EMPLOYEE OWNERSHIP IN THE EUROPEAN COMPANY: REFLEXIVE LAW, REINCORPORATION AND ESCAPING CODETERMINATION

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Abstract

This article assesses the effects of reincorporation on codetermination, focusing on the scope for escaping codetermination by restructuring under the European Company (SE). This is usually associated with the prospect of corporate flight from codetermined jurisdictions. The article 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 harmonization, 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.

Keywords: employee participation, reincorporation, codetermination, European company, reflexive law, evolution, ownership and control

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1. 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 (Hansmann, 1996:5).

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 (Gelter, 2010; Eidenmuller, 2009; Armour, 2005; Enriques, 2004). 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, which emphasizes facilitating cross-border transfers of a firm's registered office or administrative seat (Cerioni, 2010; Ringe, 2007).

This article takes a different approach, focusing instead on the effects of reincorporation on employee ownership. Codetermination is described and understood as an attribute of ownership of the firm. Ownership being a notoriously amorphous concept,[1] it is necessary to clarify that in this discussion the firm's owners are understood to be those persons, who might be defined as 'patrons' or 'stakeholders', who have ultimate control of the firm.[2] The idea of ownership as control, in economic theories about the proprietary structure of the firm, is 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 (Coase,1937; Demsetz, 1967; Jensen and Meckling, 1976; Hart and Moore, 1990; Michie and Oughton, 2002; Armour and Whincop, 2007). The predominant allocation of ownership rights to shareholders is explained by Hansmann (1996) as a choice designed to maximize investment incentives and minimize transaction costs. 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' (at 11).

The participation of labour in the board structure of two-tier firms may then be explained from a proprietary perspective. Whilst from a contractual perspective, the firm is understood as a network of contracts with the employees 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.[3] 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 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.[4]

This focus on employee ownership in the SE offers a particularly useful insight into the debates about regulatory competition in the EU. In drawing comparisons and contrasts between EU law and corporate law in the US (Dammann, 2003), it is often observed that because the European Company Statute (Regulation 2157/2001 EC[2001] OJ L294/1, hereafter the Statute) and the accompanying Employee Participation Directive (Directive 2001/86/EC [2001] OJ L294/22, hereafter the Directive) 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 (Fluck and Mayer, 2005: 2, 3).

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).[5] 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.[6] This debate would greatly benefit from a clearer understanding of the effects of reincorporation on codetermination. Focusing specifically on codetermination as part of the firm's ownership structure is particularly useful in the EU where

ownership structures vary significantly across jurisdictions.[7] This article takes a step in that direction by assessing the potential for firms to escape from codetermination by reincorporating as an SE. In order to understand the potential scope for escape more fully, it is first necessary to present a summary of the central concerns surrounding codetermination in the SE. This article identifies the four key central issues.

1.1 Codetermination and reincorporation decisions

The possibility of escaping or at least diluting codetermination is widely seen as the main attraction or danger of the SE, depending on the view taken of the role played by codetermination. For instance, Reichert (2008) 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, while Keller (2002) identifies the escape potential as a real danger. McCahery and Vermeulen (2008) 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. At the time of their study in April 2007, 78% of all SEs 'were established in countries with strict regulations' (2008: 68). This view is substantiated by the Ernst & Young study commissioned as the basis for the DG's report, which 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.[8] According to the DG's 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' (at 4). In particular, '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).

The conflicting views represented in the DG's report reflect a wider uncertainty regarding the role played by employee participation in firms' reincorporation decisions. Current data suggest that at least 19 firms which previously had a two-tier structure adopted a single-tier structure when they reincorporated as an SE, but in most cases it is not clear whether they previously had employees on the supervisory board; although they have shed their *two-tier structure* it cannot

be definitively concluded that they have shed *codetermination* (ETUI, 2010).[9] Moreover, from the time *Centros*[10] 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 jurisdictions(Becht et al, 2008). They are driven to reincorporate by 'country-specific incorporation costs and minimum capital requirements' rather than employee participation (Becht et al).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.[11]

1.2 Empty and shelf SEs

There is increasing 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 (ETUI, 2010). Empty and shelf SEs constitute a significant proportion of SEs, and as will be seen later in this article they appear to present a corporate form which can be used to avoid employee participation altogether. The classification of the total of 658 established SEs as at November 4, 2010 was as follows:

Normal SE	Has operations and at least 5 employees	166
Empty SE	Has operations but no employees	83
Shelf SE	Has neither operations nor employees	65
UFO SE	Not enough information	344

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

1.3. The influence of German firms

Approximately half of all normal established SEs are registered in Germany: 83 out of 166 normal SEs in November 2010 (ETUI, 2010). This inevitably places Germany's trend-setting firms at the heart of this debate. 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 (Gorton and Schmid, 2000). Although the German model is the best-known of European forms of codetermination, no attempt is made in this article to ask how German *law* responds to the possibilities created by EU law; while the response of German *firms* is critical to understanding the regulatory effects of EU law, the relevance of this study is not 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 member states. This study is therefore of wider relevance for European corporate law.

1.4. The role of codetermination in ownership and control

Codetermination is central to the European corporate governance debates, provoking 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 (Kubler, 2005). 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 norm owing to a 'mutual adjustment' between codetermination and shareholder value (Jackson, 2005: 4, 24). 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 (Weiss, 1996).[12] This is a sentiment echoed by some of the contributions to the DG's report.

It is therefore apparent that there are broader correlations between codetermination and the future evolution of the firm's overall structure of ownership and control. One interpretation suggests 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 (Roe, 2003). But the direction of causation may well be the reverse - it may be the fact that these firms have a closely held structure with blocks of shares and dominant shareholders presenting holdup problems that makes

codetermination necessary (Gelter, 2008). This correlation, which may plausibly 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's study of the evolution of codetermination demonstrates that wider changes in German 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' (2005: 246). Tracing the developments in codetermination therefore yields insights into more general questions about the evolving ownership structures of firms.

1.5 Overview of the article

The rest of the article proceeds as follows. In section 2, the discussion presents the possible strategies through which reincorporation as an SE may offer a means of escaping codetermination. Since there is much debate about the significance of the role played by 'escape' possibilities in choosing the SE, section 3 places this discussion within the wider context of other incentives for choosing to reincorporate as an SE. Section 4 analyses the potential escape strategies within a theoretical framework of 'reflexive harmonisation' 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 (Deakin, 2006 and 2009; Deakin and Carvalho, 2010). An analysis of the future prospects for codetermination in European firms is then offered by looking at the efficiency and policy debates in sections 5 and 6, before section 7 of the article concludes.

2. Opting Out of Codetermination

It is useful to begin with an overview of the legal framework of the Statute and Directive. 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 in Recital 18 that 'it is a fundamental principle and stated aim of this Directive to secure employees' acquired rights as regards involvement in company decisions'. 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' (Cerioni, 2010:329-335). Article 52 provides that the employee involvement model must finally be approved by the shareholders in general meeting before the SE is registered. In the case of formation by merger, this would mean the general meeting of each of the merging companies (Article 23). 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'.[13] Standard employee involvement rules are specified under the Directive (Article 5) which apply in the event that the parties are unable to come to an agreement within six months, extendable to a year.

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.[14] 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'.[15]

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'.[16] Codetermination could therefore be seen as simply one option in a broader framework allowing firms to choose between different structures. However, 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). It is therefore distinguishes itself, amongst other models of employee participation, as an institution of central interest to understanding the ownership and control of the SE.

Owing to the complexity of the legal framework, the extent to which firms can escape codetermination by reincorporating as an SE is not immediately clear.[17] 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 (Davies, 2003: 92). 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 basic fact that employee participation is subject to agreement and negotiation means the parties can simply opt out of codetermination if they both agree to do so; this Section therefore focuses on the potential to opt out *without* the employees' agreement.

2.1 Shelf SEs

The Directive relies on a 'before and after' principle, essentially safeguarding existing participation rights so that employees are not worse off after the firm is restructured as an SE. Under the before and 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' (Reichert, 2008: 303-304).

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 (Roelofs, 2010). As long as the SE declares that there are no would-be 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. 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 (Reichert, 2008). 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 within the meaning of the Directive (Johnston, 2009), or because they violate German domestic law (Werlauff, 2003; cf. Sagan, 2010). 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. Out of 66 shelf SEs in November 2010, 35 are Czech (predominantly two-tier) and 20 are German (predominantly single-tier) (ETUI, 2010). 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' (Kluge, 2010). 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' (2008: 242). 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 by the report as one of the most controversial questions (at 6).[18]

2.3 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%) (Gorton and Schmid, 2000: 872, 873). 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. 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 (Gorton and Schmid, 2000); 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 (Reichert, 2008).

There is therefore room to use the SE as an opportunity for renegotiation and agreement with the employee representatives to restructure participation in such a way that, even if not immediately defeated, codetermination can be diluted or phased out. The available data (ETUI, 2010) suggest that this may present itself as the favoured option of a trade union in a context where other forms of representation such as the introduction of a European Works Council are favoured. 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. No jurisdiction anywhere in the world actually *prohibits* codetermination, so in theory any firm could have a two-tier board despite the absence of a legislative framework facilitating two-tier boards. It is the 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.

2.3 Most advanced protection

Davies (2003) draws attention to the significance of 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. As noted earlier, it cannot be assumed that trade unions or other employee representatives will necessarily favour codetermination over other forms of worker involvement. Davies demonstrates that it is not clear how exactly to compare different systems and determine which is the most protective of employee interests. The prioritization of the 'most advanced' framework suggests one possible avenue of escape from codetermination, 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? (Davies, 2003: 86).

There is evidence (ETUI, 2010) that in reincorporating as an SE at least one large German firm has replaced its two-tier board with a single-tier, and replaced co-determination with a Works Council. This firm effectively escapes codetermination by 'down-grading' from participation to representation, which seems perfectly permissible if the rights and powers enjoyed by the Works Council are deemed superior to those held by employee representatives under the previous codetermination system. This seems likely to be the case because the firm in question has accorded the Works Council information and consultation rights which exceed the legal minimum (ETUI, 2010).

2.4 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 (2010: 814). 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 (2008) cites the example of Surteco AG (now Surteco SE) which reincorporated expressly in order to maintain the codetermination status quo of three employee representatives on a nine-member supervisory board when the number of employees crossed the parity codetermination threshold; but he notes a potential challenge to the validity of this freezing effect – if the firm's growth amounts to a 'structural' change as some commentators have suggested, it could potentially trigger an obligation in German law to renegotiate codetermination.

2.5 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. In such a case:

> 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 (Davies, 2003: 86).

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.[19] The question whether a form of restructuring which defeats employee participation is a misuse, and if so the appropriate sanction, arguably 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 (Johnston, 2009: 265, 266), the misuse provisions of the Directive are not clear and it seems uncertain, given the case law of the European Court of Justice on the freedom of establishment, whether restructuring under the Statute would in itself be deemed a misuse by reason only of its adverse implications for employee participation. As held in *Centros*, and reiterated in *Inspire Art*, 'it is irrelevant that the sole purpose of forming the company in the 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.'[20] Misuse being a matter governed by national law, there is room for a variety of responses to this question. 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.

2.6 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 (Article 66). If the national law does not require employee participation for plcs then the restructured SE will eliminate the need for employee participation:

> 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 (Gelter, 2010: 815).

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 (Article 66). 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’ (2010: 813).

2.7 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 employees in the single-tier firm greatly outnumber those 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 governing employee participation (including the principle of the most advanced jurisdiction 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. But there is an alternative possibility. Although the standard rules do not *automatically* apply, the numerically superior representatives from states without codetermination, who are merging with the codetermined firm, are entirely free to *choose* to apply the standard rules. This leaves the parties free to apply the 'most advanced' principle, making codetermination the model of choice. This would be a potential means for codetermination to be exported to jurisdictions where it did not previously exist (Davies, 2003).

So far, the only clear evidence of such an 'export' of codetermination has occurred in a German firm which, when it reincorporated as an SE, replaced its Works Council framework with parity codetermination. The new supervisory board has 12 members with 6 employee representatives (ETUI, 2010).This is consistent with the reflexive process of steering the parties to make choices which rise above minimum standards and recognize best practice. Although this particular SE was formed by conversion, it is not inconceivable that during merger negotiations where one of the firms is codetermined there would be ample opportunity for attention to be focused on the benefits enjoyed by the codetermined firm.

3. Other Incentives for Choosing the SE

How these possibilities for escape and export will affect reincorporations in the long term remains to be seen. As noted by the ETUI (2010), in the absence of a central European registry for the SE it is not possible to keep complete track of the numbers of firms adopting these strategies, as the available information on whether there are employee representatives on the supervisory board and if so the terms of their participation agreement depends on the firm voluntarily making the information public. The case therefore remains, as Becht et al observe, that the 'considerable legal debate' on the opportunities for corporate mobility is still unable to yield 'consensus about their practical consequences' (2008). The factors that drive firms to opt in and out of particular governance arrangements are still not fully understood, especially in relation to the large publicly held companies involved in codetermination. Becht et al (2008) find that minimum capital requirements, setup costs and tax liabilities are the key determinants of location of jurisdiction in small firms, and while these would also be expected to play a role in determining choice of jurisdiction in codetermined firms, it is not clear how they rank against the costs of collective decision-making associated with codetermination. It may be that where the costs of codetermination are deemed to be unacceptably high, firms may be prepared to meet comparatively high reincorporation costs:

> First, it appears that mainly in jurisdictions with widespread participation rights, the benefits of establishing an SE outweigh its considerable formation costs. For instance, German BASF AG estimated an amount of 5,000,000 [euros] to convert to an SE. This amount includes the costs of compliance with the necessary legal and accounting requirements as well as registration and disclosure costs (McCahery and Vermeulen, 2008: 67, 68).

However, since this reincorporation trend was already in evidence before the SE introduced various exit options from codetermination, and reincorporations of German firms in the UK occur largely outside the SE framework, it cannot be definitively concluded that escaping codetermination is the key driving factor in the choice to reincorporate as an SE. The picture may well remain much the same as it appears under the general freedom of establishment framework. This would imply that any *new* forms of escape introduced by the SE are not significant. Simply because such an escape is legally possible via the SE, 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. 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 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, the transaction costs of reincorporation, and the fact that the decision to reincorporate depends on many extraneous social and political factors. It may therefore well be that any form of escape 'would be seriously considered only in the most dramatic circumstances' (Hopt, 1994: 206).

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. This makes it 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. 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 (Reichert, 2008). 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 (Kirshner, 2009).

Within a group of companies, there is evidence that parts of the group may replace two-tier with one-tier structures (ETUI, 2010).This ability to move the company's business more easily to a different jurisdiction is also important 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.

These incentives may be better understood by juxtaposing them against the disincentives for firms to choose the SE. 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, the requirement that the registered office of the SE must be the place where it has its central administration is a significant disadvantage. This fusion of registered office and administrative seat in the same country, which some member states also require to be in the same location, 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 provision 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. 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.

Another disadvantage is 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. This makes complexity and legal uncertainty unavoidable (Article 9). Acquiring a European image in place of the narrower national one is cited in 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 (Reichert, 2008).

Time delays in incorporating the SE are also problematic; 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. More general costs of reincorporation must also be considered. This would include the administrative cost and burden of restructuring 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 (Fluck and Mayer, 2005).

This suggests, as Davies (2003) 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. Nevertheless for firms that *do* wish to form an SE, the employee participation provisions may influence the choice of jurisdiction where to situate the registered office. Hence it is necessary to go beyond a concern with whether the SE is being used to escape codetermination; it is increasingly important to understand more broadly how codetermination influences decisions about the firm's ownership structure and choice of jurisdiction. As Hopt writes,

> a better question is whether codetermination is a relevant 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 one (1994: 206).

4. Reflexive Harmonisation and Corporate Law

The theoretical framework of reflexive law and governance encapsulates a range of different ideas (Lenoble and De Schutter, 2010). The main aim of this Section 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.

4.1 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 diversity and 'the all-decisive potential of the market as a process of discovery and elimination' (Zumbansen, 2006: 550).

The approach taken by the Statute is consistent with other company law directives which aim to harmonise 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. 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 (Davies, 2003: 76). 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 harmonise codetermination by making it an intrinsic part of the SE. 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, or conversely whether employment protection regulations require tightening up to close any loopholes that allow the SE to have this effect. 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 (2009:224) 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. But because reflexive law may complement the harmonisation efforts of corporate law, rather than being opposed to those efforts, 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 Directive (Recital 5) 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.

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.

4.2 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. Jackson (2005) 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' (at 231). While the law governing codetermination remains relatively stable, organizational practice continually evolves by adapting itself to the firm or sector in which codetermination operates (230). 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 argues that new constellations of actors emerge, leading to 'institutional innovation' (at 230). Indeed, it is this adaptability that ensures the survival of market institutions (Deakin and Carvalho, 2010); 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' (Zumbansen, 2006: 548) making it possible to understand codetermination as part of the overall regulation of ownership and control of European firms.

4.3 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 (Zumbansen, 2006: 547).

Understanding the legal system and the industrial relations system as autopoietic, self-referential and autonomous, and explaining the processes of communication and feedback between the two, will help clarify how changes in 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. The idea that the process of evolution is not linear or one-directional is particularly important – it suggests that it would be imprudent to suppose that the free choice of firm structure under the legal framework will necessarily erode the institution of codetermination. Instead, the process of evolution being open-ended and context-dependent, it is just as likely that free choice will lead to codetermination becoming more integrated as part of the ownership structure of European firms.

4.4 Procedural self-regulation and experimentation

Reflexive harmonisation as formulated by Deakin (2009) 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 even agree to opt out of employee participation

altogether (Davies, 2003). 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 (Johnston, 2009: 262). 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.

4.5 The hazards of self-regulation

In this Section the main criticisms of reflexive self-regulation are set out, and an attempt to address those criticisms will follow in subsection 6 below. 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 employee interests to be protected 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 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 (Zamboni, 2008). In the SE debate the criticism would be that the reflexive approach does not prescribe priorities as 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 expected 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' (McCahery and Vermeulen, 2008: 57), 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 make extra effort to show 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 (Blankenburg, 1984: 285).

4.6 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' (Teubner, 1984: 299). It is based on an appreciation that owing to the autonomy and self-referential nature of social

and economic systems, it would 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 (Teubner, 1984: 299).

This can be seen in the careful attempt to balance the 'no escape' and 'no export' provisions of the SE regulations governing codetermination (Davies, 2003).

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*' (Teubner, 1984: 298). 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 (Johnston, 2009: 261, 262).

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' (Zamboni, 2008: 534). Once the interaction between current rules and the choices relating to codetermination is better understood, and possible future permutations identified, the effect is often that the possible alternatives for reform become more readily apparent (Deakin and Carvalho, 2010).

Thus the methodology of reflexive law focuses on understanding the complex interactions between the legislative framework, the decisions made by firms, and the ownership patterns across different member states, without attempting to prescribe the direction in which these interactions should develop or the outcomes which should be produced. This approach is critical if new ground is to be broken in the codetermination debates, which are currently in danger of stagnating on the question of whether codetermined firms are more or less efficient than firms which are exclusively shareholder-owned. It will be seen later in this article that the absence of conclusive empirical evidence on the efficiency question means that the codetermination debate still relies heavily on 'the same more-or-less well-informed speculation as in the 1970s' (Hopt, 1994: 210). 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.

4.7 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, chaotic (Roe, 1996) 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. 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 and thus difficult to identify, the potential for misinterpretation or simply overlooking relevant 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.

Zumbansen (2006) notes that the risk of the host jurisdiction having an unforeseen adverse reaction to norms borrowed from another jurisdiction is not mitigated by presenting the parties with a menu of non-mandatory options. Even though codetermination under the SE is designed to be optional and flexible, owing to the embeddedness of codetermination within the wider legal, cultural and political framework it may nevertheless have 'possibly severe repercussions in the receiving legal culture' with 'unpredictable effects or even serious irritations in the receiving specific disciplinary or doctrinal area' (at 548). 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. 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.

5. 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 (1996) points out, its greatest virtue is also its critical handicap. 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 before moving on to the discussion of EU policy to summarize some of the most influential efficiency arguments.

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 (Teubner, 1994; Wedderburn, 2002). It 'legally 'entrenches' employees in the firm, helping them protect their interests against potential opportunistic behaviour of shareholders'and especially to protect their firm-specific human capital investments which may be of irreplaceable value to themselves as well as to the firm; 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 (Gorton and Schmid, 2000: 6). Codetermination has other positive externalities such as social welfare gains, industrial peace and even political stability. The sum of this, as recognized by the principle of 'enlightened shareholder value' which underlies the UK's statement of directors' duties in the Companies Act 2006, is ultimately to promote the success of the firm by increasing its efficiency, productivity and competitiveness (FitzRoy and Kraft, 2005; Sadowski et al, 2000; Renaud, 2006). The overall appeal of codetermination may be illustrated by the fact that several EU member states have legislation providing for varying degrees of codetermination.[21] Many listed companies in the Netherlands, for example, opt for a two-tier board structure even when it is not mandated.

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' (2000: 864). 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' (Windbichler, 2005: 520, 521). German corporations are said to simply work around the codetermination legislation, tolerating rather than valuing it (Hansmann and Kraakman, 2004; Lane, 2003).

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' (Bermig and Frick, 2010). 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 codetermination and company performance' (Baums, 2003: 185). 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 (Windbichler, 2005: 509, 510).

The debate as to whether codetermined firms succeed *because* of codetermination, or *in spite of* it, therefore remains open. But it is clear that co-determination continues to evolve, and it is therefore important to understand emerging patterns in its adoption in European firms.

6. The Policy Debate

Firms' reincorporation choices are influenced (though not necessarily determined) by the legislative framework; the legislative framework in turn reflects very strongly the underlying policy priorities of the EU. The legislative history of the Directive makes it abundantly clear that its overriding policy goal is to protect and entrench employee participation. At the same time, the policy goal of the Statute is to facilitate reincorporation wherever desired; given that employee participation is thought to carry significant costs it would seem rational for firms to escape through reincorporation. The critical question then arises of how the overall effectiveness of the regulatory framework of the SE measures up against these divergent policy goals.

This regulatory tension is rooted 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 (Deakin, 2009). This is reflected in the emphasis of the Statute on 'creating a uniform legal framework' and the desire by the Directive 'to promote the social objectives of the Community' (Recitals 2 and 3). European corporate law is concerned with flexibility and competitiveness, focusing on hard-law legislative and judicial principles promoting harmonisation, freedom of establishment, and the free movement of capital across borders. Hence the European Commission's policy statements on corporate restructuring 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, upholding a labour-oriented model of corporate governance as an aspirational standard. This is promoted as a core, indeed unique, characteristic 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' participation on management or supervisory boards becomes standard practice' across the EU (Simons and Kluge, 2004:4).

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 (Hall and Soskice, 2001).

The main concern of social policy in a flexicurity framework 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. This includes directives on redundancies, transfers of undertakings, insolvency, mergers and takeovers; a general framework for employee participation is provided in directives on information and consultation of employees and Works Councils for firms with cross-border operations.[22] The provisions in these legislative instruments range from a simple duty to give relevant information to employees at one of the spectrum to the reservation of a proportion of seats for employee representatives on the board of directors 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 (Zumbansen, 2006: 549). 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. This allows corporate law to influence, and be 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 leaves room for a variety of historical and cultural traditions to influence the way different states organize their large firms. 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 of the firm, 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 as a difference of degree or approach. After all most jurisdictions, and arguably all

European jurisdictions including the UK, 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.

Managerial prerogative is certainly likely to be much more qualified when employee involvement is part of the structure of the firm, than when it exists in external organizations that are entirely separate from the firm. But the crucial question is not whether employment protection qualifies managerial autonomy. The important issue is whether this qualification affects the underlying normative ideology of the firm's governance, extending to the central questions of decision-making and control of the firm. As Bratton and McCahery (1999) put it, this is in turn determined by the 'interdependencies' between the framework of corporate law and the organized workforce. 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 (Roe, 2003). Shareholder value in that case is not inherently or automatically considered by the firm's directors to be more compelling than employment protection when they make decisions about corporate restructuring.

7. 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 … (Roe, 2004: 253).

What role will codetermination play in the future of the SE? The commitment of European policy-makers to preserving codetermination is undiminished. This may partly be explained by the efficiency benefits of codetermination and the tangible positive effects on employment protection. At the same time, it is undoubtedly also an emanation of path dependence in the course of market evolution; McCahery and Vermeulen (2008) find evidence that strong path dependence linked largely to employee participation has contributed to a 'non-mobility equilibrium' in Europe, where despite judicial efforts to encourage a US-style market for incorporations, the expected degree of corporate mobility has not yet materialised.

The approach of the SE Statute and Directive, understood within a reflexive law framework, seems more promising. The SE framework leaves room for codetermination to evolve by allowing firms to opt in or out of it. Such evolution is necessary for the institution of codetermination to survive. At the same time it is vital that reflexive law allows this evolution to be steered or channelled by the Directive in ways that discourage expropriation of acquired ownership rights on the part of the two major stakeholders in the firm, shareholders and employees. This is done by requiring negotiation and agreement between both stakeholders, with standard rules taking effect in default of agreement. This steering process is important because the future evolution of codetermination may have far-reaching potential effects outside corporate law, as the ability to escape obligations to employees by reincorporation in a different member state would render meaningless the territoriality principle of labour law rights and social policy more generally (Deakin, 2009). Yet the aims of forging a common market, corporate mobility and freedom of establishment are equally compelling, making necessary the self-regulatory emphasis of the steering process.

This article has highlighted some of the ways in which the legislative attempt to give effect to these ambivalent and sometimes contradictory concerns may affect codetermination in the SE. In a framework of reflexive harmonisation the outcomes of experimentation within this legal framework are open-ended: the potential for the law to facilitate escape operates alongside the potential to export codetermination to countries where it is not currently established. Both the ‘no escape’ and the ‘no export’ provisions may have unpredictable effects. Either way, it is clear that the effects on codetermination will continue to play an important role in shaping the evolving ownership and control structures of European firms.

Notes

[1] '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' (Harris, 1996: 5).

[2] The term 'patron' is used by Hansmann (1996), who defines the firm's owners as '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'(at 11). For use of the term 'stakeholder' see Njoya (2007).

[3] Coase (1937): 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. See also Parkinson (2003).

[4] '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 who relationship is one of ownership, but obtains its capital and other supplies, and sells its products, through market contracting' (Hansmann, 1996 at 20). See also Armour, Hansmann and Kraakman (2009: 15-16).

[5] 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

[6] Kluge (2010) 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'.

[7] 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 (Cheffins, 2008).

[8] Note that Becht et al (2008) find that 'legal uncertainty, language and stronger enforcement of disclosure standards do not appear to be barriers to foreign incorporations' in the context of 'small entrepreneurial firms'. They find that these factors do not outweigh the positive reincorporation drivers for *Centros* relocations.

[9] Note however that the evidence regarding employee representation on the supervisory board of the SE 'before and after' is incomplete.

[10] *Centros Ltd* v. *Erhvervs* (Case C-212/97) [1999] ECR I-1459.

[11] 'Several companies, especially in the Mittelstand (small and medium sized companies) …are keen to become a plc rather than an Aktiengesellschaft (AG) to avoid falling under Mitbestimmung rules, as they grow' (Wiesmann, 2006).

[12] 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

[13] 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'.

[14] 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.'

[15] Though it is not always straightforward in relation to corporate restructuring to distinguish between supervision and management (Raaijmakers, 2004).

[16] 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.

[17] See Davies (2003: 80), 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'.

[18] Other concerns relate to the fact that the purchaser of a shelf SE need not have cross-border operations, which seems to ignore altogether the stated aims of the Statute.

[19] 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)).

[20] *Kamer van Koophandel* v. *Inspire Art Ltd* (Case C-167/01) ECR I-10155, AG 11.

[21] 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>.

[22] Collective Redundancies Directive 75/129/EEC [1975] OJ L48/29 as amended by Directive 98/59/EC [1998] OJ L225/16; Acquired Rights Directive 77/187/EEC [1977] OJ L61/26 as amended by Directive 2001/23/EC [2001] OJ L225/6; Insolvency Directive 80/987/EEC [1980] OJ L283/23 as amended by Directive 2002/74/EC [2002] OJ L270/10; Cross-Border Mergers Directive 2005/56/EC [2005] OJ L310/1; Takeover Directive 2004/25 EC [2004] OJ L142/12; Information and Consultation Directive 2002/14/EC [2002] OJ L80/29; European Works Councils Directive 94/45/EC [1994] OJ L254/64.

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