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**Employee Ownership in the European Company: Reflexive Law,
Reincorporation and Escaping Codetermination**

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Employee Ownership in the European Company: Reflexive Law, Reincorporation and Escaping Codetermination

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This paper assesses the effects of reincorporation on codetermination as a form of employee ownership, focusing on the scope for escaping codetermination by restructuring under the SE. This is usually associated with the prospect of corporate flight from codetermined jurisdictions. The paper presents an alternative possibility, arguing that because the self-regulatory framework of employee participation in the SE encourages diversity and experimentation it does not inevitably erode the institution of codetermination. Viewed within a framework of reflexive harmonisation the effects on codetermination are better understood as part of an open-ended process of evolution in the ownership and control structures of the firm. This points to the potential for codetermination to become more, rather than less, integrated as part of the ownership landscape of European firms.

A. INTRODUCTION

Employee ownership offers much stronger efficiencies than it is generally credited with, and would be far more widespread if it were not critically handicapped by the very thing that is often considered its greatest virtue, namely, the opportunity it affords for active worker participation in governance.

- Henry Hansmann, *The Ownership of Enterprise*¹

Most discussions of the European Company (*Societas Europaea* or SE) and its legal framework are primarily concerned with the potential for developing a market for incorporation, facilitating regulatory competition, understanding the effects of regulatory arbitrage, and explaining how this might affect the overall goal of formulating a distinctly European corporate law.² This is usually analysed in the context of the jurisprudence being developed by the European Court of Justice under the freedom of establishment provisions in Articles 43 and 48 of the EC Treaty, with the emphasis being on facilitating the cross-border transfer of the firm's registered

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¹ (Harvard, Belknap Press, 1996) at 5.

² M Gelter, 'Tilting the Balance Between Capital and Labor? The Effects of Regulatory Arbitrage in European Corporate Law on Employees' (2010) available at ssrn.com; H Eidenmuller, 'Incorporating Under European Law: The Societas Europaea as a Vehicle for Legal Arbitrage' (2009) 10 *European Business Organisation Law Review* 1; L Enriques 'Silence is Golden: The European Company as a Catalyst for Company Law Arbitrage' (2004) 4 *Journal of Corporate Law Studies*; J Armour, 'Who Should make corporate law? EC Legislation versus Regulatory Competition' (2005) 58 *Current Legal Problems* 369-413.

office or administrative seat.³ This paper takes a different approach, focusing instead on the effects of reincorporation on codetermination as a form of employee ownership.⁴ In discussing the possibilities for regulatory competition, with comparisons and contrasts being drawn with corporate law in the US⁵, it is often observed that because the European Company Statute (hereafter the Statute)⁶ and the accompanying Employee Participation Directive (the Directive)⁷ provide only a general framework and leave the detailed rules of law to the member state in which the SE is registered, reincorporation as an SE serves as a mechanism for selecting the applicable law governing the corporation. Less often appreciated is the fact that reincorporation also fundamentally realigns the ownership structure of the firm:

in the process of reincorporating under different jurisdictions, a corporation fundamentally alters its form and structure ... In choosing their legal forms, companies are not just buying in normal factors of production they are determining the allocation of control of companies between managers and shareholders and between shareholders and other parties, such as employees.⁸

The possibilities of reallocating control rights from employees to shareholders, thereby altering the role played by codetermination in the ownership of European firms, is the subject of heated debate amongst corporate lawyers and regulators as evident in the recent consultation on the operation and impact of the Statute commissioned by the European Directorate General for Internal Market Services (the DG's report).⁹ Contributors to the consultation disagreed on what reforms should be made to the legal framework, but the subject of employee participation predictably proved highly controversial.¹⁰

³ L Cerioni, 'The Cross-border mobility of companies within the European Community after the *Cartesio* Ruling of the ECJ' (2010) 4 *Journal of Business Law* 311- 337; WG Ringe, 'The European Company Statute in the context of Freedom of Establishment' (2007) 7 *Journal of Corporate Law Studies* 185-212.

⁴ Ownership here is understood as the formal right to control the firm; M Jensen and W Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305-360; J Michie and C Oughton, 'Employee Participation and Ownership Rights' (2002) 2 *Journal of Corporate Law Studies* 139-154. A fuller discussion of this conceptual framework follows in Part C of this paper.

⁵ J Dammann, 'Future of Codetermination after Centros: Will German Corporate Law move closer to the US Model?' (2003) *Fordham Journal of Corporate and Financial Law* 607-688.

⁶ Council Regulation (EC) no 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) [2001] OJ L294/1.

⁷ Council Directive 2001/86/EC of 8 October 2001, supplementing the Statute for a European company with regard to the involvement of employees [2001] OJ L294/22.

⁸ Z Fluck and C Mayer 'Race to the Top or Bottom? Corporate Governance, Freedom of Reincorporation and Competition in Law' ECGI working paper no 90/2005 at 2, 3.

⁹ The DG commissioned an external study by Ernst and Young, and subsequently conducted a public consultation on the findings of the Study; its summary report on the Consultation on the Operation and Impacts of the Statute for a European Company (July 2010) is available at http://ec.europa.eu/internal_market/consultations/docs/2010/se/summary_report_en.pdf

¹⁰ N Kluge observes that in debating the report 'the participation of employees in the SE was regarded, from practical experience, as useful and not as a nuisance': 'The SE Remains and Ambitious European Project' available at <http://www.worker-participation.eu>

This debate would greatly benefit from a clearer understanding of the effects of reincorporation on codetermination. A focus on effects on the firm's ownership structure is particularly useful in the EU where ownership structures vary significantly across jurisdictions.¹¹ This paper takes a step in that direction by assessing the potential for firms to 'escape' from codetermination by reincorporating as an SE.¹² The possibility of escaping or at least diluting codetermination is widely seen as the key attraction or danger of the SE, depending on the view taken of the role played by codetermination.¹³ McCahery and Vermeulen demonstrate that the regulation of employee participation has a significant effect on firms' choice of jurisdiction in which to incorporate, as firms from jurisdictions with a more prescriptive legal framework of employee participation are disproportionately represented in the total number of established SEs.¹⁴ The Ernst & Young study commissioned as the basis for the DG's report suggested that employee involvement is seen as a 'negative driver' for setting up an SE; the DG's report observes that 'business associations, companies and legal advisors agreed with the study that employee participation plays a major part in location decisions' though this view was contested by worker organisations and labour law researchers who thought 'lack of regulatory uniformity' and 'the inadequate knowledge of the system' were more significant.¹⁵ According to the report 'the involvement of employees features under both positive and negative drivers depending on whether national law is more or less flexible on this issue than the SE Statute'.¹⁶ As will be discussed later in this paper the evidence on the role played by employee participation in firms' reincorporation decisions is suggestive rather than conclusive. From the time *Centros* raised the prospect of corporate flight from codetermined jurisdictions, studies on the drivers of reincorporation reveal that most of the firms from Germany and the Netherlands which choose to reincorporate in the UK are 'small entrepreneurial firms' which by definition would not have crossed the codetermination threshold in their home

¹¹ On this point much of the attention has focused on the differences between the closely-held ownership structure that dominates in much of Continental Europe, and the dispersed-ownership model of the UK.

¹² PL Davies, 'Workers on the Board of the European Company' (2003) *Industrial Law Journal* 75 offers an insightful analysis of when 'escape' may or may not be possible.

¹³ J Reichert, 'Experience with the SE in Germany' (2008) 5 *European Company Law* 297-304 identifies the ability to construct 'a more flexible form of codetermination' by a 'reduction of the number of supervisory board members' as a key attraction of the SE; B Keller, 'The European company statute: employee involvement – and beyond' (2002) *Industrial Relations Journal* 33 424-445 identifies the escape potential as a real danger.

¹⁴ JA McCahery and EPM Vermeulen, *Corporate Governance of Non-Listed Companies* (Oxford, OUP, 2008); there is an interesting question, however, whether jurisdictions without codetermination have functional equivalents: PL Davies, 'Board Structure in the UK and Germany: Convergence or Continuing Divergence?' (2000) 2 *International Comparative and Corporate Law Journal* 435-56.

¹⁵ Note that Becht et al find that these factors do not outweigh the positive reincorporation drivers for *Centros* relocations: M Becht, C Mayer and H Wagner, 'Where Do Firms Incorporate? Deregulation and the Cost of Entry' (2008) 14 *Journal of Corporate Finance* 241.

¹⁶ at 4. 'The employee involvement regime was considered to be a negative driver in Member States that do not have, or have a lower level of, employee participation in their national legislation (e.g. respondents from Italy, UK': at 9.

jurisdictions.¹⁷ They are driven to reincorporate by ‘country-specific incorporation costs and minimum capital requirements’¹⁸ rather than employee participation.

There are nevertheless suggestions that the escape possibilities are of increasing interest to medium sized companies trembling on the brink of the codetermination threshold, which might reincorporate as an SE to maintain the status quo with regard to worker involvement. There is also controversy and uncertainty over the legal status of employee participation in empty SEs (with no current employees) shelf SEs (with no operations or employees) and the mysterious and shadowy SEs classified as UFOs because although they probably have operations nothing much is known about them and it is difficult to predict their intentions in relation to employee participation.¹⁹ The classification of the total of 583 SEs in May 2010 was as follows:

| | | |
|-----------|---|-----|
| Normal SE | Has operations and at least 5 employees | 145 |
| Empty SE | Has operations but no employees | 82 |
| Shelf SE | Has neither operations nor employees | 84 |
| UFO SE | Not enough information | 272 |

Data source: ETUI (2010), European Company (SE) Factsheets <http://ecdb.worker-participation.eu/>

Out of a current total of 606 established SEs, almost half of all normal established SEs are registered in Germany.²⁰ This inevitably places Germany’s trend-setting firms at the heart of this analysis. Mandatory codetermination legislation in Germany provides that in firms with over 2000 employees half the seats on the board of directors are reserved for employee representatives, including a specified number of trade unions representatives who are not themselves employed by the firm.²¹ No attempt is made here to ask how German law responds to the possibilities created by European law, nor is the relevance of this study limited to German firms. Within a framework of reflexive governance which encourages experimentation and mutual learning the realigning of ownership structures under the SE in the long term may occur in both directions, not only by German firms potentially escaping from codetermination, but also by the SE indirectly exporting codetermination to other

¹⁷ Becht et al, at 242.

¹⁸ Ibid.

¹⁹ ‘Unidentified Flying Objects’: ETUI (2010).

²⁰ ETUI (2010), European Company (SE) Factsheets <http://ecdb.worker-participation.eu/>. This excludes empty and shelf SEs; if shelf SEs are included then the Czech Republic has the highest number of SEs.

²¹ G Gorton and FSchmid, ‘Class Struggle Inside the Firm: A Study of German Codetermination’ (2000) *National Bureau of Economic Research Working Paper No W7945*.

member states.²² Codetermination is a governance variant which for better or for worse will always provoke intense debate on the nature of the firm, the balance of power between shareholders and other stakeholders, and the correlation between firm structure and productivity.²³ It is a governance form which has ‘survived major economic shocks, as well as social and political upheaval’ and continues to persist in the face of global convergence towards the shareholder-primacy norm²⁴ owing to a ‘mutual adjustment’ between codetermination and shareholder value.²⁵ This trend can be expected to continue under the SE, not least because of the provisions of the Directive which entrench employee participation. When employee representatives from countries with no experience of codetermination are elected to the supervisory boards of codetermined SEs, this no doubt further helps to promote a culture where codetermination is viewed by firms more as a norm than as an exception in Europe.²⁶ This is a sentiment echoed by some of the contributions to the DG’s report.

It is also clear that there are broader correlations between codetermination and the evolution of the firm’s overall structure of ownership and control. Roe demonstrates that firms with strong historical and political traditions of codetermination adapt to that by adopting the closely-held share-ownership structure that predominates in continental Europe.²⁷ Gelter suggests that the direction of causation is the reverse - it is the fact that these firms have a closely held structure with blocks of shares and dominant shareholders presenting holdup problems that makes codetermination necessary.²⁸ This correlation, which may well occur in both directions, suggests that if a codetermined firm acquires a more fragmented shareholding it would no longer need codetermination and so would be expected to opt out of codetermination after floating on public markets. This is significant in light of the possibility of the SE reconverting to an ordinary public company in its new jurisdiction after two years. Conversely, codetermination would be expected to persist in firms which retain dominant shareholders. Jackson demonstrates that wider changes in German

²² See PL Davies, ‘Workers on the Board’ on the interplay and effectiveness of the ‘no escape’ and ‘no export’ legislative provisions.

²³ F Kubler, ‘A Shifting Paradigm of European Company Law?’ (2005) 11 *Columbia Journal of European Law* 219-240.

²⁴ G Jackson ‘Contested Boundaries: Ambiguity and Creativity in the Evolution of German Codetermination’, available at ssrn.com, at 4. He identifies (at 23) the challenges for codetermination; see also S Deakin, ‘The Coming Transformation of Shareholder Value’ (2005) 13 *Corporate Governance* 11-18.

²⁵ Jackson, at 24.

²⁶ M Weiss, ‘Worker Participation in the EU’ in PL Davies, A Lyon-Caen, S Sciarra and S Simitis, *European Community Labour Law: Principles and Perspectives: Liber Amicorum Lord Wedderburn* (Oxford: Clarendon Press, 1996); See for instance the supervisory board of Allianz SE, on which currently sits an employee representative from the UK: available at <https://www.allianz.com/en/investor-relations/corporate-governance/supervisory-board/members/page2.html>

²⁷ MJ Roe, *Political Determinants of Corporate Governance* (Oxford, OUP, 2003).

²⁸ M Gelter, ‘The Dark Side of Shareholder Influence: Toward a Holdup Theory of Stakeholders in Comparative Corporate Governance.’ ECGI Working Paper series in Law; Feb 2008, available at ssrn.com.

corporate governance such as ‘the weakening of traditional bank monitoring, growth in new institutional investors, expansion of equity-based finance and the opening of the market for corporate control’ have all had ‘strong implications for codetermination’.²⁹ Tracing the developments in codetermination therefore yields insights into more general questions about the evolving ownership structures of firms.

The rest of the paper proceeds as follows. The discussion begins by presenting as its theoretical framework the idea of ‘reflexive harmonisation’ as formulated by Deakin in an attempt to reconcile the apparent conflict between two distinct regulatory goals: the goal of facilitating corporate mobility through harmonising rules governing incorporation, and the goal of prioritizing employment protection in the European stakeholder-model of the firm.³⁰ The discussion then assesses the role played by codetermination in the ownership structure of the firm and presents the possible ways in which reincorporating as an SE may be a means of escaping codetermination. An analysis of the future prospects for codetermination in European firms is then offered before the paper concludes.

B. REFLEXIVE HARMONISATION AND CORPORATE LAW

The theoretical framework of reflexive law and governance encapsulates a wide range of different ideas.³¹ The main aim of this part of the discussion is to summarize the key ideas about reflexive law and governance which are helpful in understanding codetermination in the SE, and to show how they might help to carry the debates forward.

i) Harmonisation and Regulatory Competition

The strained relationship between the Statute and the Directive reflects the underlying regulatory tension between harmonisation and regulatory competition in corporate law. While the Statute focuses on the process of establishment of the SE, the Directive focuses on entrenching codetermination in jurisdictions where it is mandatory and continuing to support the legal framework of jurisdictions which institutionalize two-tier boards (with worker seats on the supervisory board in the German model, or entitlement to influence appointments to that board in the Dutch model). Using the discourse of reflexive law, it could be said that the Statute prioritises ‘unifying and levelling existing differences’ while the Directive prioritises

²⁹ at 22, 23.

³⁰ S Deakin, ‘Legal Diversity and Regulatory Competition’: Which Model for Europe?’ (2006) 12 *European Law Journal* 440-454; S Deakin, ‘Reflexive Governance and European Company Law’ (2009) 15 *European Law Journal* 224-245; S Deakin and F Carvalho, ‘System and Evolution in Corporate Governance’ ECGI law working paper no 150/2010 (April 2010) available at ssrn.com.

³¹ J Lenoble and O De Schutter, *Reflexive Governance: Redefining the Public Interest in a Pluralistic World* (Brussels, 2010).

diversity and ‘the all-decisive potential of the market as a process of discovery and elimination’.³²

The approach taken by the Statute is consistent with other company law directives such as the Takeover Directive which aim to harmonize corporate practice in Europe. The rationale is that corporate laws must be similar in their effects in all member states, to avoid a race to the bottom with corporate flight from more prescriptive to more permissive jurisdictions. In the context of the SE jurisdictions like Germany with codetermination legislation would be expected to bear disproportionately the cost of corporate flight, and be perceived as ‘unattractive partners’ in brokering mergers across borders.³³ This was the most controversial issue during the protracted negotiations on the Statute, which was first formally proposed in 1970 and eventually passed only in 2001. The legislation was originally intended to harmonize codetermination by making it an intrinsic part of the SE.³⁴ It eventually became clear that this ambition needed to be dropped if the Statute was ever to be passed, but intense debate still continues as to whether the adoption of the SE should be encouraged in the interests of cross-border corporate mobility even when this has the incidental effect of eroding or eliminating codetermination,³⁵ or conversely whether employment protection regulations require tightening up to close any loopholes that allow the SE to have this effect.³⁶ In the event, failure to secure agreement on the best approach has resulted in the Directive allowing, and indeed encouraging, diversity of practice.

The framework of reflexive law offers a way to accommodate the conflicting goals of corporate mobility and employment protection, viewing the tension between the two goals not as a dilemma that needs to be resolved but as an opportunity for member states to learn from diversity, experimentation and mutual monitoring. Deakin’s analysis demonstrates that owing to the tendency to assume that diversity is incompatible with harmonisation, the potential value of the reflexive approach has not been realized in the area of corporate law where harmonisation is viewed as an essential prerequisite for establishing a single market.³⁷ But because reflexive law may complement the harmonization efforts of corporate law, rather than being

³² P Zumbansen, ‘Spaces and Places: A Systems Theory Approach to Regulatory Competition in European Company Law’ (2006) 12 *European Law Journal* 534-556 at 550.

³³ Davies, ‘Workers on the Board’, at 76. Kubler suggests that ‘as long as German corporations continue to be burdened by employee participation, they are threatened to be left out of the reorganization of European industries across the traditional borderlines as nobody will want to merge with them’ at 237.

³⁴ PL Davies, in J Rickford (ed) *The European Company: Developing a Community Law of Corporations* (Oxford, Hart Publishing, 2003).

³⁵ A Sagan, ‘The Misuse of a European Company According to Article 11 of the Directive 2001/86/EC’ (2010) 21 *European Business Law Review* 15-41.

³⁶ B Keller, ‘The European company statute: employee involvement – and beyond’ (2002) 33 *Industrial Relations Journal* 424-445.

³⁷ He notes that while ‘the use of reflexive forms of governance is growing within the EU’, company law ‘seems to be an exception’: ‘Reflexive Governance and European Company’ at 224.

opposed to those efforts,³⁸ it does not impede the overall single market goal. By leaving space within the harmonising measures themselves for rule-making at the member-state level, reflexive governance allows harmonisation to co-exist with diversity of practice. Indeed ‘experimentalism based on diversity of practices’ may indirectly bring about a functional form of convergence and harmonisation of corporate law within the EU. Hence the SE legislation explicitly recognizes the diversity of rules and practices:

The great diversity of rules and practices existing in the member states as regards the manner in which employees’ representatives are involved in decision-making within companies makes it inadvisable to set up a single European model of employee involvement applicable to the SE.³⁹

The Statute relies on the Directive to regulate employee involvement, and the Directive in turn leaves the choice of model to be determined by the firm itself through negotiation between the parties, and governed by the national law of the jurisdiction of registration. In this way the approach adopted in relation to the SE exhibits the main elements of reflexive harmonization.

ii) The Evolution of Codetermination

To understand the impact of these processes on codetermination, codetermination is viewed as an evolving institution which adapts itself to changing regulations and other external influences.⁴⁰ Jackson demonstrates that the ‘balance between cooperation and interest representation within the [codetermined] firm’ is constantly shifting, and ‘actors may pull institutions in different directions as new situations emerge’.⁴¹ While the formal legislative rules governing codetermination in Germany remain relatively stable, organizational practice continually adapts itself to the firm or sector in which codetermination operates: ‘the stability of legal rules contrasts with its diversity as a social institution that has co-evolved with shifts in ideas, power relationships and coalition-building among company stakeholders’.⁴² Whether worker representatives prioritize the interests of workers or the interests of management is not decided in the abstract but is context-specific, and Jackson sees this ‘ambiguity’ in the ‘dual’ mandate of worker representatives as key to the potential of codetermination to evolve. He observes that ‘the balance between representation and cooperation has undergone shifts in response to new economic demands and socio-political circumstances. New constellations of actors emerged, and led to contention and reinterpretation of codetermination,’⁴³ eventually ‘generating new organizational capacities’.⁴⁴ Indeed, it is this adaptability that

³⁸ ‘reflexive or experimentalist approaches to European governance can be effective when they operate so as to complement mechanisms of harmonisation and regulatory competition, rather than being presented as alternatives to them’: *ibid.*

³⁹ Preamble to the Employee Participation Directive, par. (5)

⁴⁰ Jackson.

⁴¹ *Ibid.*, at 4.

⁴² *Ibid.* at 11.

⁴³ *Ibid.*, at 11, 12.

⁴⁴ *Ibid.*, at 18

ensures its survival;⁴⁵ without adapting it is unlikely that codetermination would have successfully persisted in the face of successive economic challenges. Understanding codetermination as an evolving institution opens up the possibility that restructuring under the SE will constitute not a threat to the institution of codetermination but simply part of the process of the evolution of ownership structures of the firm. More particularly, a reflexive approach ‘sheds light on the complex conditions of European company law making [and] underscores the intricate dynamics that characterise legal development as such’⁴⁶ making it possible to understand codetermination as part of the overall regulation of ownership and control of European firms.

iii) Insights from Systems Theory

The evolution of codetermination influences, and is in turn influenced by, changes in the applicable rules of law. It is useful therefore to understand the corporate governance system and legal system as two distinct and independent but co-evolutionary systems; this means that the legal framework indirectly determines and constrains choices about the firm’s ownership structure, and the law is in turn responsive to its effects on the incentives of market participants subject to its regulation. Theories of reflexive law explicitly recognize the processes of co-evolution between independent systems such as the legal system and market institutions such as the firm:

Taking an evolutionary approach to the study of legal development and of company law in particular...refutes any idea of a linear, one-directional allegedly efficiency- or coherence-driven development of legal norms. Instead, this approach considers historical and political constellations and decisions that shaped particular developments. As these environments have been and continue to be in flux, legal development will always remain unpredictable to a certain degree.⁴⁷

This clarifies how changes in systems of corporate governance such as the introduction of the SE are likely to influence firms’ selection of legal rules and other governance norms which realign control rights in the firm and therefore affect codetermination.

iv) Procedural Self-Regulation and Experimentation

Reflexive harmonisation as formulated by Deakin in the context of company law relies on a procedurally-oriented self-regulation. It focuses on the processes by which decisions are made without attempting to specify or control the content or effect of those decisions. In this light the process by which the SE must decide on its model of employee involvement is set out by law without specifying any mandatory substantive outcomes, leaving it open to the parties to negotiate an agreement or

⁴⁵ Deakin and Carvalho.

⁴⁶ Zumbansen, at 548.

⁴⁷ Zumbansen, at 547.

even agree to opt out of employee participation altogether.⁴⁸ Reflexive harmonisation encourages diversity of practice in respect of different models of employee participation; the most effective solutions from the diverse options are identified by the parties and put into practice through mechanisms of self-regulation. Sharing information and mutual monitoring allows optimal solutions to become apparent, and over time they tend to become standard across the board with no need for legislative or judicial intervention. This is precisely the way in which codetermination could potentially benefit from the emphasis placed by the Directive on negotiation and agreement by managers and employee representatives. Johnston suggests that by setting default rules which give 'management a strong incentive to reach an agreement with the SNB...the Directive encourages experimentation with participatory governance structures at the level of individual companies'; it also provides 'a means by which successful participation structures and agreements are disseminated' through trade union officials.⁴⁹ It has long been argued that the idea of mandatory codetermination is questionable, and that it ought to be presented across Europe as an optional board structure in all jurisdictions. This reflexive approach adopted in the SE framework can be seen as a response to that preference.

v) *The Hazards of Self-Regulation*

In this part out the main criticisms of reflexive self-regulation are set out, and an attempt to address those criticisms will follow in part vi. The main hazard inherent in the self-regulatory model presented above is the risk that the parties' choices will prove inadequate in protecting employees' valuable firm-specific human capital investments and will allow their legitimate expectations of continuing employment to be sacrificed to short-term share value at the expense of the firm's long term interests. These concerns have proved to be a powerful counterargument to complete deregulation, and it may be feared that self-regulation amounts to no more than a form of deregulation. It is after all possible for the parties to agree under the SE framework not to have any special form of employee involvement, leaving this to be governed by such legal rules as may exist outside the framework of corporate law.

Reflexive law, with the attention it pays to the processes of institutional evolution and allowing diversity, is also subject to criticism for being normatively non-committal, or altogether devoid of normative content, and therefore failing to offer any prescription as to what the future should look like.⁵⁰ In the SE debate the criticism would be that the reflexive approach does not prescribe priorities as

⁴⁸ Through negotiation between managers and the Special Negotiating Body of employee representatives. This is subject, ultimately, to other sources of regulation such as the Information and Consultation or European Works Councils Directives: see PL Davies, 'Workers on the Board', for a fuller discussion.

⁴⁹ A Johnston, *EC Regulation of Corporate Governance* (Cambridge, CUP, 2009) at 262.

⁵⁰ M Zamboni, 'From "Evolutionary Theory and Law" to a "Legal Evolutionary Theory" (2008) 9 *German Law Journal* 515-546.

between a greater role for employee participation in decision-making or promoting regulatory competition. In failing to specify the desired substantive outcomes, it might be said to fail to bring about any desirable changes in the law. This criticism is reflected in the view that the SE Statute, as ‘a compromise legislation’ that both sides of the debate consider to be ‘rigid and unattractive’⁵¹ has failed to make significant progress in achieving *any* of its goals. The Directive prescribes a framework for employee participation on supervisory boards, but mitigates this by insisting that ‘several models of participation are possible’ including giving employees rights to receive information on specified matters but not to have a say in making decisions or even influencing the outcome of discussions. This framework does not appeal to those who would have preferred to keep the corporate law framework for reincorporation entirely separate from employee participation laws; nor does it appeal to those who view codetermination, and not lesser forms of information and consultation, as the best available mechanism for employee participation.

Altogether, the reflexive reliance on process is said to simply end up endorsing a burdensome procedural exercise for corporate actors, who will make the decision they would have made in any case but now have to amass reams of paperwork showing that they proceeded appropriately in arriving at that decision. Management boards of two-tier companies are said to present to the supervisory board only such information as will allow them to come to the conclusion which the management board has already pre-determined. Reflexive approaches are thought to encourage such practices:

It is not unequivocally good that new regulations are merely procedural. Participation within organizations, for example, has been procedurally regulated to such a degree that the cumbersomeness of the resulting decision-making processes – best measured by the steps a decision must pass through – leads many to long for old-fashioned hierarchical bureaucracies.⁵²

vi) A Reflexive Race to the Top

In response to these concerns, reflexive harmonisation offers a framework in which diversity is coupled with the adoption of minimum standards, benchmarking, mutual monitoring and reporting on the effectiveness of diverse approaches. By these mechanisms self-regulation is steered or channelled towards best practice, resulting in an overall improvement in outcomes. The key elements of this process may be explained as follows.

With regard to the procedural orientation of reflexive law, reflexive law is not ‘just any procedurally-oriented type of law’.⁵³ It is based on an appreciation that owing to the autonomy and self-referential nature of social and economic systems, it would

⁵¹ McCahery and Vermeulen, 57.

⁵² E Blankenburg, ‘The Poverty of Evolutionism: A Critique of Teubner’s Case for “Reflexive Law”’ (1984) 18 *Law and Society Review* 273 at 285.

⁵³ G Teubner, ‘Autopoiesis in Law and Society’ (1984) 18 *Law and Society Review* 291 at 299.

be futile for the law to attempt to directly specify or control the operation and evolution of social and economic institutions. All systems, whether legal, social or economic, evolve by reference to their own internal norms and criteria. But although they are hermetically closed to direct external influence, they are at the same time open to indirect external influence if the appropriate mechanisms of communication can be harnessed. In this light, the reflexive approach does not simply suppose that any kind of procedural rules will suffice. Crucially, it makes an 'attempt to specify *what kinds of procedure* the law will develop if it is going to cope with a high degree of social autonomy...to identify the internal models of social reality and forms of "regulation" that the law will develop in dealing with social systems, which are, in principle, inaccessible to regulation.'⁵⁴ This can be seen in the careful attempt to balance the 'no escape' and 'no export' provisions of the SE regulations governing codetermination.⁵⁵

Therefore, reflexive law recognizes that decision-making in the firm will proceed by reference to itself. It then identifies the precise kinds of procedure which will be effective in influencing this decision-making not directly, as that simply would not be effective, but indirectly by finding effective means of communication. In sum, 'Taking self-reference seriously means that we have to give up conceptions of direct regulatory action. Instead, we have to speak of an *external stimulation of internal self-regulating processes which, in principle, cannot be controlled from the outside*'.⁵⁶ This emphasis on internal self-regulation is a key element in the procedural framework adopted by the Directive. Johnston depicts the approach of the Directive as a form of 'penalty default rule' which allows the management and employees to negotiate on a model of employee involvement which must thereafter be approved by the shareholders in general meeting, but steers the bargaining process by providing that if the parties fail to agree then Standard Rules will apply. These Standard Rules are in turn based on the national law regulating the SE.⁵⁷

With regard to the concern that by being non-prescriptive the reflexive approach is unhelpfully non-committal, this is in one sense deliberately the case – in the context of this discussion the concern is more with explaining how codetermination is evolving in response to the SE framework than with suggesting how the legal regulations *ought* to respond to this. But this does not mean the approach offers no contribution to the law reform debates: 'evolutionary theory, by explaining how a certain legal concept has been created, chosen and 'stabilised' in a certain legal system, also aims at being able to predict possible alternative patterns'.⁵⁸ Once the interaction between current rules and the choices relating to codetermination is better understood, and possible future permutations identified, the effect is often

⁵⁴ Ibid, (emphasis added).

⁵⁵ Explained in Davies, 'Workers on the Board'.

⁵⁶ Teubner, 'Autopoiesis in Law and Society' at 298 (emphasis in original).

⁵⁷ At 261, 262.

⁵⁸ Zamboni, at 534.

that the possible alternatives for reform become more readily apparent.⁵⁹ This is precisely the approach which is necessary to move the codetermination debates forward. At present the debate is in danger of stagnating on the question of whether codetermined firms are more or less efficient than firms which are exclusively shareholder-owned; as will be seen later the absence of conclusive empirical evidence means the codetermination debate still relies heavily on ‘the same more-or-less well-informed speculation as in the 1970s’.⁶⁰ A better approach in understanding the role played by codetermination would be to go beyond trying to assess its efficiency effects as an isolated governance mechanism, and instead seek to understand more fully how it fits within the overall structure of the firm and affects the evolution of corporations and corporate governance.⁶¹

vii) Unpredictable outcomes

The reflexive approach undoubtedly facilitates outcomes which cannot be fully predicted *ex ante*. This is not inherently problematic. Reflexive law is cognizant that the process by which law evolves is often random, chaotic⁶² and produces unpredictable and possibly irritating effects; it therefore recognizes that emerging after a protracted process of debate and negotiation that often threatened to stall altogether, the Statute and its accompanying Directive are as much the outcome of path dependence, historical accident and political compromise as of conscious design.⁶³ More specifically, in the process of co-evolution the legal framework indirectly influences and constrains choices about the firm’s ownership structure, and the law is in turn indirectly responsive to its effects on the incentives of market participants subject to its regulation. Where these effects are only indirect the potential for misinterpretation or simply overlooking key factors becomes greater. Moreover, because this interrelationship is based on a continual process of mutual feedback, continuing evolution and shifting targets, it is not possible to foresee or predict with certainty what effect each system will have on the other or how each system will interpret the information it receives from the other. Unintended effects may therefore arise. The host jurisdiction may have an unforeseen adverse reaction to norms borrowed from another jurisdiction, a risk which is not mitigated by presenting a menu of non-mandatory options.

⁵⁹ Deakin and Carvalho.

⁶⁰ Hopt, at 210.

⁶¹ ‘An all-or-nothing approach would be too simplistic. Defending the current model without questioning its corporate governance impact is as uninspired as a call for the complete elimination of boardroom codetermination. Competing legal systems or, in our case, corporate laws, are not a static four-corner box but subject to change and development. Therefore, employee involvement is worthwhile revisiting from the perspective of corporate governance and possible modernisation’: C Windbichler, ‘Cheers and Boos for Employee Involvement: Codetermination as Corporate Governance Conundrum’ (2005) 6 *European Business Law Review* 507 at 512, 513.

⁶² MJ Roe, ‘Chaos and Evolution in Law and Economics’ (1996) 109 *Harvard Law Review* 641.

⁶³ The factors which prompted member states to vote for or against the legislation in its various stages of amendment often had nothing to do with corporate law, being determined instead by the need to broker deals in the voting patterns on other issues. See Johnston for a detailed discussion of the changes made to the legislation over decades of debate.

Zumbansen notes that this effect remains equally powerful even when the new institution is non-mandatory and flexible, such as codetermination under the SE. Owing to the embeddedness of codetermination within the wider legal, cultural and political framework, even optional regulations affecting it may have ‘possibly severe repercussions in the receiving legal culture’ with ‘unpredictable effects or even serious irritations in the receiving specific disciplinary or doctrinal area’.⁶⁴ Several commentators have noted that if the interrelationship between different parts of a governance approach are not fully understood then attempts to adopt new institutional approaches from other member states may turn out to work less well when separated from the overall cultural and historical framework in which they emerged.⁶⁵ Communication between systems being imperfect and unintended consequences of regulatory prescriptions being endemic, it is not surprising that the debate over the extent to which flexibility, the free movement of capital, and the facilitation of a market for reincorporation in Europe are compatible with legal entrenchment of employee participation in board-level decision-making so far has not yielded a consensus.

viii) Summary of the legal framework

A useful insight into this problem is the debate over the potential for the SE framework to be used as a mechanism for corporations to avoid codetermination. The Statute provides that an SE cannot be registered without an agreement on employee involvement as defined by the Directive (article 12(2)). The Directive in turn declares that ‘it is a fundamental principle and stated aim of this Directive to secure employees’ acquired rights as regards involvement in company decisions’.⁶⁶ The employee involvement model must then be approved by the shareholders in general meeting before the SE is registered.⁶⁷ The Directive very helpfully distinguishes between general ‘involvement’ of employees in the decision-making process, and ‘participation’ by employees in the firm’s organizational structure. Involvement may, but need not, be based on participation. Other models of employee representation which do not relate to the composition of the board are envisaged, including simply giving employees rights of ‘information and consultation’.⁶⁸ Standard employee involvement rules are specified under the

⁶⁴ At 548.

⁶⁵ Windbichler.

⁶⁶ Paragraph 18 of the preamble. This is consistent with the general view of the European Parliament, as stated in considering the draft 14th Company law directive on the cross-border transfers of the registered offices of limited liability companies, that ‘the cross-border transfer of the registered office should not circumvent legal, social and fiscal conditions’ and that ‘the right of other stakeholders concerned by the transfer, such as minority shareholders, employees and creditors etc, should be safeguarded’: discussed in Cerioni at 329-335.

⁶⁷ Article 52. In the case of formation by merger, this would mean the general meeting of each of the merging companies: Article 23.

⁶⁸ The Directive specifies (Article 2 i and j) that information should be given ‘at a time, in a manner and with a content’ which allows the employees’ representatives to assess it, prepare consultations and express an opinion. This includes a duty to provide employee representatives with ‘such office space, financial and material resources, and other facilities as to enable them to perform their duties properly’.

Directive which apply in the event that the parties are unable to come to an agreement.⁶⁹

Participation is defined as the right of employees to influence the affairs of the company by electing or appointing representatives to the board of directors, or to recommend or oppose appointments to the board (Article 2 (k)); participation therefore envisages direct or indirect influence on decision-making on the board of directors, either the supervisory or the management board. Employee representatives sit on the supervisory board, which oversees the management board and has power to appoint and remove management board members.⁷⁰ The Statute specifies that employee participation 'does not mean participation in day-to-day decisions, which are a matter for the management, but participation in the supervision and strategic development of the company'.⁷¹

It can be seen that the legal framework of the SE does not, on the face of it, privilege or prioritize one option in favour of another, but simply states that 'several models of participation are possible'.⁷² Codetermination could therefore be seen as simply one option in a broader framework allowing firms to choose between different structures. However, a point which the discussion turns to next, codetermination can be distinguished from rights of information and consultation because it realigns the ownership and control structure of the firm. It views employee representatives not as 'outsiders' dealing with the firm at arms' length (a contractual model) but as 'insiders' with a right to make strategic decisions (an ownership model).

C. OWNERSHIP AS CONTROL

i) Definition of Ownership

⁶⁹ Article 5; within six months, extendable to a year.

⁷⁰ The Statute specifies situations in which the authorisation of the supervisory board is required. The most interesting of these, from an employment protection perspective, relates to 'the setting-up, acquisition, disposal or closing down of undertakings, businesses or parts of businesses where the purchase price or disposal proceeds account for more than the percentage of subscribed capital.'

⁷¹ Though it is not always straightforward in relation to corporate restructuring to distinguish between supervision and management: T. Raaijmakers, 'The Statute for a European Company: its Impact on the Board Structures, and Corporate Governance in the European Union' (2004) *European Business Organization Law Review* 159-194.

⁷² It allows the management or administrative boards to agree with employees on a 'model of participation' of their choice, which need not involve rights of codetermination or even of representation by a separate body (such as a works council or trade union); it only specifies that in this case the level of information and consultation must be the same as in the case of employees represented by a separate body, and also that employee representatives must be provided with such office space, financial and material resources and other facilities as to enable them to perform their duties properly.

Because codetermination in this context is understood as an attribute of ownership of the firm, and ownership is a notoriously amorphous legal concept,⁷³ it is important before proceeding with the discussion to outline what is meant by ownership in this context. The firm's owners are 'those persons who share two formal rights: the right to control the firm and the right to appropriate the firm's profits, or residual earnings.'⁷⁴ This discussion focuses on the idea of ownership as control, drawing from economic theories about the proprietary structure of the firm.⁷⁵ These theories are concerned with the optimal allocation of ownership rights in the firm, i.e. that allocation which supplies the optimal incentives for the parties to maximize utility and efficiency. The predominant allocation of ownership rights to shareholders is explained by Hansmann as a choice designed to maximize investment incentives and minimize transaction costs. The starting point is the Coasean idea that if contracting in the market were costless the initial allocation of property rights in the firm would not matter as the parties would simply redistribute these rights amongst themselves through contract, and ownership would be irrelevant. The role of law would be limited to defining property rights with precision and allowing all parties the freedom to contract for those rights which they value. Ownership becomes relevant and necessary because it may be prohibitively difficult for such contractual reallocations to occur – the initial allocation of ownership rights in the firm matters because ex post reallocation may be too costly. Hansmann identifies the costs of collective decision-making as critical here; where decision-making is the preserve of homogenous owners all sharing a unified interest (shareholders all interested in maximising profits) decision making costs are lower than where ownership is shared by heterogeneous groups (such as employees who all have different priorities depending on their skills, seniority in the firm, etc).

Building on these ideas, it is useful to follow Waldron in understanding ownership as an 'organizing idea', a 'point of reference' allowing a clear way of understanding the structure of control rights in the firm.⁷⁶ Here the concern is not so much with ownership of the physical assets of the firm⁷⁷, but with a 'bundle of rights' which includes the right to determine the firm's operations and strategy.⁷⁸ There are two key implications of this approach. First, understood as a bundle of rights, ownership need not be and seldom is an absolute concept; instead it denotes shared or

⁷³ 'All attempts in the history of theorizing about property to provide a univocal explication of the concept of ownership, applicable within all societies and to all resources, have failed': JW Harris, *Property and Justice* (Oxford, OUP, 1996) at 5.

⁷⁴ Hansmann, at 11.

⁷⁵ R Coase, 'The Nature of the Firm' (1937) 4 *Economica* 386-405; H Demsetz 'Toward a Theory of Property Rights' (1967) 57 *American Economic Review* 347-59; O Hart and J Moore, 'Property Rights and the Nature of the Firm' (1990) 98 *Journal of Political Economy* 1119-58; J Armour and M Whincop, 'The Proprietary Foundations of Corporate Law' (2007) 27 *Oxford Journal of Legal Studies* 429.

⁷⁶ J Waldron, *The Right to Private Property* (Oxford, Clarendon Press, 1988) at 42.

⁷⁷ For an approach focusing on asset ownership and 'asset partitioning' see H Hansmann and R Kraakman 'The Essential Role of Organizational Law' (2000) 110 *Yale Law Journal* 387; S Grossman and O Hart, 'The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration' (1986) 94 *Journal of Political Economy* 691-719.

⁷⁸ Waldron at 28, 29.

qualified rights and relative interests.⁷⁹ It is commonplace for this bundle of rights to include control, but not a right to profits or other cash-flow from the resource.⁸⁰ Second, because ownership here is defined in a formal sense, it is concerned with the formal allocation of control rights rather than with a description of how control is exercised in practice. This means that while empirical evidence about the effectiveness (or lack of it) of having employees on the supervisory board may be relevant to the analysing the efficiency of codetermination, it is not a factor determining the definition of codetermination as a form of ownership. The same applies, of course, to an analysis of shareholder-ownership: within this framework the fact that dispersed shareholders may in practice play no actual role in decision-making in the firm does not prevent the analysis of shareholders as owners from being useful and instructive.⁸¹ If control is defined formally as the ultimate right to make decisions or to delegate decision-making authority then it follows that a firm is shareholder-owned if formal control, through voting rights, is vested in shareholders.⁸²

Viewing ownership as control, the 'owner' is the party who is entitled to control the firm, i.e. has 'the right to elect the firm's board of directors and to vote directly on a small set of fundamental issues, such as merger or dissolution of the firm'.⁸³ The role of labour in the large publicly-held firm may then be explained from a proprietary perspective.⁸⁴ From a contractual perspective, if the firm is understood as a network of contracts then the employees are simply one of a number of constituencies who contract to receive a financial return for the input they offer to the firm: usually described as the wage-work bargain. From a proprietary perspective, the firm is much more than a nexus of contracts. It is an institutional mechanism for organizing and structuring various property rights in the market.⁸⁵ Employees are the firm's co-owners where they are formally allocated residual decision-making rights, including decisions as to the structure of the firm, overall corporate strategy and distribution

⁷⁹ KJ Gray, 'Property in Thin Air' (1991) 50 *Cambridge Law Journal* 252-307.

⁸⁰ A fuller explanation is offered in W Njoya 'Employee Ownership and Efficiency: An Evolutionary Perspective' (2004) 33 *Industrial Law Journal* 211-241.

⁸¹ As Waldron remarks of shareholders as owners, 'of course, they do not have all the rights of ownership on, say, Honore's list, but then neither does a landlord or a mortgagor' at 58. See, for the contrary argument that the view of the firm as a nexus of contracts renders the concept of 'ownership' meaningless, E Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 288-307; P Ireland 'Company Law and the Myth of Shareholder Ownership' (1999) 62 *Modern Law Review* 32-57; for a taxonomical approach classifying shares as contract rather than property see A Pretto-Sakmann, *Shares and Sub-Shares: the Boundaries of Personal Property* (Oxford, Hart Publishing, 2005).

⁸² A firm in which employees also own shares, and exercise formal control in their capacity as shareholders, cannot be said to be employee-owned in this sense.

⁸³ Hansmann, at 11.

⁸⁴ For a fuller discussion of this point see W Njoya, *Property in Work: the Employment Relationship in the Anglo-American Firm* (Aldershot, Ashgate, 2007).

⁸⁵ Coase, *The Nature of the Firm*; Firms emerge where it is more cost-effective for the firm's controllers to own various assets than it would be to purchase those inputs on the open market through arms-length contracting. J Parkinson, 'Models of the Firm and Employees' (2003) 41 *British Journal of Industrial Relations* 481-509.

of the firm's residual earnings. In this sense ownership of the codetermined firm is shared equally by employees and shareholders, in situations where the law provides for parity representation of both constituencies on the supervisory board of directors.⁸⁶

ii) The Efficiency Debate

Codetermination provides unique opportunities for worker participation in governance, to an extent not possible where the participation model falls short of giving workers ownership rights in the firm. But as Hansmann points out, its greatest virtue is also its critical handicap.⁸⁷ The claims made for and against the efficiency of codetermination are well known. The debate will not be reviewed here, though it may be helpful to summarize some of the key points. In favour of codetermination, it is said that employee and shareholder representatives cooperate in making decisions in the best interests of the firm; decision-making is independent of both shareholder and employee interests, which helps promote the interest of the firm 'in itself', and avoid hold-up problems or rent-seeking designed to advance the self-interested aims of any of the firm's constituents.⁸⁸ It 'legally "entrenches" employees in the firm, helping them protect their interests against potential opportunistic behaviour of shareholders' and especially to protect valuable firm-specific human capital investments.⁸⁹ It may better serve the long-term interests of the firm, and may 'empower employees' enabling them to 'change the objective function of the firm' by exercising their power to approve or veto important decisions made by managers.⁹⁰ Codetermination has other positive externalities such as social welfare gains, industrial peace and even political stability. This ultimately increases the firm's efficiency and productivity.⁹¹ The overall appeal of codetermination may be gauged

⁸⁶ 'In an investor-owned firm, the transactions between the firm and the patrons who supply the firm with capital occur in the context of ownership, while transactions with workers, other suppliers and customers all take the form of market contracting. An employee-owned firm, in contrast, obtains labour inputs from workers whose relationship is one of ownership, but obtains its capital and other supplies, and sells its products, through market contracting.' Hansmann, *The Ownership of Enterprise*, at 20. See also J Armour, H Hansmann and R Kraakman, 'What is Corporate Law?' in *The Anatomy of Corporate Law* at 15-16.

⁸⁷ See also McCahery and Vermeulen for a discussion of how the employee participation provisions handicap cross-border mobility. On the inefficiencies of codetermination generally see JN Gordon, 'Pathways to Corporate Convergence? Two Steps on the road to shareholder capitalism in Germany: Deutsche Telekom and DaimlerChrysler' (1999) 5 *Columbia Journal of European Law* 219.

⁸⁸ G Teubner, 'Company Interest: The Public Interest of the Enterprise "In Itself"' in R Rogowski and T Wilthagen (eds.), *Reflexive Labour Law* (Deventer: Kluwer, 1994); M Roth, 'Employee Participation: Corporate Governance and the Firm: A Transatlantic View Focused on Occupational Pensions and Codetermination' (2010) 11 *European Business Organization Law Review* 51-85; Wedderburn, *The Future of Company Law* at 36-37; Wedderburn, 'Employees, Partnership and Company Law' (2002) 31 *Industrial Law Journal* 99-111.

⁸⁹ Gorton and Schmid at 6.

⁹⁰ Gorton and Schmid, at 6.

⁹¹ F FitzRoy, K Kraft, 'Codetermination, Efficiency and Productivity' (2005) 43 *British Journal of Industrial Relations* 233-247; D Sadowski, J Junkes and S Lindenthal, 'The German Model of Corporate and Labor Governance' (2000) 22 *Comparative Labor Law and Policy Journal* 33-66; S Renaud, 'Dynamic Efficiency of Supervisory-Board Codetermination in Germany' (September 30, 2006)

by noticing that several EU member states have legislation providing for varying degrees of codetermination.⁹² Many listed companies in the Netherlands, for example, opt for a two-tier board structure even when it is not mandated.⁹³

Nevertheless the experience of employee board participation has suggested that there are difficulties in the flow of information from the management to the supervisory board which render the supervisory board less powerful or influential than it might otherwise be. Then there are the costs of collective decision-making highlighted by Hansmann. In addition an empirical study by Gorton and Schmid found that the overriding costs of codetermination include lower valuations on the stock market, disincentives for management to maximise shareholder value, and even 'longer payrolls'.⁹⁴ Employee representatives are accused of making no contribution to important discussions on corporate financial strategy, and instead taking up inordinate amounts of the board's time on 'human resources topics'.⁹⁵ German corporations are said to simply work around the codetermination laws: 'parties have learned to "survive" the mandatory system ... Normally the employee representatives and the shareholder representatives meet separately and decisions are practically taken before the supervisory board meets'.⁹⁶ The system is thus seen as 'at most, a workable adaptation to local interests and circumstances or, even more modestly, as an experiment of questionable value that would now be politically difficult to undo.'⁹⁷

With empirical evidence in support of both perspectives the efficiency debate remains inconclusive: a recent study of the effects of supervisory board size and composition on the valuation and performance of listed German firms is 'unable to find a consistent effect of either board size or board composition on firm valuation and performance'.⁹⁸ This is consistent with the recommendation of Germany's Codetermination Commission that codetermination be retained as there were 'no undisputed econometric studies on the (negative or positive) correlation between

Available at SSRN: <http://ssrn.com/abstract=968729>; M Roe, Political Determinants of Corporate Governance.

⁹² Austria, the Czech Republic, Denmark, Finland, France, Greece, Hungary, the Republic of Ireland, Luxembourg, Malta, the Netherlands, Poland, Portugal, the Slovak Republic, Slovenia, Spain and Sweden: <www.seeurope-network.org>.

⁹³ With employees entitled to oppose the election of members of the supervisory board: see Raaijmakers. Other countries with a legal framework providing for optional two-tier boards include France and Italy.

⁹⁴ Gorton and Schmid at 864.

⁹⁵ Windbichler, at 520, 521.

⁹⁶ S Lombardo, 'Regulatory Competition in Company Law in the European Community: Prerequisites and Limits (2002) at 131.

⁹⁷ H Hansmann and R Kraakman, 'The End of History for Corporate Law' in Gordon and Roe (eds.), *Convergence and Persistence in Corporate Governance*; see also C Lane, 'Changes in Corporate Governance of German Corporations: Convergence to the Anglo-American Model?' (March 2003) ESRC Center for Business Research Working Paper No. 259.

⁹⁸ A Bermig and B Frick, 'Board Size, Board Composition and Firm Performance: Empirical Evidence from Germany' (June 10, 2010) Available at SSRN: <http://ssrn.com/abstract=1623103>

codetermination and company performance'.⁹⁹ There does not seem to be a clear way of assessing the efficiency effects of codetermination:

Despite many empirical studies, evidence as to the effects of this kind of codetermination is scarce. Research results are notoriously ambiguous; the confusion of causation and correlation is ever present. There are too many variables, control groups in a technical sense of social science methodology are hardly available, statistics are under-defined and interviews are intrinsically prone to bias.¹⁰⁰

The debate as to whether economies where codetermination plays a significant role perform impressively do so *because* of codetermination, or *in spite of* it, therefore remains open. But it is clear that co-determination continues to evolve, and to exhibit 'many local variations or styles'¹⁰¹ and it is therefore important to understand patterns in its adoption in European firms.

D. OPTING OUT OF CODETERMINATION

Owing to the complexity of the provisions of the SE Statute and Directive, the extent to which firms can escape codetermination by reincorporating as an SE is not immediately clear.¹⁰² It is clearly not possible for a firm subject to mandatory codetermination laws to escape simply by transforming itself into an SE – in this situation the 'no escape' rule is closest to absolute.¹⁰³ The agreement on employee participation must not leave any existing employees worse off than they were before the restructuring, and is binding on the company throughout its existence. The point has already been made that codetermination is subject to agreement and negotiation, which itself means the parties can simply opt out if they can agree to do so. This part of the discussion focuses on the potential to opt out without the employees' agreement.

i) Shelf SEs

The Directive relies on a 'before and after' principle to protect employee participation; essentially it safeguards existing participation rights so that employees are not worse off after the firm is restructured as an SE.¹⁰⁴ Under the 'before and

⁹⁹ T Baums, 'Company Law Reform in Germany' (2003) 3 *Journal of Corporate Law Studies* 181-189 at 185.

¹⁰⁰ Windbichler, at 509-510. Hopt also notes that 'the possible effects of labor codetermination on the outcome of decision-making are much more difficult to assess. It would indeed be quite difficult to prove such effects empirically beyond individual case studies': KJ Hopt 'Labor Representation on Corporate Boards: Impacts and Problem for Corporate Governance and Economic Integration in Europe' (1994) 14 *International Review of Law and Economics* 203-214 at 208.

¹⁰¹ Jackson at 21.

¹⁰² See Davies, *Workers on the Board*, attributing the 'highly complex' legislative provisions of the Statute and Directive to the 'fear on the part of the Community legislature that the SE could be used as a way of escape from national systems of employee representation at board level': at 80.

¹⁰³ Davies at 92.

¹⁰⁴ Par 18 of the Directive (preamble) declares that 'it is a fundamental principle and stated aim of this Directive to secure employees' acquired rights as regards involvement in company decisions. Employee rights in force before the establishment of SEs should provide the basis for employee rights

after' principle codetermination is only entrenched where a substantial proportion of the workforce previously had codetermination rights. This suggests that if a shelf SE is registered in a codetermined jurisdiction without having any operations or any employees, it will not have any codetermination obligations. There were no employees 'before' who were entitled to codetermination, so those who come after are without recourse. The 'before and after' principle appears logically not to apply: 'there can be no negotiations where there are no employees at all.'¹⁰⁵ Early indications from the German courts suggest that a shelf SE cannot be denied registration for failing to negotiate an agreement with employees where there are no employees to negotiate with.¹⁰⁶ As long as the SE declares that there are no employees waiting in the wings as it were, and that it has no intention of employing any workers, then in principle there can be no 'acquired rights' to protect.¹⁰⁷ As long as it waits long enough, it may be that the SE is thereafter free to begin operations and hire employees with no obligation to negotiate an agreement on employee involvement with them.¹⁰⁸ This seems an astonishing proposition, and some commentators have suggested that such registrations may not be valid either because they are a 'misuse' of the SE or because they violate German domestic law.¹⁰⁹ A definitive answer awaits the decision of a superior court or the ECJ, which may itself be long in coming because this strategy may not be of practical use for a firm large enough to be otherwise subject to codetermination laws. Meanwhile there is a vibrant and growing market in empty shelf companies, registered mainly in Germany and the Czech Republic.¹¹⁰ In discussing the DG's report 'one participant identified himself as a prolific SE incubator from the Czech Republic, responsible for a large number of 'ready made' SEs. He described the success of his SE founding business model, for which there is clearly a market'.¹¹¹ Becht et al suggest that the role played by such 'registration agents' is significant; they 'function as intermediaries, minimize the costs of shifting between jurisdictions and reduce the significance of non-price considerations in firm choice'.¹¹² For all these reasons the importance of shelf SEs is certainly growing, and they emerge as a key point of concern in the DG's report: the 'status of the negotiations on employee involvement in shelf SE's' was identified as one of the most controversial questions.¹¹³

of involvement in the SE (the 'before and after principle'). This would appear to pre-empt any form of escape from codetermination by means of, say, reincorporating with a single tier board or merging with a firm in a jurisdiction without mandatory codetermination.

¹⁰⁵ Reichert, 303-304.

¹⁰⁶ ER Roelofs, 'Shelf SEs and Employee Participation' (2010) *European Company Law* 120-127.

¹⁰⁷ With the courts suggesting that 'the judge does not have an obligation to verify the truthfulness of such a declaration': Roelofs at 122.

¹⁰⁸ J Reichert.

¹⁰⁹ See, suggesting that such companies are not validly incorporated, Johnston at 263, 264; E Werlauff, 'The SE Company – A New Common European Company from 8 October 2004' (2003) *European Business Law Review* 85; see, contra, Sagan.

¹¹⁰ Most of these have a single-tier board structure: McCahery and Vermeulen; ETUI (2010).

¹¹¹ N Kluge.

¹¹² At 242.

¹¹³ At 6.

ii) Diluting Mechanisms

Even if an established codetermined German firm cannot altogether escape having employee representatives on its supervisory board, in practice it may welcome the absence of various supplementary features of codetermination, such as the legal obligation to have trade union representatives on the board. This may in itself be a significant alleviation of its codetermination obligations. In practice union representatives who are not themselves employees make up to 29% of employee representatives on the supervisory board, more than the percentage of representatives of middle management (13.7%).¹¹⁴ The Directive provides that 'Member States should be able to provide that representatives of trade unions [may be involved in the participation model] regardless of whether they are employees of a company participating in the establishment of an SE', but this is facilitative rather than prescriptive. The SE can avoid such provisions simply by registering in another member state where the law is silent on codetermination.¹¹⁵ The size of the supervisory boards in the parity co-determined German firm is another factor which may be diluted under the SE. Supervisory boards are considered by critics to be cumbersome;¹¹⁶ the ability to reduce the board members from 20 or more down to 12 as required by the Directive is therefore attractive. Reducing the size of the supervisory board is thought to have been a key incentive in the choice to adopt the SE form by German firms such as BASF, Allianz and Fresenius.¹¹⁷

There is therefore room to use the SE as an opportunity for renegotiation and agreement with the employee representatives¹¹⁸ to restructure participation in such a way that, even if not immediately defeated, codetermination can be diluted or phased out. This, however unlikely it may seem that employees would voluntarily opt out of codetermination, offers a potential exit. Even if codetermination is not diluted but simply reorganized so that it is tailor-made for the firm in place of being organized according to national codetermination legislation, this in itself is significant.¹¹⁹ No jurisdiction anywhere in the world actually *prohibits* codetermination, so in theory any firm in any jurisdiction could have a two-tier board despite the absence of a legislative framework facilitating two-tier boards. It is the

¹¹⁴ Gorton and Schmid, at 872, 873 (data from the period 1989-1993).

¹¹⁵ Enriques, Hansmann and Kraakman observe that 'one of the attractions of the SE, besides the fact that it allows firms to reduce the size of the supervisory board to 12 seats, is that it also allows for board representation of employees located outside Germany, thus reducing the grip of German trade unions over the company' in *the Anatomy of Corporate Law* at 101 note 51.

¹¹⁶ See Gorton and Schmid.

¹¹⁷ Reichert, noting that this strategy is potentially open to legal challenge, as there is a view that the size of the supervisory board is itself a matter that the Directive requires to be negotiated with employee representatives, so that the size could not be reduced without the agreement of the employee representatives (see Reichert at 303).

¹¹⁸ By a two-thirds majority of the Special Negotiating Board representing at least two-thirds of the employees of the participating companies.

¹¹⁹ Reichert observes that 'even if the level of co-determination remains the same, the SE provides the opportunity to negotiate an employee involvement model tailored to the specific structure and needs of the company or group and does not burden the corporation with the straitjacket of an unspecific legal solution' at 300.

legislative basis of codetermination in the European states where it exists that makes the model distinctive, and an opportunity to replace this with a model designed by agreement between the parties replaces mandatory rules with self-regulation.

iii) Most Advanced Protection

Davies draws attention to the possibilities opened up by the requirement of the Directive that where employees in different jurisdictions are subject to varying levels of protection, the applicable standard is that of the most advanced protection.¹²⁰ He demonstrates that it is not clear how exactly to compare different systems and determine which is the most advanced. This suggests one possible avenue of escape, for example where a system without codetermination is deemed to be more advanced than one with parity codetermination because, although employee representatives are not entitled to seats on the board, they can influence the appointment of the entire board:

there are no worker representatives as such on the boards of large Dutch companies, but the Works Council has some influence over the appointment of all members of the board because of its power to oppose in the court the appointment of any member of the board. It is far from clear that this gives the employee representatives greater influence than under the German co-determination system, where there is a right of appointment, but only in relation to half the board. Yet the Directive seems to treat the Dutch system as the 'higher' one. Could a German company therefore escape from parity German co-determination by merging with a large Dutch company?¹²¹

iv) Entrenchment of the status quo

Employee participation rights are generally frozen as they stand at the time of restructuring, so that they cannot subsequently be varied by the firm. This may be beneficial to employees, if the firm is moving from a jurisdiction with stronger protection to one with weaker protection. However, it may have the effect of defeating their expectations if the firm is moving to, or restructuring within, a jurisdiction with stronger protection. Gelter gives the example where an SE in Germany 'that crosses the threshold of 2000 employees is not required to increase the number of employee members on its supervisory board from one third to one half (as it would otherwise be)' under German law.¹²² Indeed this prospect of freezing its codetermination structure is thought to be particularly appealing to small and medium sized German firms which, by reincorporating as an SE, will avoid the prospect of ever becoming subject to parity codetermination. Reichert cites the example of Surteco AG, now Surteco SE, which reincorporated expressly in order to maintain the codetermination status quo; but he notes a potential challenge to the validity of this 'freezing' effect – if the firm's growth amounts to a 'structural' change it could trigger an obligation in German law to renegotiate codetermination.

¹²⁰ Davies at 84: 'the form of participation in principle to be adopted by the SE is the most advanced of the systems required by the national laws applying to the founding companies.'

¹²¹ Davies at 86.

¹²² at 814.

v) Reliance on National Law

The regulations take effect by implementation in national law, and are therefore subject entirely to the law governing corporations in different member states. This means that an SE which adopts a codetermination model because this represented the most advanced participation system, but chooses to be registered in a member state whose laws do not mandate codetermination, could in practice end up with a much watered down version of the previous codetermination system. An example of this would be to assign decision-making power to the management Board, where that power would be vested in the *supervisory* board in a codetermined jurisdiction. Another example would be a different designation of ‘employee representatives’ in national law which in a jurisdiction with low levels of unionization may fail to designate any role for trades unions. As Davies observes:

It needs no expert in comparative law to perceive that the participation system of State B may operate very differently in State A than in its home state. For example, it is a truism that the effectiveness of the German board-level participation system depends heavily upon its links with the German works councils. There is a good chance that a German-style board level system will operate differently if transposed to a country with a different system of works councils or no works councils at all but other forms of consultative mechanism.¹²³

The same hazard emerges in relation to the ‘misuse’ provisions of the Directive. The Directive provides in Article 11 that member states must take steps ‘with a view to preventing the misuse of procedures for the purpose of depriving employees of rights to employee involvement or withholding such rights’. It is presumed that a variation of employee participation within a year of reincorporation amounts to such misuse.¹²⁴ The question whether a form of restructuring which defeats employee participation is a misuse, and if so the appropriate sanction, depends on national law. Again, the interpretation of this provision therefore depends on the degree to which the particular jurisdiction is supportive of employee participation. In any event, although there are suggestions that taking advantage of escape possibilities under the Directive could be challenged by employees as a misuse,¹²⁵ the misuse provisions of the Directive are not clear and it seems unlikely given the case law of the European Court of Justice on the freedom of establishment that restructuring under the Statute would in itself be deemed a misuse by reason only of its adverse implications for employee participation.¹²⁶ As held in *Centros*, and reiterated in *Inspire Art*, ‘it is irrelevant that the sole purpose of forming the company in the

¹²³ Davies at 86.

¹²⁴ Regulation 35 of the UK Regulations (SI 2004/2326). Similarly the Directive on Cross-Border Mergers of Limited Liability Companies prohibits variation of employee rights within three years of a cross-border merger (No. 2005/56, Art 16(7)).

¹²⁵ See Johnston at 265, 266.

¹²⁶ See Sagan; and R de la Feria and S Vogenauer (eds) *Prohibition of Abuse of Law: A New General Principle of EU Law* (Oxford, Hart Publishing, 2010).

Member State concerned is the evasion of statutory provisions in the other Member State...this was not an abuse, but merely the exercise of the freedom of establishment guaranteed by the Treaty.¹²⁷ Misuse being a matter governed by national law, there is room for a variety of responses to this question.¹²⁸ Where the protective effect of the Directive is time-limited, for example in relation to the misuse presumption, what happens after the specified time expires again depends on national law.

vi) Reincorporation and Reconversion

After two years an SE can be 're-converted' into a public limited liability company (plc) in the new jurisdiction, at which point it will be subject to the ordinary legal requirements governing plcs in the relevant member state.¹²⁹ If the national law does not require employee participation for plcs then the restructured SE will eliminate the need for employee participation in this scenario described by Gelter:

A German corporation might, for example, transform into an SE by merging with its British subsidiary, and convert into a traditional British company without any employee participation after two years. Such a conversion would most likely not be considered a 'misuse'. Even if the German authorities believed that it did, they would be unable to act on that belief because British law would apply to the company at that time.¹³⁰

The Statute imposes procedural controls on this by requiring the firm to report on its reasons and justification for conversion to a plc, indicating how the change will affect shareholders and employees.¹³¹ This report must then be approved by the shareholders in general meeting. There being no requirement for employees to consent to this, Gelter concludes that there are 'possibilities of reducing the participation regime for particular employee groups without their assent that can be used to install a weaker employee participation system.'¹³²

vii) The 'No export' principle

The Directive, being a compromise between states which do and do not have codetermination, is necessarily concerned to prevent its protective measures entrenching codetermination in states which do not want it. As Davies illustrates, the most interesting problems are likely to arise in a merger between a codetermined and a single-tier firm where the number of employees in the single-tier firm greatly outnumbers that in the codetermined firm. In this situation the Directive is cautious not to simply 'export' codetermination to the single-tier jurisdiction, even though in this case codetermination is clearly the most advanced form of participation in the merging firms. Article 7 of the Directive therefore provides that the standard rules

¹²⁷ *Inspire Art*, AG 11.

¹²⁸ In the UK complaint lies to the Central Arbitration Committee under the European Public Limited-Liability Company Regulations 2004 (SI 2004/2326).

¹²⁹ Article 66, and see discussion in T Raaijmakers. Note that this conversion is also possible under the Cross-Border Mergers Directive.

¹³⁰ Gelter, at 815.

¹³¹ Article 66.

¹³² Gelter, at 813. See also Kubler, discussing the same scenario at 232, 233.

governing employee participation (including the principle of the ‘most advanced’ discussed above) do not automatically apply unless participation rights extend to ‘at least 25% of the total number of employees in all the participating companies’ in the case of formation by merger, or at least 50% of the employees in case of formation by holding or subsidiary company. This suggests that the codetermined firm will lose this structure if it merges with another firm with significantly more employees. If the employee representatives choose to apply the standard rules, it is possible that the representatives from member states without codetermination who are merging with a firm from a codetermined firm might choose to apply the Standard Rules (leaving them free to apply the ‘most advanced’ principle) even though the rules would not have automatically applied. This would be a potential means for codetermination to be exported to jurisdictions where it did not previously exist.¹³³

E. INCENTIVES FOR CHOOSING THE SE

How these possibilities for escape will affect reincorporations in the long term remains to be seen, and it is still true that the ‘considerable legal debate’ on the opportunities for corporate mobility has still not yielded ‘consensus about their practical consequences’.¹³⁴ Owing to the transaction costs of reincorporation and the fact that the decision to reincorporate depends on many factors other than codetermination, it may well be that such forms of escape ‘would be seriously considered only in the most dramatic circumstances’.¹³⁵ The legal possibilities are not the *only* factor affecting the choice of jurisdiction, and it is arguable that it is not the most significant factor as compared to other factors such as reincorporation costs. There is evidence that minimum capital requirements, setup costs and tax liabilities are the key determinants of location of jurisdiction.¹³⁶ Although German companies appear to be prepared to meet comparatively high reincorporation costs,¹³⁷ this was already the case before the SE introduced various exit options from codetermination and therefore it cannot be definitively concluded that codetermination is the key driving factor in the choice to reincorporate.¹³⁸ Simply because such an escape is legally possible, albeit after going through what may be an intricate regulatory obstacle course, does not mean that codetermined firms would choose to undergo the necessary restructuring to form an SE for sole or main purpose of avoiding codetermination.¹³⁹ For instance, it may be supposed that no firm would merge with a much larger foreign firm (in terms of size of work force) simply to trigger the ‘no export’ rule and shake off codetermination. Leaving aside

¹³³ Davies.

¹³⁴ Becht, Mayer and Wagner.

¹³⁵ Hopt at 206.

¹³⁶ Becht, Mayer and Wagner.

¹³⁷ McCahery and Vermeulen.

¹³⁸ In the Becht Mayer and Wagner study of reincorporations after *Centros*, Germany and the Netherlands have the highest number of firm exits, and the UK has the highest number of firm imports.

¹³⁹ That a significant proportion of SEs are non-operational empty shelf-companies suggests that much of the interest in the SE has related to its *potential* uses, perhaps on a wait-and-see basis.

the potential challenge to such a course of action as a misuse of the SE, much also depends on the value attached by firms to codetermination. It could therefore be argued that there is no need for regulators to fear a rush by codetermined firms for the exit. But this has not prevented the prospect of escaping codetermination from being viewed as an important incentive driving firms' choice to form an SE. It is therefore necessary to consider this question in the context of other incentives for choosing the SE.

The main incentive for firms to choose the SE, as confirmed by the DG's report, is to facilitate cross-border transfers and mergers. This is the central aim of the Statute - to enable companies to be reincorporated as European companies and thereby to move to a jurisdiction of their choice without having to dissolve the existing company and reincorporate in the new member state.¹⁴⁰ Allianz SE, the first listed company to adopt the new form, was motivated in large part by its intention to merge with its Italian subsidiary Riunione Adriatica di Sicurta.¹⁴¹ The SE form also presents an opportunity for corporate groups to reduce transaction costs by restructuring into a single entity with branches in different member states, instead of resorting to the need to set up subsidiaries and holding companies.¹⁴² This ability to move the company's business more easily to a different jurisdiction remains interesting for its potential to trigger a US-style market for incorporations, with different jurisdictions competing to create the most favourable regulatory environment to attract corporations.

There are multiple reasons why the SE has not proved as attractive as anticipated. First, although it is now easier for a company's registered office to be transferred from one jurisdiction to another, a key setback is thought to lie in the requirement that the registered office of the SE 'must be the place where it has its central administration, that is to say its true centre of operations.' This fusion of registered office and administrative seat makes the SE less attractive than other forms of cross-border transfer under which a company may transfer part or all of its business to a different member state without the need to transfer its registered office. The DG's report indicates that this is likely to receive the attention of any reform proposals, partly because it is considered a negative driver for the SE and partly because its compatibility with the freedom of establishment provisions is in doubt.¹⁴³

¹⁴⁰ essentially 'to allow European enterprises, especially those operating in several member states, to unify their organisational structures and adapt to the increasingly transnational dimension of their activities': Group of Experts, 1997, 1.

¹⁴¹ Reichert.

¹⁴² J Kirshner, 'A Third Way: Regional Restructuring and the Societas Europaea' (2009) CBR Working Paper No 385.

¹⁴³ Indeed, it has been suggested that this is unlawful as it violates the principles of free movement set out by the ECJ in the *Centros* line of cases: L Cerioni and G Ringe. Note that it is possible to achieve a separation of registered office and administrative seat under the Cross-Border Mergers Directive: Johnston.

Further, although the Statute offers a framework for forming an SE by the merger of companies from different member states, consensus seems to be that the Cross-Border Mergers Directive offers a more attractive framework for restructuring by merger.¹⁴⁴ Moreover, the fact that the Statute does not constitute a comprehensive set of rules governing the SE, referring instead to the law governing public limited-liability companies in the member state where it has its registered office, means that complexity and legal uncertainty are unavoidable.¹⁴⁵ Acquiring a 'European image' in place of the narrower national one is cited by the DG's report as a key attraction of the SE; yet this reliance of national law in shaping the form of the SE means that the identity of the SE remains shaped by the law of the member state in which it incorporates.¹⁴⁶ Time delays in incorporating the SE are also considered a disincentive; in addition to the time taken up negotiating an agreement on employee involvement the Statute offers protection for minority shareholders which may also require negotiations or provoke potential legal challenges delaying the SE formation.

The general transaction costs of reincorporation must also be considered. This would include the administrative cost and burden of restructuring under the Statute and the attendant disruption of the firm, which would henceforth be subject to the laws of a different member state where learning and adaptability costs are higher and network advantages or reputational capital may be lost. Of perhaps more interest to shareholders, the restructuring of the firm may also expose it to an adverse impact on shareholder value.¹⁴⁷

This suggests, as Davies points out, that the employee participation provisions may not *in themselves* play a significant role in the parties' decisions on whether to form an SE.¹⁴⁸ There is evidence that where firms have sufficient incentive to reincorporate they are not deterred by 'legal uncertainty, language and stronger enforcement of disclosure standards'.¹⁴⁹ McCahery and Vermeulen also suggest that German firms are prepared to pay a higher premium in the administrative costs of reincorporation, suggesting that they attach higher value to the benefits to be gained. Nevertheless for firms that do wish to form an SE, the employee participation provisions will influence the choice of jurisdiction where to situate the registered office. Hence 'a better question is whether codetermination is a relevant

¹⁴⁴ Directive 2005/56/EC. Similarly, the (currently shelved) Fourteenth Directive on seat transfer. The Statute sets out four ways of forming an SE: merger of public limited companies from different member states, formation of a holding company in a different member state from that of the registered office, formation of a joint subsidiary, or conversion of a public limited company previously formed under national law.

¹⁴⁵ Article 9.

¹⁴⁶ J Reichert.

¹⁴⁷ Fluck and Mayer.

¹⁴⁸ 'What are the incentives to use this new corporate form? If they are strong, then management may use the SE, even where that form requires board level participation and even where the management is not used to such structures under their national law, in order to gain the advantages of this new form. If they are weak, then management may not use the SE, even when no issue of triggering the participation rules of the Directive arises': Davies, *Workers on the Board* at 76.

¹⁴⁹ Becht et al at 242.

factor for a foreign company in deciding whether to incorporate an affiliate in a country with codetermination or in another without such legislation. There is some evidence that this is actually the case, even though codetermination may be only one of many factors and not the decisive one¹⁵⁰ Strong path dependence linked largely to employee participation in corporate governance may supply at least a partial explanation for Europe's 'non-mobility equilibrium' since the law has made considerable progress in creating an environment in which we would otherwise expect to see more mobility of corporations across borders, which nevertheless has not resulted as expected.¹⁵¹

F. THE POLICY DEBATE

Although the Directive could be said to aim simply at allowing a *choice* of two-tier boards should that be the firm's preference, the legislative history makes it clear that the Directive is intended to entrench employee participation. At the same time, given that codetermination and other forms of employee participation in decision-making are thought to impose heavy costs on the firm it would indeed seem rational for firms to move to a jurisdiction whose law does not mandate codetermination in circumstances where an escape is possible. The question then arises how the effectiveness of the regulatory framework measures up against the divergent policy goals it seeks to achieve.

This regulatory tension has its roots in the different approaches taken by corporate law on the one hand, and the broad framework of the European 'social policy agenda' on the other. The regulatory framework of corporate law is concerned with the flexibility and competitiveness of European firms. It focuses on hard-law instruments promoting harmonization and a market for incorporations, and allowing a choice of firm structure. A good illustration of this is the European Commission's policy statements on corporate restructuring, which emphasise competitiveness and flexibility with the aim of making Europe the world's most productive economy. Conversely, the social policy agenda encourages the adoption of codetermination across Europe through soft-law mechanisms, and upholds a labour-oriented model of corporate governance (i.e. one in which employee participation plays a key role) as an aspirational standard. This is promoted as a key, indeed unique, aspect of Europe's competitiveness, i.e. profitability of firms which does not impose externalities on employees and other stakeholders. Hence the coupling of the Directive to the Statute was hailed as 'a historic compromise whereby workers'

¹⁵⁰ Hopt, at 206.

¹⁵¹ McCahery and Vermeulen. See also Heine and Kerber, 'European Corporate Laws, Regulatory Competition and Path Dependence, (2002) 13 *European Journal of Law and Economics* 47.

participation on management or supervisory boards becomes standard practice' across the EU.¹⁵²

Overall, then, the regulatory framework is driven by an overarching goal of promoting both flexibility for firms and security for workers ('flexicurity') under the aegis of the European social policy agenda which shapes and distinguishes Europe's 'unique' variety of capitalism.¹⁵³ The main concern of social policy is the adverse implications of corporate restructuring for employment security. The special priority placed on employment security in many European member states explains the series of obligations relating to employee participation in decision-making entrenched in a broad corpus of directives regulating corporate restructuring after long and protracted debates and political compromises. This includes directives on transfers of undertakings, insolvency and takeovers with a general framework for employee participation provided for in directives on information and consultation of employees and European Works Councils for firms with cross-border operations. The provisions in these legislative instruments range from a simple duty to give relevant information to employees at one of the spectrum (information and consultation rights), to the reservation of a proportion of seats for employee representatives on the board of directors (codetermination) at the other end.

It is suggested here that a reflexive law framework might allow these apparently conflicting aims to co-exist and co-evolve in the form of the SE. How would this unfold? Reflexive harmonisation is compatible with, and indeed seeks to promote, regulatory diversity across member states. This allows it to facilitate what appear to be contradictory goals which are accorded varying degrees of priority from one member state to the next, offering a way forward in what might otherwise threaten to be a regulatory deadlock.¹⁵⁴ Within a reflexive framework the optimal equilibrium or balance between conflicting aims is struck not by imposing top-down solutions but by allowing experimentation, learning from best practice, and creating a regulatory environment in which different strategies co-evolve and adapt to each other. Open-ended and context-dependent regulations are therefore best understood as mechanisms of reflexive governance. A key insight of systems theory, and the understanding of the legal system and the industrial relations system as autopoietic, self-referential and autonomous, is to understand the communication and feedback between the two, and primarily the ways in which they directly influence each other.

¹⁵² R Simons and N Kluge (eds.), *Workers' Participation at Board Level in the EU-15 Countries: Reports on the National Systems and Practices* (Brussels: Hans Böckler Foundation and European Trade Union Institute, 2004) <www.seeurope-network.org> at 4.

¹⁵³ PA Hall and D Soskice (eds) *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford, OUP, 2001).

¹⁵⁴ See Zumbansen at 549 on the deadlock between harmonisation and regulatory competition. At any rate, which is not the same thing, reflexive theory 'at least offers an ex post rationalisation of the political compromises which have been reached in this area': Johnston, at 214.

This allows a framework in which corporate law influences, and is influenced by, the industrial relations context in different member states. By providing that the detailed rules governing the SE are to be determined by the national law of each member state, the Statute allows this influence to take effect. This allows corporate law in each jurisdiction to respond to and make allowances for the fact that many jurisdictions in Europe have an identifiable labour-oriented *model*, contrasting with the shareholder-oriented model of the UK. The difference between a shareholder-oriented and a labour-oriented firm is not merely a different emphasis on the role of workers which could be explained away as a difference of degree or approach. After all most jurisdictions, and arguably all European jurisdictions, have a concern for the role of workers in the firm and an appreciation that workers make a vital contribution to corporate enterprise. Thus all jurisdictions have a well-established legal framework of employment protection regulating workers' rights of information, consultation and collective bargaining, which will, to varying degrees, qualify the managerial prerogative in decision-making.

So the crucial question is not whether various models of employee participation or even mere involvement qualify managerial autonomy. The important issue is whether this qualification affects the underlying normative ideology of the firm's governance, and extends to the central questions of ownership and control of the firm. As Bratton and McCahery put it, the key issue concerns the 'interdependencies' between the framework of corporate law and the organized workforce.¹⁵⁵ A good test of these interdependencies is the degree of employee participation in decision-making. This is not a matter that is only incidentally connected to understanding corporate law; as Roe demonstrates corporate law exhibits an entirely different set of norms when employee participation crosses the line beyond which it is no longer credible for managers to claim to be *primarily* concerned with maximizing shareholder value.¹⁵⁶

G. CONCLUSION

Most corporate governance analyses ignore employees, and when we put them back into the governance inquiry, we get a richer understanding of how a society organizes its corporate institutions ...¹⁵⁷

Corporate governance debates usually take into account factors such as the firm's ownership and board structure, protection of minority shareholders, the growth and vibrancy of securities markets, agency problems (aligning the interests of managers with those of shareholders) and the market for corporate control (regulation of

¹⁵⁵ WW Bratton and JA McCahery, 'Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference' (1999) 38 *Columbia Journal of Transnational Law* 213–98.

¹⁵⁶ *The Political Determinants of Corporate Law*.

¹⁵⁷ MJ Roe, 'Modern Politics and Ownership Separation' in JN Gordon and MJ Roe (eds.), *Convergence and Persistence in Corporate Governance* (Cambridge, CUP, 2004) at 253.

takeover activity). Yet these factors cannot be fully understood without an appreciation of the effect of employee participation in corporate governance.¹⁵⁸ Given the potential for the reflexive approach to allow a balancing of conflicting regulatory aims, what role would we expect codetermination to play in the future of the SE?

In the broader context of EU policy-making, the commitment to preserving codetermination is undiminished. The evolution of codetermination has far-reaching potential effects outside corporate law, as the ability to escape codetermination renders meaningless the territoriality principle of labour law rights and social policy more generally.¹⁵⁹ Yet the aims of forging a common market, corporate mobility and freedom of establishment are equally compelling. It is not altogether surprising that the interrelationship between the two policy goals appears somewhat ambivalent and sometimes contradictory. This paper has highlighted the ways in which these concerns appear to conflict in regulating codetermination in the SE, and has considered how successful the approach of reflexive harmonisation might be in allowing both regulatory goals to co-exist. It can be concluded that as reflexive forms of governance continue to take centre stage in the European corporate governance, codetermination will continue to play an important role in the ownership and control of European firms.

¹⁵⁸ MM Blair and MJ Roe (eds.), *Employees and Corporate Governance* (Washington D.C.: Brookings Institution Press, 1999).

¹⁵⁹ Deakin, 'Reflexive Governance and European Company Law'.