

REFGOV

Reflexive Governance in the Public Interest

Corporate Governance

REFLEXIVE GOVERNANCE AND EUROPEAN COMPANY LAW

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Abstract

The use of reflexive forms of governance is growing within the European Union, in particular as the open method of coordination ('OMC') is applied to a wider range of contexts. Reflexive approaches view diversity of laws and practices across the member states as the basis for experimentation and mutual learning within the overall process of European integration. Company law, however, seems to be an exception to this trend: recent activity in this area has mostly taken the form of 'hard law' harmonization through directives, coupled with the stimulation of regulatory competition through judgments of the European Court of Justice concerning freedom of movement, most notably the *Centros* case. The deliberations of the European Corporate Governance Forum barely qualify as a 'company law OMC' because of the limited space allowed for 'learning from diversity'; instead, differences in the laws of the member states are seen, in the discourse of the Forum, as 'distortions of competition'. In the area of labour law, by contrast, a degree of functional convergence and a coordinated raising of standards have recently been achieved by the dovetailing of the OMC with social policy directives. The contrasting experiences of labour law and company law suggest that reflexive or experimentalist approaches to European governance can be effective when they operate so as to complement mechanisms of harmonization and regulatory competition, rather than being presented as alternatives to them.

I. Introduction

There has recently been considerable interest in the emergence of distinctive forms of governance in the EU, of which the open method of coordination is the best known, which involve the use of reflexive or responsive techniques of regulation. 'Reflexive governance', in this sense, implies that diversity of practice among the member states is a resource which, when coupled with open coordination methods such as benchmarking and mutual monitoring, provides a basis for experimentation and mutual learning. This approach has been contrasted to more traditional forms of harmonization of laws through directives, on the one hand, and to court-led regulatory competition, with its implication of deregulation, on the other. The open method is currently exercising considerable influence in such diverse areas as employment policy, social inclusion, enterprise promotion, environmental protection, energy policy, and fundamental human rights.

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Company law, and corporate governance more widely, are, however, an apparent exception to this trend. In this area, the Commission, in its proposal for the measure which eventually became the Thirteenth Company Law Directive, on takeover bids, and its proposals for a rolling programme of corporate governance reforms, effectively endorsed the principal-agent model of corporate governance which is most closely associated with American and British practice. The diversity in corporate governance structures and practices which currently exists across member states is, in this view, not an occasion for learning, but a potential distortion of competition, to be removed wherever possible.

This paper considers the implications of the recent experience of company law reform for emerging mechanisms of governance in the EU, and compares the company law case to developments in labour law in order to frame a wider discussion of the prospects for the European social model during a period of market liberalisation. Could it be that the method of open coordination will be applied in future to areas, such as employment and social policy, in which a political consensus at EU level of the kind needed to underpin new legislative measures, such as directives, is unlikely to emerge; but that hard-law mechanisms, including not just harmonization but also court judgments inducing regulatory competition, will be used to reshape other aspects of the internal market, including corporate governance? What are the risks involved in taking an asymmetrical approach – a process of mutual observation and ‘learning by monitoring’ for social and employment policy, but hard-law intervention based on a single ‘best’ model in the case of company law and the internal market? To analyse these questions, section II outlines the emergence of reflexive forms of governance within the EU and explores some of the theoretical ideas underpinning them. Section III then look in more detail at some recent substantive developments in the fields of company law and social policy, and discusses how far they map on to the models of governance which are to be found in the theoretical literature. Section IV offers an assessment and conclusion.

II. Models of governance in the EU

The case for viewing the EU as an innovator in respect of forms of governance has been influentially made by Charles Sabel in a series of papers,¹ most recently with Jonathan Zeitlin.² According to this view, ‘distinctive and surprisingly effective innovations’³ have emerged, the essence of which is that ‘the EU is creating a single market while constructing a framework within which the member states can protect public health and safety in ways that grow out of these traditions and allow them to pursue their own best judgements for innovative advance’.⁴ This analysis goes further than merely acknowledging, as others have done, the role of deliberation through the role of ‘comitological’ committees, or the use of

¹ J. Cohen and C. Sabel, ‘Directly-deliberative Polyarchy’ (1997) 3 *European Law Journal* 313; O. Gerstenberg, and C. Sabel, ‘Directly-deliberative Polyarchy: an Institutional Ideal for Europe?’ in R. Dehousse and C. Joerges (eds.) *Good Governance and Administration in Europe’s Integrated Market*. The Academy of European Law (EUI) Volume XI, Book 1 (Oxford: Oxford University Press, 2002).

² C. Sabel and J. Zeitlin, ‘Learning from Difference: the New Architecture of Experimentalist Governance in the European Union’, European Governance Papers (EUROGOV) No. C-07-02, <http://www.connex-network.org/eurogov/pdf/egp-connex-C-07-02.pdf>; forthcoming, *European Law Journal*, vol 14, no. 3 (May 2008).

³ Ibid., 5.

⁴ Ibid.

forms of multi-level ‘concertation’ which tend to dissolve the distinction between a central ‘core’ of decision-making and national ‘peripheries’. In addition, a new ‘underlying architecture of public rule making’ can be observed; this ‘can neither be mapped from the topmost directives and Treaty provisions nor read out from any textbook account of the formal competences of EU institutions’, but it nevertheless ‘regularly and decisively shapes EU governance’.⁵ Its essence is the establishment, firstly, of ‘framework goals’, jointly set by action between the member states and EU institutions, such as the goal of a high employment rate set for the employment policy OMC in the late 1990s; secondly, the devolution to ‘lower level units’, a category including but not limited to member states, of the means of implementation of these goals; thirdly, the application of a duty on the part of those units to report on their performance, to benchmark it against agreed criteria, and to take part in a peer review process by which their performance is judged collectively; and, fourthly, a recursive mechanism through which the framework itself is periodically revised in the light of the information produced by the benchmarking process.⁶

The result is distinctive, it is argued, for the following reasons. Firstly, the goal of deliberation is not, as has been thought, to reach agreement in the sense of a ‘reflective equilibrium’; rather, ‘deliberative decision making is driven at least as much by the discussion and elaboration of difference’.⁷ Secondly, the result is not, necessarily, to replace formal norms with informal ones: ‘those institutions whose explicit purpose is to expose and clarify difference so as to destabilize and disentrench settled approaches are typically highly formalised’.⁸ It is not simply that formal revisions to directives and national-level laws often result from the processes concerned; even where formal laws and sanctions are absent, the consequences of non-compliance can be far-reaching, in terms of possible economic losses and harm to reputation. Thirdly, new forms of governance rest not so much upon the imposition from above of supposedly optimal regulatory solutions, as upon a clear division of labour between EU institutions with responsibility for devising frameworks of general application, and the member states whose task is to adapt them to local conditions and to contribute, through reporting and monitoring, to a collective learning process: ‘the most successful of these arrangements combine the advantages of decentralized local experimentation with those of centralized coordination, and so blur the distinction between forms of governance often held to have incompatible virtues’.⁹ What this adds up to is a type of governance termed *directly deliberative polyarchy* – ‘polyarchy’ here referring to the element of mutual learning through monitoring by lower level units – which is, in essence, ‘a machine for learning from diversity’.¹⁰

The core illustration of the operation of deliberative polyarchy as a distinctive form of governance in the EU, although by no means the only one, is the ‘open method of coordination’ adopted at the Lisbon summit in 2000. Formally, this had four elements: the fixing of guidelines at central level, coupled with timetables for the achievement of goals; the establishment of benchmarks for tailoring performance and allowing the identification of best

⁵ Ibid., 6.

⁶ Ibid., 6-7.

⁷ Ibid., 7.

⁸ Ibid.

⁹ Ibid., 8.

¹⁰ Ibid., 9.

practice at local level; the adoption of specific targets for the implementation of guidelines, while taking into account regional and national differences; and a process of ‘periodic monitoring, evaluation and peer review organized as mutual learning processes’.¹¹ Elements of the OMC were already in existence, in the form of the Broad Economic Policy Guidelines which can be traced back to the Treaty of Maastricht, and the Employment Guidelines adopted in relation to the European Employment Strategy which was embedded in the Treaty of Amsterdam. The Lisbon Summit stimulated a proliferation of new OMCs across a wide range of areas, which now include pensions policy, strategies on social inclusion, and policies on fundamental rights, while looser variants of the same idea have been applied in the contexts of research and innovation policy, the ‘information society’, and the promotion of small and medium-sized enterprises.¹²

The arrival of the OMC appears to mark a fundamental break with what came before, and this is often the way in which it has been portrayed by critics and opponents alike. The authors of the OMC, as Sabel and Zeitlin put it, saw it as ‘a “third way” for EU governance between regulatory harmonization and fragmentation’.¹³ However, there is a case for identifying important continuities between the OMC and some long-standing debates about the proper role of harmonization within the common, later the single, market.

The EU has only a narrowly defined competence to regulate markets in the interests of promoting inter-state trade or economic integration more generally, in contrast to the position, for example, under the United States Constitution, whose Commerce Clause is more extensive in this regard than its EU counterparts.¹⁴ The EU’s labour market regulation powers, for example, were extremely limited from the start.¹⁵ The Treaty of Rome contained only a few provisions on labour law; the most important was Article 119 (now 141), which enshrined the right to equal pay between men and women. This provision owed its existence to French concerns that its apparently more protective sex discrimination laws would be a source of competitive disadvantage. A similar justification led to the inclusion of a Treaty provision relating to annual leave rights (Article 120). But for the most part, social policy was outside the scope of the Treaty. This was no accident. The founders of the European Economic Community accepted the view, set out in the Ohlin report which they commissioned from the ILO,¹⁶ that harmonizing measures in the labour law field were unnecessary.¹⁷ The

¹¹ Commission, *White Paper on European Governance*, COM (2001) 428, at 21.

¹² See generally S. Borras and K. Jacobsson, ‘The Open Method of Coordination and New Governance Patterns in the EU’ (2004) 11 *JEPP* 185; J. Zeitlin and P. Pochet with L. Magnusson (eds.) *The Open Method of Coordination in Action: The European Employment and Social Inclusion Strategies* (Brussels: PIE/Peter Lang, 2005).

¹³ ‘Learning from Difference’, op. cit., n. 2, at 24.

¹⁴ ‘The Congress shall have power... To regulate commerce... among the several states’ (US Constitution, Article I, s. 8, cl. 3). The broad reading given to the Commerce Clause for most of the twentieth century is a legacy of the Supreme Court’s acceptance of key components of the New Deal legislation of the 1930s, including the National Labor Relations Act 1935 (*NLRB v. Jones & Laughlin Steel Corp.* 301 US 1 (1937)).

¹⁵ See S. Deakin, ‘Labour Law as Market Regulation: the Economic Foundations of European Social Policy’, in P. Davies, A. Lyon-Caen, S. Sciarra, and S. Simitis (eds.) *Principles and Perspectives on EC Labour Law: Liber Amicorum for Lord Wedderburn* (Oxford: Oxford University Press, 1996).

¹⁶ International Labour Office, ‘Social Aspects of European Economic Cooperation’ (1956) 74 *International Labour Review* 99.

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implementation of the common market was expected to lead to upward pressure on wages and social welfare provisions, as states competed to attract scarce labour. At the point, in the mid-1950s, when the member states were all politically committed to the expansion of the welfare state and to the maintenance of conditions of full employment, this was not an unreasonable assumption. It was not until the early 1970s, when the EEC's expansion from six to nine states coincided with the end of the post-war consensus on the welfare state and full employment, that the member states felt it necessary to instigate the Community's first social action programme.¹⁸ This led to directives on equality of treatment and employment protection, which were adopted using general powers to regulate the common market. These initiatives paved the way for the significant expansion of social policy measures in the 1980s during the period of the Delors presidency. The Single European Act of 1986, the Treaty of Maastricht in 1992 and the Treaty of Amsterdam in 1997 each led to a widening of legislative powers in the social policy field, but it remains the case that these powers are narrowly confined, with certain areas (most notably minimum wages, collective bargaining and the right to strike) excluded altogether from the law making powers of the Community's central organs.¹⁹ In effect, state autonomy is still the order of the day in the social policy field, with only marginal incursions from Community law.²⁰

The power to introduce harmonising measures in the field of company law was, by contrast to those applying to social policy, both more extensive, and more closely related to the original economic objectives of the Community, since it originated in the freedom of establishment provisions of the Treaty of Rome. Under Article 54(3)(g) of the Treaty of Rome (now 44(2)(g) of the EC Treaty), the Council was empowered to adopt directives aimed at 'coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies and firms... with a view to making such safeguards equivalent throughout the Community'. Thus an element of uniformity in the laws protecting the right of shareholders and 'others' (this phrase could cover a range of stakeholder interests) was thought to be necessary in order to forestall a 'race to the bottom'. Directives were adopted from the late 1960s onwards, and by the early 1970s some commentators were arguing that the Community needed a thorough-going harmonization programme; the 'virtual unification of national company laws',²¹ would ensure that a race to the bottom was avoided. However, the prescriptive approach of the first company law directives gave way to so-called 'second generation' measures which set out basic accounting and audit standards in the form of a menu of options based largely on existing member state practice. Member-state autonomy was also observed in the 'third generation' measures which were based on the principle that harmonization should be limited to interventions which could be shown to be essential to the functioning of the single market,

¹⁷ See the 'Spaak Report' (Rapport des Chefs de Délégation, Comité Intergouvernemental créé par la conférence de Messine, 21 April 1956).

¹⁸ See C. Barnard, *EC Employment Law* 3rd ed. (Oxford: Oxford University Press, 2007), at 8-10.

¹⁹ *Ibid.*, 11-26.

²⁰ This situation is not greatly altered by the terms of the EU Reform Treaty agreed at Lisbon in December 2007. Under the terms of Arts. 3a and 3b of the revised EU Treaty, social policy would be an area of shared competence between the Union and the member states, as, in effect, it has been up to now.

²¹ C. Schmitthoff, 'The Future of the European Company Law Scene', in C. Schmitthoff (ed.) *The Harmonisation of European Company Law* (London: UKNCCL), at p. 9.

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and in the ‘fourth generation’ or framework directives of the 1990s which were based on the articulation of general principles rather than detailed prescription and which involved a degree of delegation of rule-making powers to trade and professional bodies at both member state and transnational level.²²

There is therefore a case for saying that reflexive forms of governance, involving a division of labour between EU institutions and the member states and commitment to experimentalism based on diversity of practices, were part of the EU’s regulatory architecture from an early point. The decision to attempt even the limited degree of harmonization in labour and capital markets which was initially envisaged through directives, as opposed to regulations which are directly applicable in national law, was itself significant. Directives are not self-enforcing; they depend for the effectiveness on implementing measures taken by member states. Directives in the social policy field are by and large designed to set a ‘floor of rights’. This model was established in the 1970s and, with some modifications and adaptations, remains the principal approach today. Most directives make explicit reference in their texts to ‘minimum standards’ which states must observe but on which they can improve, while many also contain ‘non-regression clauses’ which are intended to prevent member states from using the implementation of a directive to reduce the pre-existing level of protection guaranteed by national law. A ‘race to the top’ is thereby implicitly encouraged.²³

This distinctive European approach to the regulation of transnational markets has been described using the term *reflexive harmonization*.²⁴ Rather than seeing reflexive forms of governance as a ‘third way’ between the standardisation and fragmentation of laws, as supporters of the OMC would have it, the guiding idea here is that there is no inevitable opposition between regulatory competition and harmonization. Regulatory competition, rather than necessarily involving a race to the bottom, should be seen as a process of discovery through which knowledge and resources are mobilized in the search for effective and workable rules. The concept of ‘reflexive harmonisation’ is an adaptation of the idea that competition is a learning process dependent on norms that establish a balance between ‘particular’ and ‘general’ mechanisms;²⁵ between, that is, the autonomy of local actors, and

²² See generally C. Villiers, *European Company Law: Towards Democracy?* (Aldershot: Dartmouth, 1998).

²³ Deakin, ‘Labour Law as Market Regulation’, op. cit, n. 15. Directives in some other areas of EU law do, by contrast, seek to rule out variations in the standard of protection at member state level, on the ground that such differences can distort competition. The Product Liability Directive (Directive 85/374/EEC) is an example of this approach: see Case C-402/03 *Skov AEG v. Billa Lavprisvarehus* [2006] ECR I-199.

²⁴ S. Deakin, ‘Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation. A Law and Economics Perspective on *Centros*’ (1999) 2 *Cambridge Yearbook of European Legal Studies* 231; id., ‘Regulatory Competition versus Harmonisation in European Company Law’, in D. Esty and D. Geradin (eds.) *Regulatory Competition and Economic Integration: Comparative Perspectives* (Oxford: OUP), 190-21; id., ‘Regulatory Competition and Legal Diversity: which Model for Europe?’ (2006) 12 *European Law Journal* 440; C. Barnard and S. Deakin, ‘Market Access and Regulatory Competition’ in C. Barnard and J. Scott (eds.) *The Law of the Single Market: Unpacking the Premises* (Oxford: Hart, 2002); P. Zumbansen, ‘Spaces and Places: a Systems Theory approach to Regulatory Competition in European Company Law’, (2006) 12 *European Law Journal* 535.

²⁵ R. Sugden, ‘Spontaneous Order’ in P. Newman, *The New Palgrave Dictionary of Economics and the Law*, Vol. III (London: Macmillan), at 48.

the mechanisms which ensure a process of collective learning based on observation and experimentation. As with theories of deliberative polyarchy, a prerequisite for reflexive harmonization is the preservation of local-level diversity, since without diversity, the stock of knowledge and experience on which the learning process depends is limited in scope. However, there are several respects in which the reflexive harmonization approach differs from that of deliberative polyarchy.

The theory of reflexive harmonization was developed as part of an explicit engagement with, and response to, neoliberal critics of the EU's role in transnational rule-making. Those, for example, who argued against the European Commission's social action programmes of the 1980s and 1990s, did so on the grounds that variety within the Union as a whole should be preserved: 'hidden in the historical experience of economic integration, there is ... a very important aspect of "system dynamics": international competition in the field of the welfare state serves as a kind of process of discovery to identify which welfare state package – for whatever reason – turns out to be economically viable in practice'.²⁶ As this critique recognized, there was a strong argument against the use of harmonizing legislation to cement in a single 'best' solution. However, the theory of reflexive harmonization argued that this was not a good account of how EU governance worked. It argued, as we have just seen, that European-style harmonization had evolved to play the role of maintaining the appropriate relationship between 'particular' mechanisms operating at the sub-federal level, and the 'general' mechanisms by which learning across the Union as a whole took place. The model of reflexive harmonization held that the principal objectives of judicial intervention and legislative harmonization alike were two-fold: firstly, to protect the autonomy and diversity of national or local rule-making systems, while, secondly, seeking to 'steer' or channel the process of adaptation of rules at state level away from 'spontaneous' solutions which might lock in sub-optimal outcomes, such as a 'race to the bottom' initiated by court-led 'negative harmonisation'. In contrast, the deliberative polyarchy approach is silent on the role that minimum standards might play in shaping the process of transnational integration. There is nothing in the deliberative polyarchy approach to suggest, for example, that experimentalist solutions of a deregulatory type should be ruled out in principle, and nor is there any clear engagement with the risks which this type of regulatory competition might pose.

The idea of reflexive harmonization was also advanced by way of an explicit contrast with US experience. It is common, in critiques of the EU's harmonization programmes in the 1980s and 1990s, to contrast a US model of state autonomy and inter-jurisdictional competition with a European one centred on the application of uniform rules. However, reflexive harmonization theory argues that this view is mistaken. Federal legislation in labour and capital markets had been a significant presence in the US context since the passage of the New Deal legislation of the 1930s. The law governing collective bargaining and union security is federal law, in the form of the National Labour Relations Act, which is composed of the Wagner Act of 1935 and the amending Taft-Hartley Act 1947. Thanks to the doctrine of preemption, these federal statutes occupy the field to the exclusion of state law. It is only in those areas where the federal legislature has left open a space for state-level initiative that

²⁶ K.-H. Paqué, 'Does Europe's Common Market need a Social Dimension? Some Academic Thoughts on a Popular Theme', in J.T. Addison and W.S. Siebert (eds.) *Labour Markets in Europe: Issues of Harmonisation and Regulation* (London: Dryden, 1997), at 109.

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regulatory competition has been able to develop.²⁷ One example of this is the leeway granted to states by the Taft-Hartley Act, to enact so-called ‘right to work’ laws which operated as exceptions to the federal union security laws which underpinned the closed shop.²⁸ Laws which might have improved on the protective standards set out by the federal legislation governing worker representation continued to be confined by the preemption doctrine. In effect, a race to the bottom in labour standards was still possible, but wider experimentation was ruled out, the inverse of the situation in the EU. An ‘ossified’ structure of workplace representation, little different from that set out in the original legislation of the 1930s, remained fixed in place.²⁹

In company law, too, the US experience is very far from being one of pure regulatory competition. The widely-held image was one of a self-forming corporate law emerging on the basis of regulatory competition between the states (the ‘Delaware model’).³⁰ However, this neglects to take into account certain features of the institutional architecture of US federalism. Congress has power, under the Commerce Clause, to regulate both securities and company law, and has not hesitated to do so in response to perceived political imperatives,

²⁷ The source of the preemption doctrine is the Supremacy Clause (‘This Constitution, and the laws of the United States . . . shall be the supreme law of the Land; . . . any Thing in the Constitution or Laws of any state to the Contrary notwithstanding’: US Constitution, Art. VI, cl. 2). The precise scope of the preemption doctrine differs from one context to another, depending on the approach taken in the particular federal statute in question, and on case law. The approaches to preemption in labour law and securities law cases are at the more rigid end of the spectrum. In labour law this is largely the result of Supreme Court decisions including *San Diego Building Trades Council Local 2620 v. Garmon* 359 U.S. 236 (1959) and *Lodge 76, International Association of Machinists v. Wisconsin Employment Relations Commission* 427 U.S. 132 (1976), while in securities law it is the result of Congressional interventions of the 1990s which set out to restrict state-level securities laws on the grounds that they were undermining the federal legislation (see R. Romano, *The Advantages of Competitive Federalism for Securities Regulation* (Washington, DC: AEI Press, 2002). There is a growing debate about the preemption doctrine in the US context which mirrors some of the recent European discussion about the legitimacy of federal controls over state law and the role of legal diversity in preserving scope for experimentation. See R. Epstein and M. Greve (eds.) *Federal Preemption: States’ Powers, National Interests* (Washington, DC: AEI Press, 2007).

²⁸ The Taft-Hartley Act outlawed the pre-entry closed shop (making union membership a prior condition of employment) which the original National Labor Relations Act (the Wagner Act of 1935) had allowed, but it permitted the post-entry or ‘union’ shop (under which an employee must become a union member after being hired) subject to the right of states to opt out of this provision. The relevant amendment was contained in what became section 14(b) of the National Labor Relations Act. Prior to its adoption, around 12 states had ‘right to work’ laws; there are currently over 20. See US Department of Labor, ‘State Right to Work Laws and Constitutional Amendments in Effect as of January 1, 2008, with Year of Passage’, <http://www.dol.gov/esa/programs/whd/state/righttowork.htm> (accessed March 2008).

²⁹ C. Estlund, ‘The Ossification of American Labor Law’ (2002) 102 *Columbia Law Review* 1527.

³⁰ Both the critics of Delaware, such as William Cary (‘Federalism and corporate law: reflections on Delaware’, (1974) 83 *Yale Law Journal* 663) and Clive Schmitthoff (‘The Future of the European Company Law Scene’, op. cit., n. 21), and its supporters, such as Roberta Romano (*The Genius of American Corporate Law* (Washington, DC: AEI Press, 1993)) and Frank Easterbrook and Daniel Fischel (*The Economic Structure of Corporate Law* (Cambridge, Mass.: Harvard University Press, 1991)), stressed the spontaneous element of rule-formation implicit in the model of inter-jurisdictional competition.

which are at their most intense in periods of capital market turbulence. The pivotal New Deal measures, the Securities Act 1933 and the Securities and Exchange Act 1934, and, more recently, the Sarbanes-Oxley Act 2002, a response to the corporate failures of the early 2000s, were all federal statutes. Delaware has, at best, a precarious independence from federal control; formally, company law remains the responsibility of the states, but federal securities law is always in danger of spilling over into the domain supposedly set aside for company law to be set by state courts and legislatures. Thus the federal legislator has come to act both as a competitor to Delaware, and, to a certain degree, as a regulator of inter-jurisdictional competition.³¹

Thus there is a case for arguing that the most important difference between European and American approaches to law-making in company law is not the greater role of regulatory competition in the US context, but the degree to which the different institutional architectures operate to foster diversity of practice. Delaware's preeminence as the preferred state of incorporation has led to a situation in which there is comparatively little diversity in company law across the different US jurisdictions by comparison to the position within the EU.³² This is the consequence of the freedom which US companies have had to incorporate in the state of their choice, and of a strong version of the mutual recognition principle, under which courts in all states are required to recognize that choice as far as the 'internal affairs' of the corporation are concerned.³³ In the EU, at least until the *Centros* case was decided,³⁴ states were free to retain the 'real seat' principle under which a company's applicable law was the state in which its main office was situated or with which it had the strongest functional connection. This provided protection for high-regulation states against the threat of corporate flight. It also constrained any 'race to converge' of the kind which the US had experienced as, in the course of the twentieth century, state laws clustered around the essential features of the Delaware model.³⁵

Where the theory of reflexive harmonization stresses the distinctiveness of the EU's approach to multi-level governance and contrasts it to the US approach, the theory of deliberative polyarchy sees the EU as simply one case amid a larger set of emerging governance forms to be found at national, regional and global level. Thus Sabel and Zeitlin cite instances of experimentalism in the US including environmental protection, education policy, child protection, and food safety, and are also prepared to extend the deliberative model to cover global-level governance: 'developments cast doubt on the singularity of the EU's innovative regulatory architecture',³⁶ with the WTO and ILO, among others, beginning to borrow elements of the OMC approach.

³¹ M. Roe, 'Delaware's Politics' (2005) 118 *Harvard Law Review* 2493.

³² Deakin, 'Two Types of Regulatory Competition', op. cit., n. 24.

³³ This principle originated in the judgment of the Supreme Court in *Paul v. Virginia* (1868) 9 Wall 168, although it is doubtful whether the Court intended to use this conflicts of law case to stimulate inter-jurisdictional competition as such (see F. Tung, 'Before Competition: Origins of the Internal Affairs Doctrine' (2006) 32 *Iowa Journal of Corporate Law* 33).

³⁴ Case C-212/97 *Centros Ltd. v. Erhervs-og Selskabsstyrelsen* [1999] ECR I-1459; see below, section III.

³⁵ Deakin, 'Two Types of Regulatory Competition', op. cit., n. 24.

³⁶ Sabel and Zeitlin, 'Learning from Difference', op. cit., n. 2, at 58.

Whether the OMC truly represents a template for the global governance of the near future is a matter to which we shall return. The next step in the analysis is to consider how far the models of governance just described are reflected in some recent substantive developments in the areas of company law and labour law.

III. Recent Developments in European Governance: the Contrasting Experiences of Company Law and Labour Law

Since the turn of the century there has been what seems, on the face of it, to be a huge increase in the volume and range of EU-level company law. Important new directives have been adopted on takeover bids,³⁷ cross-border mergers,³⁸ the responsibilities of boards for financial statements and key non-financial information,³⁹ transparency requirements for publicly traded companies,⁴⁰ the conditions for incorporating a company as a *Societas Europaea* or European Company,⁴¹ and the rights of shareholders in listed companies.⁴² Two significant recommendations have been published, one on directors' remuneration⁴³ and one on the duties of non-executive or supervisory directors and the role of committees of the board.⁴⁴ The Court has been active, too, in extending the freedom of establishment logic of the *Centros*⁴⁵ case in such a way as further to undermine the real seat principle, and using the capital movement provisions of the Treaty to attack laws seen as undermining shareholder sovereignty and liquidity. Corporate governance also has its own OMC, of a kind, thanks to the establishment of a process deliberation over principles of general application, under the auspices of the European Corporate Governance Forum.

By contrast, labour law initiatives seem log-jammed. Three measures, on parental leave, part-time work and fixed-term employment,⁴⁶ were adopted in the late 1990s as 'framework agreements' under the social dialogue procedure which enables the force of a directive to be given to accords made by the social partners at EU level, and a new directive on information and consultation of employees was agreed in 2002,⁴⁷ after the failure of the social dialogue

³⁷ Directive 2004/25/EC on takeover bids.

³⁸ Directive 2005/56/EC on cross-border mergers of limited liability companies.

³⁹ Directive 2006/46/EC on board responsibilities and improvement of financial information relating to financial and corporate governance matters.

⁴⁰ Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

⁴¹ Regulation 2001/2157/EC on the Statute for a European company (SE) and Directive 2001/86/EC supplementing the Statute for a European company with regard to the involvement of employees.

⁴² [Directive 2007/36/EC](#) on the exercise of certain rights of shareholders in listed companies.

⁴³ Recommendation 2004/913/EC fostering an appropriate regime for the remuneration of directors of listed companies.

⁴⁴ Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

⁴⁵ Case C-212/97 *Centros Ltd. v. Erhervs-og Selskabsstyrelsen* [1999] ECR I-1459.

⁴⁶ Directive 96/34/EC on the framework agreement on parental leave UNICE, CEEP and the ETUC, Directive 97/81/EC concerning the framework agreement on part-time work concluded by UNICE, CEEP and the ETUC, and Directive 99/70/EC concerning the framework agreement on fixed-term work UNICE, CEEP and the ETUC.

⁴⁷ Directive 2002/14/EC establishing a general framework for informing and consulting employees in the European Community.

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process in this case. Since then, there has been a failure among the member states to reach agreement on a revision of the working time directive and on a new directive on temporary work. While new labour law legislation is stalled, attention has shifted to the employment strategy OMC, which has become the focus for debates about the merits and demerits, from the point of view of competitiveness, of particular features of national labour law systems; these debates which have frequently had a deregulatory tone to them, as in the Commission's 2006 Green Paper on modernizing labour law.⁴⁸

Intense legislative activity in the area of company law can therefore be contrasted to a period of relative stasis in labour law coupled with a growing preference for soft-law measures in preference to legislation. There appears to have been a downgrading of efforts at integration in the labour law field, creating a potentially dangerous asymmetry between a strengthened, pan-European company law and a weakened and decentred system of labour law. Closer inspection suggests, however, that the integration-through-hard-law approach is already encountering difficulties in the company law field, while the more reflexive approaches taken in labour law are fostering functional convergence of laws at member state level without imposing uniform outcomes.

A. The Company Law Modernisation Programme: Towards an Integrated Capital Market?

There are elements of the legislative programme in company law which conform to a conception of harmonisation as standardization, and which as a result have little if any common ground with deliberative or reflexive approaches. The first significant document in the current round of initiatives was the report of the High Level Group of Experts on takeover bids, published in October 2002. This argued that what the EU needed was 'an integrated capital market' in which 'the regulation of takeover bids [would be] a key element'. The report noted that 'the extent to which in a given securities market takeover bids can take place and succeed is determined by a number of factors', including general or structural factors affecting financial markets, and company-specific factors such as rules of company law and articles of association affecting voting rights, protection of minority shareholders, and the legitimacy of takeover defences. It then observed that 'there are many differences between the Member States in terms of such general and company specific factors', with the result that the EU lacked a 'level playing field'.⁴⁹

The substantive content of state-level company laws was also an issue for the High Level Group. The essence of the problem was that the laws of most member states did not sufficiently conform to a model of corporate governance in which managers understood their principal duty to return value to shareholders, and in which takeovers played a crucial disciplinary role in reminding them of this obligation:

'actual and potential takeover bids are an important means to discipline the management of listed companies with dispersed ownership, who after all are

⁴⁸ Commission, Green Paper, *Modernising labour law to meet the challenges of the 21st century*, COM(2006) 708 final.

⁴⁹ *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, 2002, at 18.

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the agents of shareholders. If management is performing poorly or unable to take advantage of wider opportunities the share price will generally underperform in relation to the company's potential and a rival company and its management will be able to propose an offer based on their assertion of their greater competence. Such discipline of management and reallocation of resources is in the long term in the best interests of all stakeholders, and society at large. These views also form the basis for the Directive'.⁵⁰

The High Level Group could not have been clearer: they were proposing a measure based on the standard finance-theory or 'principal-agent' view of the role of hostile takeover bids in enhancing shareholder value. The assertion that managers are 'after all' the agents of shareholders in one based on a particular economic-theoretical position, which has been contested⁵¹ and which, moreover and most relevantly for present purposes, has no grounding in the legal conceptions of the company which the High Level Group might have looked for in the laws of the Member States. Even UK company law does not go this far; it has not followed the Delaware practice of sometimes referring to duties owed by directors to the shareholders, rather than to the company as a separate entity.⁵² Be that as it may, it was very largely to the UK that the EU experts looked to fill out the content of the Directive. Even more so than its many predecessors, this draft of the Thirteenth Directive drew on the model of the City Code on Takeovers and Mergers, a text notable for the high level of protection it gives minority shareholders and for its restriction of poison pills and other anti-takeover defences which US law, which is other takeover-friendly, by and large allows.⁵³

The High Level Group's second report, in November 2002, struck a similar note in stressing the role of non-executive directors in monitoring management, which is a feature of British and American practice, but is relatively underdeveloped in other member states:

'Good corporate governance requires a strong and balanced board as a monitoring body for the executive management of the company. Executive managers manage the company ultimately on behalf of the shareholders. In companies with dispersed ownership, shareholders are usually unable to closely monitor management, its strategies and its performance for lack of information and resources. The role of non-executive directors in one-tier board structures and supervisory directors in two-tier board structures is to fill this gap between the uninformed shareholders as principals and the fully informed executive managers as agents by monitoring the agents more closely'.⁵⁴

⁵⁰ Ibid., at 19.

⁵¹ See, e.g., M. Blair and L. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

⁵² See P. Goldenberg, 'Shareholders versus Stakeholders: the Bogus Argument' (1998) 19 *Company Lawyer* 34.

⁵³ See S. Deakin and G. Slinger, 'Hostile Takeovers, Corporate Law, and the Theory of the Firm' (1997) 24 *Journal of Law and Society* 124.

⁵⁴ *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe*, 2002, at 59.

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Again, the standard finance-orientated or ‘principal-agent’ model was stressed, and a feature of the British and American systems was presented as if it had universal validity. Features of national systems which did not conform to the principal-agent approach, such as the distinctive role of worker directors and community representatives in two-tier boards, were simply shoehorned into the supposedly universal model. The High Level Group’s second report set out a series of objectives for reform of corporate governance (among other things) which reflected this point of view, and which were then incorporated into the Commission’s Action Plan on Company Law, with effect from 2003.⁵⁵

What happened next, and in particular the fate of the Thirteenth Directive, is instructive. Although the Directive was eventually adopted, in 2004,⁵⁶ this was only after a series of compromises had been agreed, which considerably diluted the draft presented by the Commission in 2002. Contrary to the expectation that the Directive would roll out a liberal-market model of takeover regulation along similar lines to that of the UK’s City Code on Mergers and Takeovers, in its final form it allows member states to retain laws which permit multiple voting rights and limit shareholder sovereignty in various ways, such as allowing anti-takeover defences to be put in place both in advance of bids and after they are made.⁵⁷ Some of these provisions are transitional; the general thrust of the Directive is still in favour of the principle of one share one vote and proportionality between investment risks and decision-making powers, is clear. Yet, rather than impose a single model on member states, the Directive has in effect set out an experimentalist framework for law-making at state level. This was far from being its original objective. But the result of the rough-hewn compromises which informed the final text of the Directive is that the liberalisation of takeover rules can be achieved in one of several different ways, which may take into account specific features of the legal and institutional environments of the different member states.

Another significant feature of the Thirteenth Directive is that provision was made for the reformed takeover rules to make provision for information and consultation of employees.⁵⁸ An element of employee consultation was present in earlier drafts of this Directive, and the provisions on this issue which were included in the final text are not especially far-reaching,

⁵⁵ See *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, op. cit., n. 51, at 10-12. On the Action Plan, and its development since 2002, see Commission, 2003, and the company law website of the Internal Market Directorate: http://ec.europa.eu/internal_market/company/index_en.htm.

⁵⁶ Directive 2004/25/EC.

⁵⁷ The most important of the provisions of the Directive in this respect are the ‘board neutrality’ rule in Article 9, which requires boards to maintain a position of neutrality on the merits of bids and constrains the scope for post-bid defences, and the ‘breakthrough rule’ in Article 11, under which a bidder can overcome multiple voting rights and other obstacles to a successful takeover. Member states were given the choice of making these rules optional, and of allowing companies which adopted them voluntarily to disapply them if they were faced with a bid from a company which were not bound by them (the ‘reciprocity’ principle). Following the implementation of the Directive, five out of the seventeen member states already applying the board neutrality rule had introduced the reciprocity principle (or indicated their intention to do so) by 2007. Only one member state had introduced the board neutrality rule for the first time. Almost all the member states had introduced the breakthrough rule on an optional basis. See Commission, *Report on the implementation of the Directive on Takeover Bids*, Brussels, 21.02.2007, SEC(2007) 268.

⁵⁸ See Arts. 6(1), 8(2) and 14.

and do not go as far as the laws of a number of member states. However, the Thirteenth Directives set a pattern, in that mandatory employee consultation provisions were then included in other company law directives, including the directive on cross-border mergers, as well as the *Societas Europaea* measures (where again there has been a long debate on this issue).

The translation of the principal-agent model of corporate governance from the level of high theory into specific legal provisions has, then, been far from straightforward. The agency model espoused by the High Level Group finds no room for managerial engagement with employees on issues of corporate governance, regarding it as a qualification to the principle of shareholder-based control of the firm. However, the issue of employee involvement is unavoidable when it comes to legislating at EU level. This is not just because organised labour interests have numerous possibilities for presenting their view when directives are being formulated, which they do not least because of the role of the Parliament, but also because the principle of employee consultation in the event of corporate restructurings has come to be recognised, over several decades, as an important point of reference within the European legal order, as it is embodied in numerous labour law directives as well as in the Charter of Fundamental Rights.⁵⁹

A further paradoxical and perhaps unexpected consequence is that, following the adoption of the Thirteenth Directive, the UK rules on takeover bids have had to be substantially modified in order to accommodate the employee consultation principle. The UK's City Code may have provided the model for the Directive, but the Code could not remain unaffected by the wider implications for corporate governance of the Directive's adoption. In particular, more prescriptive provisions concerning the potential impact of takeovers on employees have had to be introduced. The bidder must now provide detailed information on its strategic intentions with regard to the target, possible job losses, and changes to terms and conditions of employment,⁶⁰ and the target must give its views, in the defence document, on the implications of the bid for employment.⁶¹ In addition, employee representatives of the target have the right to have their views of the effects of the bid on employment included in relevant defence document issued by the target.⁶² The full impact of these rules on UK takeover law and practice remains to be seen, but their adoption could well have implications for the operation of information and consultation requirements in the context of labour law.

B. A Company Law OMC or 'A Determined Fight against Perverse National Behaviour'?⁶³ The Deliberations of the European Corporate Governance Forum

There are other signs that the so-called modernisation of company law is not proceeding in a straightforwardly linear fashion towards the instantiation of the agency model, and that the

⁵⁹ See Barnard, *EC Employment Law*, op. cit., n. 18, chs.13-15.

⁶⁰ City Code on Takeovers and Mergers, rule 24.1.

⁶¹ Ibid., rule 25.1(b).

⁶² Ibid., rule 30.2(b). This is however subject to the target board receiving the employee representatives' views in good time, which may not always be straightforward. See Takeover Panel, *The Implementation of the Takeovers Directive. Statement by the Panel and the Code Committee following the External Consultation Process on PCP 2005/5* (2006), 32-3, for discussion.

⁶³ See n. 71, below.

reform process has had to take on board the diversity of state-level practices. Corporate governance now has its own OMC-type mechanism, thanks to the establishment of establishment in 2003 of the European Corporate Governance Forum. The Forum's existence was prefigured in the November 2002 report of the High Level Group, which recommended that the Commission

'set up a structure which facilitates the coordination of the Member States' efforts to improve corporate governance. Member States should be required to participate in the coordination, but the process itself and the results of the process should be voluntary and non-binding. Market participants (including of course companies) should be invited to be actively involved in the coordination exercise'.⁶⁴

In practice, the European Corporate Governance Forum represents something less than a fully fledged OMC for company law. Its members, '15 outstanding high level experts in corporate governance',⁶⁵ are selected by the Commission. The composition of the group is intended 'to ensure a balanced representation of all those having an interest in sound corporate governance practices: investors, issuers, regulators, worker representatives and academics'.⁶⁶ The task of the Forum has been described as 'to help the convergence of national efforts, encourage best practice and advise the Commission'.⁶⁷ It meets three times a year and its published minutes indicate that most of its business so far has been devoted to discussion of a number of corporate governance issues, most notably the operation of the 'comply or explain' principle in state-level codes (that is, the principle that companies may either comply with the provisions of codes on board structure and other aspects of governance, or issue a statement explaining why they have not done so). As part of this process, the Forum has issued a statement of its own on the 'comply or explain' principle which is akin to a guidance note. The Forum has expressed its intention to approach regulatory bodies and other relevant organs at member state level with a view to collecting information on corporate governance practices, but whether this will mature into a peer-review or benchmarking process, is not yet clear.

Only one trade unionist sits on the group; most of its members are senior representatives of financial industry trade associations, institutional shareholder groups, and bodies which campaign for enhanced shareholder protection. At its June 2006 meeting, the Forum heard a presentation from the European Trade Union Confederation on the role of employees as stakeholders in corporate governance. The nature of the Forum's likely future attitude to issues of employee involvement can be inferred from this entry in the minutes:

'members pointed out to possible risks of including employees and other stakeholders into the corporate governance debate. In some cases, their

⁶⁴ *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe*, op. cit., n. 56, at 73.

⁶⁵ Speech of Commissioner Bolkestein, European Corporate Governance Conference, The Hague, 18 October 2004, available on the Internal Market Directorate company law website: http://ec.europa.eu/internal_market/company/index_en.htm.

⁶⁶ Ibid.

⁶⁷ Ibid.

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interests are used by the management as an excuse for following its own line and acting contrary to the interests of the shareholders. This can even result into being detrimental to the employees who increasingly are shareholders themselves, either directly or through their pension funds. One member also pointed out to the OECD principles [on corporate governance] that deal with the position of employees only in very general terms and took the view that the Forum should stay within that framework'.⁶⁸

In other respects, there are signs that both the Forum and the Internal Market Directorate to which it reports are broadly committed to the convergence of EU systems around the global corporate governance standard embodied in the OECD principles, and which is closely aligned to US and UK practice. While references are made to the importance of understanding diversity in the company laws of the member states, there is an underlying emphasis on the role of the Commission in encouraging convergence. Sometimes this takes the form of the suggestion that 'a process of convergence in Member States' approaches to Corporate Governance is already underway',⁶⁹ with comply or explain being used as the foremost illustration; on other occasions, the need for further reforms is stressed:

'Why should the Commission step up to meet the challenge and become embroiled in matters which most often depend on national laws and regulations, as well as traditions and practices? Basically because what is at stake is of enormous concern at the European level, cannot be achieved solely through competition across systems, and sometimes requires a determined fight against perverse national behaviour. Corporate governance differences and related discrepancies in corporate law are very often powerful barriers to integration, which stand in the way of the Internal Market. If these barriers did not exist, if investors could not confidently buy equity in countries other than their own and feel that they had the same rights and obligations as in their home markets, if the control of a corporation was open to the most competent managers, irrespective of their nationalities, the efficiency of European capital markets would improve markedly, and the quality and performance of management would certainly have to meet higher standards'.⁷⁰

In practice, as we have seen, the Forum has not yet got to the stage of initiating a benchmarking programme designed to test member states' compliance with what it takes to be internationally accepted corporate governance standards. If harmonisation remains a distant prospect and mutual learning a mere aspiration, can an integrated capital market be

⁶⁸ Minutes of the Sixth Meeting of the European Corporate Governance Forum, 1 June 2006, available on the European Corporate Governance Forum website: http://ec.europa.eu/internal_market/company/ecgforum/index_en.htm.

⁶⁹ Speech of Commissioner Bolkestein, Conference on the German Corporate Governance Code, 24 June 2004, available on the Internal Market Directorate company law website: http://ec.europa.eu/internal_market/company/index_en.htm.

⁷⁰ Speech of Mr. Antonio M. Borges, member of the European Corporate Governance Forum, to the Hearing on Future Priorities for the Action Plan on Company Law and Corporate Governance, Brussels, 3 May 2006, available on the Internal Market Directorate company law website: http://ec.europa.eu/internal_market/company/index_en.htm.

achieved through regulatory competition? This is the possibility held out by the Court's free movement jurisprudence.

C. Company Law and Freedom of Movement

The Court's case law has long given a principal role to the role principles of mutual recognition and non-discrimination in the construction of the internal market, albeit with some significant doctrinal distinctions according to the precise context which is being considered.⁷¹ However, these principles have also been subject both to provisions of the EC Treaty itself which embody a number of derogations on public policy grounds from the free movement principle, and to a further set of derogations developed by the Court itself as its jurisprudence has evolved, using variants of the proportionality test.⁷² Thus from the inception of this process, respect for the autonomy and territorial sovereignty of the member states has operated as a countervailing force to pressure for economic liberalisation.

The *Centros* case placed critical pressure on this long-standing compromise. Before that decision, only a minority of member states observed the 'state of incorporation' rule under which a company is free, by virtue of its decision on incorporation, to choose the law which applies to its internal governance. Most member states followed a version of the 'real seat principle' which generally meant that courts would regard the applicable law of the company as that of the state in which the company had its main centre of operations – its head office or principal place of business. The effect of the real seat principle was to render impossible the kind of market for corporate charters or constitutions which operates in the US. A company in a 'real seat state' could not choose its own applicable law, and 'incorporation states' could not require real seat states to abide by the mutual recognition principle. The legality of the real seat doctrine was an obvious target for free movement jurisprudence from an early stage but the process took a decisive turn in favour of a strict reading of the free movement principles after *Centros*.

In this case the Court decided that the Danish company registrar should have recognized the validity of the incorporation of a small private company, Centros Ltd., in the United Kingdom, even though the founders of the company were two Danish citizens carrying on business in Denmark, who had chosen English law in order to avoid Danish minimum capital requirements. Since Denmark is not a real seat state the decision, in itself, hardly represented a direct assault on the real seat principle, but in later decisions the Court more clearly cast doubt on that principle,⁷³ while, as in *Centros* itself, allowing the possibility of a proportionality defence where a legitimate, countervailing interest could be shown. However, in *Centros* the Court brushed aside policy arguments in favour of creditor protection legislation in a way that was not convincing. Not all member states have minimum capital requirements, but those that do not, such as the United Kingdom, have functional equivalents

⁷¹ For some of the subtleties, see Barnard and Deakin, 'Market Access and Regulatory Competition', op. cit., n. 24.

⁷² See generally the contributions in Barnard and Scott (eds.), *The Law of the Single Market*, op. cit., n. 24.

⁷³ See, in particular, Case C- 208/00 *Überseering v. Construction Company Baumanagement GmbH (NCC)* [2002] ECR-I Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.* [2003] ECR-I 10115; Case C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

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for the protection of creditors such as laws on director disqualification, which deter opportunistic insolvencies and screen out a certain proportion of companies more likely to fail. Corporate governance systems consist of interlocking parts; if one part is removed by court-led deregulation, the effects on the rest cannot be straightforwardly be predicted. *Centros* and the decisions which followed it led to the incorporation of tens of thousands of small, closely-held German and Danish companies in the United Kingdom, and to a reduction in the level of creditor protection legislation in several other EU member states.⁷⁴ As a result, creditors, employees and other third parties have been exposed to a higher risk of corporate failure in those countries. Arguably, *Centros* has undermined the effectiveness of regulatory mechanisms both in the UK (which now has the responsibility of enforcing company registration rules for a large number of businesses which are owned and run outside the jurisdiction) and in the several other member states in which a large number of UK-incorporated firms are physically located. There is also evidence that corporate migration is already taking place with the aim avoiding laws providing for worker directors on supervisory boards, one aspect of the German-origin system of codetermination.⁷⁵ In May 2006 the German airline Air Berlin registered as a UK-based plc, apparently in order to escape German codetermination legislation, a move which, it has been predicted, others will follow.⁷⁶

The broad-brush approach taken to the proportionality issue in *Centros* does not bode well for any future attempt to argue that an exception to freedom of establishment should be made in the case of codetermination laws, for example, on the grounds that employee and community participation in the processes of corporate governance can bring benefits to processes of corporate governance, in particular in states with a long tradition of such arrangements. The Court's unwillingness to do more than refer in passing to employee interests as a legitimate countervailing factor was on display again in the more recent *Volkswagen* case,⁷⁷ in which it struck down German legislation providing for weighted voting and guaranteed board-level participation for employees and communities in Volkswagen AG, on the grounds that it infringed the principle of free movement of capital under Article 56 of the EC Treaty. The Court ignored the historical context of the Volkswagen law, namely, that employee and community interests had abandoned historical ownership claims in the late 1950s in return for the law placing limits on the voting rights of any single shareholder. The Court's insistence that weighted voting and share caps create barriers to the integration of European capital markets directly recalls the High Level Group's advocacy of shareholder value and the agency model.⁷⁸ But as with the Thirteenth Directive, the results of the Court's intervention

⁷⁴ M. Becht, C. Mayer and H. Wagner, 'Where do Firms Incorporate? Deregulation and the Cost of Entry' ECGI-Law Working Paper No. 70/2006.

⁷⁵ German codetermination has two bases: worker representation on the supervisory board and employee participation in decision making at organisational level through works councils. For an argument that the two forms of codetermination are complementary and that removing one would weaken the other, see P. Zumbansen and D. Saam, 'The ECJ, Volkswagen and European Corporate Law: Reshaping the Varieties of Capitalism' CLPE Research Paper 30/2007.

⁷⁶ 'German companies flee to the UK', *Financial Times*, 24 June 2006. Corporate flight to avoid codetermination rules is also an issue in the context of the Societas Europaea Directive. See J. McCahery and E. Vermeulen, 'Does the European Company Prevent the "Delaware Effect"?' (2005) 11 *European Law Journal* 785.

⁷⁷ Case C-112/2005, Judgment of 23 October 2007.

⁷⁸ See Section III.A, above.

in *Volkswagen* were perhaps not quite what was expected. Rather than paving the way for dispersed share ownership in Volkswagen AG, its decision made it possible for the owners of Porsche, the Piech family, to consolidate their position as controlling blockholders in a merged company.⁷⁹

D. Innovation in Labour Law: The Impact of Social Dialogue

With company law the focus of such activity and attention, what has been happening in labour law? As we noted earlier, there seems to have been a move away from hard-law driven integration in favour of open coordination methods of various kinds. The legal mechanisms used have been less directly interventionist than those adopted in the company law field; but rather than implying a scaling back of the integration process, there is evidence that these more reflexive approaches are acting, as intended, as a catalyst for developments at member state level.

The attribution of rule-making power to processes of social dialogue is the single most important step in the development of European Union labour law over the past decade and a half. Social dialogue between the peak-level federations representing trade unions and employers' associations was first given clear institutional recognition in the Maastricht Treaty.⁸⁰ A number of options for decentred law making, in which self-regulation is legitimised while also being 'framed' within a wider institutional architecture, have been recognised. One route is for framework-style collective agreements between the 'social partners' to be given legal effect as directives; this option was chosen for the directives on parental leave, part-time work and fixed-term employment in the late 1990s.⁸¹ If the social partners cannot reach a consensus on a framework-style collective agreement, the Community's law-making organs can step in as they did in the case of the directive on information and consultation of employees at national level which was adopted in 2002.⁸² A third option is for the social partners to reach a collective agreement which has no independent legal force, but which they are intended to monitor and police at member state level. The first such agreement along these lines, on employment conditions in teleworking, was made at in 2002,⁸³ and there have since been others.⁸⁴

Each of the measures just referred is 'reflexive' not simply in the way in which it was made (through self-regulation within a wider institutional frame) but also in its intended mode of implementation. The directives on parental leave, part-time work and fixed-term employment set out standards in the form of default provisions which can be adjusted through agreement between the social partners at sectoral, enterprise or plant level. There is some evidence that this approach to standard-setting can create act as a catalyst for developments at member state level. These three directives have a number of related goals, the most important of which is the normalisation' flexible forms of work (part-time and fixed-term employment). On the one

⁷⁹ See Zumbansen and Saam, 'The ECJ, Volkswagen and European Corporate Law', op. cit., n. 77.

⁸⁰ The relevant powers are now contained in Arts. 137-139, EC Treaty. See Barnard, *EC Employment Law*, op. cit., n. 24 above, at 88-104.

⁸¹ Respectively, Directives 96/34, 97/81/EC and 99/70/EC.

⁸² Directive 2002/14/EC.

⁸³ Social Partners' Framework Agreement on Teleworking, 16 July 2002.

⁸⁴ See Barnard, *EC Employment Law*, op. cit., n. 24, at 91.

hand this implies new regulation, in the form of a requirement of equal treatment between part-time and fixed-term workers, respectively, and those employed on ‘normal’ full-time, indefinite-duration contracts. An element of liberalisation is also envisaged, in the form of the removal of barriers to the adoption of flexible working arrangements. Encouragement for parents to share childcare responsibilities is a linked aspect of this policy.⁸⁵ In these respects the directives share common ground with important elements of the employment strategy OMC, including the so-called pillars on adaptability and equal opportunities which were used to shape the Employment Guidelines in its initial phases.⁸⁶

Studies of the impact of the directives suggest, firstly, that their effects vary according to the prior state of the law in each country, which suggests that they were formulated in a way which was sensitive to pre-existing diversity across the member states. They also indicate that while there are considerable variations in the impact of the directives at member state level, there has been a raising of standards and a borrowing of models across states, suggesting that not only in a learning process going on, but that a measure of functional convergence has been combined with the preservation of formal differences which reflect the different legal and industrial relations traditions of the member states. This trend, which has been generally observed across the member states, can be illustrated by a brief comparison of the modes of implementation of two member states with diametrically opposed traditions, Germany and Britain.

In Germany, before the adoption of the fixed-term employment directive, case law had already set strict conditions for the adoption of this form of work; if these were not met, a hiring would be regarded as permanent or indeterminate. The implementation of the directive led to a de facto loosening of these conditions and to their clarification in legislation.⁸⁷ In Britain, on the other hand, the law prior to the early 2000s set no substantive conditions on the making of fixed-term contracts. When the directive was implemented, there was, for the first time, a need to justify the use of fixed-term employment contracts beyond a certain duration, and a tightening of the rules governing the non-renewal of such contracts.⁸⁸ Although there is only limited evidence, to date, of collective agreements being used to adjust the statutory default rules applying to fixed-term contracts, the operation of these new laws has had a discernible impact on practice in sectors of the economy where this type of employment was widely used, such as the public sector and higher education. In both countries, the part-time work directive was implemented in a way which went beyond its core obligations. In Germany, a right to part-time work in circumstances where family circumstances justified it was enacted.⁸⁹ In Britain, the law did not go this far, putting in place a limited right to request

⁸⁵ See Barnard, *ibid.*, at 460-486 for an overview of these directives and an account of their policy objectives.

⁸⁶ The ‘pillars’ contained in the initial stages of the employment strategy gave way to ‘objectives’ from 2003. See Barnard, *ibid.*, at 115-127.

⁸⁷ The relevant legislation here is the Teilzeit- und Befristungsgesetz, or TzBfG, of 1 January 2001. This implemented both the fixed-term employment directive and the part-time work directive.

⁸⁸ The relevant changes to UK law were brought about by the Fixed-Term Employees (Prevention of Less Favourable Treatment) Regulations, SI 2002/2034.

⁸⁹ See M. Fuchs, ‘Germany: part-time work – a bone of contention’, in S. Sciarra, P. Davies and M. Freedland (eds.) *Employment Policy and the Regulation of Part-Time Work in the European Union* (Cambridge: CUP, 2004), at 145-148, discussion section 8 of the TzBfG.

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flexible working, but further legislative proposals have made which suggest a willingness to move to a more complete recognition of the right to part-time work as part of the wider 'work-life balance' agenda, which is also increasingly reflected in the practice of certain sectors.⁹⁰ Both countries have also seen a debate about leave-sharing between male and female parents, which is not strictly required by the parental leave directive, but which is understood to be an aspect of practice in the Nordic member states, the significance of which has been highlighted by information-sharing involved in the employment strategy OMC.⁹¹

The Telework Agreement provides for even more flexibility than the social dialogue directives do in the mode of enforcement, in the sense that it does not provide for a legally binding default clause to come into effect if neither the social partners nor national governments take action to enforce it. In that sense it is a short step away from the employment strategy OMC itself, which provides for no legal floor of rights or default clause of any kind. Art. 139(2) provides that unless the social partners call on the Council to give an agreement of this kind the force of law through a 'decision', the agreement is to be implemented 'in accordance with the procedures and practices specific to management and labour and the Member States'. This implies a form of implementation which is more only slightly more substantive than the obligations imposed on member states in relation to the OMC by the Employment Title of the EC Treaty. The proximity, in practice, of the Art. 139 procedure to the OMC was highlighted when, in 2004, the social partners agreed to implement the framework agreement on lifelong competences and qualifications via the OMC itself, rather than through state-level collective agreements.⁹²

In countries without a tradition of direct legal enforcement of collective agreements, there is danger that the Telework Agreement will have very little impact, in a formal sense, on legal and industrial relations system of the member state concerned. In Britain, where the Agreement was implemented in the form of a guidance note (akin to a code of practice) endorsed by government and the social partners, there is little evidence of it influencing collective bargaining or employment practice at either sectoral or company level. But in several other member states, national governments have gone far beyond the basic legal obligations associated with the Telework Agreement by embodying its terms in legislation, while others have put it into the form of a legally binding national collective agreement.⁹³ Thus soft-law measures at European level can sometimes translate into hard law at national level.

IV. Conclusion

⁹⁰ The relevant legislation here includes the Part-Time Work (Prevention of Less Favourable Treatment) Regulations, SI 2000/1551, implementing the part-time work directive, and measures contained in subsequent legislation concerning work-life balance issues (see S. Deakin and G. Morris, *Labour Law* 4th. ed. (Oxford: Hart Publishing, 2005), 711-713).

⁹¹ On the implementation of the directive on parental leave, see G. Falkner, O. Treib, M. Hartlapp and S. Leiber, *Complying with Europe: EU Harmonisation and Soft Law in the Member States* (Cambridge: CUP, 2005), ch. 8 (referring to 'voluntary over-implementation' of the parental leave directive).

⁹² Barnard, *EC Employment Law*, op. cit., n. 24., at 91.

⁹³ *Implementation of the European Framework Agreement on Telework*, Report by European Social Partners, September 2006.

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The recent experience of company law presents a multi-faceted picture from the point of view of governance. Although there have been very substantial new initiatives in the company law field, prospects for the standardisation of company laws, which briefly resurfaced in the early 2000s in the context of deliberations over the Thirteenth Directive, have once again receded, in part as a result of the outcome of that process, which some have seen permitting an undesirable fragmentation of state-level laws. The same outcome can however be understood as introducing a reflexive element into the application at member state level of the general principles now governing takeover bids. Fragments of an OMC for company law can also be identified, in the activities of the European Corporate Governance Forum. However, this currently falls far short of a full information exchange, nor is there any effective benchmarking or peer review, as yet.

More generally, the company law reform process demonstrates a fixation on a particular conception of best practice, which is represented by the principal-agent model of corporate governance, in particular as it is expressed in the ‘global standard’ set by the OECD principles and, to a large degree, by US and British practice. Diversity of practice at member state level is also being potentially undermined by the increased possibilities for corporate migration following the *Centros* case.

Labour law, despite the recent political log-jam on new regulatory measures such as the revisions to the Working Time Directive, represents a more hopeful case for methods of open coordination. The employment strategy OMC has dovetailed with the social dialogue directives of the late 1990s to stimulate a range of state-level responses to the Commission’s demand for a better reconciliation of the goals of flexibility and social protection.⁹⁴

This review of recent developments prompts the following reflections on the prospects for the OMC and for the wider case which has been made for deliberative polyarchy as a mode of governance.

Firstly, clarity would be assisted in current debates if there were a more explicit recognition that the OMC is not a radical break with the past but is the latest in a series of developments which have seen the emergence and application of reflexive modes of governance in the EU. The origins of reflexive governance go back to the early years of the Community and to developments in the 1980s and 1990s which the theory of deliberative polyarchy appears to have overlooked.

Secondly, as Charles Sabel and Jonathan Zeitlin rightly emphasise in their account of deliberative polyarchy, the ‘informal’ mechanisms of the OMC should be seen as complementary to the ‘formal’ ones associated with law-making via directives and court

⁹⁴ The reflexive turn in labour law could conceivably be undermined by the tendency of the Court to introduce into the social policy field the rigid approach to freedom of movement cases which it has been pursuing in company law. Its judgments in the *Viking* and *Laval* cases (Case C-438/05 *International Transport Workers’ Federation v. Finnish Seamen’s Union*, Judgment of 11 December 2007, and Case C-341/05 *Laval un Partneri v. Svenska Byggnadsarbetareförbundet*, Judgment of 18 December 2007) are perhaps an instance of this, but it is too soon to be sure. A full consideration of the *Viking* and *Laval* cases lies outside the scope of the present article.

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judgments. Effective interaction between the framework rules set by the EU and the responses of member states is most likely to occur when a combination of informal and formal mechanisms is present.

Thirdly, and relatedly, the most important choice facing the EU in terms of governance is not that between formality and informality. Labour law, rather than suffering from the effects of ‘asymmetric regulation’ or a lack of formally binding measures by comparison with company law since the turn of the century, has benefited from the flexibility offered by the OMC in combination with the social dialogue procedure for law making. Rather, the critical issue, which affects both company law and labour law, is how to resolve the tension between member state autonomy and the requirements of economic integration at EU level. Proponents of deliberative polyarchy claim that it enables market liberalization to proceed alongside the preservation and reconfiguration of national-level systems of social protection. This claim arguably understates the risks inherent in the appearance of a form of relatively unconstrained regulatory competition which, in the name of freedom of movement, has the potential to undermine national-level decision making. The problem here is not simply that the OMC, in particular, and deliberative polyarchy, more generally, provide a weak bulwark, at best, against the deployment of free movement jurisprudence and the logic of cross-border freedom of choice to impose a market integration test on state-level regulation. The learning model embedded in deliberative polyarchy is itself part of the problem. As the case of the company law OMC illustrates, the learning process which is at the core of the open method, while paying lip service to cross-national diversity, can degenerate into a mechanism for entrenching a single ‘best model’, against which the practices of the member states are subsequently benchmarked. This can be contrasted with learning models, such as those associated with the model of reflexive harmonization, which are more clearly focused on the preservation of diversity *as such*. Claims for the OMC as a template for global governance should, for this reason, be very carefully scrutinized.

