Codetermination and Corporate Governance in a Multinational Business Enterprise

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I. INTRODUCTION

The extensive body of legal and economic literature on codetermination\(^1\) has, for the most part, not focused on the fundamental question of how employee participation affects...
the governance of corporations and, in particular, of multinational corporations whose major operations span across jurisdictions with different corporate and labor law regimes. Such a gap in legal scholarship is hardly surprising. The historical divide between capital and labor has been replicated in the American law school. The dominance of the contractarian paradigm focused the attention of corporate law scholars for a decade or so on explaining, refining, or challenging the notion that maximizing shareholder value is the most efficient form of corporate governance because it allocates resources efficiently and thereby maximizes social welfare, reduces the cost of collective decisions because of shareholder homogeneity, and matches organizational structures with the interests of residual claimants. Mark Roe’s work on the path-dependency of American corporate law did prompt an interest in looking to other legal systems, such as those of Europe and Japan, for alternative structures of corporate governance. Yet such comparative analyses—evaluating the relative economic efficiency of the systems, identifying the common functional elements underlying the superficial differences, and seeking prospects of systemic convergence—simply move the intellectual debate to a different forum. For the most part, American corporate law scholars have scantily examined the reasons for and the implications of worker participation in the governance of corporations from codetermination countries.


   The legal literature [on participatory management] is especially disappointing. Most of it is concerned with purely doctrinal issues of labor law. The rest, generally, is concerned with “ought” rather than “is” questions. In particular, the literature is heavily weighted towards the question of government intervention—namely, should the government mandate participatory management—with a strong bias in favor of government mandates.


8. See generally Edward B. Rock, *America’s Shifting Fascination with Comparative Corporate Governance*, 74 Wash. U. L.Q. 367, 390 (1996) (“The tremendous variety of approaches to corporate law that one sees in a comparative survey, combined with an attention to the specific and distinctive histories of financial regulation, cautions against any straightforward attempt at transplanting. It also pushes comparative law in a fundamentally different direction.”).
On the other side of the divide, "... an entire generation of labor law academics focused their scholarship upon perfecting the system of collective bargaining created by the Wagner Act for ordering the legal relations between employers and employees." 9 This preoccupation with "our national labor policy" continued even as union membership plunged from forty percent of the workforce to less than fourteen percent, a level below that existing before the Wagner Act.10 The decline of collective bargaining has led some American labor law scholars to call for employee participation in corporate governance as a means to resolve management-worker conflicts.11 The calls persist despite warnings, based on the European experience, that "the development of labor representation on corporate boards has not occurred as a result of rational decision, but rather through a process of political assertion and compromise."12 "Employee codetermination practices and legislation are deeply rooted in a country's history and institutions and cannot easily be exported from one country to the next."13 In addition, despite a recognition that "labor relations go swimmingly in Germany as compared to the United States," the regulatory features that these scholars seek to transplant "are but a small part of a much larger mosaic that regulates German labor law, and it is that larger mosaic that explains the success of the works councils."14

This Article partially fills the gap in the literature of both corporate and labor law by attempting to provide a systematic analysis of employee codetermination in corporate governance, focusing specifically on comparisons between the American and German paradigms and how the differences affect the governance of a multinational corporation. The purpose is not to reconceptualize U.S. corporate or labor law—neither to challenge "the deep-seated American commitment to freedom of contract"15 nor to disrupt "our national labor policy"16—or to counsel Germans of the wisdom of American law in regulating corporate behavior. Rather, this Article examines what happens when the two

12. Hopt, supra note 1, at 211.
14. Gottesman, supra note 9, at 2806. See also Bainbridge, Participatory Management, supra note 2, at 720-21 ("There are radical differences in the U.S. and German legal systems that pervasively impact the employment relationship. One cannot selectively choose certain aspects of the German corporate and labor laws to be transplanted to the United States.").
15. Gottesman, supra note 9, at 2807.
systems of corporate governance and labor relations merge or, put another way, come into conflict—as when a German corporation merges with an American corporation to form a truly multinational enterprise.

Part II provides a brief description of the American and German regulatory systems of corporate governance and labor relations. It highlights the key similarities and differences between the two systems. While the prevailing descriptions of differences—American corporate law as contractarian and German as constitutive, American labor relations as adversarial and German as cooperative—17—are generally true in many respects, this Part will take particular care to note the commonalities that exist in practice. Part III reviews the extent theories of the corporation and relates them to the question of managing the relationship between capital and labor in a corporate enterprise. Part IV applies these practical and theoretical observations to analyze the consequences of a merger of corporate entities operating under these disparate regulatory systems, using as an occasional example the recent merger between Daimler-Benz and Chrysler. Based on observations of probable conflicts among various groups of claimants to the resources of such a multinational corporation, this Part concludes that—whatever its merits as a mechanism for regulating domestic enterprises—the German model is ill-equipped to resolve efficiently these conflicts of competing claimant interests in a multinational enterprise.

II. LABOR RELATIONS AND CORPORATE GOVERNANCE IN GERMANY AND THE UNITED STATES

A. The German Approach

Three primary features characterize the German system of labor relations and corporate governance: collective bargaining by industry unions, statutory works councils at the plant level, and employee codetermination on the corporation's supervisory boards.18 These three components work together to give German workers voice in the governance of the corporate enterprise.19 The ability of employees to help govern the corporation rather than solely to protect their interests through collective bargaining explains the prevalent characterization of the German approach as cooperative, as opposed to American adversarialism.20

Collective bargaining in the German context differs in some respects from the American experience. First, unions are extremely large and are organized according to
industry, with "industry" being broadly defined. The unions in turn belong to federations, with sixteen leading unions in one federation, the Deutschen Gewerkschaftsbundes. The federations, however, are loosely knit conglomerations and do not have independent authority to bargain with the management of particular industries or companies.

Second, although German unions have legal authority to bargain collectively with employers' associations, the resulting agreements are of necessity quite general because they cover many companies and workers. Workers who do not belong to the union are still fully covered by the collective bargaining agreement. Correspondingly, the works councils, which are responsible for implementing the union agreement, also assume the responsibility to bargain over specific terms for particular companies. They build upon the framework established through collective bargaining by working out the specifics on wages, hours, and other pertinent matters at the company level. The resulting agreement between the works council and the employer is thus analogous to the union-management collective bargaining agreement in the United States.

The works councils are comprised of employee representatives chosen by their coworkers at individual companies. Representatives receive no payment and are proportionately elected by blue and white-collar workers. The councils have "the powers of information, consultation, codetermination, and direct autonomous management of some business actions." In addition to providing a particularized annex to union-negotiated collective bargaining agreements, the works councils are consulted in all situations relating to:

- (1) reduction of operations or closures of an entire plant or substantial parts of a plant;
- (2) relocation of an entire plant or substantial parts of a plant;
- (3)
merger with other plants; (4) fundamental amendments to the organization of a plant, to the objective of the plant, or to the equipment used in a plant; and (5) introduction of completely new working practices and manufacturing processes.\textsuperscript{33}

Regarding these matters, the law requires management to consult and negotiate with the works councils.\textsuperscript{34} Because the employer is required only to enter into negotiations, the works councils "rarely succeed in effecting substantial amendments to the operational changes originally planned."\textsuperscript{35} Even so, the works councils can delay changes and have a significant effect on corporate actions.\textsuperscript{36}

Modern works councils are mandated for companies with five or more employees by the 1952 Labor-Management Relations Act, as amended by the 1972 Works Council Act (Betriebsverfassungsgesetz).\textsuperscript{37} The roots of such employee participation, however, reach much deeper into German history.\textsuperscript{38} A movement promoting works councils in Germany began in the mid-1800s, and workers' committees started having powers to review implementation of workshop regulations in 1891 (Arbeiterschutzgesetz).\textsuperscript{39} The first works council legislation was passed in 1920, but was suspended by the Nazi regime until the resumption of democratic institutions.\textsuperscript{40}

Understandably, unions wanted some assurance of control over the works councils before committing their full support to the arrangement. "[T]he work council system could be built up only after the unions decided to use the work councils as their outposts in the plant."\textsuperscript{41} Thus, although there are no formal ties between works councils and unions,\textsuperscript{42} most works council representatives are union members.\textsuperscript{43} The relationship between the works councils and a union is best understood as that between a democratic institution of popularly elected representatives and a party apparatus to maintain political discipline. "The union is somewhat akin to a national political organization concerned with matters within a given industry. The works council is somewhat analogous to a parliament, with the union supporting its active members for seats on the works council."\textsuperscript{44}

\begin{itemize}
\item \textsuperscript{34} See id. at 336-37. If management does not consult with the works council about operational changes, employees may claim compensation, and the works councils may obtain preliminary injunctions. \textit{Id.} at 340.
\item \textsuperscript{35} \textit{Id.} at 337.
\item \textsuperscript{36} \textit{Id.}
\item \textsuperscript{37} See BetrVG, supra note 28, § 1; see also Rasnic, supra note 31, at 276.
\item \textsuperscript{38} See Rasnic, supra note 31, at 280.
\item \textsuperscript{39} See Rippey, supra note 18, at 630.
\item \textsuperscript{40} See Buschmann, supra note 28, at 33. The Allied Control Council Act No. 22, reinstating the First Works Council Act of 1920, was superseded by the 1952 Labor-Management Relations Act. See Rasnic, supra note 31, at 281.
\item \textsuperscript{42} Id. "The Works Constitution and the works council it established exist independent of the trade union network as a matter of law." Buschmann, supra note 28, at 29.
\item \textsuperscript{43} See Bellace, supra note 17, at 446.
\item \textsuperscript{44} \textit{Id.} at 444.
\end{itemize}
The final, and most relevant for present purposes, component of the German approach to labor relations and corporate governance is employee codetermination in corporate governance. Germany has a two-tiered board system, comprised of a management board and a supervisory board. The management board is made up of managers responsible for the operational management of the corporation, while the supervisory board appoints the management board and oversees its actions. The managerial board has to report to the supervisory board regularly and upon request.

The 1976 Co-determination Act (Mitbestimmungsgesetz) mandates that labor directors hold half the seats on the supervisory board of corporations with two thousand or more employees. The size of the company determines the number of labor directors on the supervisory board and how they are elected. In companies with more than eight thousand employees, delegates elect labor directors; if there are less than eight thousand employees, they are directly elected. There are separate elections of directors between blue and white-collar workers, with proportional representation of each group. The Co-Determination Act also designates a certain number of labor seats on the supervisory board to be held by union representatives.

Despite the even distribution of supervisory board members between employee and shareholder representatives, shareholder interests hold a slight advantage. The chairman is selected by a two-thirds majority of the board, or by the shareholder representatives should such a supermajority not be attained. The chair is given two votes in case of a tie on any question. Moreover, in industries other than coal and steel, senior executives of the corporation nominate at least one of the labor representatives.

Quite apart from the lack of dispositive power in board deadlock situations (a deliberate feature of the “quasi-parity” codetermination scheme), another reason limits the influence of labor representatives through the supervisory board: the influence of the

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46. See id; Rasnic, supra note 21, at 41.
47. See Rasnic, supra note 31, at 284.
48. See Mitbestimmungsgesetz (hereinafter MitbG), 1976 BGB 1 S.
49. See Rippey, supra note 18, at 636. The prescriptions are summarized as follows:

<table>
<thead>
<tr>
<th>Employees</th>
<th>Total Directors</th>
<th>Labor Directors</th>
<th>Union Directors</th>
</tr>
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<tbody>
<tr>
<td>Fewer than 10,000</td>
<td>12</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>10,000 – 20,000</td>
<td>16</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>More than 20,000</td>
<td>20</td>
<td>10</td>
<td>3</td>
</tr>
</tbody>
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MitbG, supra note 48, § 7. The union directors occupy designated labor seats and are not appointed in addition to labor directors. Id.
50. See MitbG, supra note 48, § 9.
51. See id. § 10.
52. If there are six or eight labor seats, two are reserved for the union; for boards with ten labor seats, three are reserved for the union. See id. § 7.
53. Rippey, supra note 18, at 636.
54. See id.
55. Gifford, supra note 21, at 129-30 n.181 (citing Friedrich Fuerstenburg, Industrial Relations in the Federal Republic of Germany, in INTERNATIONAL AND COMPARATIVE INDUSTRIAL RELATIONS 177 (Greg J. Bamber & Russell D. Lansbury eds., 1987)).
56. Hopt, supra note 1, at 204.
supervisory board is often quite limited.57 Decisions affecting employee relations are often resolved through bargaining or arbitration at the works council level, and conversely, managerial decisions are made by the managerial board without much intervention from the supervisors.

In corporations that are controlled by one or more shareholders, for example, in corporations that belong to a group of companies, the supervisory board is sometimes just an instrument in the hands of those shareholders. In corporations with dispersed ownership (sometimes called "public companies," Publikumgesellschaften) the supervisory board is quite often in a close relationship with the management board. The management board at times even makes informal suggestions of candidates for the supervisory board. In many cases the supervision by the supervisory board is only ex post facto and rather limited in effect.58

As Mark Roe has explained, the weakness of the supervisory board may be attributable to codetermination itself.59 The presence of labor representatives on the board with potential power over corporate decisions creates an incentive for managers and shareholders to keep the supervisory board weak. An alternative mechanism monitors the opportunistic behavior by corporate managers: direct shareholder influence through blockholding by investor families, corporate groups, or financial intermediaries. Because owners of such closely held companies do not want to cede control either to the managers (if shares are dispersed) or to the workers (if the supervisory board were utilized to monitor the managers), they will tend to sell to other blockholders and thus retain the concentrated corporate structures.60

Taken together, the complement of collective bargaining, works councils, and codetermination suggests neither that the German system is entirely cooperative in nature nor that the labor role in corporate governance is substantial. What it does suggest, first, is that the process of bargaining between management and labor is a continuing one. By locating the responsibility for bargaining over specific terms at the company works councils, the German approach avoids catastrophic disagreements at the collective bargaining stage with the industry unions.61 While the negotiations for particular terms may very well be adversarial, the dispersion of such disagreements across time and among different companies contributes to a more cooperative result insofar as it avoids the impasses that lead to strikes or other union actions. Second, because of the weak role of supervisory boards, the influence of labor representatives on corporate governance through those board seats is limited. By the same token, however, their formal recognition and status as supervisors of the corporate enterprise provide a potential for labor involvement62—albeit a potential that is realized perhaps only under certain

58. Hopt, supra note 1, at 204.
60. See id. at 178-79. Hopt's exceptions to his general observation of weak supervisory boards—"in groups of companies (in which the supervisory board will not have been appointed against the will of the parent) and in economically difficult and rescue situations," Hopt, supra note 1, at 205—are consistent with Roe's theoretical explanation.
61. See Rippey, supra note 18, at 632.
62. See O'Connor, supra note 11, at 937-38.
structural or financial conditions. At the very least, the presence of labor supervisors serves the useful function of providing access to accurate information about the corporate enterprise.63

B. The American Experience

The inclusive German approach to the role of employees in corporate governance stands in sharp contrast to the American experience. Ever since the venerable Adolf Berle opined that corporate powers were held in trust "at all times exercisable only for the ratable benefit of all the shareholders,"64 and the equally celebrated Merrick Dodd countered that the corporation was "an economic institution which has a social service as well as a profit making function,"65 a debate has raged over the role of the corporation in society.66 But the interesting feature of the continuing debate today is that so much ideology is committed and ink spent on comparatively so little; at stake is simply the definition of the boundaries of the corporation’s commitment to shareholder interests. The debate does not challenge the core of that commitment.

To the present day, the primacy (as opposed to exclusivity) of shareholder interests as the goal of the corporate enterprise is generally assumed in both corporate jurisprudence and scholarship.67 Even A.P. Smith Manufacturing Co. v. Barlow,68 which

63. Hansmann, supra note 1, at 1803; O'Connor, supra note 11, at 937; see also MASAHIKO AOKI, THE CO-OPTATIVE GAME THEORY OF THE FIRM 171 (1984) ("In practice, top management might appropriate actual decision making power, by relying less on the board. Then the board representation of workers may not have direct advantages to workers and unions except for possible access to managerial information released to the board.").


66. The Berle-Dodd debate continued with Adolf Berle, For Whom Corporate Managers Are Trustees: A Note, 45 HARV. L. REV. 1365 (1932) and Merrick Dodd, Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?, 2 U. CHI. L. REV. 194 (1935). See also A.A. Sommer, Jr., Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later, 16 DEL. J. CORP. L. 33 (1991); Joseph Weiner, The Berle-Dodd Dialogue on the Concept of the Corporation, 64 COLUM. L. REV. 1458 (1964). The vitality of the debate continues through different voices. Compare MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962) ("Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.") with Elliot J. Weiss, Social Regulation of Business Activity: Reforming the Corporate Governance System to Resolve an Institutional Impasse, 28 UCLA L. REV. 343, 418 (1981) ("Corporations are creations of law, and have as their ultimate purpose the welfare of society.").

67. See Jonathan R. Macey, An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties, 21 STETSON L. REV. 23 (1991). But see Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 VA. L. REV. 247, 287, reprinted in 24 J. CORP. LAW 751, 778 (1999) (challenging the prevailing notion that "as a descriptive matter, American corporate law follows the shareholder primacy model"). Although the normative debate has been loosely characterized as one over shareholder primacy, it actually has focused more precisely on the exclusivity of shareholder interests. Compare Macey, supra, at 31 ("It is often difficult for directors acting in good faith to divine what is in the best interests of shareholders and the corporation. If directors are required to consider other interests as well, the decision-making process will become a balancing act or search for compromise.") with David Millon, Communitarianism in Corporate Law: Foundations and Law Reform Strategies, in PROGRESSIVE CORPORATE LAW 2 (Lawrence E. Mitchell ed., 1995) ("Management's duty of exclusive regard to shareholder interests necessarily threatened nonshareholder interests in any situation in which there was a conflict.").

68. 98 A.2d 581 (N.J. 1953).
upheld a corporate gift to Princeton University and prompted Berle to concede defeat,\(^6\) reasoned that the gift was justified because it arguably advanced the corporation's long-term business interests.\(^7\) And even the wave of constituency statutes, the institutional apogee to date of corporate communitarianism, did no more than simply expand directors' fiduciary duties beyond an exclusive focus on maximizing shareholder returns.\(^8\)

Where does labor fit into this shareholder-centric vision of corporate governance? In very few places,\(^9\) if at all. Labor seeks its share of the corporate pie by explicit contracting with management, who, at least in theory, represents the shareholders' interests.\(^10\) "Our national labor policy" is focused on providing parity in bargaining power by facilitating collective bargaining by unions in order to offset the collective action problem inherent in coordinating employee interests.\(^11\) The structural relationship between shareholders and managers on the one hand, and labor on the other, contemplate arms length dealing, if not outright conflict, as opposed to the comparatively cooperative relationship among the three groups under the German approach.

The topic of works councils, or their equivalents stateside, best illustrates the contrast between the American and German approaches. The 1990s saw hints of a movement toward shopfloor management practices somewhat similar to the German model. "Firms have implemented participatory work programs that encourage workers to engage in problem-solving and dialogue concerning production inefficiencies."\(^12\) The promise of such transplantation of the German institution, however, is illusory. Although

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\(^7\) 98 A.2d at 589. Cf. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (stating that the board may not "conduct the affairs of the corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others"); Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. 1968) (permitting corporate consideration of neighborhood concerns because "the long run interests of the corporation in its property value at Wrigley Field might demand all efforts to keep the neighborhood from deteriorating").

\(^8\) For a representative debate on constituency statutes, see William W. Bratton, Jr., Confronting the Ethical Case Against the Ethical Case for Constituency Rights, 50 Wash. & Lee. L. Rev. 1449 (1993), and Lawrence E. Mitchell, A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes, 70 Tex. L. Rev. 579 (1992).

\(^9\) See, e.g., Kent Greenfield, The Place of Workers in Corporate Law, 39 B.C. L. Rev. 283, 283 (1998) ("Workers have no role, or at most almost no role, in the dominant contemporary narrative of corporate law."). Constituency statutes expanded fiduciary duties to permit, and in some cases require, directors to consider the interests of employees in making fundamental corporate decisions. Employees may also influence corporate actions through voting shares in ESOPs or control the corporation outright through labor-led buyouts; however, the employees' role in corporate governance in such instances derives from share ownership, not from their status as labor qua labor.

\(^10\) The separation of ownership and control and the attendant agency costs of managerial opportunism, of course, are matters well established. With respect to collective bargaining, however, the managers' and shareholders' interests are aligned insofar as both groups seek to minimize the employees' compensation. The alignment is not perfect, as managers still have some incentive to pursue purely distributive strategies which maximize their share of the corporate pie at the expense of both shareholders and employees.


\(^12\) O'Connor, supra note 11, at 901.
30,000 U.S. corporations reportedly use some form of participatory management, only 37 percent of a representative sample of 700 firms have "high performance work practices" such as participatory management. Thus, "what is happening is best described as limited and piece-meal experimentation with employee involvement, rather than a fundamental shift in the nature of workplace relationships." Works councils as they exist in Germany could actually be prohibited by the National Labor Relations Act ("NLRA"). Some participatory management programs may be characterized as a "labor organization" and, under Section 8(a)(2) of the NLRA, the employer may not "dominate or interfere with the formation or administration of a labor organization or contribute financial or other support to it." In Electromation, Inc. v. NLRB, the court held that Electromation's action committees violated Section 8(a)(2) and suggested that Congress re-evaluate that provision in light of changed circumstances. Congress responded to the call by passing the TEAM Act, which was vetoed by the President.

III. THEORIES OF THE CORPORATION: SHAREHOLDERS, MANAGERS, AND EMPLOYEES

Contemporary theories of the firm and their attendant prescriptions for corporate governance curiously adopt an all or nothing approach to define the interests at stake. Progressive—or perhaps more aptly, communitarian—approaches emphasize the nature of the corporation as a distinct and separate entity which owes some sort of obligation to those who are affected by its actions. The stakeholders in this corporate entity include not only the various forms of capital (debt and equity) and labor (management and employees), but also the immediate community, and indeed, the general society. Conversely, contractarians view the corporation as a conceptual and legal fiction—shorthand for the bundle of contracts that define the rights and obligations of those who participate in the economic enterprise. Although the participants obviously include interests other than shareholders, such as bondholders and employees, the theory proposes that these other interests are better protected through explicit contractual covenants rather than through the corporate governance mechanism. The goal of corporate governance is to maximize shareholder value.
The analysis that follows proposes that, at least with respect to employee participation in corporate governance, these extant theories argue either too much or too little. Let's review briefly the relevant intellectual history. Berle and Means influentially described the now familiar concept of separation of ownership and control in the modern corporation. As the title of their book suggests, Berle and Means began their analysis from a property law perspective. Because an owner has exclusive control and residual rights, “his desire for personal gain, for profits, can be relied upon as an effective incentive to his efficient use of any industrial property he may possess.” In the modern quasi-public corporation, however, this correlation of incentives breaks down because the owners (shareholders) do not control the corporation, and those who control the corporation (managers) do not significantly share in the residual profits. Because the interests of managers and shareholders diverge, fiduciary duties exist in order to ensure that managers act in the best interests of shareholders—hence “corporate powers as powers in trust.”

Then came the economists, who extrapolate not from the law of property but from the intuition of contracts. The corporation is not a piece of property but rather a nexus of the various contracts that define the contributions and rewards, the rights and obligations of various contributors to the economic enterprise. As such, the corporation is no more than a legal fiction, conceptually “a useful heuristic,” that represents the contractual relationships among the various participants. Although the concept of “ownership” of the corporation is prevalent in some contractarian accounts, the use of the term is in some respects a misnomer. No one owns a fiction, and property rights over a heuristic stretch the limits of logic and imagination. Thus, the separation of control and ownership is more properly conceptualized as the separation of management and control. Ownership

our view, the principal function of corporate law.”), with D. Gordon Smith, The Shareholder Primacy Norm, 23 J. CORP. L. 277, 322-23 (1998) (arguing that shareholder value maximization “may be one of the most overrated doctrines of corporate law”).


87. Id. at 8.

88. Id. at 9.

89. Id. at 335-55.


91. Bainbridge, Participatory Management, supra note 2, at 660.

92. See, e.g., Joseph W. Singer, The Reliance Interest in Property, 40 STAN. L. REV. 614, 639 (1988) (“Shareholders do not occupy the position of the traditional fee simple owner or the traditional owner of a cotenancy interest.”).


94. See Eugene F. Fama & Michael C. Jensen, Separation of Ownership and Control, 26 J.L. & ECON. 301, 301 (1983) (“In more precise language, we are concerned with the survival of organizations in which important decision agents do not bear a substantial share of the wealth effects of their decisions.”). Fama and Jensen break down the decision process into decision management (the initiation and implementation of decisions) and decision control (the ratification and monitoring of decisions). Id. at 303-04.
in this context is thus simply the right to specify the terms not specified in an incomplete contract.\textsuperscript{95}

To which party in the bundle of corporate contracts, then, should such control rights be allocated? To the party who is the residual claimant—he who receives profits of the enterprise or bears its losses after expenses are paid from revenues. In the traditional property rights analysis, both control rights and residual claims vest in the same bundle of rights conventionally known as ownership. In the contractarian analysis of the corporation, which does not readily admit to conventional ownership, the efficiency maximizing objective is to merge (or re-merge) control rights with residual claims. The logic of this solution is simple. Residual claimants have the greatest incentive to maximize net returns to the corporate enterprise and thus should be given the control rights to do so.\textsuperscript{96} Were control rights divorced from residual claims, the holder of control rights would have no incentive to increase the efficiency of the economic enterprise, or worse, would have an incentive to hold up enterprise productivity in order to extort money from the residual claimant.\textsuperscript{97}

In American public corporations, both control rights and residual claims are typically thought to reside by default with shareholders. However, this recognition is, at best, a default presumption. First, for a variety of well documented reasons, shareholders do not exercise these control rights in order to manage the corporation directly. Managers do so. They are, in a way, agents of the shareholders in that they perform part of the decisional function (decision management), leaving the shareholders with the more limited task of decision control.\textsuperscript{98} But notably they are not agents of the shareholders as that concept is understood in the traditional legal sense.\textsuperscript{99} As a descriptive matter, shareholders do not in any meaningful way direct the activities of the manager, as in a traditional principal-agent relationship.\textsuperscript{100} At a theoretical level, the reason why there is no such traditional direct principal control of the agent is because, within the context of a corporate contract, the managers’ authority is \textit{sui generis} and is not delegated from or derivative of the shareholders’ control rights. Unlike a landlord who can direct the tenant farmer how to till the land, shareholders cannot tell managers what to do for the simple reason that a corporation is not a piece of property and the shareholders are not its owners in the conventional sense of the word.\textsuperscript{101} Like shareholders, managers are thus simply

\textsuperscript{95} {See Oliver Hart, \textit{Firms, Contracts, and Financial Structures} 5-6 (1995).}
\textsuperscript{96} {See \textit{id.}, at 64-66; see also Romano, \textit{supra} note 6, at 3; Williamson, \textit{supra} note 6, at 1210-11.}
\textsuperscript{97} {See Hart, \textit{supra} note 95, at 64.}
\textsuperscript{98} {See Fama & Jensen, \textit{supra} note 94, at 312-15.}
\textsuperscript{100} {See Orts, \textit{supra} note 99, at 311 (“Managers are high-level employees of the corporation, yet they are delegated considerable authority to act on behalf of the firm—often as if they were principals.”).}
\textsuperscript{101} {See, e.g., Hart, \textit{supra} note 95, at 57 (noting the failure of contractarian theorists to explain “the source of an employer’s authority over an employee”).}
another constituency in the corporate enterprise or, more aptly, another party to the set of contracts that comprise the corporation.\textsuperscript{102}

Second, as a conceptual matter, there is no reason to think that control rights and residual claims \textit{must} reside with shareholders. Within the contractarian framework, residual claimants are simply those parties to the corporate contract who have agreed to receive profits of the enterprise or to bear its losses after expenses are paid from revenues. As Fama and Jensen explains more precisely:

\begin{quote}
The contract structures of most organization forms limit the risks undertaken by most agents by specifying either fixed promised payoffs or incentive payoffs tied to specific measures of performance. The residual risk—the risk of difference between stochastic inflows of resources and promised payments to agents—is borne by those who contract for the rights to net cash flows. We call these agents the residual claimants or residual risk bearers.\textsuperscript{103}
\end{quote}

In the typical corporation, those who contract for the residual risk are contributors of equity capital; but they need not be. Consider a simple case where A, B, and C would like to form a corporation to produce widgets. A has money but does not know how to make widgets. B knows how to make widgets but has no money. C knows how to sell widgets and has some money. There are many permutations as to the legal and capital structure of the resulting corporation, but for present purposes consider two. In Corporation 1, A owns 90\% of shares (commensurate with his pro rata capital contribution), B is the chief executive officer with a base salary and incentive bonuses based on net profits, and C owns 10\% of shares (again, commensurate with his capital contribution) and is also a salesman with a base salary and commission on sales. In Corporation 2, A owns 40\% of shares, B owns 40\% of shares, and C owns 20\% of shares; A uses cash for consideration of shares, B uses her future services, and C uses a combination.\textsuperscript{104} Although the contributions to the economic enterprise are the same in the two corporations, residual claimant status has shifted among the capital provider (A), manager (B), and employee (C).\textsuperscript{105}

Of course, the shifts between Corporation 1 and Corporation 2 occurred solely through shareownership; thus, B and C have residual claims in Corporation 2 as shareholders, not as manager qua manager or employee qua employee. However, it does not take much creative lawyering to structure a set of contracts whereby the shift can occur without shareownership. Profit sharing and loss bearing compensation schemes for B and C are perhaps the simplest mechanisms, and other complex devices such as the

\textsuperscript{102} See Williamson, \textit{supra} note 6, at 1215-17. Agency costs, then, are not losses in entitlement to which the shareholders had a right, but rather simply the transaction costs of the shareholder-manager contract. See Jensen \& Meckling, \textit{supra} note 90. For a description of models of corporate behavior focusing on managerial discretion and incentives, see John C. Coffee, \textit{Shareholders versus Managers: The Strain in the Corporate Web}, 85 MICH. L. REV. 1, 28-31 (1986).

\textsuperscript{103} Fama \& Jensen, \textit{supra} note 94, at 302.

\textsuperscript{104} Modern corporation statutes authorize low or zero par value shares, \textit{see} DEL. CODE ANN. tit. 8, § 151 (1998), and the use of services as consideration for shares, \textit{see} DEL. CODE ANN. tit. 8, § 152 (1998).

\textsuperscript{105} The example is derived from helpful comments by Chun-Jen Chen.
The fabled Hollywood production contracts can also serve the same purpose. The challenge with such alternative arrangements, from an efficiency standpoint, is also to match proportional control rights with shifting residual claims in order to align incentives appropriately. The important point for present purposes is to recognize that, within the contractarian paradigm, exclusive focus on shareholder interests need not be a talisman and, indeed, a more searching analysis as to the location of residual claims vis-à-vis control rights may be required before one can make conclusive predictions about the efficiency of organizational structures.

In their important new article which serves as the basis for this symposium, Margaret Blair and Lynn Stout appear to concur with the above analysis in many respects. They would go one step further, however, and revive the pre-contractarian notion that the corporation is an entity separate and distinct from its constituent parts. Building on the economic literature on joint production, Blair and Stout view the corporation not as a nexus of contracts among autonomous groups of independent players, but rather as a team of actors who have agreed to maximize the joint gains from cooperative production by contributing specialized inputs into the corporation. "The interests of the corporation, in turn, can be understood as a joint welfare function of all the individuals who make firm-specific investments and agree to participate in the extracontractual, internal mediation process within the firm." All team members, then, have a commonality of interests in working jointly to maximize the returns to the economic enterprise. The question that remains is how to commit to and maintain that jointness in light of the potential for individual opportunism. Corporate governance

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107. There are, of course, efficiency-enhancing reasons external to the analysis offered above to favor the channeling of all shifts in residual claims through shareownership. Roberta Romano has concisely summarized them:

First, in competitive markets, maximizing share value allocates resources efficiently and thereby maximizes social welfare. Second, in competitive markets, it provides managers with a clear-cut decision rule that maximizes the utility of the firm's owners who may have disparate preferences for current and future consumption, because it enables shareholders to trade against the increased share value to achieve whatever consumption pattern they wish without affecting the firm's policy. In this regard, it also reduces the cost of collective decisions, because shareholders' interests are more homogeneous than other groups.

ROMANO, supra note 6, at 2-3 (citations omitted).

108. For an excellent discussion of labor, capital, and residual claims from an industrial organization perspective, see Edward B. Rock & Michael L. Wachter, Tailored Claims and Governance: The Fit Between Employees and Shareholders, in EMPLOYEES AND CORPORATE GOVERNANCE, supra note 1.

109. See Blair & Stout, supra note 67. The article is important because it offers a fresh challenge to "the dominant legal academic view" of the contractarian corporation, William T. Allen, Contracts and Communities in Corporation Law, 50 WASH. & LEE L. REV. 1395, 1400 (1993), and presents a new argument in a debate that "has been fully played out." Bainbridge, Participatory Management, supra note 2, at 661.


111. Id. at 253-54, reprinted in 24 J. CORP. L. 751, 755-56 (1999).


supplies the answer, so goes the theory, by providing a mediating hierarchy in order to enforce the requirements of joint maximization. This mediating hierarchy furnishes an ex ante instrument of credible commitment and an ex post mechanism for resolving disputes among various members of the team. At the top of the hierarchy is the board of directors, who owe a fiduciary duty to advance the best interests of the corporation qua joint economic enterprise and who, of necessity, cannot be beholden to any one team member. The corporate surplus resulting from such joint maximization is retained or distributed to all the team members who make specialized contributions to the corporate enterprise,\textsuperscript{114} not exclusively to shareholders.

Although "[t]he joint-enterprise perspective seems to offer more fresh insights and a better understanding of economic functions,"\textsuperscript{115} it relies on heroic levels of faithfulness to fiduciary duties among corporate directors. Placing directors at the top of the corporate hierarchy to prevent shirking and sharking by other contributors to the enterprise leads to the obvious question of who is watching the watchers. One answer maybe a challenge to the premise of the question. As Eric Orts succinctly puts it, "Abuse of authority and power in the firm also has a normative dimension beyond economic analysis. Ethics as well as economics should set the ground rules of contemporary business civilization."\textsuperscript{116} Beyond ethics, there is law. Breaches of fiduciary duties carry legal sanctions. The problem with these answers is that, first, current rules for derivative suits grant standing only to shareholders and thus provide no support for Blair's and Stout's extension of the team to include other potential stakeholders. Second, even if all team members may seek redress for breaches of directors' fiduciary duties, the theory places too much emphasis on judicial competence to enforce those duties in a manner that maximizes the joint welfare function. At best, director fiduciary duties and the accompanying threat of judicial intervention provide only a second-best answer to the joint production problem identified by Blair and Stout.

More important, the team production theory inadequately addresses a major feature of corporate governance—the mechanisms for selecting the board of directors. If the goal of the board is to monitor all team members and to enforce the requirements of joint maximization, it seems odd to vest the power to select those policemen-judges solely in the hands of one team member, the shareholders. Vesting such decision control rights in the hands of only one group of residual claimants misaligns the incentive to maximize joint productivity. Worse, it also gives the group with such control rights significant leverage to unfairly extract rents from the joint enterprise—in other words, to focus on distribution rather than on production.

Blair and Stout respond with the Berle and Means notion of separation of ownership and control.\textsuperscript{117} Modern proxy rules, collective action problems, and managers' strategic creativity render the shareholders' voting rights "so weak as to be virtually

\textsuperscript{114} "For most public corporations these are primarily executives, rank-and-file employees, and providers of equity capital, but in particular cases the corporate team may also include other stakeholders such as creditors, or even the local community if the firm has strong enough geographic ties." \textit{Id.} at 288, reprinted in 24 J. CORP. L. 751, 778-79 (1999).


\textsuperscript{116} Orts, \textit{supra} note 99, at 328.

meaningless." These limited rights held by shareholders, their analysis continues, are really for the good of the corporate entity, and that the shareholders are in the best position to utilize these rights. But this answer somewhat begs the question. Shareholders do not effectively exercise their decision control rights because managers, through their creative use of decision management rights, have usurped this authority. But then the question remains as to why the managers should be able to exercise actual power over the selection of board members; after all, they are just another team member, just like the shareholders. Even if one expands the director selection mechanism, as with the German approach, to provide each team member with informal and formal mechanisms to choose members of the board, the question still nags. Any internal mechanism for choosing these theoretically independent hierarchs carries the potential that the board will not act with Leviathan-like authority and benignity, as Blair and Stout envision. Instead, the board would be what it currently is in many circumstances: at best, a forum for resolving conflicts among various team members or, at worst, a rubber stamp for one or another of the competing interests. Team production, as a theory of corporate governance, must depend on some external, team-neutral mechanism to select truly impartial and independent directors to perform the role of benevolent dictators, a suggestion that has not gained much favor since the idea of the National Director Corps.

Despite what seems to be a structural shortcoming in their theory, the key insight that drives Blair and Stout is critically important: "that shareholders are not the only group that may provide specialized inputs into corporate production. Executives, rank-and-file employees, and even creditors or the local community may also make essential contributions and have an interest in an enterprise's success." The analysis outlined above suggests that this recognition is consistent with contractarian theory and that the contractarian framework, properly conceived, can account for shifting residual claimants and control rights within the bundle of corporate contracts. The key is to identify the residual claimants and to align organizational design with incentives.

Holders of debt represent the easy case for exclusion from the corporate governance analysis. In many respects, holders of debt resemble shareholders. They contribute capital to the corporate enterprise and incur some risk of nonpayment through default or bankruptcy; they can reduce such risk by diversifying their portfolio of investments. Unlike shareholders, however, debtholders negotiate the rate of return on their investments and, where necessary, demand security to protect against the risk of loss. Debtholders thus are simply contributors of capital who have expressly contracted away from residual claimant status. To return to the previous widget hypothetical, A quite

118.  Id. at 310, reprinted in 24 J. CORP. L. 751, 794 (1999).
119.  See id. at 313, reprinted in 24 J. CORP. LAW 751, 796 (1999).
120.  See Elliott Weiss, Social Regulation of Business Activity: Reforming the Corporate Governance System to Resolve an Institutional Impasse, 28 UCLA L. REV. 343, 426-32 (1981) (advocating a corps of directors, with Presidential appointment and Senate confirmation, from which corporations must select two-thirds of their board members).
122.  See EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, supra note 4, at 35-39.
easily could have contracted to lend B and C her money in exchange for guaranteed payments of principal and interest; to protect against the risk of nonpayment, A could demand any number of covenants, guarantees, or collaterals. Bearing no residual risk, A should have no control rights; indeed, granting her such control rights would create holdup problems that dampens the corporation's productivity.

Community interests likewise are excludable. In general, vague notions of society and community interests do not rise to the level of stating a claim on corporate residuals or control rights because neither the general society nor any particular community has made any specialized contribution to any specific corporation. Society and community, of course, play a large role in enabling the corporation and its activities. But compensation for such legal and even physical infrastructure can be achieved, in the large run of cases, through corporate taxation. To the extent that there are externalities, negative or positive, associated with corporate conduct, such externalities can be internalized through regulatory penalties or incentives outside of the corporate governance mechanism. To the extent that a community makes a specialized input into a particular corporation that the community fears will be expropriated, the community can explicitly contract for reciprocal specialized investments (thus deterring advantageous behavior with the credible threat of retaliatory expropriation) or for specific commitments and covenants.

Employees, however, are a different story. Unlike shareholders and debtholders, employees contribute not real capital but human capital to the company. The important difference is that they cannot diversify such human capital in order to reduce the risk of loss through corporate failure. And while employees, like any other claimant, can negotiate the rate of return on their investment (in terms of wages and benefits), there is no effective security to protect against their risk of loss in the event of corporate failure. In this respect, employees occupy the same position as the managers and have as much justification to be counted as constituents in the corporate governance analysis.

Recognizing that employees have a claim in the corporation, however, suggests nothing as to how that claim may be satisfied. Indeed, the latter question is the central inquiry in a comparison of the American and German approaches to labor relations. One may seek to satisfy the employees' claim either through explicit employment contracts that specify wages or through consensual participation in corporate governance that permits implicit quasi-rent extraction. The analysis up to this point advocates neither mechanism. It only suggests that a presumption of shareholder primacy excludes employees as a relevant party to the corporate contract, and thus erroneously concludes that employee claims can only be satisfied through explicit contracts outside of the corporate governance mechanism. Properly conceptualized, contractarian theory acknowledges the possibility that residual claimant status and proportional control rights can shift to employees and advances the analysis to a more interesting question: Under what circumstances is codetermination a preferable mechanism to compensate employees for their investment in the corporation?

123. See Williamson, supra note 6, at 1214-15.
124. Unemployment compensation plans provide some insurance in the event of layoffs—a forced divestiture of employees' investment in the business enterprise. Such legally mandated insurance diversifies risk at a different level and with significant transactions costs, and thus is a second-best solution to the problem.
125. See Greenfield, supra note 72, at 321.
One standard objection to codetermination, from a political economy perspective, is that it is an inefficient form of social or political control over private capital: "By granting workers major control rights without regard to their actual investment position in the firm, state programs have violated an important rule for ensuring rational allocation—namely, the rule that those making decisions should bear the full cost of the decisions they make."\textsuperscript{126} This objection presumes that employees do not have a stake in the corporation and rests on the premise that their "actual investment position in the firm" is low, if not zero. But employees do make a nondiversifiable investment in human capital, an investment that increases the employee's stake in the corporation proportionately to the firm-specificity of the human capital.

Another significant objection to codetermination, one relying on the market, was influentially stated by Jensen and Meckling in 1979: "If co-determination is beneficial to both stockholders and labor, why do we need laws which force firms to engage in it? Surely they would do so voluntarily."\textsuperscript{127} However, asymmetric information about the level of firm-specific investments by employees and problems of credible commitment (either by the worker to invest in human capital or by the employer not to exploit such investments) may well explain why there is no significant evidence of voluntary codetermination.\textsuperscript{128} Which of these alternative stories is more plausible is a question of empirics that has yet to be answered.\textsuperscript{129} The point here simply is that, at least at a theoretical level, it is not obvious that excluding employees from the bundle of implicit corporate contracts and distributing their share of the corporate surplus through express collective bargaining is the sole or necessarily most efficient mechanism to account for employee interests in the corporate enterprise.\textsuperscript{130}

This Part has provided the conceptual justification for an observation made elsewhere by others: the modern corporation can be best abstracted into the three claimant groups of shareholders, managers, and employees.\textsuperscript{131} Within this abstract heuristic, each of these groups is an autonomous contributor to the corporate enterprise, and their respective roles, rights, and obligations arise from implicit contracts that comprise the corporation. None is beholden to another, except as envisioned by the contracts. The terms and interpretation of those corporate contracts, like any other contracts, may be mandated or adjusted by external legal mandate, in which case the parties will adapt their behavior accordingly in order to maximize their individual interests. The next Part applies this framework to a concrete example to analyze the


\textsuperscript{127} Jensen & Meckling, supra note 1, at 474. For an insightful discussion of this question from the perspective of institutional economics, see Stephen M. Bainbridge, *An Organizational Failures Analysis*, supra note 2.


\textsuperscript{129} Baums & Frick, supra note 1, at 3.

\textsuperscript{130} See, e.g., Alfred F. Conard, *The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law*, 82 Mich. L. Rev. 1459, 1484-86 (1984) (describing German codetermination and American misunderstanding of its theoretical basis); Rock, supra note 8, at 385 ("Codetermination is important in helping to undermine the traditional assumption of hostility between labor and capital.").

\textsuperscript{131} See Roe, supra note 1; Pistor, supra note 1.
interaction among these corporate participants in a dynamic situation, where the rules regarding codetermination converge—when a German corporation merges with an American corporation to form an integrated multinational enterprise.

IV. LABOR RELATIONS AND CORPORATE GOVERNANCE IN A MULTINATIONAL ENTERPRISE

When one abstracts the corporation into the three groups of primary claimants (managers, shareholders, and employees) each competing to maximize the returns on its specific investments in the corporation, the differences between the American and German approaches become quite easily appreciable. Under the contemporary American system of corporate governance (which focuses primarily on the principal-agent relationship between shareholders and managers) and of labor relations (which relies primarily on arms-length collective bargaining between union and management), managers and shareholders are allied against employees at the bargaining table. Because express contracting is the mechanism through which employees receive returns for their investment in the corporate enterprise, the more corporate resources that managers give away in the collective bargaining agreement, the smaller the surplus that remains to be shared with the shareholders. Thus, the managers’ interests are closely aligned with those of shareholders in this instance—namely, to minimize the effective compensation of employees.

Under the German system of works councils and codetermination, where employees have some control rights and the returns to employee investments are received partially through rent distribution in corporate governance, mutuality of interests between any two groups of claimants cannot be assumed and alliances are much less predictable. “As a result, management gains the upper hand in the process of coalition building, because it is most flexible in selecting from among the opposite parties, and the position of both shareholders and employees as agents of corporate governance is weakened.” That is so because the managers, who by virtue of their supervision of the day-to-day affairs of the corporation have decision management functions, can select between employees and shareholders (each of which have decision control rights) in seeking approval of its corporate decisions. This task of building coalition can be quite benign in purpose and effect—as when managers make decisions to integrate or mediate the interests of shareholders and employees toward the end of advancing the corporate enterprise, in what Aoki describes as the corporative managerialism model. Alternatively, depending on the effectiveness of control mechanisms, the managers can make decisions to maximize their own utility subject to constraints imposed by shareholders and employees—as in Aoki’s managerial discretionary model. In either case, the splitting

133. Pistor, supra note 1, at 24.
134. See AOKI, supra note 132, at 172-96. Although Aoki identified the German experience as an example of the different model of participative management, the fact that German management have appropriated actual decision making power by relying less on the supervisory board and that shareholdings in response have been concentrated in block holdings, see supra text accompanying notes 57-60, makes the corporative managerialism model more appropriate. See AOKI, supra note 132, at 171, 183.
135. Id. at 126.
of decisional control rights between shareholders and employees actually gives more bargaining power to managers relative to both groups because it permits the managers to form strategic alliances with one or the other group in different circumstances.

Perhaps the best illustration of such advantageous coalition-shifting is provided by Jürgen Schrempp, the Chairman of Daimler-Benz, whose championing of shareholder value through aggressive cost-cutting in the 1990s earned him the nickname “Rambo” from employees. In a dramatic turnaround, Schrempp in 1996 “asserts that worker-management conflict should be avoided and speaks favorably about the German consensus model of labor relations.”

Mr. Schrempp has concluded that the confrontation model, which succeeded in winning the confidence of international investors, has taken him as far as he can go in turning around Daimler-Benz. Further improvement will require substantial cooperation from the workforce, he says, and so he has adopted the softer tone of consensus.

The apparent shift in focus prompted the pro-business Frankfurter Allgemeine Zeitung to ask in an editorial, “is there a new Schrempp in a Daimler concern for whose reorganization he seeks the support of the workers?”

The potential for managers to increase their influence over the enterprise through strategic alliances is a critical factor in analyzing the dynamics of a cross-border and, more importantly, trans-systemic corporate merger. When Daimler-Benz merged with Chrysler in May 1998, a major issue was whether the IG Metall union would cede one of its three seats on the supervisory board to the UAW. The UAW got its seat as part of the merger, a beachhead of sorts for the UAW’s long term strategic goal of creating an

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136. John Schmid, German Cost-Cutter Opt for Peace in Bid to Workers: Daimler-Benz Chief Plays Down 'Shareholder Value,' INT'L HERALD TRIB., Nov. 16, 1996, at 1. Schrempp’s mantra at one time was “profit, profit, profit.” Id.
137. Id.
138. Id.
139. Id.
140. A merger between U.S. and German corporations most starkly presents the issues discussed herein. Other business structures, such as a foreign subsidiary wholly owned by a U.S. corporation, or forms of business combinations, such as an asset transfer, pose different questions. See generally TON DEVOS, U.S. MULTINATIONALS AND WORKER PARTICIPATION IN MANAGEMENT: THE AMERICAN EXPERIENCE IN THE EUROPEAN COMMUNITY (1981) (discussing the effects of different business structures). For example, Ford recently purchased Volvo’s automotive facilities in the form of an asset transfer, while Volvo kept its commercial truck operations and non-automotive products. Volvo cars are keeping the Volvo name and the companies did not merge. See John O’Dell, Ford to Buy Volvo’s Car Operations for $6.4 Billion, L.A. TIMES, Jan. 28, 1999, at C1. Thus, even though Sweden has employees on corporate boards and a highly developed system of works councils, American workers’ interests are not implicated by the asset transfer. See Rippey, supra note 18, at 648. For a general discussion of various forms of corporate transactions and their effect on labor relations, see Edward B. Rock & Michael L. Wachter, Labor Law Successorship: A Corporate Law Approach, 92 MICH. L. REV. 203 (1993).
141. German law requires employee and union representatives on the supervisory board. See supra, text accompanying notes 45-55. Employee representatives are elected by German employees of the company, while union directors are selected by the union. Thus, any UAW representation needed to come from IG Metall. See UAW Will Get Seat on DaimlerChrysler Board, (visited Mar. 8, 1999) <http://www.uaw.com/workingnews /uawnews.98_2.html>.
international auto workers union. The board seat was seen as a major step for the union, because it puts a UAW leader "in the lofty company of other supervisory board members, including top executives of Germany's largest bank, the chairman of multinational conglomerate Bayer AG and the former technology minister of France." Rumors of the rebirth of American auto workers with the corporate marriage, however, may be greatly exaggerated. When a German company merges with an American company, there should be real concern that the German workers, whose returns are achieved partially through rent-sharing in corporate governance, will align opportunistically with the management at the expense of the American workers, whose compensation is negotiated through arms-length collective bargaining. Because German workers can appropriate a share of corporate residuals through the corporate governance mechanism, they have an interest in maximizing the amount of such residuals. Because expenses paid to foreign workers as wages reduce the corporate surplus, domestic workers in the German corporation (like managers and shareholders in American corporations) will be aligned against foreign workers who seek higher returns on their human capital investment through collective bargaining. A seat on the supervisory board is scant protection against such strategic alliances, especially since the board is functionally weak and most of the rent-seeking by employees is achieved at the works council level. At best, the seat gives American workers access to corporate information that may be of strategic value during collective bargaining.

The adverse effect of the alliance between domestic workers and management in a codetermined corporation against foreign workers is illustrated by considering an alternative arrangement. Take, for example, a cross-border but not trans-systemic merger between an American and a Canadian corporation. The transaction is not trans-systemic because neither jurisdiction mandates codetermination and thus both employ collective bargaining as the primary mechanism for achieving employee returns. Because each national union will engage in arms-length negotiation against managers and shareholders for its share of the corporate surplus, there is no incentive for either union to collude with the manager-shareholder coalition against another union. Indeed, following the old adage that an enemy of my enemy is my friend, there would be incentives for the national unions to work together against the manager-shareholder coalition. Conversely, there is no incentive for the manager-shareholder coalition to make side payments to any national unions in exchange for cooperation, for the simple reason that such cooperation (apart

144. This intragroup conflict of interest across border lines does not attach to the same extent, if at all, to shareholders. That is so because money is more fungible than skills, and capital is more mobile than labor. See Howard Chang, Migration as International Trade: The Economic Gains from the Liberalized Movement of Labor, 3 UCLA J. INT'L & FOR. AFF. 371 (1998).
145. There has been some commitment to alleviate the problems posed by the relative power of German and foreign workers in the management of DaimlerChrysler. See UAW Will Get Seat on DaimlerChrysler Board supra note 141 ("IG Metall and UAW leaders said they would seek changes to German law to allow DaimlerChrysler workers worldwide to participate in the election of their representatives on the supervisory board."). Because board representation is but one way German employees affect the management and operation of the corporation, see supra text accompanying notes 56-63, such legal changes would alleviate, but not eliminate, the problem.
from the generalized benefit of harmony) has no strategic purchase. By contrast, when the domestic employees can influence the business enterprise through informal and formal mechanisms of corporate governance, the manager-shareholder coalition has an incentive to pay off domestic employees for their cooperation.\textsuperscript{146} The expense of such side payments may come from the managers' and shareholders' share of the corporate surplus, but more likely they will come from the foreign workers' share, whenever possible.

The above analysis suggests that there will be a systematic distributional effect, but does the conflict of interests impose any efficiency cost on the corporate enterprise? The answer is yes. To the extent that the coalition of domestic interests is successful at enlarging the corporate surplus by reducing the effective wage of foreign workers, such a reduction will increase the potential for unrest among foreign workers. Because such unrest can more easily transform into strikes or other labor actions in America than in Germany, there is a real economic cost to the opportunistic rent-seeking behavior of the domestic coalition. Even if no such strikes or labor actions result, the inherent conflict among the different segments of a claimant group imposes a governance cost that must be borne by the corporation.

Consider, for example, an issue that will likely recur—the location of production facilities.\textsuperscript{147} German workers will strive to keep factories and jobs in Germany in order to maximize their claim on the corporate surplus. This would occur even if it were more cost efficient for the corporation to export factories or jobs out of the country. German workers could assert their influence through the works councils and board participation, while collective bargaining would provide scant protection to foreign workers who seek to maintain or expand their ranks. So long as there are trans-systemic operations, as with the case of DaimlerChrysler, the analysis suggests that domestic (German) workers would have the incentive and ability to maximize their interests even at the expense of the enterprise interest—in other words, to focus on distribution at the expense of production. The situation would be different if either codetermination or collective bargaining were the global norm. Workers would cooperate across national boundaries because their interests would be aligned against other claimant groups. Both domestic and foreign workers would have the same incentives to maximize their collective claims, without distributional considerations between the two groups, as is the case under dual systems of codetermination and collective bargaining.\textsuperscript{148}

One final issue: what of the decision by Daimler-Benz to remain a German corporation after the merger? As one business commentator noted, "Mitbestimmung [German codetermination] received a boost when Daimler-Benz decided to take over Chrysler of the US and incorporate the new company under German law."\textsuperscript{149} Could the

\textsuperscript{146} See, e.g., Schmid, supra note 136, at 1 (quoting an analyst who opined that "[s]ocial peace is a production factor").

\textsuperscript{147} Because of high labor costs in Germany, Daimler-Chrysler may seek to shift production abroad, including to its United States facilities. See Frank Swoboda, Chrysler Deal Ties 2 Unions: Labor Sees Risk, Opportunity Ahead, WASH. POST, May 8, 1998, at A1.

\textsuperscript{148} An interesting corollary, beyond the scope of this paper, is whether global collective bargaining would be preferable to global codetermination.

\textsuperscript{149} Peter Norman, Germany's Unique Worker Co-Determination Model Will Survive EMU But Not Spread Far, FIN. TIMES, June 1, 1998, at 18.
example be one small answer to Jensen’s and Meckling’s rhetorical question in 1979: “If
co-determination is beneficial to both stockholders and labor, why do we need laws
which force firms to engage in it? Surely they would do so voluntarily?”150 It would
seem not. Favorable tax treatment, such as a generous tax loss carry forward, may have
played a more prominent role in the decision.151 More important, even if codetermination
were a motivating factor in the reincorporation decision, it is more likely a product of
corporate opportunism rather than an vote of approval under the classic Tiebout model of
regulatory competition.152 German managers may favor codetermination because it
deters transnational takeovers. In addition, as the above analysis suggests, codetermination may facilitate an alliance of unlikely domestic interests against foreign
claimants of the corporation. Both of these observations suggest significant governance
costs to the corporation, costs that are presumably outweighed by the strategic gains by
one or more of the domestic interests.

V. CONCLUSION

Like ships passing in the night, arguments advanced by contractarian theorists and
communitarian corporate law scholars for the past decade have followed separate
courses. Contributions advance the intellectual theories in their respective paths, but did
so little to address each other that Stephen Bainbridge justifiably observed: “Contractarians and non-contractarians no longer have much of interest to say to one
another; indeed, they barely speak the same language.”153 Where one talks of economics,
the other of law; where one relies on markets, the other on fiduciary duties; where one
favors shareholders, the other stakeholders; so on and so forth, an unwitting academic
tribute to Gershwin emerges.154

Likewise, the academic discussion about codetermination has proceeded along lines
that focused on divergent and seemingly irreconcilable normative objectives. The
corporate law debate generally pits shareholder interests against employee interests.
Even within labor law, advocates of codetermination meet defenders of collective
bargaining and union membership.

For a limited purpose, this Article has sought to bring these powerful intellectual
vessels to port—to discover common strands of thought or at least to join issue over
competing claims. What seems to result is an appreciation that the world of business
enterprises is too complex to admit of a single unifying theory and that the problems of
labor and capital cannot be solved with a single panacea. Add to this complexity the
peculiar issues that arise in transjurisdictional and multinational enterprises, and the
picture becomes even more complicated.

Nevertheless, rid of the excess rhetoric and normative presumptions, the extant
strands of thought significantly converge to clarify the picture of multinational corporate

150. Jensen & Meckling, supra note 1, at 474.
151. Norman, supra note 149, at 18.
153. Bainbridge, Participatory Management, supra note 2, at 661.
154. See George Gershwin & Ira Gershwin, Let’s Call the Whole Thing Off, on I GOT RHYTHM: THE
SMITHSONIAN GEORGE GERSHWIN COLLECTION (Smithsonian 1995) ("You like potato and I like potahto/You
like tomato and I like tomahto/Potato, potahto, tomato, tomahto/Let’s call the whole thing off.").
governance. From this convergence the Article has drawn its tentative conclusions. First, the contractarian understanding of the corporation does not of necessity preclude consideration of employees as claimants of the business enterprise (or, put another way, as potential stakeholders in the corporation). Second, how one satisfies the employees' claims—through express arms length contracting or by treating them as quasi-residual claimants with some control rights—has significant impact on the governance of the business enterprise. Finally, because the various groups of claimants to the business enterprise seek to maximize their interests through strategic interactions within the corporate governance structure, changes in that structure may lead to rather counterintuitive results. Specifically, dividing decisional control rights between shareholders and employees (as in a codetermination system) may enhance the power of managers relative to these groups because managers can use their decisional management function to form strategic coalitions with either employees or shareholders. Moreover, as the analysis of the DaimlerChrysler merger suggests, strategic incentives may differ and thus interests may diverge even between different segments of the same claimant groups. The game has not been fully played out, of course, but intuition would suggest that what first appears to be a governance boon to American employees of Chrysler may prove otherwise—that their interests may be subordinated to those of management and German workers in the merged corporation.

The conclusions here are tentative because neither the conceptual analysis is exhaustive nor the factual observations final. The goal is simply to suggest that an integrative approach toward analyzing corporate governance may help move the debate beyond its current stalemate and contribute to a better collective understanding of the business enterprise and its increasing complexity.