. 83.015. This draft law on the corporation (26th title of the Swiss Code on Obligations dating from 1936) contains only those proposals that are considered indispensable, other proposals being postponed. Some of the major targets of the draft law include investor protection, better disclosure, clearer delineation of the competences and tasks of corporate organs, especially the board and auditors (Revisionsstelle), and corporate capital requirements.

In Belgium, a draft law on commercial companies was presented to the Parliament on December 5, 1979, and is still under consideration by that body. *See* Lempereur, *The Belgian Bill to Amend the Corporation Law — New Perspectives for Belgian Securities Regulation,* 5 J. COMP. BUS. & CAP. MKT. L. 195 (1983).

10. In the context of merger control, see Schluep, *The Swiss Act on Cartels and The Practice of the Swiss Cartel Commission Concerning Economic Concentration,* in 1 LEGAL AND ECONOMIC ANALYSES ON MULTINATIONAL ENTERPRISES: EUROPEAN MERGER CONTROL 123 (K. Hopt. ed. 1982) [hereinafter cited as 1 EUROPEAN MERGER CONTROL].

ment and the board are continuously refined by courts through legal doctrine. France and Belgium, however, have developed the "action en comblement du passif,"[11] which can be brought against directors of a bankrupt corporation who, if found to have acted negligently, may be held personally liable not only for specific damages, but for all or part of the corporate deficit. The philosophy behind this action is that the privilege of incorporation with limited liability is not without bounds, and that the real corporate actors should be required under certain conditions to back up their actions with their personal wealth.[12]

A more general reform strategy may be discerned in the new and intense focus on the functions of the corporate board.[13] It is well known in Europe that the corporate board does not live up to the legislature's expectations with respect to the board's supervision and control of the corporation's management.[14] Thus, the attempt is being made to activate this controlling function by giving boards greater rights to information from management,[15] by discarding or mitigating the temptations of self-interest[16] and by imposing legal liability on directors.[17]

Not only is the corporate board's controlling function being revitalized but attention has turned as well to those "who control the controllers." This attention has led to the imposition of liability on auditors and banks. In

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11. *See* Art. 99 of the French Act No. 67-563 of July 13, 1967 J.O. 7059, 7065, 1982 D.S.L. 269, 275; *see also* B. MERCADAL & P. JANIN, SOCIÉTÉS COMMERCIALES (MÉMENTO PRATIQUE FRANCIS LEFÈBVRE), 1981-1982, at 928-31 (12th ed. 1981) (Nos. 3848-55: obligations des dirigeants au paiement du passif social) (French case law). For Belgium, see van Ommeslaghe, *Les groupes de sociétés et l'expérience du droit belge,* in Hopt, *supra* note 5, at 59, 92-94.

12. For the historical developments concerning this philosophy, see L. GOWER, *supra* note 3, at 43-57 (England). For an analysis of the outer bounds of limited liability in modern corporation law, see H. WIEDEMANN, *supra* note 4, at 217-36.

13. *See* CORPORATE GOVERNANCE — DIRECTORS' DUTIES AND LIABILITIES 15-18, 29-30, 113-16, 166-73, 429, 449 (K. Hopt & G. Teubner eds. 1984) (papers to the International Colloquium in Florence, Apr. 13-16, 1983) [hereinafter cited as CORPORATE GOVERNANCE]; Papers to the Congress on Corporate Governance, Paris, Mar. 9-11, 1983 (forthcoming).

14. In Germany, with its obligatory division between management board and supervisory board, this had already been discussed extensively by the turn of the century. *See* A. CAHN, DER AUFSICHTSRAT DER AKTIENGESELLSCHAFT 249-64 (1907). The development of the supervisory board in the nineteenth and early twentieth centuries is treated by Hopt, *Zur Funktion des Aufsichtsrats im Verhältnis von Industrie und Bankensystem,* in N. Horn & J. Kocka, *supra* note 1, at 227. For Great Britain, see Wedderburn, *The Legal Development of Corporate Responsibility,* in CORPORATE GOVERNANCE, *supra* note 13, at 20-32. *Cf.* A. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977); M. MACE, DIRECTORS: MYTH AND REALITY (1971) (for the United States).

15. *See, e.g.,* M. LUTTER, INFORMATION UND VERTRAULICHKEIT IM AUFSICHTSRAT (Abhandlungen zum deutschen und europäischen Handels- und Wirtschaftsrecht No. 25, 1979); Mertens, *Zur Berichtspflicht des Vorstands gegenüber dem Aufsichtsrat,* 25 AG 67 (1980). As regards the flow of information to the board and the role of the accountant, see M. EISENBERG, *supra* note 5, at 186-211.

16. *See* K. Hopt, *Self-Dealing and the Use of Corporate Opportunity and Information: Regulating Directors' Conflicts of Interest,* in CORPORATE GOVERNANCE, *supra* note 13, at 285-326 (Europe); Brudney & Clark, *A New Look at Corporate Opportunities,* 94 HARV. L. REV. 998 (1981).

17. In this regard, see the *Schaffgotsch* decision of the German Federal Court Judgment of December 21, 1979. Bundesgerichtshof, W. Ger., 33 NJW (Vol. 2) 1629 (1980); *cf.* Ulmer, *Aufsichtsratsmandat und Interessenkollision,* 33 NJW (Vol. 2) 1603 (1980).

Switzerland, a new body of case law holds corporate auditors liable in cases of malfeasance.[18] And in Germany, where banks traditionally play a key role in the corporate proxy machinery and on corporate boards, this role is being bolstered by the imposition of legal duties and liabilities on banks and bank representatives in various corporate contexts.[19] This is quite unlike what the United States attempted to do with the Glass-Steagall Act, which was designed to negate the role of banks on corporate boards.[20] For Germany, it is safe to say that traditional corporate law and governance cannot be understood without knowledge of the developments in banking law. On the whole, however, none of these measures solve the problem of corporate governance.

Taking into consideration the phenomenon of director ineffectiveness, which in part seems but an outgrowth of the broader phenomena of organizational slack and bureaucratic inefficiency,[21] some European countries have turned to the market to find a control mechanism. The market for corporate control, which provides such a check,[22] has thus become the object of regulatory concern in Great Britain, France, and Belgium. These countries have delineated the rights and duties of the participants in corporate takeovers, which are now supervised by state or self-regulatory bodies.[23] Germany, however, has not witnessed such a development: in Germany, takeovers in general, let alone unfriendly ones, do not play a

18. In particular, see the decision of the Swiss Federal Court. Judgment of Sept. 23, 1980, 106 BG II 232, *summarized in* 70 DIE PRAXIS DES BUNDESGERICHTS 68 (1981); *see also* Forstmoser, *The Duties and Liabilities of Auditors under Swiss Law,* 5 J. COMP. BUS. & CAP. MKT. L. 305 (1983). For Germany, see W. EBKE, WIRTSCHAFTSPRÜFER UND DRITTHAFTUNG (Schriften zum Deutschen und Europäischen Zivil-, Handels- und Prozessrecht No. 95, 1983). For the United States, see Pitt & Williams, *The Convergence of Commercial and Investment Banking: New Directions in the Financial Services Industry,* 5 J. COMP. BUS. & CAP. MKT. L. 137 (1983). The system of all-purpose banking that is practiced in Germany, Switzerland, and other countries has been the object of scrutiny as to its economic and legal implications. The results of this scrutiny favor such a system so long as legal safeguards are maintained. GERMAN FEDERAL MINISTRY OF FINANCE, BERICHT DER STUDIENKOMMISSION "GRUNDSATZFRAGEN DER KREDITWIRTSCHAFT" (1979) (Banking Law Study Commission).

19. Examples of such contexts include use of the banks' depository vote; conflicts of interest of bank representatives on corporate boards; prospectus liability of banks; piercing the corporate veil in the event of bank participation; fiduciary duties of banks to shareholder-clients; and the duties and liabilities of banks involved with failing companies. *See, e.g., Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht,* 147 ZHR 165-222 (1983); 145 ZHR 177-272 (1981); 143 ZHR 113-226 (1979) (contributions to three Banking Law Symposia).

20. Banking Act of 1933 (Glass-Steagall Act), ch. 89, 48 Stat. 162, 184 (codified at various sections of 12 U.S.C., including 12 U.S.C. §§ 24, 78, 335, 377 & 378) (1982).

21. *See* J. MARCH & H. SIMON, ORGANIZATIONS 36-82 (1958); H. MINTZBERG, THE STRUCTURING OF ORGANIZATIONS 372-79 (1979) (discussing problems of coordination, discretion, and innovation, and the danger of dysfunctional responses).

22. To what degree it does so in reality is open to question. Available evidence shows that quite often financially healthy enterprises are the target of tender offers. Furthermore, all real markets are imperfect, and these imperfections are especially marked for capital markets in Europe. *See* EEC COMMISSION, DER AUFBAU EINES EUROPÄISCHEN KAPITALMARKTS (1966) (Segré report).

23. *See* C. SCHMITTHOFF, F. GORÉ & T. HEINSIUS, ÜBERNAHMEANGEBOTE IM AKTIENRECHT (Arbeiten zur Rechtsvergleichung No. 77, 1976) (takeover bids); Immenga, *Öffentliche Übernahmeangebote (Take over Bids),* 47 Schw. AG 89 (1975); *cf.* Behrens, *Rechtspolitische Grundsatzfragen zu einer Europäischen Regelung für Übernahmeangebote,* 4 ZGR 433 (1975) (European harmonization).

major role.[24]

More generally, since capital markets can also act as a check against inefficient corporate management by, for example, making corporate and credit relations with banks more difficult, these markets have become the object of regulation by laws and ongoing scrutiny by capital market commissions. Again, this is the case in France, Belgium, and, in a more complicated and self-regulatory fashion, Great Britain. In Germany, capital market law is less developed and there is no body other than the stock exchanges in charge of supervising the capital markets.[25] However, Germany has been the first to realize the significance of the relationship between corporate power and antitrust law, particularly merger control, by using antitrust law to control transnational enterprises.[26]

Improving corporate governance through market forces is, of course, problematic. Unresolved questions include how to develop such market forces if they do not yet exist or work satisfactorily;[27] what is the right mix between state regulation and self-regulation for these markets;[28] and how state-controlled corporations, groups of companies, and transnational enterprises can be effectively exposed to such market forces.[29]

At any rate, there is widespread conviction in Europe that these and other means of controlling the performance of corporate managers and board members — such as the use of contingent salary mechanisms, premiums, and stock bonuses — do not solve the problem, even though they may be steps in the right direction.[30] This conviction has contributed to the willingness of various European states to experiment with labor representation on corporate boards. Indeed, the idea of worker co-determination on the board is widespread and has even reached a stage in which the European Communities are considering making such co-determination obligatory in one way or another for all member states. This movement finds its rough

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24. In Germany, there are only nonbinding guidelines, which were recommended by the Stock Exchange Experts Commission in January 1979. For the text and (short) commentary, see BAUMBACH, DUDEN, & HOPT, HANDELSGESETZBUCH MIT NEBENGESETZEN (OHNE SEERECHT) 1059-63 (25th ed. 1983).

25. *See* F. KÜBLER, GESELLSCHAFTSRECHT 365-75 (1981); Hopt, *Vom Aktien- und Börsenrecht zum Kapitalmarktrecht?,* 141 ZHR 389 (1977); Kohl & Walz, *Kapitalmarktrecht als Aufgabe,* 22 AG 29 (1977).

26. *See* Hopt, *Merger Control in Germany,* in 1 EUROPEAN MERGER CONTROL, *supra* note 10, at 71.

27. *See* Kübler, *Unternehmensstruktur und Kapitalmarktfunktion — Überlegungen zur Krise der Aktiengesellschaft,* 26 AG 5 (1981).

28. *See* L. GOWER, *supra* note 8, ¶¶ 8.10-8.27 (self-regulatory agencies). In continental European countries, especially Germany, the attitude towards complete self-regulation is basically negative, such as in the context of insider regulation.

29. Each of these organizations exhibits a strong tendency to insulate itself from outside control, whether by markets or by law. In state-controlled corporations, this insulation stems from the lack of responsiveness to financial pressures. In groups of companies, the specific corporate structure facilitates insulation, while in transnational enterprises, the territoriality principle and the differentials of nation-state regulation contribute to insulation from outside control.

30. *See* Baellwieser & Schmidt, *Unternehmensverfassung, Unternehmensziele und Finanztheorie,* in UNTERNEHMENSVERFASSUNG ALS PROBLEM DER BETRIEBSWIRTSCHAFTSLEHRE 645, 662-77 (K. Bohr, J. Drukarczyk, H.-J. Drumm & G. Scherrer eds. 1981) [hereinafter cited as K. Bohr].

equivalent in the trend in the United States toward the appointment of outside directors.[31] Both movements are characterized by high hopes, contrasted with an overall evaluation so far that may dampen these hopes. Before turning to such an evaluation of the European movement, however, this Article shall outline the most recent developments in corporate governance in the European Communities.

C. *Harmonizing Corporate Governance Rules in the European Communities: The 1983 Draft of the Fifth Directive*

After a sluggish fifteen-year period, the harmonization movement in European company law gained momentum in the late 1970's. Already, six company law directives based on article 54(3)(g) of the European Economic Community (EEC) Treaty have been enacted by the Council and are binding on Member States. The core of the harmonization work concerning company structure is contained in the draft Fifth Directive. The original version of the draft presented by the European Commission in 1972[32] led to great controversy in the European Parliament and in the Member States because of its proposals on an obligatory two-tiered board, labor co-determination, and other issues. After ten years of deliberation, however, the European Parliament gave its opinion[33] and the European Commission responded quickly by presenting an extensively revised draft Fifth Directive in 1983.[34]

The 1983 draft focuses only on stock corporations, where transnational activities are predominant. For Member States like Germany, where other company forms compete very successfully with the stock corporation,[35] this

31. *See* M. EISENBERG, *supra* note 5, at 144-46, 174-77; E. HERMAN, *supra* note 3, at 30-48, 281-83; Brudney, *The Independent Director — Heavenly City or Potemkin Village?*, 95 HARV. L. REV. 597 (1981).

32. Commission Directive, Proposition d'une cinquième directive tendant à coordonner les garanties qui sont exigées dans les États membres, des sociétés, au sens de l'article 58 paragraphe 2 du traité, pour protéger les intérêts, tant des associés que des tiers en ce qui concerne la structure des sociétés anonymes ainsi que les pouvoirs et obligations de leurs organes, art. 58, 15 J. O. COMM. EUR. (No. C 131) 49 (Dec. 13, 1972). For reviews in English, see Lang, *The Fifth EEC Directive on the Harmonization of Company Law* (pts. 1-2), 12 COM. MKT. L. REV. 155, 345 (1975); Conlon, *Industrial Democracy and EEC Company Law: A Review of the Draft Fifth Directive*, 24 INTL. & COMP. L.Q. 348 (1975).

33. European Parliament Minutes of Proceedings of May 11, 1982, 25 O.J. EUR. COMM. (No. C 149) 12, 20-43 (June 14, 1982) [hereinafter cited as European Parliament].

34. Commission Preparatory Act, Amended proposal for a Fifth Directive founded on Article 54(3)(g) of the EEC Treaty concerning the structure of public limited companies and the powers and obligations of their organs, 26 O.J. EUR. COMM. (No. C 240) 2 (Sept. 9, 1983) [hereinafter referred to as draft Fifth Directive]. For a first comment in German, see Kolvenbach, *Die Fünfte EG-Richtlinie über die Struktur der Aktiengesellschaft (Strukturrichtlinie)*, 36 DER BETRIEB 2235-41 (1983).

35. In Germany, there are 2140 stock corporations, of which some 450 have their shares quoted at the stock exchange, while there are 300,000 limited liability companies (GmbH, as of 1984). *See Der Aktienmarkt in der Bundesrepubik Deutschland und Seine Entwicklungs Möglichkeiten*, MONATSBERICHTE DER DEUTSCHEN BUNDESBANK, Apr. 1984, at 12-21.

The number of partnerships with a limited liability company as the only fully liable partner (GmbH & Co) is not recorded. On the resulting regulatory problems, compare Kübler, *supra* note 27, with Schmidt, *Mehr Unternehmen an die Börse durch differenzierte Marktorganisation* in 1981 HANSEATISCHE WERTPAPIERBÖRSE HAMBURG 4 (Annual Report of the Hamburg Stock Exchange).

restriction tends to widen the regulatory gap that exists between the different company forms and to intensify the movement away from the stock corporation. Thus, the danger exists that the harmonization envisaged by the draft Fifth Directive, which applies only to segments of the real enterprise world, may give rise to complacency.[36] After all, regulatory goals such as investor and creditor protection and management responsibility do not lose their importance when an enterprise leaves the corporate form or chooses another form from the start. In terms of the European theoretical discussion, the slogan "from corporate law to enterprise law"[37] reflects this concern.

The European Commission has exhibited a clear preference for the German two-tier board system, not only because it appears to bolster the supervisory function in general, but also because the two-tier board is a much easier target for the varying co-determination formulas.[38] Yet the Commission understood that it could not successfully promote its 1972 proposal of an obligatory separation between a management board and a supervisory board. Thus, the 1983 draft contains a compromise. The dual system is introduced as a general rule, but each Member State may opt for a unitary board system. This arrangement lasts for only five years, at which time the Commission is to evaluate the system and decide whether further harmonization will be necessary. Given the realities of the present decisionmaking process in the Commission, however, such a possible revision may be little more than a face-saving provision for the Commission.

As a result, the draft contains elements of separation even for the optional unitary board system. Managing and nonmanaging members of the unitary board must be distinguished. Managing members are to be appointed by nonmanaging members, and the number of nonmanaging members must be higher than that of managing members. All this is designed to prepare the way for labor co-determination. Even the obligatory nomination of a member of the management board as the member who is primarily responsible for labor relations is maintained under the unitary board system: this so-called labor director (Arbeitsdirektor) must be a managing member of the unitary board. Member States that currently use a unitary board system will undoubtedly realize that under these circumstances their option to continue such a system under the Fifth Directive is little more than nominal, and will react accordingly. In practice, however, the acceptance of the proposed reforms would result in less radical change than one watching this harmonization struggle might expect, since in many large corporations the unitary board acts much like a supervisory board vis-à-vis management.[39]

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36. This danger has become real with the Fourth Directive Concerning Disclosure and Balance Sheets, which does not reach the German GmbH & Co., *see* note 35 *supra*, even though GmbH and GmbH & Co. are company forms that are in many ways equivalent alternatives for business. The German legislature does not intend to apply the Fourth Directive to GmbH & Co., even though the resulting discrepancies are quite arbitrary.

37. *Cf.* Enterprise Law Commission Report, *supra* note 8.

38. Co-determination can be confined to the supervisory board, the functions of which are undetermined, *see* note 14 *supra*, but which in any case do not include the whole range of entrepreneurial decisionmaking in the corporation.

39. *See* L. GOWER, *supra* note 3, at 71 (England); E. HERMAN, *supra* note 3, at 30-48, 52.

The other main controversy under the 1972 draft was labor co-determination.[40] In this battlefield the Commission was forced to acknowledge the political realities confronting its Member States and sound the retreat. Thus, the draft provides for labor co-determination on the following terms: The threshold for obligatory labor co-determination is a work force of 1000 or more employed within the same group of companies. Member States may provide that the majority of the workers of the corporation can vote against co-determination. This option is modeled after similar solutions in Scandinavia and Great Britain and has been on the list of requests by the European Parliament. If such a veto of the workers is not expressed, four possible models of co-determination may be prescribed by the Member States:

(1) Selection of at least one-third, but no more than one-half, of the members of the supervisory board by labor. In the latter case ultimate decisionmaking power must lie with the representatives chosen by the general assembly. This is necessary to make this model compatible with the German Constitution.[41] Member States may also provide that no more than one-third of the board members can be elected other than by the general assembly or the workers, leaving open the possibility of a third group of public-interest directors or state representatives, like that which exists in certain French state enterprises, most recently in those enterprises nationalized in 1982.[42]

(2) Co-optation of new members by the supervisory board itself. In this case, the general assembly and the work council have the right to appeal to an independent state-appointed body. This model is a near total imitation of the Dutch co-determination system.[43]

(3) Informing and deliberating with a separate labor representation body within the corporation. This model has received attention in the British reform debate[44] and has parallels in Norwegian corporation

40. For a comparative law inventory as well as a critical appreciation of the different co-determination models and their difficulties, see Hopt, *Grundprobleme der Mitbestimmung in Europa,* 13 ZFA 207 (1982); Westermann, *Tendenzen der gegenwärtigen Mitbestimmungsdiskussion in der Europäischen Gemeinschaft,* 48 RABELSZ 123 (1984)

41. *See* Judgment of Mar. 1, 1979, Bundesverfassungsgericht, 50 BVerfG 290, *reprinted in* 32 NJW 699 (1979). For a summary of this decision, see 28 AM. J. COMP. L. 88 (1980) and the critical comment by Wiedemann, *Codetermination by Workers in German Enterprises,* 28 AM. J. COMP. L. 79 (1980). For a much more positive view, see Simitis, *Workers' Participation in the Enterprise — Transcending Company Law?,* 38 MOD. L. REV. 1 (1975). Most observers today would say that one can live with the German Codetermination Act of 1976 and with the Court's decision upholding it. *See* Part III *infra.*

42. Blanc-Jouvan, *La participation des travailleurs à la gestion des entreprises en droit français,* in MITBESTIMMUNG DER ARBEITNEHMER IN FRANKREICH, GROSSBRITANNIEN, SCHWEDEN, ITALIEN, DEN U.S.A. UND DER BUNDESREPUBLIK DEUTSCHLAND 33, 54 (Arbeiten zur Rechtsvergleichung No. 92, 1978); Loi de nationalisation (no. 82-155 du 11 février 1982), art. 7, 1982 J.O. 566, 567, 1982 D.S.L. 92, 92.

43. As to the Dutch Codetermination Act of 1971, see Sanders, *Employee Participation in the Netherlands,* 1977 J. BUS. L. 209. As to experiences with the Act, see Honée & De Groot, *The Appointment of Supervisory Directors in Major Companies* (Report in Dutch) (1979) (Summary in English) (Social and Economic Council, 's-Gravenhage 1979); Honée, *Erfahrungen mit der Kooptation von Aufsichtsratsmitgliedern in den Niederlanden,* 11 ZGR 87 (1982).

44. *See* INQUIRY ON INDUSTRIAL DEMOCRACY COMMITTEE, FIRST REPORT, CMD. 6706 (1977) (Bullock Report); Kahn-Freund, *Industrial Democracy,* 6 INDUS. L.J. 65 (1977); Davies,

law.[45]

(4) Introduction of co-determination either within or outside of the board under terms that are the result of collective bargaining. Such a system is in force in Sweden[46] and has had a strong appeal to the partisans of labor co-determination in England.

From the compromises reached regarding two main areas of contention, to wit, the propriety of a two-board system and of labor co-determination, one might conclude that even if the draft is adopted by the Council, which is hard to predict, the ambitious goal of European harmonization of company structure will be reached only to a modest degree. Yet such a conclusion is superficial for several reasons.

First, there exist many areas, such as the ambit of the general assembly and the rights of shareholders, on which harmonization without hedging will be reached. It is true that most of these areas are less conspicuous and of a more technical nature than the propriety of a two-board system or of co-determination, but corporate governance is reached only by a full configuration of many protective devices.

Second, one can hardly expect harmonization to be reached in a single leap. Not surprisingly, company law harmonization shares the fate of European integration in general.[47] The European Commission has favored the only sensible route, taking the European bull by the horns and narrowing the options as far as possible: politics, after all, is the art of the possible.

Third, and most important, even a full harmonization of company law and labor co-determination on the board would not ensure harmonization of behavior, decisionmaking processes, and the locus of responsibility within the corporation. Transplanting legal devices and institutions from one country to another and from one socioeconomic context to another is social experimentation with all its attendant uncertainties. This general observation applies with great force in the field of labor relations and co-determination.[48] Indeed, full harmonization as planned in 1972 might lead to less *real* homogeneity than that proposed in 1983, since in some countries trade unions that are oriented towards conflict and class struggle in the Marxian tradition may use co-determination in quite a different spirit than,

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The Bullock Report and Employee Participation in Corporate Planning in the U.K., 1 J. COMP. CORP. L. & SEC. REG. 245 (1978).

45. *See* Kolvenbach, *supra* note 34, at 2239.

46. *See* F. SCHMIDT, LAW AND INDUSTRIAL RELATIONS IN SWEDEN (1977). For a rather critical opinion, see Victorin, *Co-determination in Sweden: the Union Way*, 2 J. COMP. CORP. L. & SEC. REG. 111 (1979). The most recent study is by economists E. Gerum & H. Steinmann, Unternehmensordnung und tarifvertragliche Mitbestimmung in Schweden — Ein Beitrag zur vergleichenden Unternehmensverfassungsforschung aus sozioökonomischer Sicht, 2 vols. (text and materials) (DFG-Abschlussbericht Ste 97/9, Mar. 1983) (report available from the German Science Foundation).

47. *See generally* R. BUXBAUM & K. HOPT, EUROPEAN INTEGRATION IN THE LIGHT OF THE AMERICAN FEDERAL EXPERIENCE (forthcoming) (contribution to the Florence Project on European Integration in the light of the "American Federal Experience") (directed by M. Cappelletti) (discussing the harmonization of company and capital market law).

48. *See* Summers, *Worker Participation in the U.S. and West Germany: A Comparative Study from an American Perspective*, 28 AM. J. COMP. L. 367, 367-68, 391-92 (1980).

for example, the German trade unions, which have been very successful with co-determination.

II. The Many Roads to "Industrial Democracy": Political Crossroads to Worker Co-determination

A. *Basic Strategies of Enhancing Labor's Influence on the Corporation*

In European countries labor's influence on corporations has grown steadily since World War I. This growth has not followed any logical sequence, since the development of labor representation on corporate boards has not occurred as a result of rational decision, but rather through a process of political assertion and compromise. One must take into account the institutional framework within which such boardroom co-determination has developed.[49]

The main source of labor influence on the corporation has been collective bargaining. The preeminence of this mechanism remains unquestioned even when other devices such as boardroom co-determination are requested or obtained by labor. This does not, however, preclude conflicts between collective bargaining and boardroom co-determination.[50] Indeed, the former is basically an adversarial strategy which includes such tools as strikes and lockouts, while the latter can succeed only if practiced with a sense of cooperation. It is precisely because of this conflict that boardroom co-determination has been denounced by some as the last trick of capitalism. On the other hand, the scope of collective bargaining — the main, but by no means exclusive, object of which is to fix wages — may expand if, as in Sweden, it extends to various forms of co-determination within the enterprise and within the board.[51]

More important than the body of law in this area are the traditions, behavior, and goals of the trade unions in a particular European country. Just as European and American trade unions are purported to be completely different, trade unions within the European Community vary widely in character.[52]

Work councils are found in most European countries. These councils

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49. For the historical development of co-determination in Germany from the early nineteenth century until today, see Mitbestimmung: Ursprünge und Entwicklung (Zeitschrift für Unternehmensgeschichte Beiheft No. 19) (H. Pohl ed. 1981). For the socioeconomic background in England, see Wedderburn, *supra* note 14. For a very sharp comparative study of the institutional framework of worker participation in the United States and West Germany, see Summers, *supra* note 48. For Sweden, see F. Schmidt, *supra* note 46. *Cf.* Industrial Democracy in Europe (IDE), International Research Group, Industrial Democracy in Europe (1981) (comparing the worker participation schemes in twelve countries); Industrial Democracy in Europe (IDE) International Research Group, European Industrial Relations (1981) (describing the various legal and socioeconomic factors relevant to a comparison of the twelve countries studied).

50. *See* Summers, *Codetermination in the United States: A Projection of Problems and Potentials,* 4 J. Comp. Corp. L. & Sec. Reg. 155, 163-67 (1982).

51. For the ensuing, highly difficult problem of reconciling corporation law and these collective agreements, see Victorin, *supra* note 46, at 130-33.

52. *See* Wedderburn, *supra* note 14, at 19.

are usually imposed by law, but may also be formed voluntarily.[53] They are geared towards increasing the participation of workers at the *plant level* in shaping the workplace environment. Accordingly, participation is organized from the bottom up, that is, at the shop-floor level. The participatory rights of these work councils vary greatly. Depending on the country, work councils range from the merely informational, to councils with obligatory consultation and co-deliberation rights, and finally, to councils with full participation rights and a veto in decisionmaking. Again, conflicts between collective bargaining and work council participation exist, but they are usually mitigated by the legal priority of the former.[54]

Labor participation from below implies at least indirect influence on the level above, and decisions at the plant level ultimately affect the social and economic policy of the enterprise as such. This observation, and the thrust of the participation movement in the last decade, justify the conclusion that participation necessarily transcends the plant level and plays a role in co-determining enterprise policy.[55] Short of outright board room co-determination, such participation at the enterprise level may be practiced within a system that fosters strategic informational exchange and consultation with labor.

The organization and extent of this participation differ widely. In Germany, the economic committee of the workers must be informed in a timely and thorough manner about a wide range of economic matters, such as the economic and financial situation of the enterprise, the production and investments program, changes in the organization, and other plans that could vitally affect the employees' interests.[56] In Sweden, similar rights are given to the trade unions in order to promote "informed bargaining."[57] In France, the "comité d'entreprise" has recently obtained not only the right to full information about the enterprise and its economic prospects but also the right to present requests to and consult with the board.[58] Also, European countries are presently engaged in heated discussion concerning the far-reaching information rights to be granted to the workers in transnational enterprises, particularly those working in subsidiaries with foreign parents.[59]

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53. Examples are given by Kübler, *Dual Loyalty of Labor Representatives*, in CORPORATE GOVERNANCE, *supra* note 13, at 431; Simitis, *supra* note 41, at 3-4.

54. For comprehensive legal information on many countries, see W. KOLVENBACH, EMPLOYEE COUNCILS IN EUROPEAN COMPANIES (1978). For an empirical study on the practice under the German work council system, see H.U. NIEDENHOFF, PRAXIS DER BETRIEBLICHEN MITBESTIMMUNG (1979).

55. *See* Simitis, *supra* note 41, at 7.

56. *See* Betriebsverfassungsgesetz arts. 106-111, 1972 BGBl I, pt. 1, at 13, 34-36 (W. Ger.). For an English translation and commentary, see M. PELTZER & R. BOER, BETRIEBSVERFASSUNGSGESETZ/LABOR MANAGEMENT RELATIONS ACT 240-59 (2d. ed. 1977).

57. *See* E. GERUM & H. STEINMANN, *supra* note 46, at 54-56; *cf.* L. GOWER, *supra* note 3, at 68-69 (England).

58. *See* Loi no. 82-915 du 28 octobre 1982 relative au développement des institutions représentatives du personnel, art. 29, 1982 J.O. 3255, 3263, 1982 D.S.L. 456, 463 (inserted into the labor code art. 432-5 (new)); *cf.* Viandier, *La loi no. 82-915 du 28 octobre 1982 et le droit des sociétés*, 1983 J.C.P. I No. 25, at 3116 (éd. générale).

59. This is the so-called Vredeling-Proposal of the European Commission. *See* Commission Proposal for a Council Directive on procedures for informing and consulting the employ-

These strategies combine with and culminate in labor representation on the corporate board. Sometimes such labor representation on the board is characterized as a German experiment. Yet, while it is true that this system is most entrenched in Germany, various degrees of and formulas for worker representation on corporate boards have been instituted in the Netherlands, Denmark, Luxembourg, Norway, Sweden, and Ireland.[60] In 1982, France took a step in the same direction.[61] Thus, labor representation on the corporate board can be fairly described as a European movement. Of course, all these systems are instituted or at least supported by appropriate legislation, in stark contrast to the American case where Chrysler and the United Automobile Workers (UAW) simply appointed UAW President Douglas Fraser to the Chrysler board.[62]

B. *Trade Union Representation on Corporate Boards*

One of the major problems of co-determination stems from the natural antagonism between the trade unions, on the one hand, and the workers and their bodies, on the other hand, that exists in the single enterprise or plant. The development of work councils illustrates this phenomenon.[63] Employers have not always resisted the temptation to play work councils off against trade unions. And trade unions themselves have often opposed the development of a work council system, or at least a system that did not incorporate their interests. For example, English trade unions were clearly opposed to any kind of work council outside the trade union machinery, while in Germany the work council system could be built up only after the unions decided to use the work councils as their outposts in the plant. In fact, in Germany eighty percent of council members and nearly all work council chairmen today are union members.

The process of instituting boardroom co-determination has displayed this very same tension.[64] In Germany, boardroom co-determination was

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ees of undertakings with complex structures, in particular transnational undertakings, 23 O.J. EUR. COMM. (No. C 297) 3 (Nov. 15, 1980). *See also* Birk, *Unterrichtung und Anhörung der Arbeitnehmer in transnationalen Unternehmen,* in RECHTSVERGLEICHUNG, EUROPARECHT UND STAATENINTEGRATION: GEDÄCHTNISSCHRIFT FÜR LÉONTIN-JEAN CONSTANTINESCO 33 (G. Lüke, G. Ress & M. Will eds. 1983); Vandamme, *L'information et la consultation des travailleurs dans la proposition de directive sur les entreprises à structure complexe, en particulier transnationale,* 24 REV. MARCHÉ COMM. 368 (1981).

The European Parliament has recommended extensive modifications to this draft directive. The European Commission has responded with a modified draft. *See* Commission Amendment to the proposal for a Council Directive on procedures for informing and consulting employees, 26 O.J. EUR. COMM. (No. C 217) 3 (Aug. 12, 1983) [hereinafter referred to as *European Commission*]. This new draft is commented upon by Westermann, *supra* note 40, at 169-79. For a complete documentation, see R. BLANPAIN, F. BLANQUET, F. HERMAN & A. MOUTY, THE VREDELING PROPOSAL (1983); *Cf.* the critique in L'INFORMATION ET LA CONSULTATION DES TRAVAILLEURS DANS LES ENTREPRISES MULTINATIONALES (J. Vandamme ed. 1984).

60. *See* Hopt, *supra* note 40; *see also Symposium: Worker Participation in Management,* 4 COMP. L. Y.B. 3-163 (1981) (information on nine countries).

61. *See* notes 42 and 58 *supra.*

62. *See* Summers, *supra* note 50, at 155-56.

63. *See* L. GOWER, *supra* note 3, at 68-69 (England); H. WIEDEMANN, *supra* note 4, at 587-88 (Germany).

64. The development of German legislation in the area of union representation is briefly

possible only because union representatives obtained up to one-third of the workers' seats. As a consequence, German labor is represented by at least some professional spokesmen who will look beyond short-term enterprise interests to broader and more long-term work force and union interests. In 1983, for example, seventy-five percent of all labor directors were members of unions belonging to the Deutscher Gewerkschaftsbund, and eight percent belonged to the Deutsche Angestellten-Gewerkschaft. Thus, German unions have assumed a role in the enterprise whereby they take a certain responsibility for the enterprise and its workers.

Direct union representation is difficult, however, if, *unlike* in Germany, a large part of the work force is not unionized or there are many competing unions in a single enterprise.[65] Furthermore, both organization theory and union practices show that the unions themselves do not always have a free and democratic structure.[66] This problem led the European Commission to prescribe certain minimum standards for unions in its draft Fifth Directive.[67] Antagonisms between different layers of the work force, antagonisms between white-collar and blue-collar workers, and antagonisms between executives with managerial tasks and the rest of the work force, illustrate the difficulties here. In Germany, these difficulties have been resolved in the 1976 Co-determination Act by guaranteeing at least one seat on the board to executives, while taking into account the interests of wage-earning and salaried employees through the voting procedure.[68]

C. *The Parity Problem*

Organizing labor representation on corporate boards involves many political decisions, as is illustrated by the options made available to the Member States by the 1983 draft Fifth Directive. It is beyond the scope of this Article to compare in depth the unitary system with the two-tier board system, or the experiences of the German election model with those of the Dutch co-optation model.[69] However, this Article shall address briefly

described in P. HANAU & P. ULMER, MITBESTIMMUNGSGESETZ § 7 No. 32-37 (1981). For English developments, see L. GOWER, *supra* note 3, at 74-75.

65. Direct union representation is still possible in such a situation. *See, e.g.*, Summers, *supra* note 50, at 160-63 (United States).

66. For Germany, see R. MICHELS, ZUR SOZIOLOGIE DES PARTEIWESENS IN DER MODERNEN DEMOKRATIE (Kröners Taschenausgabe No. 250, 2d ed. 1970); H. STINDT, VERFASSUNGSGEBOT UND WIRKLICHKEIT DEMOKRATISCHER ORGANISATION DER GEWERKSCHAFTEN (1976); *see generally* BEITRÄGE ZUR SOZIOLOGIE DER GEWERKSCHAFTEN (1979). For the United States, see Summers, *supra* note 48, at 385-91.

67. Art. 4(i) of the 1983 draft Fifth Directive requires the Member States to respect the following principles: (a) labor representatives must be elected in a proportional representation scheme with specific protection for minorities; (b) all workers must have the chance to participate in the elections; (c) elections must be secret; (d) free expression of one's opinion must be granted. *See* draft Fifth Directive, *supra* note 34, at 10.

68. Mitbestimmungsgesetz [MitbestG] art. 15(2), 1976 BGBl, pt. 1, at 1153, 1157 (W. Ger.) (1976 Codetermination Act). The Act was pushed through by the liberal Free Democrats in the face of protest by the trade unions, which perceived the Act as threatening to the homogeneity of labor. The Act has been justified by the idea that all three factors—capital, labor, and disposition—are to be represented. The rule has made it necessary to alleviate the strict incompatibility between management and supervisory board membership.

69. *See* notes 39, 40 & 43 *supra*.

what has been the most controversial policy issue of boardroom co-determination in Germany, to wit, the parity problem.

The parity problem has been approached on three different levels. The first is a philosophical one, and raises questions of what risks workers bear within the corporation and what kind of influence corresponds to such risk-bearing. Two opposing answers have been posited. According to one view, the shareholders bear the entrepreneurial risk and therefore should have the influence. According to another view, since the workers bear the risk of losing their jobs, they are members of the company to a far greater extent than the shareholders and deserve the lion's share of influence within the corporation.[70]

A second level of the parity problem is legal-political. This level involves questions of what degree of influence in the corporation can be achieved in the political arena, how the resulting compromise may be codified, and whether such law is compatible with the country's constitution.[71]

A third level of the parity problem involves issues such as how shareholders, management, and workers behave under a parity model; what economic and societal effects various models of underparity, parity, and overparity may have; and whether the uncertainties involved in answering such questions favor boardroom co-determination. The first attempts to address this level were made in Germany in 1970 by the Biedenkopf Commission; this attempt was based on the Commission's extensive use of questionnaires and hearings concerning experiences with the full-parity German coal and steel co-determination.[72] Since the late 1970's, a growing body of experiences with the quasi-parity co-determination under the 1976 Act has become available.[73] Some of the most recent contributions are made either by economists or by those writing with a socioeconomic perspective on the law.[74]

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70. The first view is the conventional one. For the second view, see, e.g., L. GOWER, *supra* note 3, at 10-11; Jonsson, *Labour as Risk Bearer,* 2 CAMBRIDGE J. ECON. 373 (1978); Summers, *supra* note 50, at 170.

71. This corresponds to most of the discussion led in Germany before the 1976 Codetermination Act and until the decision of the Federal Constitutional Court in 1979. *See* note 41 *supra.* In the meantime (1984) German unions continue to ask for full parity and in some socialist-governed German states, as for example Hamburg, they will get it on a voluntary basis in all state companies.

72. *See* Mitbestimmungskommission, Mitbestimmung im Unternehmen: Bericht der Sachverständigenkommission zur Auswertung der bisherigen Erfahrungen bei der Mitbestimmung (1970) [hereinafter "The Biedenkopf Report"].

73. *See, e.g.,* MITBESTIMMUNG UND EFFIZIENZ (F. J. Säcker & E. Zander eds. 1981).

74. *See generally* K. Bohr, *supra* note 30; R. WICKENKAMP, UNTERNEHMENSMITBESTIMMUNG UND VERFÜGUNGSRECHTE (1983); Gäfgen, *Zur volkswirtschaftlichen Beurteilung der Entscheidungsteilnahme in Unternehmungen: Die deutsche Mitbestimmungsregelung als Beispiel,* in H. STEINMANN, G. GÄFGEN & W. BLOMEYER, DIE KOSTEN DER MITBESTIMMUNG 9 (Gesellschaft, Recht, Wirtschaft No. 5, 1981); EIGENTUMSRECHTE UND PARTIZIPATION (J. Backhaus & H.G. Nutzinger eds.) (Frankfurter Abhandlungen zu den gesamten Staatswissenschaften No. 2, 1982).

III. The Economic and Societal Impact of Labor Representation on the Board: Myth, Hope or Reality?

A. *Intra-Enterprise Effects*

Labor representation on corporate boards that is mandated by law involves a choice of governance. Judging the impact of this choice is an uncertain and inexact "science." Thus, although lately implementation research has become a major interdisciplinary effort, it has taught us to be aware of methodological pitfalls and to dampen our expectations.[75] Still, legislators and lawyers must act in the face of uncertainty, while welcoming whatever certainty may be gleaned from experience. In this field direct causal relationships seldom exist, and the evaluation of specific decisions is difficult. But it seems that, at least, impact tendencies are recognizable and, even under the line of extreme retreat marked by von Hayek, that pattern predictions are possible. Thus, it makes sense to discuss what players should participate, and how to set the game or the market.[76] This also applies to the task completion ability of alternative corporate governance structures[77] and to labor co-determination through which new actors are introduced into the corporate board.[78]

Within the corporation, a first and rather obvious impact of labor representation on the board is the creation of an additional layer of control both on the supervisory board and on management. In contrast to outside directors in the United States, who characteristically play a passive role as invited guests "tied to the inside hosts by some sort of personal or business relationship,"[79] the worker-directors belong to different social strata and have experienced a different socialization process than their co-directors. In addition, worker-directors are on the board by their own right, as representatives of the work force, and through the union, to which they feel loyalty and by which they are controlled.[80] Union representatives are usually professionals like the other members on the board, while nonunion labor

75. *See generally* 1 Implementation politischer Programme, (R. Mayntz ed. 1980) (Empirische Forschungsberichte); 2 Implementation politischer Programme (R. Mayntz ed. 1983) (Ansätze zur Theoriebildung). For a recent survey of German contributions, see Reese, *Implementationsforschung,* 1982 Soziologische Revue 4, 37-44.

For labor co-determination, see especially Gäfgen, *supra* note 74, at 9-11, 14-19; Steinmann, *Kosten-Nutzen-Analyse der Mitbestimmung?,* in H. Steinmann, G. Gäfgen & W. Blomeyer, *supra* note 74, at 39.

76. *See* F. von Hayek, Die Theorie Komplexer Phänomene (Vorträge und Aufsätze No. 36, 1972); F. von Hayek, *Die Anmassung von Wissen,* 26 ORDO 12-21 (1975).

77. *See* Williamson, *The Modern Corporation: Origins, Evolution, Attributes,* 19 J. Econ. Literature 1537 (1981); *see also* Comment, *An Economic and Legal Analysis of Union Representation on Corporate Boards of Directors,* 130 U. Pa. L. Rev. 919 (1982) (attempting to apply Williamson's approach to labor co-determination).

78. The following observations relate primarily to the large modern corporation under the system of full parity (with a neutral eleventh board member) in the German coal and steel industry, and under the general system of quasi-parity (i.e., representatives of the shareholders having the last say by means of a double vote of the chairman of the board) under the 1976 Co-determination Act. A complex institutional framework is thereby assumed as a given. *See* Part II *supra.*

79. E. Herman, *supra* note 3, at 48.

80. There are instances in which a labor representative on the board has been considered a renegade and has been harassed by the unions and the press as a result of this branding.

representatives typically are not, compensating for their lack of professional training with full-time devotion, training provided by the unions, and the experience they have garnered at the grassroots level of the enterprise. Additional compensation is not an important motivating force for these worker-directors, mainly because the unions have persuaded their members to keep only a basic amount of their compensation and turn the excess over to a union foundation. Status, influence, and career chances within the labor movement are more powerful incentives for serving as a worker-director.

The worker-directors' monitoring function is facilitated by information flows to which nonworker directors are not privy. This information emanates from the work councils, to which many worker-directors belong, and from the unions, to which most worker-directors belong even if they were not elected as union representatives. Of course, even if obstructionary tactics such as denying full and equal access to committee work are blocked, as was recently done by the German courts,[81] this merely means an improved *possibility* of monitoring by worker-directors.

Co-determination has clearly had an impact on board decisionmaking, transforming and slowing down the whole process. A substantial number of shareholders and board members asked by the Biedenkopf Commission deemed this to be a significant disadvantage of co-determination.[82] While these complaints were made in the context of the full-parity coal and steel co-determination approach, the impact under the quasi-parity system is no different since, much to the chagrin of the nonworker board members, the worker representatives have overwhelmingly chosen to act as a clique under this system. Thus, even under the quasi-parity system, the decision-making process is complicated by the need for counter-fractionalizing, prior arrangements, separate meetings, adjournments, and group bargaining. And although most decisions made by the supervisory board require careful deliberation, co-determination has contributed to the growing bureaucratization of the whole decision-making process, with its well-known spillover effects.[83] This slowdown and bureaucratization of the board's decision-making process is thus one negative effect of co-determination to be weighed against the possible informational and motivational gains achieved through worker representation on the board.[84]

The effect of co-determination on the substantive decisions made by the board is less clear, but certain tendencies can be observed. Co-determination has led to greater consideration of the societal impact of enterprise decisions. Decisions concerning new investments, cutbacks or shutdowns of works, geographical transfer of works, and other changes in the organiza-

81. Judgment of Feb. 25, 1982, Bundesgerichtshof, 83 BGHZ 106; Judgment of Feb. 25, 1982, Bundesgerichtshof, 83 BGHZ 144; Judgment of Feb. 25, 1982, Bundesgerichtshof, 83 BGHZ 151 (all W. Ger.).

82. *See* The Biedenkopf Report, *supra* note 72, at pt. III, No. 32. In the Netherlands, a work council's complaint against a specific co-optation to the board was most often based on not having been left enough time to deliberate. *See* Honée, *supra* note 43, at 99.

83. *See* Zander, *Personalwirtschaftliche Konsequenzen der unternehmensverfassungsrechtlichen Mitbestimmung,* in K. Bohr, *supra* note 30, at 309, 326-28; *see also* note 21 *supra.*

84. *See* Gäfgen, *supra* note 74, at 24.

tion are acceptable for the labor representatives only if the social impact of these changes is taken into account.[85] Thus, when Volkswagen planned to open a subsidiary in the United States, labor feared that this would foreclose the creation of new jobs in Germany, or even lead to layoffs. As a result, the final decision was blocked for two years, and consent was finally given only in part and under the condition that there would be no layoffs in Germany for a certain period of time and that further investment in the United States would be subject to the prior consent of the board. Similar effects have been noted in the area of dividend distributions. The worker representatives on the board favor the retention of earnings rather than distribution to the shareholders, a position in which management concurs. This effect of co-determination reinforces the tendency of German enterprises to keep dividends at a fixed and relatively low level, instead of giving out varying dividends according to the year's business. Labor's concern with the societal impact of enterprise decisions should not be construed as a rejection of the profit motive, however. In fact, the Biedenkopf Report could point to no case in which the profit motive was abandoned by a board under the co-determination system.[86] And although cutbacks and shutdowns were delayed considerably, they were never finally blocked.

Finally, co-determination has exhibited effects on management, which is nominated by the supervisory board. The shareholders' side rarely uses its second vote to get its candidate nominated, since this would lead to a deterioration of the cooperative climate within the enterprise and would make it difficult for the manager to fulfill his tasks. Instead, prior agreement is nearly always sought and reached between capital and labor about new appointments. Sometimes the shareholders' side gets the representative of the executives with managerial tasks to favor their candidate, as in the recent appointment of the president of Daimler Benz, but even in such a case a formal split of the labor faction hardly ever occurs. As a matter of fact, the representatives of the executives with managerial tasks vote regularly with the other worker-directors, with occasional exceptions when the above-mentioned *Arbeitsdirektor* is to be nominated. Such agreements between capital and labor have their price. In a number of cases, the candidate favored by labor is nominated. More significantly, the profile of management changes.[87] New appointees must be acceptable to labor, who will examine their attitudes and their prior record toward labor. This implies that top managers must attempt to establish and maintain good relations with labor if they want to be reelected in the same enterprise or to have a chance to be elected in another enterprise that is subject to union co-determination. This effect of labor is even stronger on the member of the managing board who is in charge of social matters and labor relations (the *Arbeitsdirektor*), especially if the unions obtain veto power over this post.[88]

Whether the increased influence of labor under a system of co-determi-

85. *See* The Biedenkopf Report, *supra* note 72, at pt. III, Nos. 33-53.

86. *Id.* at pt. III, No. 36. *See generally* D. BRINKMANN-HERZ, ENTSCHEIDUNGSPROZESSE IN DEN AUFSICHTSRÄTEN DER MONTANINDUSTRIE (1972); W. TEGTMEIER, WIRKUNGEN DER MITBESTIMMUNG DER ARBEITNEHMER (Wirtschaftspolitische Studien No. 30, 1973).

87. For the Netherlands, see Honée, *supra* note 43, at 98-106, 107.

88. *See* Zander, *supra* note 83, at 313-17.

nation results in a greater acceptance of board decisions by workers, and thereby has the effect of promoting intra-enterprise efficiency,[89] is not fully clear. While there is empirical evidence of a correlation between participation and worker motivation, this evidence relates to the more direct participation of the single worker at his particular work place or, at the most, in his plant.[90]

B. *Effects on Markets and the Economy*

Effects on markets and the economy from a system of co-determination are probable, but somewhat difficult to confirm and describe. Some conclusions follow from observations of the intra-enterprise effects of labor co-determination, while others are more speculative.

To begin, however, the notion that co-determination mandated by law rather than by market forces is inefficient[91] must be discarded. This notion not only ignores important legal goals, but it fails to consider that although individual actors in the market may be efficient in minimizing their own transaction costs, they may also neglect externalities and the overall economic consequences of their behavior.[92]

The clearest effects of co-determination are on the capital markets. As previously noted, labor representatives on the board tend to reduce dividend payments to shareholders and, insofar as they have any influence, favor higher salaries and social benefits for the workers. Furthermore, labor representatives tend to slow down and weaken management decisions that may affect jobs and other labor interests. These effects are not without consequences on the valuation of the shares of the co-determined corporation, even though these consequences may be difficult to prove empirically. Even more important, however, shareholders will be reluctant to extend more capital to corporations with a co-determination system and will instead look for other investments.[93] Proposals to make the burden even for all companies within a state are of doubtful merit, since there is always the possibility of exporting one's capital abroad to a less regulated area.

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89. *See* Gäfgen, *supra* note 74, at 12, 19-20, 23; Steinmann, *supra* note 75, at 59-60; *cf.* Cable & FitzRoy, *Productive Efficiency, Incentives and Employee Participation: Some Preliminary Results for West Germany,* 33 KYKLOS 100 (1980) (discussing voluntary participation below the board level).

90. *See* G. Teubner, Co-Determination Through Law: Social Functions of Law in Institutional Innovations 9-11 (European University Institute Paper, Florence 1982) (unpublished) ("somewhat depressing findings").

91. *See* Furubotn, *Codetermination and the Efficient Partitioning of Ownership Rights in the Firm,* 137 ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT 702, 705 (1981); Jensen & Meckling, *Rights and Production Functions: An Application to Labor-managed Firms and Codetermination,* 52 J. BUS. 469, 473 (1979); Pejovich, *Codetermination: A New Perspective for the West,* in THE CODETERMINATION MOVEMENT IN THE WEST 3, 16-20 (S. Pejovich ed. 1978).

92. *See* Brinkmann & Kübler, *Überlegungen zur ökonomischen Analyse von Unternehmensrecht,* 137 ZEITSCHRIFT FÜR DIE GESAMTE STAATSWISSENSCHAFT 681, 683 (1981); Picot, *Der Beitrag der Theorie der Verfügungsrechte zur ökonomischen Analyse von Unternehmungsverfassungen,* in K. Bohr, *supra* note 30, at 153, 168-69. Principal objections to the transaction cost approach in this context are voiced in 1 E. GERUM & H. STEINMANN, *supra* note 46, at 108-12 ("costs follow the constitution").

93. *See, e.g.,* Engels, *Arbeitsorientierte Unternehmensverfassung und Risikenmechanik,* in K. Bohr, *supra* note 30, at 199, 212-18; Gäfgen, *supra* note 74, at 28-30.

It has been alleged that co-determination will increase costs for labor (salary, social benefits, job security) that cannot be sufficiently offset by improved efficiency, and that co-determination will thereby lead to competitive disadvantages vis-à-vis foreign firms. It has also been claimed that necessary changes may be delayed, potential innovations reduced, and the dynamics of the economy affected.[94] However, these dire prognoses lose some of their theoretical force when one considers that real markets are imperfect and leave management with considerable room for decisionmaking. Profit maximization has long since given way to a full range of goals pursued by the management of the large corporation, profit being a general guideline only except in specific difficult situations when it becomes pivotal again.

Furthermore, co-determination may have a number of positive effects on the economy. It may lead to decisionmaking, both inside the board and in the collective bargaining context, based on more information, which results in better decisions. Efficiency of production and economic allocation may thereby be enhanced. More important, however, co-determination is expected to reduce the level of conflict between capital and labor, to make unions more cooperative and responsive, and to reduce the economic losses that are caused by strikes and lockouts.[95] The traditionally excellent German record in avoiding strikes is sometimes cited to support this last expectation. The German record, however, is due to many institutional and other factors, and cannot be used to prove the above hypotheses. Specifically, two factors are crucial to the German success story, to wit, the character of the German trade union movement and the overall economic position of Germany. If these factors were to change — if, for example, German co-determination were exported to a country with trade unions hostile to the system, or if co-determination were practiced during a serious and long-lasting recession — the record might very well be quite different.

C. *Societal Effects*

Most difficult of all to ascertain are the societal effects that may be expected from co-determination. Differences in political and economic theory influence any evaluation of such societal effects. This problem in evaluation is aptly illustrated by examining the antitrust concerns that co-determination has spawned. Thus, American observers of co-determination have voiced reservations about such a system because they fear its potential for anticompetitive effects through the presence of union members on many boards.[96] Viewed from the German experience, which relies heavily on the

94. *See* G. PROSI, VOLKSWIRTSCHAFTLICHE AUSWIRKUNGEN DES MITBESTIMMUNGSGESETZES 1976 (1978) (This was an opinion mandated by the shareholder side in the proceedings before the Federal Constitution Court. *See* note 41 *supra*.); Prosi, *Mitbestimmung und Innovationen*, in INNOVATIONSPROBLEME IN OST UND WEST 115-21 (A. Schüller, H. Leipold & H. Hamel eds. 1983) (Schriften zum Vergleich von Wirtschaftsordnungen No. 33).

95. *See* Gäfgen, *supra* note 74, at 18-19, 22-23; Summers, *supra* note 50, at 167, 168, 184; *see also* Picot, *supra* note 92, at 169 (at least in the short term no impairment of efficiency by co-determination, but this could possibly be due to extraneous factors).

96. *See* Steuer, *Employee Representation on the Board: Industrial Democracy or Interlocking Directorate?*, 16 COLUM. J. TRANSNATL. L. 255, 270-74 (1977); Summers, *supra* note 50, at 179-83.

societal and libertarian aspects of antitrust policy, this concern is overstated. While some scenarios of co-determination may imply such dangers, for example, a scenario in which unions constructed information systems about enterprises and used them on the boards of different enterprises in a collusive way,[97] no such fears have been realized. Thus, at least at the moment, it is fair to say that the relationship between co-determination and antitrust does not present problems in Germany.[98]

Other expectations of the societal effects of co-determination are connected with two schools of thought that have been influential in postwar German legal theory and for which Habermas and Luhmann are the main proponents. The concept of industrial democracy, and labor's request that it be given representation and voting power on corporate boards, may be characterized as examples of the free dialogue ("herrschaftsfreier rationaler Diskurs"). According to Habermas and the Francfort and Erlangen school of thought, this free dialogue, if led by equal partners in a constructive spirit, may be the only way to modern problem-solving in philosophy, as well as in government and in society.[99] It would be too easy to dismiss this — as has been done in the philosophical debate — by merely pointing to the real world difficulties in creating the structural and motivational preconditions for such a dialogue on free and equal terms. Some of these difficulties have already been mentioned, and include questions as to the professional competence of both partners, the willingness to cooperate, the internal democracy of the employers' associations and trade unions, whether labor has enough financial support to qualify as an equal partner, and whether a hospitable economic and political situation exists for such a dialogue. Yet the idea that in modern society the need for consensus is growing, that conflicts between blocks of interests are best solved by dialogue and bargaining, has its appeal. Such problem solving may also ultimately produce better overall economic effects.

Clues as to the societal effects of co-determination are also provided by social systems theory. The economy and single large corporations are conceived of as (sub)systems with a relatively large degree of independence. Systems theory as applied to the enterprise sector can draw upon the fact that markets, as well as state intervention, fail to fulfill the governing and steering functions that are conventionally attributed to them. One way out of this dilemma may be to make the systems themselves responsive to other and more general needs than their own, by organizing them in a way that makes the pursuit of outside interests possible and even probable. In this sense, co-determination is an instrument of societal steering by decentralized systems organization.[100] Again, it would be easy to dismiss this ap-

97. *See* Hopt, *supra* note 40, at 229.

98. *See* P. HANAU & P. ULMER, *supra* note 64, at Einleitung no. 7.

99. *See especially* Steinmann, *supra* note 75, at 46-48 (discussing the philosophical sources of co-determination); Steinmann, *The Enterprise as Political System,* in CORPORATE GOVERNANCE, *supra* note 13, at 402-05; Gäfgen, *supra* note 74, at 34-35; *see also* H. STEINMANN & E. GERUM, REFORM DER UNTERNEHMENSVERFASSUNG: METHODISCHE UND ÖKONOMISCHE GRUNDÜBERLEGUNGEN (Abhandlungen zum deutschen und europäischen Handels- und Wirtschaftsrecht No. 33, 1978) (addressing the philosophical sources of enterprise law in general).

100. *See* G. Teubner, *infra* note 105, at 160-64 (specific reference to Luhmann). *See gener-*

proach philosophically, as well as in its application to co-determination. Indeed, the theory may be formulated in such generic terms as to make it meaningless for practical problems, or even worse, so as to hide choices and value judgments in seemingly neutral language. Yet the concept of decentralized steering, that is, setting up a framework for corporate organization and decisionmaking such as co-determination, cannot be easily dismissed. The challenge to such decentralized steering lies less in the many problems with all alternative steering instruments, but rather in such a system's reliance on structural and procedural control mechanisms[101] and in its potential for delegalization.[102] The crucial question remains, of course, whether performances that in classical theory have been attributed only to markets can also be claimed for forms of enterprise organization. The evolution of the modern corporation seems to give an affirmative answer, if one agrees that leaving certain economic activities to the market place or internalizing them in an intra-enterprise or intra-group structure has not been the result of historical coincidence, but rather of economic choice and performance.[103]

IV. Conflicts of Interest, Board Secrecy, and Other Legal Problems

A. *Recognizing Conflicting Loyalties*

Through the political and socioeconomic decision to mandate labor representation on corporate boards, national legislatures install the players and set up the game. Writing the rules of the game in detail, and rendering them compatible with other fields, is left to the lawyers and the courts. The body of such rules is growing fast, and is the focus of attention of both enterprises and of that part of the legal and academic profession addressing co-determination issues.[104] The overwhelming impression garnered from the German and other European experiences is that, contrary to what is sometimes believed in the United States, problems arising from labor representation on corporate boards, such as conflicts of interest and threats to board secrecy, are difficult but resolvable.

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ally Teubner, *Substantive and Reflexive Elements in Modern Law*, 17 Law & Socy. Rev. 239 (1983).

101. On this point, many participants of the Florence colloquium on corporate governance, *see* note 13 *supra*, seem to agree. *See* Wedderburn, *supra* note 14, at 44; G. Teubner, *supra* note 90, at 166-72; Hopt, *supra* note 13, at 315-20; Kübler, *supra* note 53, at 439-41; and Steinmann, *supra* note 99, at 422-25; *see generally* Simon, *From Substantive to Procedural Rationality*, in Method and Appraisal in Economics 129 (S. Latsis ed. 1976); Ballwieser & Schmidt, *supra* note 30, at 677.

102. *See generally* Galanter, *Legality and its Discontents: A Preliminary Assessment of Current Theories of Legalization and Delegalization*, in Alternative Rechtsformen und Alternativen zum Recht 11 (6 Jahrbuch für Rechtssoziologie und Rechtstheorie 11 (1980)); *see also* H. Zacher, S. Simitis, F. Kübler, K. Hopt & G. Teubner, Verrechtlichung von Wirtschaft, Arbeit und Sozialer Solidarität (1984) (symposium, Bonn, Sept. 21-24, 1983).

103. *See, e.g.*, Williamson, *supra* note 77.

104. For information about the struggle between German enterprise and unions over these rules even after the affirmative decisions of the Federal Constitution Court, see sources cited in note 41 *supra; see also* Hopt, *supra* note 40, at 224-26. For details about the state of the law, see P. Hanau & P. Ulmer, *supra* note 64.

The most obvious legal problem arising from co-determination is the conflict of interest that it creates for labor directors. The conventional wisdom of traditional corporate law was that board members owed loyalty only to the corporation and, directly or indirectly, to the shareholders. This conventional wisdom never reflected the reality of large corporations, however. Indeed, there is a long history in Germany of the broadening of this traditional concept to include other corporate goals and beneficiaries of corporate fiduciary duties.[105] Under co-determination the standard formula used to prescribe the object of the board member's duty of loyalty is the interest of the enterprise, whatever that may be. Opinions of what is encompassed by the interest of the enterprise range from strict profit maximization, to long-term profit optimization with wide discretion in the board, and finally, to the explicit inclusion of external goals and interests. The same controversies that were observed with respect to the effects of co-determination on markets and the economy apply as well to the duty of loyalty. Thus, while there are those who want to subject management and the board to the strict control of profit and market forces, the reality of imperfect markets and undisputed discretion in corporate decisionmaking seems to argue against this position.

Although much of the discussion of the conflicting loyalties of worker board members lies within the realm of legal theory, practical answers are needed to some important questions. For example, may a labor director participate in decisions of the board relating to wage policy, social matters, and industrial relations and conflicts? Or may the union member who sits on the board actively join or even organize strikes and other measures against the enterprise? In some jurisdictions, such as Denmark and Ireland, legislation provides that they may do neither. In others, the delineation between the permissible and the impermissible is extremely controversial.[106] Compromise solutions, such as allowing labor directors to deliberate but not to participate in a final vote, or limiting union members to passive participation in strikes, have been offered. If expectations of the economic and societal benefits of co-determination are translated into legal rules, these solutions are hardly convincing. The conflicting loyalties of the

105. For a short survey in English, see Vagts, *Reforming the "Modern" Corporation: Perspectives from the German,* 80 HARV. L. REV. 23, 38-43 (1966) (changing the corporate purpose). For a procedural approach, see sources cited in note 101 *supra; see also* A. GROSSMANN, UNTERNEHMENSZIELE IM AKTIENRECHT (Abhandlungen zum deutschen und europäischen Handels- und Wirtschaftsrecht No. 29, 1980); Laske, *Interrehmensinteresse und Mitbestimmung,* 8 ZGR 173, 196-200 (1979); G. Teubner, *Corporate Fiduciary Duties and Their Beneficiaries: A Functional Approach to the Legal Institutionalization of Corporate Responsibility,* in CORPORATE GOVERNANCE, *supra* note 13, at 154-55.

106. *See* P. HANAU & P. ULMER, *supra* note 64, at § 25, Nos. 27-28, 96-98; § 26, Nos. 19-25 (containing different answers and further references); Kübler, *supra* note 53, at 432-38. For England, see the discussion between Kahn-Freund, *supra* note 44, at 76-77, and Davies & Wedderburn, *The Land of Industrial Democracy,* 6 INDUS. L.J. 197, 200-02 (1977); *see also* L. GOWER, *supra* note 3, at 580. For the United States, see Note, *Serving Two Masters: Union Representation on Corporate Boards of Directors,* 81 COLUM. L. REV. 639, 656-60 (1981); Summers, *supra* note 50, at 165, 169-71; Comment, *supra* note 77, at 954. Whether the worker-director *himself* prefers to abstain or even suspend his participation in such matters is an altogether different question. UAW President Fraser did just that while on the Chrylser board, as did the worker-directors in the German Arbed Saarstahl GmbH when drastic reorganization measures were required.

labor director have to be respected by *not* depriving him of his vote and by *not* forcing him to desert his fellow union members. Otherwise the factionalization of the board members is reinforced, and the functions of the union representative both on the board and in the union are impaired.

B. *Board Secrecy: Different Standards for Shareholders' and Workers' Representatives?*

Even more controversial than the conflicting loyalties of labor members of corporate boards is the issue of whether the traditional obligation of maintaining board secrecy applies equally to worker-directors. In Germany, it is generally held that there cannot be different standards for shareholders' and workers' representatives to the board. This is also the express position of the 1983 draft Fifth Directive.[107] But while board secrecy is not much of a burden for the shareholders' representatives,[108] this is not true for worker representatives.

Workers' representatives are expected by the work councils, the unions, and the work force of the enterprise to report on their participation on the board and the current problems facing the enterprise. These constituencies expect workers' representatives to express their interest in the board and to show that they are performing competently in their role. Even if such expectations are contrary to German law, where board secrecy is strictly upheld and informing the work force may be exclusively a decision for the management board,[109] reality does not always correspond to this legal picture. There have been clear cases in which even highly sensitive information, such as the planned sale of an unprofitable subsidiary to another group of companies, or plans and decisions as to cutbacks, shutdowns, and reorganization measures, has been released prematurely.

Whether this gap between law and reality can be left open indefinitely is questionable. Approaches to a somewhat more flexible attitude can be discerned, however. In Germany, for example, important information interests of the work force have been characterized as part of the enterprise interest and therefore properly taken into account. This might lead to the conclusion that such information cannot be treated as secret, so that the information would thereby become disclosable without imposing different standards on shareholders' and workers' directors. Furthermore, a board member must be allowed to get expert advice if this is necessary to fulfill his function;[110] but if the expert is not bound by professional secrecy, the board

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107. *See* draft Fifth Directive, *supra* note 34, at 12.

108. This does not mean that there are no conflicts of interest, but simply that the expectations of those who send the representative to the board, like banks, major business partners, lawyers, and other professionals, are usually different from labor. As to the difficult questions regarding the conflict of interest of the former, see Lutter, *Bankenvertreter im Aufsichtsrat,* 145 ZHR 224 (1981) (Germany). For a comparative analysis, see note 1 *supra.* For the United States, see E. HERMAN, *supra* note 3, at 129-37, 283-89.

109. As to the latter, see M. LUTTER, *supra* note 15, at 136. *But see* F.J. SÄCKER, INFORMATIONSRECHTE DER BETRIEBS- UND AUFSICHTSRATSMITGLIEDER UND GEHEIMSPHÄRE DES UNTERNEHMENS 82 (Schriften des Betriebs-Beraters No. 60, 1979). *See generally* P. HANAU & P. ULMER, *supra* note 64, at § 25, No. 99-115.

110. *See* Judgment of June 5, 1975, Bundesgerichtshof, 64 BGHZ 325, 331-32 (W. Ger.). But the individual labor representative does not have the right to take an outside expert with

member has the duty to oblige him contractually to keep the secret. These rules are important and should not be construed too narrowly, for if co-determination is expected to have a positive economic impact by better informing the unions and the work force, it would hardly make sense to impede such an information flow with legal rules.

The difficult task is, as always, the delineation of what is secret, because even though the need for secrecy is often exaggerated, every enterprise needs some inner secrecy beyond the mere withholding of industrial secrets to maintain strategic maneuverability. Sweden has come up with one interesting alternative to legal rule making in this area. There, collective bargaining may also extend to the question of what board matters shall be kept secret.[111] Under the German model, an equivalent procedural approach would be to leave the issue of confidentiality to the shareholders' and workers' representatives on the board to discuss and decide, but then to make this board decision binding on all individual members. This approach seems to have been taken in doubtful cases by the co-determined boards in the coal and steel industry.[112]

C. *Co-determination in Groups and Transnational Enterprises: Towards the Limits of Law*

Together, groups of corporations and transnational enterprises define modern corporate reality. Regulatory ideas and corporate governance concepts meet their ultimate test with these entities. Corporate law has not yet come to grips with groups, and is even further away with transnational enterprises.[113] This is the case for Germany, with its first codified law of groups, and for the United States, where the phenomenon of transnational enterprises was first observed and analyzed. Co-determination is plagued by this same inability of the law to keep pace with modern corporate reality. Problems posed by this inability in the field of co-determination are quite challenging, but the scope of this Article permits only two final observations on the European scene.[114]

First, the difficulty of installing co-determination in company groups[115] consists in finding a solution that on the one hand gives the workers, including those in the subsidiaries, effective influence on the parent corporation

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him when inspecting the auditors' report of which no personal copies are given out. *See* Judgment of Nov. 15, 1982, Bundesgerichtshof, 85 BGHZ 293 (W. Ger.).

111. *See* 1 E. GERUM & H. STEINMANN, *supra* note 46, at 146-48.

112. *See* Enterprise Law Commission Report, *supra* note 8, at No. 477. There was complete disagreement about the best solution to the board secrecy problem. *Id.* at Nos. 461-85.

113. *See* sources cited in note 5 *supra.*

114. For details, see the abundant German literature on art. 5 of the 1976 Co-determination Act (co-determination within the group of companies) and on the territorial reach of the Act. Some of it is recorded in P. HANAU & P. ULMER, *supra* note 64, vor § 5, vor § 1. For some empirical data, see Gerum, Richter & Steinmann, *Unternehmenspolitik im mitbestimmten Konzern*, 41 DIE BETRIEBSWIRTSCHAFT 345-60 (1981) (condensed version in; K. Bohr, *supra* note 30, at 293-308).

115. That is, parents with control over subsidiaries. Mere financial participation and ties do not suffice. Whether such control exists in the case of partially owned subsidiaries is as unclear here as elsewhere in corporate law. The difference is that here a complex co-determination structure depends on an answer to this question.

where the real decisions are made, and on the other hand does not impair the control of the parent over the subsidiaries. The German solution, giving all workers of the group a vote for co-determination on the board of the parent and at the same time co-determination in their subsidiary, has met with criticism. The difficulties are increased if the parent is not subject to co-determination, for example, because it is organized as a partnership with the personal liability of a natural person, or because it is a foreign corporation. The German rule of treating the next highest-ranking subsidiary as a fictitious parent for the purposes of co-determination (so-called Teilkonzern) has also been criticized by most commentators. Similar difficulties have arisen in other European countries.[116] These problems have been considered so thorny that the European parliament has requested that most of the Fifth Directive should not be applied to groups. Moreover, the European Commission, while rightly refusing to dilute the directive in this way, has included in its 1983 draft an option for the Member States to postpone applying parts of the directive until the planned Ninth Directive on Harmonization of the Law of Groups is enacted.[117]

Installing effective co-determination in transnational enterprises is even more problematic than is the case with company groups. There are two sets of problems, one legal and one economic. The legal set is an outgrowth of the territoriality principle, and is a well-known problem facing other national regulatory strategies such as antitrust, securities regulation, and banking law. Beyond the usual conflicts of law rules, strategies to deal with this problem are the above-mentioned Teilkonzern in German law or the European Vredeling proposal.[118] Quite apart from these legal problems is the question whether national legislatures are ready to assume the risk of the possible economic consequences of a co-determination decision, to wit, the possible exodus of transnational enterprises from the country, or at least the strategic allocation of new foreign capital and new subsidiaries of the transnational enterprises to competing third countries. The Dutch legislators, fully resigned to this possibility, have granted transnational enterprises far-reaching exemptions from co-determination.[119] The Germans, on the other hand, have not done so, and thus have taken the risk of moving ahead in the hope that the European Communities will follow.

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116. For the Netherlands, see Honée, *supra* note 43, at 93; van Veenroy, *Konzernrecht und Mitbestimmung in den Niederlanden,* 14 ZFA 121-40 (1983). For France, see Viandier, *supra* note 58. For Sweden, see Gerum & Steinmann, *supra* note 46, at 24, 135-43.

117. *See* European Parliament, *supra* note 33, at 43 (art. 63(a)); draft Fifth Directive, *supra* note 34, at 36-37 (art. 63(b) and the reasons given for it).

118. *See European Commission, supra* note 59.

119. *See* Honée, *supra* note 43, at 92; Hopt, *supra* note 40, at 233-34 (perspectives for a European harmonization).