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The relative position of employees in the corporate governance context: An international comparison

Andrew Clarke*

This article examines the situation of employees within the existing and emerging corporate governance paradigms in five countries, namely Australia, the United Kingdom, the United States, Germany and Japan. The countries chosen represent a counterpoint to the Australian position, and their governance arrangements as regards employees can provide a source of innovation for the development of Australia's provision. The United Kingdom and United States, given their historical and political ties to Australia, represent examples of governance systems that have borne, and continue to bear, influence. In this respect, they have an enduring importance to the Australian corporate landscape in much the same way as aspects of the United States and United Kingdom constitutional arrangements came to be embedded in the Australian political settlement and resultant Constitution. Germany is an example of a radically different conception of the corporate structure and of the active role played by employees. Japan's system represents an amalgam of influences which are of note, particularly due to Australia's close trading relationship and the fact that Japan may point the way in terms of emerging governance trends in the Asian region.

This article will briefly critique the key features of the systems of the five countries and concludes that, as with other critical governance issues, the issue of employee involvement is evolving as national systems search for the elusive concept of "best practice". This aim is made all the more critical by the challenges of the "turbo-charged twenty-first century economy" where "change has become the steady state" (Stace D and Dunphy D, Beyond the Boundaries: Leading and Creating the Successful Enterprise (2nd ed, McGraw Hill, Sydney, 2001) p ix). This article will suggest in Australia's case, that its lack of engagement with employees as part of its corporate governance arrangement is out of alignment with other systems. This gap, rather than being merely disconcerting, provides scope for the improvement and enriching of Australia's provision in this area. Given the severity of recent corporate collapses and their profound effect on employees, this issue looks to be a central one in the forthcoming decade. The article will conclude by suggesting how the Australian corporate governance arrangement in the area of employee provision may be better shaped to meet the needs of contemporary commerce and society.

1. INTRODUCTORY ISSUES

There are two important factors to bear in mind when examining the corporate governance provisions of a particular country. A primary, amorphous set of influences is the fact that the underlying cultural, economic and political values relevant to each country play a vital role in the emergent legal arrangement. At a basic level, research has been conducted to illustrate how national cultural

* B Juris, LLB (UWA), LLM (Bristol), MPET (Deakin), Senior Lecturer, School of Law, UNE. This article arises from SJD studies at Bond University under the supervision of Professor John Farrar.

arrangements, in particular, impact on how business is conducted.[1] In the governance context, Jonathon Charkham has noted that:

> no system [of corporate governance] … can be understood without first looking at the salient features of the particular society in which it developed. Everyone is to some extent imprisoned by their history, social, political, and economic.[2]

This article will therefore proceed, where apt, to briefly review some of these deeper forces pertinent to particular corporate governance systems. A second, and more precise influence is the role played by, and the basic conception of, the "company". The operating model adopted will be critically informative of broader corporate governance provisions. We will now examine this issue in more detail.

Identifying basic conceptions of the corporation

The nominated countries, whilst all first world economies, provide for quite differing conceptions of the employee's role within the corporate governance concept. The origins of this different treatment lie in the broadly divergent models of the company deployed within national systems. The company may be viewed as a shareholder-focused entity, or as an entity with a wider array of interests to be met. If it is viewed as a shareholder-focused vehicle, it is likely that employees will play little or no part in the corporate governance of the corporation. If, on the other hand, it is seen as a broader-based entity, it is likely that employees will be central to a range of corporate governance arrangements.

Debate about the role and purpose of the corporation has been part of both academic and applied debate for a substantial period of the 20th century. In the early 1930s, a series of three articles published in the United States by Professors Berle and Dodd set out the basic dichotomy between the shareholder-focused model and the broader conception of the corporation.[3] These articles marked the first "great acclaim" of the corporate governance concept.[4] Critically, their debate allows us to calibrate the various national systems as operating on a spectrum between the two models.

Professor Berle's article was first in time. His thesis was that "all powers granted to a corporation or the management of a corporation … are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interests appear".[5] The problem for Berle was that the use of this power is subject to the vagaries of equitable limitation. This tension between the competing notions of power on the one hand, and its proper exercise on the other, meant that the issue had great practical importance. He noted that the question is not merely academic because it could "give greater flexibility to corporate management in certain respects".[6] Berle's solution to the manager's dilemma was to suggest "that managerial powers are held in trust for stockholders as sole beneficiaries of the corporate enterprise".[7] Professor Berle "adopted a classic shareholder-centred model of fiduciary duties, in which profit maximization for shareholders was to be the guiding principle for directors".[8] Under this model of the corporation, employees had little or no formal role in the corporate governance framework.

Professor Berle's thesis generated debate about the basic role and nature of the modern corporation. A year after his paper appeared, Professor Dodd wrote in response in the next volume of

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[1] Trompenaars F, *Riding the Waves of Culture* (2nd ed, McGraw Hill, New York, 1998) p 4. Studies by Trompenaars have revealed the extent of the differences in societies in terms of key business indices such as risk assessment, relationships within the firm and other essential traits of business practices.

[2] Charkham J, *Keeping Good Governance: A Study of Corporate Governance in Five Countries* (Oxford University Press, Oxford, 1994) p 1.

[3] The three articles are Berle A, "Corporate Powers as Powers in Trust" (1931) 44 Harv L Rev 1049; Dodd E, "For Whom are Corporate Managers Trustees?" (1932) 45 Harv L Rev 1145; and Berle A, "For Whom Corporate Managers are Trustees: A Note" (1932) 45 Harv L Rev 1365.

[4] Pistor K, "Co-determination: A Sociopolitical Model with Governance Externalities" in Blair M and Roe M (eds), *Employees and Corporate Governance* (The Brookings Institution, Washington, 1999) p 164.

[5] Berle A, "Corporate Powers as Powers in Trust" (1931) 44 Harv L Rev 1049.

[6] Berle, n 5 at 1049.

[7] Dodd E, "For Whom are Corporate Managers Trustees?" (1932) 45 Harv L Rev 1145 at 1147.

[8] Hill J, "Corporate Governance and the Role of the Employee" in Gollan P and Patmore G (eds), *Partnership at Work: The Challenge of Employee Democracy* (Pluto Press, Sydney, 2002) p 114.

the *Harvard Law Review*. Whilst Professor Dodd was "thoroughly in sympathy"[9] with some of the technical suggestions made by Berle, he disagreed as to the fundamental conception of the company as a shareholder-driven entity. He highlighted the limitations of management focusing on shareholders by examining the use of property exercised by corporations. He noted that "property employed in certain kinds of business is devoted to public use while property employed in other kinds of business remains strictly private".[10] He went on to state that "it may well be that the law is approaching a point of view which will regard all business as affected with a public interest".[11] Dodd espoused a view that company directors are "guardians of all the interests which the corporation affects and not merely servants of its absentee owners",[12] ie, the shareholders. He believed it to be undesirable "to give increased emphasis at the present time to the view that business corporations exist for the sole purpose of making profits for their stockholders".[13] Dodd "suggested that directors held their fiduciary powers in trust, not only for shareholders, but for a broader constituency associated with the organization, including employees, creditors and consumers".[14] Dodd concluded that "public opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as a profit-making function".[15]

Berle's model of the corporation as shareholder-driven and as governed by private law principles is in sharp contrast to the more complex, broad stakeholder, public law model favoured by Dodd. Whereas Berle's model provides no formal place for employee involvement in governance arrangements, Dodd's model foreshadowed the increasing importance of employee participation in the governance of companies. Indeed, Dodd noted that "there is a widespread and growing feeling that industry owes to its employees not merely the negative duties of refraining from overworking or injuring them, but the affirmative duty of providing them so far as possible with economic security".[16] Such a statement, now some 70 years old, is disconcertingly prescient, given the recent corporate collapses resulting in the loss of many jobs and the accompanying employee entitlements.[17]

Corporate models and employee provision

The basic differences in the conception of the company highlighted by Berle and Dodd provide an organising mechanism for corporate governance arrangements. At one end of the spectrum is the de minimis, shareholder-focused model and at the other, the more complex, hybrid model asserted by Dodd. Though their debate was about United States corporations and took place more than 70 years ago, it remains highly pertinent for other countries and other corporate contexts.[18] It also serves to highlight the basic models of corporate governance provision for employees.

The Berle model and the "non-recognition" of employees

At one end of the spectrum, the role of employees may not be formally recognised in statute or in other formal sources of law. This model is based on the precepts set out in Professor Berle's first article outlined above. It focuses on the absent owners of the company, namely the shareholders. Given its focus on shareholders, it essentially blocks employees and others from a participatory role in the basic conception of the corporation. It provides a rational, linear operational model of the corporation. As a result, it requires precise legislative and other rules to cater for employees and stakeholder groups beyond the defined remit of the shareholders.

[9] Dodd, n 7 at 1147.
[10] Dodd, n 7 at 1149.
[11] Dodd, n 7 at 1149.
[12] Dodd, n 7 at1157.
[13] Dodd, n 7 at 1148.
[14] Hill, n 8, p 114.
[15] Dodd n 7 at 1148.
[16] Dodd n 7 at 1151.
[17] Hill, n 8, p 118.
[18] See, eg, Parkinson J, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford University Press, Oxford, 1993).

The Dodd model extrapolated: The formal recognition of employees

At the other end of the spectrum, employees may be formally recognised and accepted as integral players in the corporate governance paradigm. This "formal recognition" model foregrounds the role and interests of employees. It is predicated on the broader, more complex notion of the corporation espoused by Professor Dodd referred to above. Under this public law, community-focused model, the board of directors is required to pay attention to the needs and collective welfare of the employee group. Indeed, in the case of German corporate governance, employees actually assume guaranteed positions on the supervisory board under their two-tiered system board arrangement.

Placing corporate governance models on the spectrum

In terms of the five countries to be examined, Australia is most closely associated with the "non-recognition" model, whereas Germany (and Japan to a degree) formally recognise and account for the roles played by employees. The United States and the United Kingdom approaches to employees and corporate governance provision sit somewhere between the two divergent models. This article will, in effect, move across the spectrum, dealing first with non-recognition systems and moving to systems displaying formal recognition features. Given this approach, we start be examining the corporate governance system in Australia.

2. AUSTRALIAN EMPLOYEES AND CORPORATE GOVERNANCE

The continuing paradox: The non-recognition of employees in Australian corporate law

In essence, Australia has adopted a "narrow legal perspective"[19] to its corporate governance debate and formulation. This encapsulates both "hard" and "soft" law[20] such that it is dominated by broadly legal concerns, even when the aim has been to widen the debate, especially in light of the corporate scandals of recent years. This has meant that the Berle shareholder focused model has predominated and, as a corollary, less attention has been paid to the interests of employees. Two recent examples of this essentially legal bias are the ASX Corporate Governance Council's *Principles of good corporate governance and best practice recommendations* and CLERP 9. The ASX document "articulates 10 core principles that the ASX Corporate Governance Council believes underlie good corporate governance".[21] The ASX Principles focus primarily on the relationship between the board and shareholders and make little reference to employees. ASX Principle Two, for example, is titled "Structure the board to add value". It provides in part:

> Stakeholder Perspectives
>
> An important function of directors is to bring the perspective of stakeholders to the oversight of a company. ASX directors bring many perspectives to the Board's deliberations including those of customers such as listed companies and participating organisations, members of the broader investment community such as fund managers and regulators, service providers such as lawyers and accountants and the views and interests of employees.

The order of this list is instructive. Employees are mentioned last after service providers. It reflects the fact that employees are not first priority stakeholders. It is consistent with the larger pattern of Australian company law that treats employees "as corporate 'outsiders', unlike shareholders, directors and others who are regarded as 'insiders' with all the benefits attached to that status".[22]

The focus of CLERP 9 is auditor independence and remedial practices to seek to ensure that there is no repeat of home-grown sagas, HIH or One.Tel, or the United States versions, Enron and Worldcom. Both CLERP 9 and the ASX Principles add a further layer of rules and compliance to the

[19] Farrar J, *Corporate Governance in Australia and New Zealand* (Oxford University Press, Melbourne, 2001) p viii.
[20] Farrar, n 19, pp 4-5.
[21] http://asx.com.au/shareholder/CorporateGovernancePractices_as2.shtm
[22] Forsyth A, "Corporate Collapses and Employees' Right to Know: An Issue for Corporate Law or Labour Law?" (2003) 31 ABLR 81 at 83.

already crowded corporate domain. They buttress the hegemony in Australia of the Berle-inspired, shareholder-first model. The essential point is that shareholders in Australian companies have by a process of slippage assumed their interests as concordant with the company. This is in line with "the traditional approach of Anglo Australian Corporate Law" which is one "of persistent equivocation between treating the corporation as a separate legal person and equation of the corporation with its shareholders".[23] The outcome of this chain of logic is that the corporate governance term "stakeholder" has been largely synonymous with the corporate law term "shareholder".

This methodology has also proved to be a very effective device for sidelining the voice and interests of employees. For example, there is no *mainstream* or central provision for the protection of employee interests in the Australian corporations law. Employees only assume interests in worst case scenarios such as windings-up and the like, for example, if their wages and other contractual entitlements are construed as preferred debts.[24] The protection of entitlements, even on this basis, only dates back to 30 June 2000 as the result of the enactment of the *Corporations Law Amendment (Employee Entitlements) Act* (the Act). The Act was designed as a corrective "to improve the law's protection of the entitlements of failed companies"[25] and to salvage a public relations disaster for the Federal Government in light of National Textiles and other high profile corporate collapses. It "inserted a new Part 5.8A into the corporations legislation and was specifically aimed at protecting workers left with unpaid entitlements following corporate collapse".[26]

The central thrust of the Act is "to make company directors, among others, personally liable to compensate employees, if the directors enter into agreements or transactions with the intention of defeating employee entitlements".[27] The problem with the Act is that it affords broad scope to directors to defend claims. As Jennifer Hill notes, "corporate flexibility, however, presents a potential problem to the effectiveness of Part 5.8A, since the focus on 'intention' raises the possibility that directors will argue successfully that the agreement or transaction was simply motivated by ordinary commercial factors".[28] As a result, she concludes that "this will inevitably limit its scope and effectiveness as a protective mechanism for employees".[29] Given these practical limitations, the Act is hardly revolutionary law. The right to secure one's employee entitlements will often be "protracted" as in the case of the 1,700 One-Tel employees who eventually "won entitlements worth $19 million".[30] Similarly, 3,000 employees were affected by the HIH collapse; it is little wonder that the new provisions of the corporations law offer scant comfort to Australian employees.

The incongruity of this situation in the contemporary work setting has been subject to critique.[31] The lack of rights afforded employees and the resulting silence effectively imposed on employees in terms of their workplace role has profound repercussions; how can they, for instance, be regarded as "industrial citizens" when they "have no right to elect a consultative body to participate in workplace governance"?[32] There has been a "failure of existing corporate law arrangements to recognise the value of the contribution that workers make to the firm, their investment of 'human capital', and the risks that they take on".[33]

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[23] Farrar J, "Frankenstein Incorporated or a Fools' Parliament? Revisiting the Concept of a Corporation on Corporate Governance" (1998) 10 Bond LR 142 at 143.
[24] See ss 588G-588M *Corporations Act 2001*; Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (11th ed, Butterworths, Sydney, 2003) pp 888-889.
[25] Ford et al, n 24, p 888.
[26] Noakes D, "Recovering Employee Entitlements and Uncommercial Transactions in Insolvency" (2000) 1 *Insolvency Bulletin* 20.
[27] Hill, n 8, p 118.
[28] Hill, n 8, pp 118-119.
[29] Hill, n 8, p 119.
[30] White A, "Flow on Effects of Recent Collapses" in *Collapse Incorporated: Tales, Safeguards and Responsibilities of Corporate Australia* (CCH Australia Limited, Sydney, 2001) p 51.
[31] Combet G, "Employee Consultation in an Australian Context: The Works Council Debate and Trade Unions" in Gollan P and Patmore G (eds), *Partnership at Work: The Challenge of Employee Democracy, Labor Essays 2003* (Pluto Press, Melbourne, 2003) p 134.
[32] Combet, n 31, p 134.
[33] Forsyth, n 22 at 87.

The approach to Australian corporations law development has been subject to criticism. For example, the current laws have been described as:

> too cumbersome, having been added to year after year by amendments which make it more and more difficult to discern a clear message underpinning the legislation, and to provide a clear message to the courts in deciding cases that are brought before them.[34]

The Australian legal position largely ignores the rights, interests and welfare of company employees. This situation can be characterised as unfair. The prism of unfairness can be seen to have several aspects, including the following arguments:

- It is inconsistent with the tenor of Australian workplace and social history; in this respect, the non-recognition of employees remains a paradox in this country.
- It represents an anomaly of comparative law in the age of globalisation.
- It is out of step with contemporary management theory and practice. It means that the law in this regard lags behind management and social theory, as regards the pivotal importance of employees within organisations.

These aspects will now be examined in more detail.

Historical paradigms

For Australian corporate law purposes, the phrase "the best interests of the company" has a simple, distinct and one-dimensional meaning. It translates as being for the best interests of the shareholders. This, in turn, is about what is best for the share price and dividends. Is the company making money and is it returning it to the owners who had the faith to invest in the enterprise? This approach is logical, scientific and commendable to corporate positivists, but it has not always been thus. It is out of step with our national "history" in several respects, including Australia's legal heritage. For example, early High Court cases stressed the underlying social credentials of firms.[35] As Griffiths CJ noted in 1912 in *Miles v Sydney Meat Preserving Co Ltd* (1913) 16 CLR 50 at 66:

> the law does not require … the members of a company … to maintain the character of the company as a soulless and bowelless thing, or to exact the last farthing in its commercial dealing or forbid them (the members) to carry on its operations in a way they think conducive to the best interests of the community as a whole.

Not only has modern corporate jurisprudence moved well away from this model, but additionally, this type of judicial sentiment would appear almost revolutionary in the current climate with its stress on competitiveness, market forces and the other elements of an economic rationalist paradigm.

The contemporary incongruity of Griffiths CJ's observation is, however, lamentable on other historical bases. It reveals the lack of progress made in Australia as regards the evolution of companies. This is particularly paradoxical in a country that for a good part of the 20th century led the world in terms of important social and political reform. The minimum wage, pensions, welfare reform and universal franchise were Australian innovations of the early 20th century[36] that have since been adopted around the world. Given that rich social history, the modern model of the Australian corporation without a place for employees as protectable per se is an anachronism. It is discordant with a country where employees' basic rights were given priority, and which has promoted to the point of national legend, wider social and historical legacies such as the values of mateship, egalitarianism and the "fair go". Are these tangible reflections of the workplace or mere slogans rendered meaningless by Australia's corporations law? In the face of the absence of the formal place for employees in the company context, they mean little. There is an incongruous gap between that rich social history and the thin philosophical gruel of our current corporate governance arrangement. It is essentially a myopic legal view frozen in an age of steam trains and symptomatic of an era when companies were wedded to their own tailor-made Act of Parliament. In this sense, the lack of

[34] Baxt R, "The Necessity for Appropriate Reform" in *Collapse Incorporated*, n 30, p 329.
[35] Farrar, n 23 at 162.
[36] Ward R, *A Nation for a Continent: The History of Australia 1901-1975* (Heinemann Educational Australia, Melbourne, 1977).

provision for employees in the Australian corporate governance arrangement actually works against Charkham's observation that the emergent governance arrangements are a reflection of deeper forces at play.[37]

An anomaly by way of comparative law

The emerging globalised economy is marked by intense competitiveness as firms search for new markets and news ways of remaining both competitive and profitable.[38] The nature of work and of the firm's role in society have changed as knowledge and service industries have risen at the expense of traditional manufacturing and Fordist means of production. We now have a mixed economy with post-Sony, high-tech corporations sitting alongside pre-Fordist, low-tech firms. The thesis of United Kingdom management writer, Charles Handy, is that companies in the "knowledge economy"[39] or "information age",[40] will have to treat their staff more like citizens, rather than employees.[41] The Dutch management theorist, Arie de Geus, argues that "knowledge organisations" of the future will be best served by linking work and ownership more closely.[42] In the United States there are echoes of the same sentiment; with the former CEO of General Electric, Jack Welch, opining that: "employees seem to rise to new heights of creativity and passion to close deals, to improve product and to recruit new star employees … Employees won't think and act like owners, unless you make them owners."[43]

These views have shaped corporate governance systems elsewhere. The promotion of employee rights, for example, has been a key plank of European economic and political integration. According to the management literature, valuing employees has a tangible effect on competitiveness.[44] A growing trend in Europe is for employees to assume positions, which for common law lawyers at least, make them more akin to owners. This is particularly true in Germany's case discussed in Part 5 below.

As a result, Australia is increasingly isolated in terms of the paucity of its schemes of employee recognition. The little law there is to assist employees is out of touch with the emerging "knowledge economy". It is creating an unwieldy gap. As globalisation intensifies, and national systems come under greater scrutiny in a competitive environment, the fundamental differences between the Australian governance regime and other systems of governance will become more marked.

Out of step with management theory and practice

The lack of employee recognition in Australian governance contrasts with the array of emerging management theory that is mutating and evolving alongside larger economic and social forces. This larger project is a Western world, if not global, phenomenon.

Modern theories of management and human resource development (formerly often described as 'personnel management') demand that employees be treated as the most valuable asset of the organisation. Critically important theories developed in the 1980s and 1990s such as the learning organisation and total quality management have revolutionised the role of management and the relationship between the managers and the employees. Other management innovations, which include double loop learning,[45] for example, which is a variant of the learning organisation, have allowed companies to experiment and then learn from their first efforts. These changes, in essence, have

[37] Charkham, n 2.
[38] Albrow M, *The Global Age* (Polity Press, Cambridge, 1996).
[39] As quoted in Davidson P and Griffin RW, *Management: Australia in a Global Context* (John Wiley and Son, Milton, 2000) p 420.
[40] Walker G and Fox M, "Globalisation: Meanings and Implications" in Fisse B and Walker G (eds), *Securities Regulation in Australia and New Zealand* (Oxford University Press, Oxford, 1994) p 389.
[41] Davidson and Griffin, n 39, p 420.
[42] Davidson and Griffin, n 39, p 420.
[43] Davidson and Griffin, n 39, p 420.
[44] See, for example, Senge PM, *The Fifth Discipline: The Art and Practice of the Learning Organization* (Doubleday/Currency, New York, 1990).
[45] Bolman LG and Deal TE, *Reframing Organizations: Artistry, Choice and Leadership* (2nd ed, Jossey-Bass, San Francisco, 1996).

placed employees at the apex of the organisation. Organisation theory has evolved at a rapid pace in the last 20 years and continues to do so.

Perhaps the most significant change has been the mapping of the various perspectives or frames available to management in terms of how they perceive and operate an organisation. Lee Bolman and Terrence Deal developed four frames in their seminal work, *Reframing Organizations: Artistry, Choice and Leadership*.[46] These frames are human resources, political, cultural/symbolic and structural. In particular, the human resources frame has led to the empowerment and enrichment of the employee's role. The human resource frame also refers to issues such as the ongoing training and development of each individual within the firm.

Organisation theory has allowed management, at both a theoretical and practical level, to recognise that employees are critical to the success of the firm. Their health, happiness and motivation are vital to the company's ability to first survive and then prosper. They drive the profits and power the revenues. Diversity programs are now part of the organisational landscape – that is, the workforce and its heterogeneous qualities are recognised. Management theory moves on in exciting ways as it borrows and adapts ideas from around the world. It is open to best practice as it seeks to reflect what firms do and how they are enriched and propelled by people or human capital. For example, total quality management (TQM) arose out of Japan and "swept across corporate America in the 1980s".[47] The leaders of TQM "differed on specifics, but all emphasized workforce involvement, participation, and teambuilding as essential components of a serious quality effort".[48] TQM was a theory "consistent on the whole with existing research on effective human resource management".[49]

Despite the possibilities provided by such theories, and the fact that there has been an immense amount of new legislation as regards companies, the simplest of problems and the most obvious of gaps in the whole scheme – the absence of employee rights – remains. It is, and has stubbornly remained, an anachronistic still-point. Australia with its heavy reliance on shareholder-focus has been aligned with Milton Friedman's economic rationalism model that places considerations of the share price above other corporate considerations. Within this paradigm, costs embedded in employee numbers are more likely to be viewed as "soft" costs and more easily reduced than other costs. Employees can be shed from the company's books with little by way of legal consequence, except in the instance of a liquidity situation. This can be done without any impact on the test of whether it is in the company's best interests because of its one-dimensional definition. The fact of the employment function and its quality and scope – its immense human capital value – are critically ignored.

In summary, the non-recognition of employees in Australia's corporate governance framework is out of step with larger economic, social and managerial forces. These forces take a holistic view of the company, whereas the law struggles to escape an essentially 19th century mind-set. We can conclude that the end result is one of inefficiency both at an economic and human level. The law is working against management theory. There is a tension between the two, which means that effort is being wasted. The approaches of the law and management theory need to be synchronised. They need to move in the same direction, rather than dissipate their efforts.

Some preliminary conclusions on Australia's corporate governance system vis-à-vis employees

The current profile for employees in Australian corporate governance represents a narrow de minimis model. The complex emerging system of governance heavily promotes the interests of shareholders at the expense of other stakeholders. This Berle-inspired model provides for a simple operating system for directors. It equates sound corporate performance with robust shareholder valuation. It assumes that if this central mission of solid share price and content stockholders is achieved, then the interests of other stakeholders will be accounted for. The value of this system is its simplicity and correlative efficiency. Its potential downside is that it is too shareholder-centric and, in being so, ignores other

[46] Bolman and Deal, n 45.
[47] Bolman and Deal, n 45, p 134.
[48] Bolman and Deal, n 45, p 134.
[49] Bolman and Deal, n 45, p 134.

interests increasingly relevant to a 21st century corporation. It provides a single focus to the bottom line, as opposed, for example, to the triple bottom line approach.

The central challenge for the development of corporate governance in Australia is for the debate to be widened, and thereby strengthened, beyond the realms of a rule-based, technical, top-down approach. This is vital because of the growing importance of corporate governance contexts. The lawmakers have, however, dominated the governance domain in Australia to date and yet the fundamental point is that "corporate governance is too important a subject to be left to the lawyers".[50]

We will now look beyond Australia's legal shores to begin mapping out a profile for employees which might be regarded as more concordant with the evolving set of 21st century corporate and social values.

3. THE UNITED KINGDOM POSITION IN RELATION TO EMPLOYEES

Contextual issues in the United Kingdom debate

Whereas Australia's employee provisions are anachronistic, the United Kingdom is forced to face the future. Its future is the EU. The EU, through legal and social reform, is leading the way with a socially constructed view of corporations and the incremental development of a model that foregrounds the role of employees as assets of the corporation. As such, they are stakeholders with a formal part to play in key managerial decisions. This involvement necessitates a dialogue with the more complex, hybrid model of the corporation asserted by Dodd with its array of stakeholders and its early conception of an emergent form of social responsibility. This engagement has created a certain tension in the United Kingdom because whilst "the European Union has long had proposals for greater work participation in corporate governance" for employees "so far this has been resisted by the UK".[51] We will return to these broader concepts of employee participation in the review of German corporate governance provisions for employees. For the moment we can briefly review a specific United Kingdom provision that highlights the gap between the Australian position of mainstream non-recognition of employees.

Section 309, the Companies Act 1985 (UK)

In addition to the board having to consider "the interests of the employees in a redundancy situation",[52] the United Kingdom legislation provides what we can characterise as a mainstream provision dealing with the interests of employees. As such, it has the potential, at least, to operate throughout the trading life of the company, rather than merely as a corrective at its end, as in the case of the Australian insolvency provisions. Section 309 of the *Companies Act 1985* provides as follows:

> Section 309(1)
>
> [Interest in company's employees in general]
>
> The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.

There is no equivalent to s 309(1) in Australian corporate law. United Kingdom company law actually provides that the interests of employees are a formal part of the content of the director's duty of care. The characterisation of s 309(1) is critical. It is a mainstream, rather than speculative or secondary right conferred on employees. It appears to lie at the centre of the day-to-day operation of the company. United Kingdom commentators, however, have not been overly enthusiastic about the practical effect of s 309. They argue that there are several reasons for this. These include:

- the fact that the provision is open to more than one interpretation;
- that its chief outcome is to provide a defence for directors; and

[50] Farrar, n 19, p viii.
[51] Farrar J and Hannigan BM, *Farrar's Company Law* (4th ed, Butterworths, London, 1998) p 302.
[52] Farrar and Hannigan, n 51, p 302.

- that given the inherent laxity in United Kingdom corporate law compliance, there is an endemic culture of such provisions having little practical effect.

These reasons will be examined in more detail.

The claims of s 309 are more modest than they first appear. It has been argued that "this measure is unlikely to have a significant impact on how companies are run and its wording is an important reason why".[53] Likewise it has been concluded that "despite its mandatory language to give the directors a *discretion* to act in the interests of the employees where they consider it appropriate in preference to those of the shareholders, they do not have a practicably enforceable obligation to further employee interests".[54]

Whilst employees and shareholders may "share a community of interests" they will also have conflicts of interests,[55] so that the company cannot be run by reference to shareholders and employees as "joint stakeholders".[56] It has been noted that "it would be very difficult to establish that the directors have failed to comply with the section".[57] The section's effect is also proscribed by the fact that "the duty is owed only to the company" so that "enforcement of the duty will be at the discretion of the company".[58] It is "enforceable only at the instance of the shareholders".[59]

The irony of this apparent effort to broaden the scope of relevant stakeholders only serves to reinforce the hegemony of the shareholder group and to stylise the workings of the section within the purview of Professor Berle's shareholder-focused model. The probable effect of s 309 is that it provides a defence for directors "in the event of their making a decision that favours the employees at the shareholders' expense".[60] The employees cannot therefore use s 309 as either a substantive bargaining chip or as a litigation weapon. It is, at best, "a statutory provision without teeth but nevertheless it represents a tentative step towards recognising the employees' role in the enterprise".[61] However, the future of s 309 is not altogether clear, for "an attempt is being made to close even this small window for the recognition of employees under United Kingdom company law".[62] The thrust of the changes would be "to relegate the firm's relationships with employers, along with those with its suppliers and customers, to the status of 'material factors' that directors must consider in fulfilling their primary duty"[63] owed to the company.

Uneasy comparisons: Australian and United Kingdom positions

Whatever the fate of s 309, its existence reveals that the United Kingdom is more reform-minded in this field of the law (another recent example where the United Kingdom leads the way is in the removal of the barrister's immunity in negligence).[64] This is somewhat unsettling for Australian lawyers, for the accepted model of Australian legal history and development has generally been to extend and adapt United Kingdom law. In this sense, United Kingdom law has been viewed as "past" law that allowed for such law to be a starting point for local law. Such law was then to be modernised, improved and adapted for Australian conditions. This approach was given shape by the *Australia Act 1986* that emboldened a distinctive Australian common law. In terms of legislative innovation generally, Australia has prided itself on law reform. And yet on this point, the law of the "mother country" has been clearly in advance of Australian attempts. The irony of this is that despite the flurry of legislative activity in recent years in the field of corporate law with CLERPS 1, 2 and onwards to 9, Australia's law-makers have not advanced the mainstream rights of employees.

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[53] Cheffins B, *Company Law: Theory, Structure and Operation* (Oxford University Press, Oxford, 1997) p 224.
[54] Parkinson, n 18, p 84.
[55] Parkinson, n 18, p 82.
[56] Parkinson, n 18, p 82.
[57] Farrar and Hannigan, n 51, pp 385-386.
[58] Farrar and Hannigan, n 51, p 386.
[59] Forsyth, n 22 at 87.
[60] Parkinson, n 18, p 84.
[61] Farrar and Hannigan, n 51, p 386.
[62] Forsyth, n 22 at 87.
[63] Forsyth, n 22 at 87.
[64] *Arthur JS Hall and Co v Simons* and *Barratt v Ansell* and *Harris v Scholfield Roberts and Hill* [2000] UKHL 38; 3 All ER 673; 3 WLR 543.

The United Kingdom's slow journey towards European integration

As we have seen, the United Kingdom legislation via s 309 of the *Companies Act 1985* makes limited reference to the interests of the employees. It is not likely to end there, however, because as the United Kingdom goes deeper and further into the EU project, as inevitably it must, its espousal of employee interests will become an integral part of that commitment. Whilst the United Kingdom has often shown "a stubborn and ill-founded belief Britain could do without the rest of Europe"[65] that oppositional stand will surely erode as economic integration continues apace. The record so far has been that "failure to realize the necessity of participating in the European Community from the beginning, compounded by indecision and inertia, has kept the UK out of the forum of European decision-making".[66] The choice is clear in the context of employee governance. Does the United Kingdom in the 21st century cling to the past or does it move forward and enlarge the European debate on governance provision for employees?

To date, the United Kingdom has had a "stop start" relationship with EC directives dealing with the recognition of employees' rights. The Bullock Report of 1975 was a pivotal scene setter; ever since that report, "the issue of employee representation on boards has been dead".[67] The Fifth Directive of 1984 (which would make such representation mandatory) "hovered in the wings"[68] for several years. The "early drafts of Fifth Directive owed much to the work of the Germans on the Commission's staff".[69] The "success of German industry and Germany's important role in the Economic Community even before the UK joined meant that German influence was considerable".[70] The Fifth Directive was rejected by the Conservative United Kingdom government led by John Major in 1994 when it opted out of the Social Chapter of the Maastricht Treaty.[71] For those countries that adopted the Social Chapter, "it became compulsory for companies with more than 1,000 workers to have a workers' committee to represent all its European employees".[72]

The EU Social Chapter proposal generated great opposition in the United Kingdom in 1994 and would do so today. In effect, neither side of the political divide in the United Kingdom has seen much mileage in building on the narrow platform of employee interests created by s 309. Were the battle of the models of the corporation to take place exclusively within a domestic United Kingdom setting, the model proposed by Professor Berle would prevail. The countervailing model advanced by Professor Dodd is a concomitant element of more advanced involvement in the EU project and this will involve a fascinating collision of social, legal and supra-national interests in the coming decade.

4. THE UNITED STATES POSITION IN RELATION TO EMPLOYEES

Contextual issues in the United States corporate governance debate

The United States has, as with Australia, a federal mosaic of laws and jurisdictional issues. Whereas Australia federalism has given rise to a national corporations law, and governance arrangement, the United States has operated on a State-by-State basis. Given this system, the United States has produced some "beacon" States with enterprising approaches to governance issues. The best known of these is the State of Delaware.

The United States also has a strong history of individual rights, with the early set of amendments to their Constitution being the most famous examples. This influences the United States experience of the law in general, and of corporate governance in particular. It promotes individual rights over group concerns. It underpins the whole contextual approach to law-making and reform, and fuels, for

[65] Kendall N and Kendall A, *Real-World Corporate Governance: A Programme for Profit-Enhancing Stewardship* (FT Pitman Publishing, London, 1998) p 64.
[66] Kendall and Kendall, n 65, p 64.
[67] Charkham, n 2, p 271.
[68] Charkham, n 2, p 271.
[69] Charkham, n 2, p 279.
[70] Charkham, n 2, p 279.
[71] Kendall and Kendall, n 65, p 64.
[72] Kendall and Kendall, n 65, p 64.

example, such statements as "there is a risk that negotiation or mediation could become merely a means to coerce social harmony at the risk of individual rights or justice".[73]

In the 1930s, Adolphe Berle Jr and Gardiner Means made the "ground-breaking observation … that control of the enterprise had been separated from ownership".[74] Whilst this can be seen as simply offering another version of the principle emergent from *Salomon v Salomon* [1897] AC 22, Berle and Means went on to invest their finding with an early version of social responsibility on the part of the corporation. This "popular wariness of corporations"[75] and the view expressed that as "creatures of the state" they in turn "owe a deep duty to the state".[76] This sentiment represents a watering down of Berle's shareholder-focused model discussed earlier and begins to move it along the spectrum towards the more complex, stakeholder model advocated by Dodd. This view of companies as key components within a public framework may also account for the high degree of corporate gift giving in the United States. United States corporate governance has also encompassed periodic "debate about the proper role of the corporation – does it exist solely to serve the profit motive of shareholders or does it have a broader social purpose?"[77]

The importance of "constituency statutes"

In addition to the social centrality of United States companies, it has been argued that the genius of United States corporate law is its flexibility.[78] For example, whilst there is a general rule that directors must devote appropriate time and energy to fulfilling their roles, the details that underpin this general proposition "will depend on the circumstances of the corporation and of the individual directors and those circumstances will change over time – hence the need to avoid a one-size-fits-all approach".[79] Against this notion of flexibility, the counterargument is that the sheer multiplicity of United States corporate law provides confusion in the marketplace.[80] This is because the provision reflects the complex federal political structure. Whilst there is federal securities regulation, each State is a separate corporate jurisdiction (unlike Australia's de facto federal corporate regime consented to by the States and Territories). This multiplicity of jurisdictions creates certain issues of identification and classification.

In particular, how can we characterise United States corporation law as a single system with so many competing variants? Surveys have identified no less than eight varieties of corporate law and "several stigmatas of laxity".[81] These stigmatas have arisen for various reasons such as the silence of laws on key issues[82] or, in other cases, the multiplicity of interlocking laws that provide too complex a framework for advisers and investors.[83] Nevertheless, the United States corporations law has proved to be a popular rental device for global corporations. This has been a feature of its operation since the 19th century as the States have competed for business and for innovative ways of doing business (as in the concept of the corporate group). The most popular site of registration is the State of Delaware. Another popular variant produced by the Bar Association is the *Model Business Corporations Act* that has been adopted by many States.

The United States federal arrangement has generated its own discourse about how best to provide for its corporate governance arrangement. There has been a deal of debate about the nature and

[73] Nader L, "When is Popular Justice Popular?" in Merry SE and Milner N (eds), *The Possibility of Popular Justice: A Case Study of American Community Justice* (Ann Arbor, University of Michigan Press, 1993) as quoted by Benjamin RD, "Negotiation and Evil: The Sources of Moral and Religious Resistance to the Settlement of Conflicts" (1998) 15 (Spring) *Mediation Quarterly* 3.
[74] Cole TA, "United States" [1998] (April) *International Financial Law Review* – Corporate Governance Special Supplement 64.
[75] Farrar, n 23 at 143.
[76] Farrar, n 23 at 143.
[77] Cole, n 74 at 64.
[78] Cole, n 74 at 64.
[79] Cole, n 74 at 66-67.
[80] Conard AF, *Corporations in Perspective* (The Foundation Press, New York, 1976) p 3.
[81] Conard, n 80, p 3.
[82] Conard, n 80, p 18, the example is in relation to stock watering.
[83] Conard, n 80, p 19.

quality of the United States market. This has focused on fundamental questions such as how the United States corporate law rental market should be characterised. The answers to this question have been diverse and contested; for some it provides a fertile ground for delivering best practice and for others, it effectively drives standards to a lowest common denominator. Whatever the case, United States governance arrangements have been remarkably successful in attracting business registrations and as providing the hub for most global businesses.

United States corporate governance has generally to date displayed a light regulatory touch. This is evidenced by the business judgment rule developed via case law in the State of Delaware. It provided directors with immunity from liability if they make business decisions in good faith and comply with other failsafe mechanisms. Australia, on the other hand, is the only country to legislate the terms of a business judgment rule.

Employee protection under United States corporate law

Much has been written about the operating structures of large United States companies.[84] In particular, organisations such as General Electric and General Motors have been leaders in this area. These industrial behemoths have provided blueprints for the efficient managerial organisation of huge employee numbers and complicated processes of production. The sentiment that employees are important is expressed by American corporate leaders such as Jack Welch referred to earlier. Almost like nation states, they have taken on the mantle of producing their own corporate governance manuals. General Motors, for example, has adopted its own model of corporate governance which added to the pre-Sarbanes-Oxley[85] environment of a market of governance practices.

Against this view is the argument that the United States "structure of corporate governance has played an important role in limiting worker involvement with strategic decisions".[86] This practice stems largely from the other primary factor of United States corporations law identified by Berle and Means which is "the ideology of managerial autonomy"[87] which is, in turn, the natural outcome of the shareholder-focused model of the company advocated by Berle. This competing ideology has "discouraged initiatives that might have increased labour involvement at the expense of managerial autonomy".[88] This has contributed to "the 'short-term' orientation of managers" at the same time as discouraging "the development of long-term cooperative implicit contracts between workers and managers".[89] A particular facet has been the often heavy-handed means by which unions have been controlled and sidelined.[90]

Questions of structure have therefore spilled over into the issue of governance arrangements for employees. In general terms, structural issues have impeded the development of United States corporate governance in this context because United States corporate governance has generated "resistance to cooperative solutions".[91] In general terms "labor directly influences corporate governance structures in the United States less than it does in some other countries".[92] These include the cases of Germany and Japan discussed below.

Recent challenges to United States corporate governance

The United States corporate market, like Australia, has suffered in recent times from spectacular examples of corporate failure and dishonesty. The Australian cases, One.Tel and HIH, are, however, minnows alongside WorldCom and Enron. These corporate failures, which seem to be generated every decade, raise fundamental questions. In particular, are they evidence that it is the corporate governance system which is generally at fault, or are these isolated events and the subject of an

[84] See, eg, Mintzberg H, *The Structuring of Organizations* (Prentice-Hall, Englewood Cliffs, NJ, 1979).
[85] *Sarbanes–Oxley Act of 2002*.
[86] Charny D, "Workers and Corporate Governance: The Role of Political Culture" in Blair MM and Roe MJ (eds), *Employees and Corporate Governance* (The Brookings Institution, Washington, 1999) p 108.
[87] Charny, n 86, p 108.
[88] Charny, n 86, p 108.
[89] Charny, n 86, p 108.
[90] Charny, n 86, p 108.
[91] Charny, n 86, p 108.
[92] Blair and Roe (eds), n 86, p 2.

unfortunate alignment of other issues? These include, but are not limited to, poor management, directorial dishonesty, lax auditing, and business plans that were neither realistic nor vetted. The moot point is whether these cases represent an "aberration"[93] or whether they are truly reflective of a deeper malaise? Are such cases an inevitable part of a long running business cycle? As Hugh Morgan, the newly installed President of the Business Council of Australia, has noted:

> every 20 years or so we have what seems to be an eruption of corporate malfeasance. There will always be corporations somewhere, sometime, in which directors and/or management, put their own interests far above the interests of the shareholders, or who will deliberately defraud the shareholders, customers, and suppliers, for their own benefit.[94]

In order to examine these cases, we still need to bear in mind the "cultural and moral standards which prevail within the community at large" and the "cultural and social foundations upon which everything else depends".[95] In the post-Enron environment, companies face a double series of fundamental challenges. First, they are seeking to navigate their way in a complex 21st century economy in which predictability has been greatly reduced[96] where all corporations face the dilemmas of major change strategy.[97] The second, and more particular phenomenon is the sense of moral panic assumed by regulators and legislators. This is particularly relevant in relation to current developments in United States governance. The *Sarbanes-Oxley Act* is the chief, new regulatory weapon against perceived corporate laxity. It marks a return to an interventionist mentality not seen since Roosevelt's New Deal.[98] It may prove to be a classic case of legislative overkill; it is the response to a problem brought about by .1 of 1% of the market.[99] Based on this analysis, the Enron and WorldCom fiascos are atypical market case studies.

The critical issue is whether the legislation too heavy handed? The legislation has changed the whole tenor of governance such that it "reflects a potential shift in the philosophy underlying the United States securities laws from disclosure to substantive regulation of corporate governance".[100] According to Larry Ribstein, the new regime raises three potential problems for the United States system. One is that rental market for United States company law may diminish as the regulatory environment becomes more onerous. The costs of keeping the company in the form and shape required by the new laws will be considerable and will particularly affect the compliance costs of foreign firms.[101] For example, the costs of the audit committee and the liabilities associated with non-executive directors are just two issues which will see a significant increase in the time devoted and dollar resources expended on compliance. This raises the second issue, which is that the number of foreign firms adopting United States law may well diminish as firms seek less restrictive regimes around the globe;[102] this may lead, in effect, to a *global* "race to the bottom". The third issue is that exceptions will probably have to be made for important global markets and multinational companies registered in the United States because "nearly a sixth of the listings on the New York Stock Exchange are foreign-based issuers".[103] The Act moves the primary process from one of disclosure of structures to a situation where those structures need to actually comply with United States law. It is anticipated that "compliance with Sarbanes-Oxley may be particularly costly for foreign firms that have non-US-style governance – especially those with co-determined boards in which labour

[93] Branson D, "Enron and its Aftermath" (Conference paper delivered at the International Conference of Governance and Regulation: Challenges and Prospects, Kuala Lumpur, Malaysia, 5-6 March 2003).
[94] Newman G, "Laws an attack on way of life", *The Australian* (2 December 2003) p19.
[95] Newman, n 94.
[96] Stace D and Dunphy D, *Beyond the Boundaries: Leading and Creating the Successful Enterprise* (2nd ed, McGraw Hill, Sydney, 2001) p 4.
[97] Stace and Dunphy, n 96, pp 247-249.
[98] President Bush made reference to the fact that they were "the most far reaching reforms of American Business Practices since the time of Franklin Delano Roosevelt", per Branson, n 93.
[99] Branson, n 93.
[100] Ribstein LE, "International Implications of Sarbanes-Oxley: Raising the Rent on US Law" (2003) 3 *Journal of Corporate Law Studies* 299.
[101] Ribstein, n 100 at 300.
[102] Ribstein, n 100 at 300.
[103] Ribstein, n 100 at 306.

participates in governance".[104] Perhaps unwittingly, *Sarbanes-Oxley* has created particular compliance problems for German firms with the clash between the United States need for a completely independent audit committee and the German practice of codetermination via two-tier board structures.[105]

The so-called "outreach issues" referred to above will only intensify as the power of nation states is further challenged by the forces of global commerce. The competitive demands of the next phase of globalisation will place real pressure on the *Sarbanes-Oxley* regime, especially if the United States perceives a shrinking of its corporate governance rental market.

The general tenor of the *Sarbanes-Oxley* reforms is to reconfirm the hegemony of the Berle-inspired shareholder-focused model of the corporation. Given this approach, the promotion of a broader stakeholder model is likely to be in abeyance for the foreseeable future. The United States system is instructive for Australia in terms of the importance of viewing the national governance system as being in competition with other systems as part of a globalised marketplace.

Sarbanes-Oxley reflects the delicate balancing act sought by corporate governance systems as they seek to impose a set of workable standards so that business can thrive, and yet do so in a fair and equitable environment. The pendulum has swung away from stewardship theory towards agency theory.[106] Where does this leave employees in the United States? Unfortunately, at a fairly low level of priority because the spotlight is for the moment firmly focused on issues of directorial competence and honesty. Allied to this stance are the strictures concerning the relationship between the board and the auditors. Once these critical issues are seen as "fixed", or perceived as no longer a point of crisis, perhaps issues relating to the status of employees as a stakeholder group can resume, as the United States participates in the next wave of globalisation.

5. THE GERMAN POSITION IN RELATION TO EMPLOYEES

Contextual issues in the German debate

Germany provides a fundamentally different corporate governance model that, in turn, underpins its elaborate approach to the recognition and formulation of the rights and entitlements of employees. The German model is one of "codetermination" where employees have a formal and legally enforceable place in the corporate governance framework. Germany's model is a reflection of its economic and social history; it has developed a strong rights-based movement that has been enshrined in many aspects of its law since World War Two.

Germany is the leading example of employee involvement. The role of the German corporation is that of a legal entity cast with social responsibility. German governance is the national system most closely aligned to Professor Dodd's complex, broad stakeholder model of the company in action. As such, German governance illustrates the strong links between the conception of the company and the resulting governance provision.

The complex company model has long been a feature of German commerce; "German company law from the Weimar period (1919-1933) recognized a broader range of stakeholders in the corporation"[107] than the United Kingdom and other common law countries. In particular, whilst corporate governance is a concept whose genesis occurred in the Berle and Dodd debate of the 1930s, the concept of codetermination predates it and originated in the "social movements of late nineteenth-century Europe".[108] It is from these sources that the legacy of employee involvement and participation in the company emerged. It was seen as a way of overcoming "the contradiction between the classic liberal ideals of self-determination and the rights of the individual, on the one hand, and the reality of

[104] Ribstein, n 100 at 301.
[105] Ribstein, n 100 at 307.
[106] Tricker RI, *Pocket Director: The Essentials of corporate governance from A to Z* (The Economist Books, London, 1996) p 137.
[107] Farrar, n 23 at 154.
[108] Pistor, n 4, p 164.

industrialization, on the other".[109] The interplay between these types of diametrically opposed forces has been in evidence therefore for more than a century.

The structure of German corporations

Particular structural issues have emerged from these tensions between individualism and industrialisation. First and most obviously, the German board structure is two-tiered with a supervisory board and an executive board, as opposed to the unitary board structure favoured in the United States, the United Kingdom and Australia. This more formal structure compartmentalises the company because "the members of the supervisory board are totally separate from the top management team".[110] Under German corporate law, the members of the supervisory board are elected by the shareholders.[111] The supervisory board has three broad functions: it is in charge of appointing and dismissing members of the executive board, of supervising the executive board and of providing the management body with advice.[112] The supervisory board is precluded by German law from being involved in the day-to-day management of the company; instead, operational affairs are the exclusive province of the executive board.[113] Its role is therefore that of overseer or supervisor.[114]

The German practice of "codetermination" is set out in the Codetermination Act.[115] Employee representation on the supervisory board is guaranteed by law and is calibrated by reference to the number of employees in the particular organisation. In particular, "under the Codetermination Act, the number of employees that work for a company determines the size of the supervisory board".[116] Employee codetermination of management decisions is "a specialty of the German stock corporation".[117] The codetermination threshold is a company with 500 employees and thereafter operates on a sliding scale:

- For businesses with less than 2,000 employees, one-third of the supervisory board must be employee representatives;
- For businesses between 2,000 and 10,000 employees, there are six representatives on the supervisory board for both employees and shareholders;
- For businesses with between 10,000 and 20,000 employees, there are eight each;
- For businesses with more than 20,000 employees, there are ten each.[118]

In these larger corporations or "aufsichtsrat",[119] employees share an equal stage with shareholders; this marks the German model as vastly different from the Australian one and one more akin to "a form of 'partnership' between capital and labour".[120] The employee representatives "on the supervisory board are directly elected by the employees by means of a complicated procedure".[121] Deadlocks are avoided by virtue of the fact that the chairperson of the supervisory board has an additional casting vote.[122]

The supervisory board's chief weapon in its exercise of control over the management board is "the authority to grant or refuse consent" to interim decisions.[123] Other control mechanisms vested in the supervisory board include the right "to comment on management board decisions, which

[109] Pistor, n 4, p 164.
[110] Tricker, n 106, p 20.
[111] Pistor, n 4, p 168.
[112] Pistor, n 4, p 168.
[113] Pistor, n 4, p 168.
[114] Zschocke C, *The German Stock Corporation Act* (3rd ed, Fritz Knapp, Frankfurt, 2001) p 45.
[115] Zschocke, n 114, p 45.
[116] Zschocke, n 114, p 45.
[117] Zschocke, n 114, p 44.
[118] Zschocke, n 114, p 46.
[119] Tricker, n 106, p 55.
[120] Tricker, n 106, p 55.
[121] Tricker, n 106, p 46.
[122] Tricker, n 106, p 46.
[123] Tricker, n 106, p 45.

corresponds to a right to information".[124] The management board may disregard the supervisory board's opinion, but there is "a resulting obligation of the management board to justify its action, in particular vis-à-vis the supervisory board members".[125]

Works councils

The German Federal Constitution provides via Art 14(2) that: "property imposes duties. Its uses should also serve the public good." This formally recognises the corporation as a social institution. This is in accord with the sentiment that: "a corporation is the legal personification of a firm which is a social institution. This legal personification should not distort the underlying social reality."[126] This grand narrative of the firm appears to be exemplified in German corporate theory and practice. The "objectives of German companies do not stop at profit maximization, but recognize a broader concept of the interest of the company as a whole".[127]

As we have seen, Germany adopts a consultative, participatory model in relation to its two-tiered board system and the role of the supervisory board. The second institutional reflection of the "broader conception of the company"[128] is the Works Council. The Works Council is a European Union innovation and is part of a European corporate governance approach, suited to its particular cultural and business traditions. The Works Councils reflect the traditional robust advocacy of social and community values in terms of European Union developments. The balance between the need to make a profit and broader notions of fairness, akin to social responsibility theory, have been central in terms of EU thinking, as highlighted by treaties such as Maastricht in 1994. This picture of the German firm places it most firmly at the Dodd-inspired end of the spectrum. The company is a complex, stakeholder driven model in which employees are key stakeholders. In this sense, German corporate governance is a "multiplayer game".[129]

Germany's system of "codetermination offers *social governance*, whereas corporate governance provides firm-level governance" (emphasis added).[130] This statement reveals the depth of German governance and the fact that commentators on German governance have actively adapted new concepts to cover very broad emerging philosophies such as "social governance". Such concepts cover very broad arrangements. For example, codetermination is "practiced on two levels: at the shop-floor level, through workers' councils, which give employees the right to obtain information and to participate in decisions that directly affect their workplace; and at the corporate level, through employee and union representation on supervisory boards".[131]

The way forward

The German scheme of "collective governance"[132] therefore reflects a sophisticated approach to employee involvement and one quite distinct from United Kingdom and Australian conceptions. The United Kingdom is, however, as we have noted, influenced by EU policy, and as the European project advances and the United Kingdom's involvement deepens, the question will be whether the de minimis United Kingdom model of employee provision will be able to influence the hegemony of German provision.

The German system is not, however, without its critics. Corporate decision-making under this arrangement is likely to be slower and more costly because more stakeholders are involved and they will have differing levels of knowledge, therefore requiring more lead-time to become fully informed about corporate decisions. Codetermination "not only adds to costs of firm-level governance, but it

[124] Tricker, n 106, p 45.
[125] Tricker, n 106, p 46.
[126] Farrar, n 23 at 162.
[127] Farrar, n 23 at 155.
[128] Farrar, n 23 at 155.
[129] Pistor, n 4, p 179.
[130] Pistor, n 4, p 163.
[131] Pistor, n 4, pp 165-166.
[132] Pistor, n 4, p 178.

also alters the dynamics in ways that will tend to reduce the company's control over management".[133] This unexpected result arises because "the traditional focus of the corporate governance debate on the dichotomy between owners and manager loses much of its explanatory power".[134]

With a multi-player governance system, and the resultant increase in agency costs, "the public corporation should be viewed less as a series of bargains than as a series of coalitions".[135] The operating paradigm of German employee governance illustrates the complexities of the Dodd-styled model of the company. Once the company is operated beyond the simple linear relationship between the board and owners, the unfolding dynamics are both hard to predict and to control. This, in turn, raises fresh questions about the transparency of processes and of accountability issues in terms of the exercise of power. Each model of employee governance therefore carries within it potential causes for concern.

6. THE JAPANESE POSITION IN RELATION TO EMPLOYEES

Contextual issues in the Japanese debate

Japan is a prime example of the importance of recognising the existence of the deeper underlying forces that impact on the law. The Japanese conception and role of the law is heavily influenced by the religion of Confucionism. Its central precept is "wa", meaning harmony. As such, it is a concept superior to, and one that predates the law. It provides a person with "internalised moral rules of propriety".[136] Law, on the other hand, historically in Japan was viewed simply as "an instrument in the hands of the ruler to re-educate those who had not internalized the moral rules of propriety".[137] Law was one-dimensional; its role was to "fix" aberrant behaviour, rather than to fill a mainstream role within society. It was a corrective of delinquency, not a code of citizenship.

Japanese laws until the end of the 19th century "merely imposed duties on citizens" rather than construct and counteract such duties with a series of rights. The law was man-made, external, punitive, centralised and duty driven. "Wa", on the other hand, was religious and god-driven, internal, positive, and individual. The closest analogy in Western law would be that it amounts to a code of good faith and good conscience. Wa stresses social responsibility. In terms of this dimension, it comes close to the German conception of companies as operating in the sphere of the "public good". Whilst this may be laudable as a broad aim, it can, as another example of multi-player governance, create a complex and opaque operating environment.

The interplay of structural and societal issues

As with German corporations, Japan favours the two-tiered board structure.[138] This inverts the United Kingdom and Australian approaches which place shareholders as the pre-eminent stakeholders. It also changes the perceived priorities of the company, for Japanese corporate governance emphasises the corporation as a social institution with shareholders tending to rank lowest in the list of stakeholders.[139] Japanese directors reflect these values in terms of the way they place the relative importance of company stakeholders; customers and employees rank well ahead of shareholders.[140] United States and Australian directors, on the other hand, overwhelmingly promote shareholders as their first priority.[141] The United States-Australian approach accords with the views of the economist,

[133] Pistor, n 4, p 179.
[134] Pistor, n 4, p 179.
[135] Coffee, John C Jr, "Unstable Coalitions: Corporate Governance as a Multi-player Game" (1990) 78(5) *Georgetown Law Journal* 1495-1549 at 1496.
[136] Jagtenberg R and De Roo A, "The 'New' Mediation: Flower of the East in a Harvard Bouquet" (2001) 9(No 1) *Asia Pacific Law Review* (Kluwer Law International) 30.
[137] Jagtenberg and De Roo, n 136 at 30.
[138] Ezzamel M and Watson R, "Wearing Two Hats: The Conflicting Control and Management Roles of Non-Executive Directors" in Keasey K, Thompson S and Wright M, *Corporate Governance: Economic, Management, and Financial Issues* (Oxford University Press, Oxford, 1997) p 62.
[139] Farrar, n 23 at 155.
[140] Farrar, n 23 at 156.
[141] Farrar, n 23 at 156.

Milton Friedman, "that widening the interpretation of social responsibility will undermine the economy by detracting from the basic mission of business: to earn profits for owners".[142]

The situation in Japan is further complicated by a disconcerting gap between law and practice. That is, the surface emergent law does not, in fact, realistically reflect what goes on beneath the surface in terms of day-to-day practice. Given the homocentric rather than egocentric nature of Japanese society,[143] the "group", the "social" and the "community" are all issues advanced ahead of stockholders. As Jonathon Charkham notes, "the three main features that affect Japanese attitudes towards corporate governance are their concepts of 'obligation', 'family', and 'consensus', and all are linked".[144] A particular emanation of this skein of forces at play in the Japanese corporate governance system is the "keiretsu" which is a network of Japanese companies "connected through inter-trading, cross-directorships and cross-holdings. Often the network includes a financial institution".[145] This is a form of super codependency; there is an intricate web connecting the parties and their corporate fates are intimately connected. The structure of the keiretsu determines its function; "chairmen and senior directors of companies in the keiretsu meet regularly and have close, informal relationships".[146] This may be seen as confirmation of Jonathon Charkham's observation that deeper societal forces have a critical bearing in terms of emergent issues of process and structure. It could, however, also be argued that issues of structure and process in turn help to create and solidify certain societal stances and attitudes. There is a complex dynamic at play.

Japanese boards are typically large and comprise several layers with executive and ordinary directors. Decision-making takes place "by consensus, involving a lengthy process of discussion and negotiation throughout the organization before agreement is reached".[147] The board "consequently tends to be a decision-ratifying body rather than a decision-initiating and decision-taking forum, as in the West".[148]

A particular mystique surrounded Japanese companies through the 1980s and early 1990s as the West looked on and wondered at the secrets of the Asian way of doing business and the phenomenal growth of the so-called Asian Tigers. These facets included high levels of unity throughout the organisation, non-adversarial relationships, lifetime employment, enterprise unions, personnel policies which emphasise factors such as commitment, initiation into the corporate family, cross-functional training and promotion based on loyalty and social compatibility, as well as performance.[149] The fact that Japan has been in prolonged recession has dented this mystique and has resulted in the social responsibility facets of Japanese corporate life receiving less Western adulation.

Deconstructing Japanese corporate provision for employees

In fact, as a result of the recession, many of these features of Japanese corporate life have been re-examined in recent times. For example, the feature of lifetime employment with the one company has been reviewed and seen not as a primary or innate characteristic of the Japanese corporation or society, but as a coincidence of a buoyant employment market (especially in the 1980s before recession took hold). The "political economy of Japanese lifetime employment"[150] has been deconstructed. Whilst it is the case that Japanese firms "invest in workers' human capital",[151] their reason for doing so may not in fact be altruistic. They do so "*not* because they have promised the employees lifetime jobs, but because their employees cannot readily move elsewhere".[152] This is an incidence of the essentially closed and inflexible Japanese labour market as compared with the "open

[142] Davidson and Griffin, n 39, p 135.
[143] Clark R, *The Japanese Company* (Charles E Tuttle Company, Tokyo, 1979).
[144] Charkham, n 2, p 70.
[145] Tricker, n 106, p105, and the successors to the "zaibatsu" of the early 20th century.
[146] Tricker, n 106, p105.
[147] Tricker, n 106, p 103.
[148] Tricker, n 106, p 103.
[149] Tricker, n 106, p 103.
[150] Gilson RJ and Roe MJ, "The Political Economy of Japanese Lifetime Employment" in Blair MM and Roe MJ (eds), *Employees and Corporate Governance* (The Brookings Institution, Washington, 1999) p 239.
[151] Gilson and Roe, n 150, pp 239-241.
[152] Gilson and Roe, n 150, p 241.

external labour market of the United States".[153] It has been this feature of a closed labour market that has been argued to be the most influential factor in developing "human capital investment incentives in Japan".[154] This is essentially a negative justification, rather than an enlightened pro bono publico approach. The "political deal of lifetime employment and a closed external market"[155] has long persisted, because of the convergence of a series of factors. These include the long-held fear of "labour strife",[156] the fact that "Japanese courts buttressed lifetime employment"[157] and by "raising the costs to any firm that wanted to change"[158] the deal struck after World War Two to end the labour disputes that had until then prevailed. These arguments and theories are essentially about unlocking the fundamental differences between Eastern and Western conceptions of the company and corporate governance provision for employees. They reflect and reinforce, as Jonathon Charkham notes, the fundamental importance of the deeper underlying social, cultural and economic forces at play.[159] They also illustrate that such forces are not simply a one-way relationship but are in turn, shaped and remapped over time.

The mysteries of the Japanese corporate governance market will generate a new round of inquiry as Japan emerges from its long slumber of recession; in particular, its model of governance will provide a counterfoil to the robust Sarbanes-Oxley model under construction in the United States. For developments in terms of Australian employee provision, it will also serve, along with Germany, as providing a more complex stakeholder model which promotes the interests of employees. As such, its governance arrangement is based on the Dodd model of the corporation.

7. DEVELOPING PRACTICAL SOLUTIONS FOR AUSTRALIA'S EMPLOYEE GOVERNANCE

This article has sought to extract and critique some of the key features of employee governance provisions in terms of Australia's system and that of some of its key historic, political and trading partners. It is trite, but true, to observe that no national system is perfect. Along with other key aspects of governance, such as executive remuneration and the audit function, the role of employees is, and will be, part of a vigorous ongoing debate. In terms of possible innovations and developments to improve the Australian system for employees, the following matters can be considered:

- Promoting debate beyond the narrow legal realm about how to best advance corporate governance debate generally and provision for employees specifically. At a basic level this can be done by enunciating differing models of the corporation along the Berle and Dodd spectrum. This would better allow Australian debate to identify that its focus has been narrow and technical to date, largely beholden to a shareholder-focused model.
- Developing technology-based mechanisms to allow employees in firms to be consulted on key decisions and to register a vote. Key decisions might include the sale of major assets or the proposal of new business directions or strategies. Consultation of the employees on "the really important decisions" has been a fundamental factor in the success of the renowned Brazilian company, Semco.[160] Semco has been described as providing "a dramatic illustration of organizational democracy in action".[161] In that company "workers hire new employees, evaluate their bosses, and vote on all major decisions".[162] Obviously there needs to be a balance between commercial confidentiality and employee citizenship. This type of innovation would be based on

[153] Gilson and Roe, n 150, p 241.
[154] Gilson and Roe, n 150, p 241.
[155] Gilson and Roe, n 150, p 255.
[156] Gilson and Roe, n 150, p 255.
[157] Gilson and Roe, n 150, p 255.
[158] Gilson and Roe, n 150, p 256.
[159] Charkham, n 2.
[160] Semler R, *Maverick: The Success Story Behind the World's Most Unusual Workplace* (Random House, London, 1993) p 112.
[161] Bolman and Deal, n 45, p 133.
[162] Bolman and Deal, n 45, p 133.

the German model of codetermination, but would avoid the sort of gridlock that can afflict corporate decision-making in that country.

- Adopting a s 309 *Companies Act 1985* (UK) type provision into the corporations law for large firms in terms of their key decisions that specifically adopts disclosure and consultative elements for the board to perform vis-à-vis the employee cohort. The challenge, as evident from the United Kingdom experience, is to invest s 309 with practical content.
- Increasing the sanctions for tampering with employee entitlements and accruals. This involves broadening the scope of the provisions in Pt 5.8A of the *Corporations Law Amendment (Employee Entitlements) Act 2000* (Cth).
- Broadening the system for employees becoming shareholders. This spreads wealth and improves employee morale. Instead of share options being seen as an executive reward system, this form of remuneration could be extended through the organisation. The recent Virgin Blue airline float makes a feature of this aspect of its governance. Many of Virgin Blue's 2780 employees emerged as stockholders, with the shareplan including eligible employees receiving $1000 worth of shares as a tax-free gift.[163] This was not only excellent PR for the new entity, but is also very sound human resources management. It builds employee loyalty, reduces staff turnover and provides employees with a tangible reward for being part of this particular organisation.
- Developing governance systems that seek to be reward-based, rather than penalties-driven. This means keeping compliance systems simple and avoiding the box-ticking mentality that can infect overly technical approaches. The dangers of governance systems evaporating into mere box-ticking practices has been a constant thread in the corporate governance narratives of both the United Kingdom and Australia in recent years.
- Providing for a competitive internal market for corporate governance development. This can be encouraged by keeping the rules simple and minimal and by allowing domestic industries to develop best practice in an organic manner, rather than as a series of dictats that are imposed, top down, and which focus on complex rule compliance. In particular, this would mean avoiding the complexities of the emerging United States system.
- Encouraging informal mechanisms to begin to measure "good corporate governance" practices in more sophisticated ways. A recent example of this is the firm RepuTex[164] with its published reports on corporate governance compliance. These emerging practices will help to broaden the stakeholder environment and to highlight the central role played by employees.

The ongoing challenge is to develop provision for employee governance which is both fair and efficient, with transparent and robust operating systems in place. For national systems this will involve steering a middle course. This will mean, on the one hand, avoiding an overly prescriptive compliance system which seeks an unrealistic high-ground and correspondingly high degree of employee participation. On the other hand, it will be important to avoid a race to the bottom, where employee corporate governance is another form of "flag of convenience" commerce, such that standards and practices can be driven down and costs lowered.

There will be an inevitable tension between cost and compliance issues in the elusive search for fair, efficient and equitable employee governance. In this context, the 70 year old Berle and Dodd models of the company look set to drive this debate well into the 21st century.

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[163] Munro P and Kruger C, "The accountant who turned a few pints into $78m", *The Sydney Morning Herald* (11 November 2003) p 1.

[164] http://www.reputex.com.au/reputex.html Its website states: "RepuTex Social Responsibility (SR) Ratings provide a broad appraisal of a company's capacity to meet the expectations of community-based stakeholders and business experts in four RepuTex categories: Environmental Impact, Corporate Governance, Social Impact and Workplace Practices."