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Codetermination: A Poor Fit for U.S. Corporations

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Abstract

The idea that a corporation's employees should be allowed to elect some of the corporation's board members, a system known as codetermination, has moved to the forefront of U.S. corporate law policy. Elizabeth Warren's Accountable Capitalism Act calls for employees of large firms to elect 40% of all board members. Bernie Sanders's Corporate Accountability and Democracy Plan goes even further and states that workers should elect 45% of board members.

Both Warren's and Sanders's plans are broadly similar to the German law on codetermination, which for many decades has allowed employees of large German corporations to elect up to half of all board members. It is therefore unsurprising that Senator Sanders points to Germany's successful economic development as evidence that economic progress and mandatory codetermination can go hand in hand.

However, this Article argues that codetermination promises to be a poor fit for U.S. corporations. While Germany arguably reaps significant benefits from codetermination, legal, social, and institutional differences between Germany and the United States make it highly unlikely that the United States would be able to replicate those benefits. Furthermore, the costs of codetermination would probably be much higher in the United States than they are in Germany.

Keywords: Codetermination, Corporate Governance, Corporate Objectives, Shareholder Value, Comparative Law, United States Corporations, Sanders Proposal, Warren Proposal, German Law

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However, this Article argues that codetermination promises to be a poor fit for U.S. corporations. While Germany arguably reaps significant benefits from codetermination, legal, social, and institutional differences between Germany and the United States make it highly unlikely that the United States would be able to replicate those benefits. Furthermore, the costs of codetermination would probably be much higher in the United States than they are in Germany.

* Ben H. and Kitty King Powell Chair in Business and Commercial Law, the University of Texas School of Law. For helpful comments and suggestions, we are grateful to Luca Enriques, Willy Forbath, Simon Jaeger, Ewan McGaughy, Konstantinos Sergakis, James Spindler, Wendy Wagner, and workshop participants at the Universities of Oxford and Texas. For excellent research assistance, we are indebted to Emilie Pagano.

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INTRODUCTION

U.S. corporate gives shareholders—and only shareholders—the sole right to elect corporate directors.[1] This governance arrangement is a natural choice if one subscribes to the idea that directors should put the interests of shareholders before those of other constituencies, a principle often referred to as shareholder primacy.[2]

Delaware courts[3] and the vast majority of U.S. corporate law scholars[4] traditionally endorse shareholder primacy as the lodestar of corporate law. Admittedly, a substantial minority of U.S. scholars believe that corporate boards should put an increased focus on other interests such as those of employees or

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[1] DEL. CODE ANN. tit. 8, § 211(b) (providing that shareholders elect directors at the annual meeting or by written consent); MODEL BUS. CORP. ACT § 8.03(c) (Am. Bar Ass'n 2016) (providing that shareholders elect directors at the annual meeting or by written consent).

[2] The concept of shareholder primacy can be defined in different way. For example, it may refer to the duty to maximize shareholder wealth or it may be used to capture the fact that the law gives shareholders "ultimate control". *See* Robert B. Thompson, *Anti-Primacy: Sharing Power in American Corporations*, 71 BUS. LAW. 381, 386-92 (2015) (contrasting these two meanings). The duty to maximize shareholder wealth can also be understood in different ways. A particularly radical understanding of this duty might conceivably hold that directors and officers should manage the corporation *solely* for the benefit of shareholders to the exclusion of other interests. Much of the critique directed against shareholder primacy targets this narrow interpretation of shareholder primacy. *See, e.g.*, Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 673 (2006) (asserting that "[e]xisting legal doctrine and economic theory do not justify evaluating regulatory policy exclusively in terms of shareholder interests"). However, defenders of shareholder primacy typically define shareholder primacy as meaning that managers have to put the interests of shareholders ahead of those of other constituencies. *E.g.*, Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1424 (1993).

[3] *E.g.*, Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998) (stressing that "[t]he board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners"); Weinstein Enterprises, Inc. v. Orloff, 870 A.2d 499, 508–09 (Del. 2005) (stressing that the board of directors must manage the corporation's business for the shareholders' benefit).

[4] *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440-441 (2001) (noting a "growing academic consensus [that] . . . managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders..."); Ian B. Lee, *Efficiency and Ethics in the Debate About Shareholder Primacy*, 31 DEL. J. CORP. L. 533, 535 (2006) (noting that "a nearly overwhelming chorus of academic voices endorsed 'shareholder primacy...').

society as a whole.[5] Moreover, this view seems to have gained a firm place in corporate rhetoric. For example, in 2019, 196 CEOs signed a Business Roundtable resolution, according to which corporations should not only serve the interests of shareholders, but also those of other constituencies.[6]

However, even those scholars and CEOs that critique the shareholder primacy principle typically fail to call into question its corporate governance analog, namely the principle that shareholders are the only stakeholders that have the right to elect

[5] For example, Margaret Blair and Lynn Stout argue in favor of a "team production model" of corporate law—a concept originally advanced by Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972)--and claim that "boards exist . . . to protect the enterprise-specific investments of all the members of the corporate 'team,' including shareholders, managers, rank and file employees..." Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 253 (1999). *Cf.* Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 161 U. PA. L. REV. 2003, 2022 (2013) (arguing that the losses that shareholder primacy imposes on non-shareholder constituents may outweigh its benefits to shareholders). Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 739 (2005), advances several reasons why it may be efficient to allow corporate boards to sacrifice some corporate profits for the benefit of society but does not question shareholders' right to elect directors. David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 228 (2013), argues that boards should pay "faith attention to the interests of multiple corporate stakeholders..."). *Cf.* David J. Berger, *Reconsidering Stockholder Primacy in an Era of Corporate Purpose*, 74 BUS. LAW. 659, 662 (2019) (noting "a growing recognition that the model of stockholder primacy is no longer acceptable, and that corporations must focus on broader corporate purposes, beyond stockholder value"). For a historical account of employee's influence on Corporate Governance in the U.S. see Ewan McGaughey, *Democracy in America at Work: The History of Labor's Vote in Corporate Governance*, 42 SEATTLE U. L. REV. 697 (2019) (arguing that "[t]he United States has one of the world's strongest traditions of democracy at work"). For a decidedly critical view of stakeholder models of corporate governance see Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, CORNELL L. REV. (forthcoming Dec. 2020) (arguing that stakeholderism, in addition to harming shareholders, also imposes substantial costs on stakeholders).

[6] *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans,'* Business Roundtable, (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

corporate directors.[7] It is particularly remarkable, therefore, that two well-known liberal senators and erstwhile contenders for the Democratic presidential nomination, Bernie Sanders and Elizabeth Warren, have embraced the idea of giving the employees of large corporations a voice in corporate governance.[8]

Under Senator Warren's Accountable Capitalism Act,[9] which would apply to corporations with more than $1 billion in annual gross receipts, a corporation's employees would elect 40% of corporate directors.[10] Senator Sanders's proposal is aimed at corporations that are publicly traded or have assets or revenues of at least $100 million. According to his proposal, corporations' employees are to elect 45% of corporate directors.[11]

One can advance several possible justifications for codetermination. To begin, some proponents of codetermination argue in favor of codetermination on dignitary grounds, asserting that codetermination is necessary to preserve the dignity of employees, who ought to be more than mere cogs in the machinery of large corporations.[12] Alternatively, one can defend codetermination on grounds of

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[7] See the authors cited *supra* note 5, none of whom questions the principle that shareholders alone are responsible for electing directors. *See also* Jeffrey N. Gordon, *Addressing Economic Insecurity: Why Social Insurance Is Better Than Corporate Governance Reform*, The CLS Blue Sky Blog (Aug. 21, 2019), https://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-is-better-than-corporate-governance-reform/ (advocating a "kind of lifetime human potential insurance" and arguing that neither a "codetermination strategy" nor abolishing the shareholder primacy principle would adequately address economic insecurity).

[8] Accountable Capitalism Act [hereinafter Accountable Capitalism Act], S. 3348, 115th Cong. § 6(b)(1) (2018); Bernie Sanders, Corporate Accountability and Democracy [hereinafter Sanders, Accountability], https://berniesanders.com/issues/corporate-accountability-and-democracy/(last visited Sept. 7, 2020).

[9] Accountable Capitalism Act, *supra* note 8.

[10] *Id.* § 6 (b) (1).

[11] Sanders, Accountability, *supra* note 8.

[12] The enactment of Germany's 1976 Codetermination Act was prepared by the Mitbestimmungskommission [Commission on Codetermination], which submitted a report on Germany's prior experience with codetermination. Drucksache des Bundestages [BT-Drs.] VI/334 [hereinafter Codetermination Report], http://dipbt.bundestag.de/doc/btd/06/003/0600334.pdf. One of the justifications for codetermination that the Codetermination Report invoked was the idea that it was inconsistent with human dignity to treat employees as mere cogs in a wheel. *Id.* at 18.

distributive justice or fairness. In other words, one can argue that codetermination is necessary to ensure that employees receive their fair share of the wealth created by corporations.[13] Furthermore, one can focus on codetermination's relevance for the political process and ask whether codetermination can help to protect the democratic state against excessive corporate power.[14]

This Article, however, focuses on the economics of codetermination: it asks whether the economic costs of codetermination, if introduced in the US, would outweigh its economic benefits.[15] Crucially, these costs and benefits include not just those accruing to shareholders, but also those imposed on or enjoyed by other constituencies, most notably employees. Further, some costs and benefits—such as the potential satisfaction that employees may derive from having a say how a corporation is run—may be hard to quantify in monetary terms. However, this should not lead one to ignore such costs or benefits.

A plausible analog to the proposals advanced by Senators Warren and Sanders is the German system of mandatory "parity codetermination,"[16] which allows

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[13] *Cf.* Lowell Gallaway, *The Economic Consequences of Codetermination on Employment and Income Distribution*, in THE CODETERMINATION MOVEMENT IN THE WEST 169, 170 (Svetozar Pejovich, ed. 1977) (noting that one of the "standard arguments" in support of codetermination is that codetermination can result in "a more equitable division of wealth, income, and influence").

[14] *See* Jens Dammann & Horst Eidenmüller, *Taming the corporate Leviathan: Codetermination and the Democratic State* (ECGI., Law Working Paper No. 536, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3680769&download=yes (arguing that codetermination can play an important role in protecting democratic institutions).

[15] Hence, we apply a cost/benefit standard as benchmark to judge the merits of codetermination. Cost/benefit analysis is based on the so-called Kaldor/Hicks test for judging the welfare effects of policy measures. According to this test, a measure increases overall efficiency if the "winners" under the measure could compensate the "losers" (i.e. could make them whole) and still enjoy a residual benefit. *See, e.g.*, HORST EIDENMÜLLER, EFFIZIENZ ALS RECHTSPRINZIP: MÖGLICHKEITEN UND GRENZEN DER ÖKONOMISCHEN ANALYSE DES RECHTS 51-54 (4th ed. 2015).

[16] The term parity codermination is commonly used in the literature. *E.g.*, Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539, 547 (2000); Vahid Dejwakh, *The Directorist Model of Corporate Governance: Why A Dual Board Structure for Public Corporations Is Good for Shareholders, Entrepreneurs, Employees, Capitalism, and Society*, 8 WM. & MARY POL'Y REV. 57, 93 (2016).

employees of firms with more than 2,000 employees to elect half of the board members.[17] The Warren and Sanders proposals resemble parity codetermination because both come close to the German model regarding the number of board seats that they allocate to employee representatives. Moreover, Germany is the largest Western economy to reserve a substantial number of board seats to employee representatives,[18] which makes it tempting to extrapolate from the German experience. In fact, Senator Bernie Sanders explicitly invokes German codetermination as a model, pointing out that his proposal is "similar to what happens under 'employee co-determination' in Germany, which long has had one of the most productive and successful economies in the world."[19]

This Article therefore analyzes the prospects for codetermination in the United States, taking into account the German experience. We argue that while codetermination may offer substantial economic benefits at relatively low costs in Germany, there are compelling reasons to think that it would be a poor fit for the United States, at least as long as other institutional, legal, and economic differences between the two economies persist.

Drawing on the economic theory underlying codetermination, we show that many of the core benefits that Germany reaps from codetermination are much less likely to materialize in the United States.[20] Additionally, the costs of codetermination would likely be much more substantial in the United States than in Germany.[21] Therefore, while mandatory codetermination may well be an efficient and desirable regime for Germany, the United States would likely suffer a welfare loss by following in Germany's footsteps.

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[17] *See infra* Part I.A.

[18] Of the largest European economies—Germany, the United Kingdom, France, Spain, and Italy—only France and Germany have embraced codetermination, and in France, employees are only entitled to elect one or at most two directors. *See infra* Table 1.

[19] Sanders, *Accountability*, *supra* note 8.

[20] *See infra* Part IV.

[21] *See infra* Part V.

The argument we present in this Article comes with two important caveats. First, we disregard the question of whether codetermination might be desirable for non-economic reasons, an issue that we explore in other work.[22] Second, we concede that some of the structural differences between the United States and Germany, to which we point in this Article, may theoretically diminish over time. For example, the United States could accord a much more central role to collective bargaining, move from a corporate law system that consists largely of default rules to one relying heavily on mandatory law, and reduce the role of capital markets in financing firms and instead rely more heavily on bank financing. If these and other changes were to occur, codetermination might be as good a fit for American firms as it is for German firms. However, we assume that it is highly unlikely that the United States will fundamentally reshape its business institutions, law, and economy in the foreseeable future. Therefore, for the purpose of our current analysis, we disregard the possibility of such changes.

This Article is structured as follows: Part I summarizes the German law on codetermination. Part II highlights the differences between the German rules on codetermination and the proposals by Senators Sanders and Warren. Part III analyzes the economic scholarship on the impact of Germany's codetermination regime on firm productivity, wages, and shareholder wealth and shows that the results are, by and large, inconclusive. Part IV argues that if the United States were to adopt a mandatory codetermination regime, U.S. corporations and workers would be unlikely to reap some of the core benefits that codetermination yields in Germany. Part V addresses the potential costs of codetermination and demonstrates that these would likely be much higher in the United States than they are in Germany.

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[22] *See supra* note 14 (arguing that codetermination can help to protect democratic institutions by curbing excessive corporate power).

I. THE GERMAN LAW ON CODETERMINATION

Laws on board-level participation of workers exist in many jurisdictions, most of them in Europe.[23] However, the German codetermination regime stands out for two reasons. Germany is by far the largest western economy to reserve a substantial number of board seats to employee representatives.[24] Moreover, the "German model" is particularly far-reaching in that it reserves half of all board seats to employee representatives at the largest corporations (Table 1).[25] Perhaps for these reasons, Germany's codetermination regime often serves as a prototype[26] or at least as a reference point for alternative policy proposals.[27]

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[23] See the surveys on the European Trade Union Institute website http://www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation2 (last visited Mar. 12, 2020). Outside of Europe, China has adopted codetermination based on the German regime. Tom C. Hodge, *The Treatment of Employees As Stakeholders in the European Union: Current and Future Trends*, 38 SYRACUSE J. INTL. L. & COM. 91, 102 (2010).

[24] *Supra* note 18.

[25] *See, e.g.*, Franklin Allen et al., *Stakeholder Governance, Competition, and Firm Value*, 19 REV. FIN. 1315, 1316 (2015) (calling Germany "[t]he most striking example" of a stakeholder model).

[26] *Cf.* Cynthia Estlund, *Will Workers Have a Voice in China's "Socialist Market Economy"? The Curious Revival of the Workers Congress System*, 36 COMP. LAB. L. & POL'Y J. 69, 89 (2014)(noting that "German WC system is recognized as a 'prototype' within Europe and is relatively familiar outside Europe").

[27] *See* Andreas Kokkinis & Konstantinos Sergakis, *A flexible model for efficient employee participation in UK companies*, 20 J. CORP. L. STUD. (2020) (in print) (arguing for a more flexible model of employee participation than the German model of codetermination against the background of the broader UK institutional framework).

The current German law on codetermination mainly relies on two statutes:[28] the 1976 Codetermination Act[29] and the 2004 One-Third Participation Act.[30]

Table 1: Board-Level Codetermination and Board Structure in European Countries

Country	Percentage	Board	Country	Percentage	Board
Austria	1/3	2-tier	Hungary	1/3	Either
Croatia	1 rep.	Either	Luxembourg	1/3	1-tier
Czech Rep.	1/3	2-tier	Norway	1/3	1-tier
Denmark	1/3	2-tier	Slovakia	1/3	2-tier
Finland*	¼	Either	Slovenia	1/2	Either
France**	1 rep.	Either	Sweden	3 rep.***	1-tier
Germany	½	2-tier			

Note: This table displays the maximum number of employee representatives that must be included on corporate boards. If that percentage differs depending on a corporation's size, we focus on the largest corporations. Special rules for particular industries or for companies that are fully or partially owned by the government are disregarded. * In Finland, the number of employee representatives is determined by agreement between management and workers. However, if no agreement is reached, the employees are entitled to elect one fourth of all board members. ** In France, employees have the right to elect one board member, but that board member only has an advisory function. ** In Sweden, the law allows employees at companies with more than 1000 employees to elect 3 representatives to the corporate board. However, the shareholders can determine the total number of board members and can therefore determine the fraction of employee representatives. In practice, about one third of board members tend to be employee representatives. Sources for the various national laws are provided in the footnotes.

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[28] The German law on codetermination involves other statutes as well, but they are of marginal importance to this Article. In particular, Germany has enacted a special statute on codetermination governing stock corporations in the coal and steel industry, the so-called Coal and Steel Codetermination Act of 1951. Gesetz über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie [Law on the Participation of Workers in the Supervisory Boards and Managing Boards of Companies in the Coal, Iron and Steel Industries], May 21, 1951, Bundesgesetzblatt I at 341 [hereinafter Coal and Steel Codetermination Act]. For a summary of this statute see Jens C. Dammann, *The Future of Codetermination After Centros: Will German Corporate Law Move Closer to the U.S. Model?*, 8 FORDHAM J. CORP. & FIN. L. 607, 619-20 (2003) [hereinafter Dammann, *The Future of Codetermination*]. For a historical analysis of the German codetermination regime *see* Ewan McGaughey, *The Codetermination Bargains: The History of German Corporate and Labour Law*, 23 COL. J. EUROP. LAW 125 (2016).

[29] Gesetz über die Mitbestimmung der Arbeitnehmer [MitbestG] [Codetermination Act], May 4, 1976, Bundesgesetzblatt BGBl I at 1153 [hereinafter Codetermination Act].

[30] Zweites Gesetz zur Vereinfachung der Wahl der Arbeitnehmervertreter in den Aufsichtsrat Article 1 [One-Third Participation Act], May 18, 2004, BGBl I at 974 [hereinafter One-Third Participation Act].

Sources for the various national rules on codetermination[31] and board structure[32] are provided in the footnotes.

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[31] Austrian law allows employees of stock corporations to allow one-third of the supervisory board's members. BETRIEBSRÄTEGESETZ [Works Council Act], May 15, 1919, STAATSGESETZBLATT [STGBL] 283/1919, § 3 (11). Croatian law allows employees of stock corporations to elect one board member. Maja Ključar, *Unternehmensmitbestimmung der Arbeitnehmer in Kroatien [Employee Codetermination in Croatia]*, 14 WIRTSCHAFT UND RECHT IN OSTEUROPA [WIRO] 359, 361 (2005). Czech law allows employees at stock corporations with at least 500 employees to elect one-third of all supervisory board members. L. Fulton, *National Industrial Relations: Czech Republic: Board-level Representation: an Update*, WORKER PARTICIPATION (2020), http://www.worker-participation.eu/National-Industrial-Relations/Countries/Czech-Republic/Board-level-Representation#_ftn1. In Denmark, employees at stock corporations with at least 30 employees have the right to elect one-third of all supervisory board members. FELIX HÖRISCH, UNTERNEHMENSMITBESTIMMUNG IM NATIONALEN UND INTERNATIONALEN VERGLEICH: ENTSTEHUNG UND ÖKONOMISCHE AUSWIRKUNGEN [A COMPARATIVE AND INTERNATIONAL PERSPECTIVE ON CODETERMINATION: HISTORY AND ECONOMIC IMPACT] 33 (2009). In Finland, employees at least 150 employees are entitled to negotiations over employee board representation. If these negotiations fail, employees are entitled to elect one employee representative for every four shareholder representatives, but the minimum number of employee representatives is one and the maximum number is four. HÖRISCH, *supra*, at 34. The employer can choose whether codetermination applies to the managing board or the supervisory board. *Id.* In France, employees at stock corporations with at least 1,000 employees in France or 5,000 employees globally have the right to elect one board member. Code de Commerce [C. Com.] [Commercial Code] art. L225-27-1(II) (Fr.). The number of employee board representatives increases from one to two if the board as eight or more members. *Id.**;*** Loi 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises [Law No. 2019-486 of May 22, 2019 Relating to the Growth and Transformation of Business] O. J. No. 119, May 23, 2019, Text No. 2, Art. 184 (1) (4) (b) (replacing the word twelve with the word eight). In Germany, employees at corporations with more than 2000 employees elect half the members of the supervisory board. Codetermination Act, *supra* note 29, at 29(2). In Hungary, the situation is more complicated in that it depends on whether a stock corporation has a one-tier or a two-tier board structure. Hungary's 2006 Business Corporation Act allows single-tier boards as well as two-tier boards and makes codetermination optional in companies with single-tier boards. *László Neumann, Board-Level Employee Representation in Hungary: A Useful Tool for Company Unions and Works Councils¸ in* EUROPEAN BOARD-LEVEL EMPLOYEE REPRESENTATION 101, 104 (James Waddington, ed. 2018). By contrast, employees of stock corporations with a two-tier board structure and at least 200 employees by default have the right to elect one-third of the corporation's supervisory board members. *Id.* However, even in corporations with a two-tier board structure, the corporation can opt out of codetermination, albeit only if the corporation's works council approves. *Id.* In Luxemburg, employees at corporations with at least 1000 employees have the right to elect one third of all supervisory board members. Valérie Raynaud, *Employees' Co-Determination in*

Luxembourgian Companies, *in* EMPLOYEE-CODETERMINATION IN THE MEMBER STATES OF THE EUROPEAN UNION 63, 65 (Theodor Baums & Peter Ulmer eds., 2004). In the Netherlands, employees at corporations with at least 100 employees have the right to nominate one-third of all supervisory board directors. Levinus Timmerman & Salco-Jan Spanjaard, *Arbeitnehmermitbestimmung in den Niederlanden* [*Codetermination in the Netherlands*], *in* EMPLOYEE-CODETERMINATION IN THE MEMBER STATES OF THE EUROPEAN UNION 75, 75 (Theodor Baums & Peter Ulmer eds., 2004). In Norway, employees at corporations with 30 to 49 employees have the right to elect one board member, and corporations with 50 or more employees have the right to elect one-third of all board members. Inger Marie Hagen, *Norwegian Board-Level Employee Representatives: Still in a Prominent Position*, *in* EUROPEAN BOARD-LEVEL EMPLOYEE REPRESENTATION 119, 123-24 (James Waddington ed., 2018). In the Slovak Republic, employees in stock corporations with at least 50 employees elect one-third of all supervisory board members. L. Fulton, *Worker representation in Europe: Slovak Republic: Board-level Representation*, WORKER PARTICIPATION (2013), http://www.worker-participation.eu/National-Industrial-Relations/Countries/Slovak-Republic/Board-level-Representation. In Slovenia, employees at corporations with at least 500 employees elect one-third of all board members. HÖRISCH, *supra*, at 41; Valentina Franca, *Board-Level Employee Representation in Slovenia: From the Constitution to Practice*, *in* EUROPEAN BOARD-LEVEL EMPLOYEE REPRESENTATION 143, 143 (James Waddington ed., 2018). In Sweden, employees at corporations with at least 25 employees have the right to elect 2 board members and that employees at corporations with at least 1000 employees have the right to elect three board members. Fredrik Movitz & Johanna Palm, *Board-Level Representation in Sweden: A Neglected Aspect of the Swedish Model?*, in EUROPEAN BOARD-LEVEL EMPLOYEE REPRESENTATION 155, 158-59 (James Waddington ed., 2018).

[32] Austrian stock corporations have a two-tier board structure. Aktiengesetz [Stock Corporation Act], March 31, 1965, BGBl. Nr. 98/1965 [hereinafter Austrian Stock Corporation Act], § 70 (providing for a managing board), § 86 (providing for a supervisory board). Crotian stock corporations have a two-tier board structure Ključar, *supra* note 31, at 360 (noting that a supervisory board is mandatory); Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1, 72 n.107 (2011)(noting that Croatian law imposes a two-tier board structure). Stock corporations in the Czech Republic can choose between a one-tier system and a two-tier system, though the two-tier system is the legal default. Petr Bohata, *Tschechische Republik: Gesetz über Korporationen—Teil 6: Aktiengesellschaft* [*Czech Republic: Corporation Act—Part 6: Stock Corporations*], 22 WIRTSCHAFT UND RECHT IN OSTEUROPA [WIRO] 17, 18-19 (2013). In Denmark, the law on stock corporations mandates a two-tier system. *E.g.*, Cynthia Van Hulle, *On the Nature of European Holding Groups*, 18 INTL. REV. L. & ECON. 255, 276 n.3 (1998). In Finland, stock corporations can choose between a one-tier board structure and a two-tier board structure. Hanjo Hamann, *Unpacking the Board A Comparative and Empirical Perspective on Groups in Corporate Decision-Making*, 11 BERKELEY BUS. L.J. 1, 12 (2014). Stock corporations in France also have the choice between a one-tier board structure and a two-tier board structure. Hamann, *supra*, at 12-13. Stock corporations in Germany have a two-tier board structure. Aktiengesetz [Stock Corporation Act], Sept. 6, 1965, BGBl. I 1089 [hereinafter German Stock

A. THE 1976 CODETERMINATION ACT

German stock corporations have a mandatory two-tier board structure consisting of the managing board and the supervisory board. The managing board is in charge of day-to-day operations.[33] The supervisory board appoints the members of the managing board,[34] monitors the managing board's work,[35] and has the power to remove managing board members for cause.[36]

Under Germany's main codetermination statute, the 1976 Codetermination Act, shareholders elect half of the members of the supervisory board and employers elect the other half.[37] It is therefore common to speak of this system as "parity

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Corporation Act], § 76(1) (providing for a managing board), § 95 (governing the size of the supervisory board). In Hungary, stock corporations have the choice between a one-tier structure and a two-tier structure. Neumann, *supra* note 31, at 104. The law governing stock corporations in Luxembourg adheres to a one-tier structure. Van Hulle, *supra* note 31, at 258. Norwegian stock corporations have a one-tier board structure. Hagen, *supra* note 31, at 121 (noting that a Norwegian board combined monitoring and supervisory functions); Anne Sweigart, *Women on Board for Change: The Norway Model of Boardroom Quotas As A Tool for Progress in the United States and Canada*, 32 NW. J. INT'L L. & BUS. AMBASSADOR 81A, 101A (2012)(noting that Norwegian corporations have a one-tier board system); Martin Gelter & Geneviève Helleringer, *Lift Not the Painted Veil! To Whom Are Directors' Duties Really Owed?*, 2015 U. ILL. L. REV. 1069, 1078 (2015)(noting that Norway imposes a one-tier board structure). In the Slovak Republic, stock corporations have a two-tier board structure. Fulton, *supra* note 31. In Slovenia, stock corporations can choose between a one-tier and a two-tier system, although the vast majority of corporations have a two-tier board structure. Franca, *supra* note 31, at 145-46. In Sweden, the law on stock corporations provides for a two-tier system. Movitz & Palm, *supra* note 31, at 159-60.

[33] German Stock Corporation Act, *supra* note 32, at § 76(1).

[34] *Id.* at § 84(1).

[35] *Id.* at § 111(1).

[36] *Id.* at § 84(3).

[37] Codetermination Act, *supra* note 29, at § 7(1). Only German employees can stand for election, and only German employees have the right to vote, even in German companies with a clear majority of non-German employees. Whether this is compatible with European anti-discrimination laws is highly questionable. See, *e.g.*, the contributions in MATHIAS HABERSACK, CASPAR BEHME, HORST EIDENMÜLLER & LARS KLÖHN (EDS.), DEUTSCHE MITBESTIMMUNG UNTER EUROPÄISCHEM REFORMZWANG (2016). The Court of Justice of the European Union (CJEU) nevertheless upheld

codetermination." However, the balance is tilted slightly in favor of the shareholders:[38] if the board is deadlocked, the chairperson of the board holds the swing vote.[39] This rule tends to give an edge to the shareholder representatives because if the board cannot agree on a chairperson, the shareholder representatives elect the chairperson.[40]

Moreover, it is worth noting that the German Codetermination Act does not treat employees as a monolithic group. Rather, at least one of the workers' representatives must be a managerial employee.[41] As a result, the employee representatives may not represent identical interests and may not always vote as a block.[42]

German stock corporations are subject to the 1976 Codetermination Act if they have more than 2000 employees.[43] A different statutory regime applies to firms in the coal and steel industries.[44] Charitable, political, and news organizations are exempt.[45]

Privately held firms are typically incorporated as limited liability companies known as *Gesellschaften mit beschränkter Haftung* (GmbH).[46] The 1976

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the German rules in a landmark judgment in 2017: CJEU, Case C-566/15 (Konrad Erzberger v. TUI AG), Judgment of Jul. 18, 2017, http://curia.europa.eu/juris/celex.jsf?celex=62015CJ0566&lang1=en&type=TXT&ancre=.

[38] Jens C. Dammann, *Future of Codetermination, supra* note 28, at 620-21.

[39] Codetermination Act, *supra* note 29, § 29(2).

[40] *Id.* § 27(2). Against this background, some scholars prefer to use the term "quasi-parity codetermination" in connection with the 1976 Codetermination Act. *E.g.*, Mariana Pargendler, *The Grip of Nationalism on Corporate Law*, 95 IND. L.J. 533, 545 (2020).

[41] Codetermination Act, *supra* note 29, § 11(2).

[42] *See e.g.*, Henry Hansmann, *Worker Participation and Corporate Governance*, 43 TORONTO L.J. 589, 602 (1993) (noting that managerial employees sometimes side with management).

[43] Codetermination Act, *supra* note 29, § 1(1)(2).

[44] Coal and Steel Codetermination Act, *supra* note 28.

[45] Codetermination Act, *supra* note 29, § 1(4).

[46] *Taxable Persons and Entities and their Products and Services 2018*, FEDERAL OFFICE OF STATISTICS (Sept. 7, 2020) https://www.destatis.de/DE/Themen/Staat/Steuern/Umsatzsteuer/Tabellen/voranmeldungen-rechtsformen.html, (reporting that in 2018, the number of Aktiengesellschaften (stock corporations)

Codetermination Act applies to limited liability companies as well, as long as these have more than 2,000 employees.[47] Unlike stock corporations, limited liability companies do not, by default, have a two-tier board structure.[48] However, a limited liability company that is subject to the 1976 Codetermination Act is required to have both a managing board and a supervisory board.[49]

B. THE ONE-THIRD PARTICIPATION ACT

Companies with 2,000 or fewer employees do not fall under the 1976 Act.[50] However, they may be subject to codetermination under the so-called One-Third Participation Act of 2004.[51] The One-Third Participation Act applies to corporations and limited liability companies that have at least 500 employees.[52] It gives employees the right to elect one third of the company's supervisory board members and is thus less far-reaching than the 1976 Act.[53]

II. THE PROPOSALS BY SENATORS WARREN AND SANDERS

Senators Warren and Sanders' proposals come close to Germany's 1976 Codetermination Act. However, this should not divert from the fact that there also remain significant differences. As we discuss below, these differences relate

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filing tax returns was 7,777 whereas the number of GmbHs (limited liability companies) filing tax returns was 544,738).

[47] *Id*. § 1(1).

[48] Gesetz betreffend die Gesellschaften mit beschränkter Haftung [GmbHG] [Limited Liability Companies Act], Apr. 20, 1892, RGBl. at 477, last amended by Gesetz [G] of Jul. 17, 2017, BGBl. I at 2446, available (with English translation) at https://www.gesetze-im-internet.de/englisch_gmbhg/index.html (last visited Sept. 9, 2020), Art. 52 (providing which rules apply if the articles of organization call for the creation of a supervisory board).

[49] Codetermination Act, *supra* note 29, § 6(1).

[50] *Id.* § 1(1)(2).

[51] *Supra* note 30.

[52] One-Third Participation Act, *supra* note 28, § 1(1).

[53] *Id.* § 4(1).

primarily to the number of firms and less to the number of employees covered by the respective proposals.

C. SCOPE OF APPLICATION

Perhaps the most obvious difference concerns the scope of application. Senator Warren's bill would apply to corporations and limited liability companies (LLCs), as long as they are engaged in interstate commerce and have more than $1,000,000,000 in gross receipts.[54] Senator Sanders's proposal targets corporations that are publicly traded, have at least $100 million in annual revenues, or at least $100 million in balance sheet total (total assets).[55] By contrast, the 1976 Codetermination Act applies whenever the company has more than 2,000 employees, and it captures both corporations and limited liability companies.

These different criteria can lead to vastly different outcomes. Table 2 illustrates this point by applying the various approaches to public corporations that are headquartered in the United States and included in Standard & Poor's Compustat—a database commonly used for empirical research in economics and finance.[56] For the purpose of this exercise, we treat U.S. corporations and limited liability companies as equivalents to German stock corporations, *Aktiengesellschaften*, and German limited liability companies (GmbHs), respectively.

Compustat relies on data from companies' financial statements filed with the Securities Exchange Commission (SEC). Therefore, Compustat does not include privately held firms. Accordingly, Table 2 only highlights the differences between the various approaches for publicly traded firms. Even for these firms, however, the differences are substantial. Sanders' plan applies to all 3,437 public corporations headquartered in the United States and included in the CRSP/Compustat Merged

[54] Accountable Capitalism Act, *supra* note 8, § 2 (2).

[55] Sanders, *Accountability*, *supra* note 8.

[56] We disregard the "interstate commerce" requirement contained in the Accountable Capitalism Act, since Compustat data do not allow us to ascertain whether that requirement is met. However, as a practical matter, it is safe to assume that the vast majority of publicly traded corporations do not limit their business to one state.

database for the year 2019, the most recent year for which data is available. By contrast, Warren's Accountable Capitalism Act would cover about 40% fewer companies, as would the 1976 Codetermination Act. The differences become smaller, however, if the focus is on the number of employees covered, the combined market capitalization, or the assets of covered firms. This is because the large public corporations that are within the scope of all three plans account for the bulk of employees, assets, and market capitalization.

Table 2: Coverage of Public Corporations (2019)

	Number of companies	Employees (in millions)	Market Capitalization (in $ trillion)	Assets (in $ trillion)
Sanders	3,437	31.47	29.9	45.3
Warren	1,237	29.56	27.9	42.3
1976 Act	1,349	30.55	27.4	40.8

Note: We drop partnerships and trusts as well as entities headquartered or incorporated outside the United States. Limited liability companies (LLCs) are included in the numbers for the Warren proposal and the 1976 Act, but not in those for Sanders' proposal. The variable total revenues is employed to capture total revenues (Sanders) and gross receipts (Warren).[57]

The policy goals underlying these different criteria are not always obvious. The German approach, which focuses on the number of employees, is perhaps the most intuitive: codetermination is meant to protect employees, and a greater number of employees means that there are more people who need protection. We suspect that Senator Warren's proposal focuses on gross receipts mainly because they are readily apparent from a corporation's tax return. Similarly, Senator Sanders' focus on annual revenues, balance sheet totals, and a firm's status as a public corporation may partially be motivated by ease of administration. In addition, a switch to mandatory codetermination is bound to trigger substantial compliance costs, and a

[57] We only include firm observations for which the variables employees ("emp"), total assets ("at"), market capitalization, ("prcc_f" * "csho"), and total revenues ("revt") are available. These restrictions reduce the datasets by 446, 0, 1, and 7 observations, respectively.

corporation's gross receipts or balance sheet totals may be an indicator of that corporation's ability to shoulder these costs.

D. BOARD COMPOSITION

The U.S. proposals also differ from German codetermination law with respect to their impact on corporate boards. Part of the difference pertains to the general structure of boards. Germany has traditionally relied on a two-tier board structure with respect to public corporations. The management board is responsible for the day-to-day management of the corporation[58] and the supervisory board for the supervision of the management board.[59] German codetermination law only requires that one of the two boards, namely the supervisory board, include employee representatives.[60] By contrast, U.S. corporations have a one-tier board, and the codetermination proposals that Senators Sanders and Warren have put forth do not purport to change this structure. Hence, if implemented, codetermination would directly impact the management of U.S. corporations.

Moreover, it is important to note that the two U.S. proposals differ slightly from German law with respect to the number of employee representatives. The 1976 Codetermination Act allows employees to elect 50% of the supervisory board members,[61] whereas Senator Warren's plan calls for employees to elect 40% and Senator Sanders' plan 45%.[62]

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[58] *See* German Stock Corporation Act, *supra* note 32, at § 76 (1) (1) (providing that the managing board is responsible for managing the corporation).

[59] *Id.* § 111 (1) (providing that the supervisory board monitors the corporation's management). See Sections 76 and 111 of the German Stock Corporation Act ("Aktiengesetz").

[60] Codetermination Act, *supra* note 29, § 7(1).

[61] *Id.*

[62] Accountable Capitalism Act, *supra* note 8, § 6 (b) (1); Sanders, *Accountability*, *supra* note 8.

III. THE EMPIRICAL SCHOLARSHIP ON CODETERMINATION

Germany's relative economic success[63] suggests, at the very least, that codetermination does not constitute an insurmountable obstacle to prosperity.[64] But the question remains whether German firms would be doing even better without codetermination. Since the enactment of the 1976 Codetermination Act, numerous empirical studies have sought to analyze the impact of codetermination on shareholder wealth, firm productivity, wages, and job security. However, as shown in the following section, many of the existing studies face substantial methodological challenges. Moreover, different studies have yielded vastly different results.[65] In that sense, the empirical literature remains inconclusive. Furthermore, existing empirical studies must take into account additional factors, as this article does in subsequent sections.

E. CORRELATION STUDIES

Many early studies on codetermination looked for correlations between codetermination and variables such as firm performance or wages.[66] For example,

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[63] As of 2019, Germany's GDP per capita was $46,258, placing it ahead of various most major economies, including, for example, Canada ($46,194); France ($40,493); Japan ($40,293), South Korea ($31,762) and the United Kingdom ($ 42,300), though well behind the United States ($65,118), let alone Switzerland ($81,994). The World Bank, GDP Per Capita (Current $US), https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?most_recent_value_desc=true (last visited Sept. 9, 2020).

[64] *See* Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INTL. REV. L. & ECON. 203, 206 (1994) (noting that even though it is unclear whether codetermination is a success, "the prognosis of dramatic systemic consequences has proved wrong").

[65] *See, e.g.*, the various sources cited *infra* note 66.

[66] *E.g.*, Larry Fauver & Michael E. Fuerst, *Does Good Corporate Governance Include Employee Representation? Evidence From German Corporate Boards*, 82 J. FIN. ECON. 673, 686 (2008) (using a sample of 786 publicly traded German firms, 400 of which have employee representatives on their boards, and finding that codetermination is associated with a higher Tobin's q); Gary Gorton & Frank Schmidt, *Capital, Labor, and the Firm*, 2 J. EUR. ECON. ASSOC. 863 (2004) (focusing on 250 large German public corporations and finding that firms that are subject to parity codetermination have a 31% lower market-to-book ratio than firms with one-third codetermination);

in a seminal paper from 2004, Gary Gorton and Frank Schmidt showed that parity codetermination was associated with an average 31% decline in firms' market-to-book ratio.[67]

The obvious problem with such studies is that correlation does not imply causation. Instead, observed correlations may be due to unobserved ("omitted") variables.[68] This problem is particularly conspicuous in the context of codetermination: to fall under the 1976 Codetermination Act, a firm must have more than 2,000 employees, and there are reasons why some firms have more employees than others. For example, a company that can automate much of its production may be able to reduce the number of workers and thereby increase its profitability.[69] Thus, the ability to automate can be an omitted variable that causes the firm's stock price (and hence its market-to-book ratio) to rise while also leading to a decline in the number of employees, thereby preventing the application of the 1976 Codetermination Act. In this example, a negative correlation between parity codetermination and market-to-book ratio may result, but that correlation does not imply that codetermination *causes* a decrease in book value.[70]

Andreas Bermig & Bernd Frick, *Board Size, Board Composition and Firm Performance*, Working Paper, University of Paderborn, 2010, https://d-nb.info/1036553361/34, run fixed effects regressions using panel data on 294 firms for the years 1998 to 2007. They find that no statistically significant evidence that the share of union representatives and employee representatives is associated with Tobin's q. They find that the share of independent employee representatives is negatively associated with Tobin's q, but that finding is only significant at the 10% level. *Id.* at 135 fig. 9 (summarizing the findings).

[67] Gorton & Schmidt, *supra* note 66, at 879.

[68] For an useful introduction to the problem of omitted variable bias *see, e.g.*, JOSHUA D. ANGRIST & JÖRN STEFFEN PISCHKE, MOSTLY HARMLESS ECONOMETRICS 59-64 (2009).

[69] *Cf.* Cynthia Estlund, *What Should We Do After Work? Automation and Employment Law*, 128 YALE L.J. 254, 258 (2018) (discussing claims that automation boosts profits while reducing the number of middle-class jobs).

[70] To reduce the problem of unobserved variable bias, some studies use panel data (meaning datasets containing observations for the same set of firms at different points in time). Panel data have the advantage that they allow for the use of firm fixed effects, meaning that one can compare a company's performance at a given time to that same company's *average* performance. This approach makes it possible to filter out the impact of time-invariant firm-level variables, even if one

F. DIFFERENCE-IN-DIFFERENCES

One common econometric approach to overcome the limitation of correlation studies is to identify a so-called natural experiment, meaning some exogenous event, and apply a difference-in-differences analysis.[71] The intuition behind a difference-in-differences approach is straightforward: one identifies a group of subjects that the event impacts, the so-called treatment group, and another group that the event does not impact, the so-called control group. By comparing outcomes in the two groups before and after the fact, one can ascertain the event's impact.

Several well-known studies on codetermination employ this technique, typically using the enactment of the 1976 Codetermination Act as the treatment event.[72] However, even for the 1976 Codetermination Act, these studies yield

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cannot observe these variables. For example, if a company's ownership structure does not change over time, then that ownership structure cannot be the reason why the company performs better in one year than in others. However, the use of firm fixed effects cannot exclude unobserved variable bias resulting from variables that change over time. Furthermore, there can be many unobserved changes in a firm's economic, legal, and institutional environment that may both impact the firm's performance and cause firms to fall above or below the 2000-employee threshold. Accordingly, even if regressions control for firm fixed effects, observed correlations can tell us very little about the impact of codetermination.

[71] For a relatively recent analysis of the strengths and weaknesses of difference-in-differences approaches *see*, *e.g.*, Michael Lechner, *The Estimation of Causal Effects by Difference-in-Difference Methods*, 4 FOUNDATIONS & TRENDS IN ECONOMETRICS 165 (2011); Sebastian Bunnenberg & Steffen Meyer, *Trusting Difference-in-Differences Estimates More: An Approximate Permutation Test*, Working Paper, Feb. 22, 2017, available at https://ssrn.com/abstract=2805116.

[72] *E.g.*, Felix R. FitzRoy & Kornelius Kraft, *Economic Effects of Codetermination*, 95 J. ECON. 365 (1993) (using a sample of 112 German corporations, comparing their performance in 1975 and in 1983, and finding that parity-codetermination is associated with lower productivity) [hereinafter FitzRoy & Kraft, *Economic Effects*]; Frank A. Schmid & Frank Seger, *Arbeitnehmermitbestimmung, Allokation von Entscheidungsrechten und Shareholder Value* [*Codetermination, Allocation of Decision Rights, and Shareholder Value*], 68 ZEITSCHRIFT FÜR BETRIEBSWIRTSCHAFT 453 (1998) (using a sample consisting of data for 160 publicly traded corporations in the years 1976, 1987, and 1991 and focusing on firms' market-to-book value as a dependent variable); Kornelius Kraft & Marija Ugarković, *Gesetzliche Mitbestimmung und Kapitalrendite (Codetermination and Return on Equity),* 226 JAHRBÜCHER FÜR NATIONALÖKONOMIE 588 (2006) (using a sample of 179 firms for the years 1971 to 1976 and 1981 to 1986 and finding a small but statistically significant positive correlation between parity

contrary results, finding either a negative or a positive impact on firm productivity or no impact at all.[73] Similarly, different studies have yielded mixed results on whether or not the enactment of the 1976 Act led to higher wages.[74]

This variation in findings is not particularly surprising if one takes into account the limitations of difference-in-differences studies. Such studies are potentially much more useful than mere correlation studies. Difference-in-difference designs are, in principle, a recognized "identification strategy", meaning an approach that uses observational data[75] to approximate a scientific experiment.[76] However, they remain highly vulnerable to unobserved variable bias.[77] Any change in an

codetermination and return on equity); Michael A. Gurdon & Anoop Rai, *Codetermination and Enterprise Performance*, 42 J. ECON. BUS. 289, 299 tab. 6 (1990) (using a sample of 63 firms and observations for the years 1970, 1975, 1980, and 1985 and finding that parity-codetermination is associated with a statistically significant decline in productivity while also finding an increase in profitability, though the statistical significance of the latter depends on the years observed).

[73] FitzRoy & Kraft, *Economic Effects*, *supra* note 72 (using a sample of 112 German corporations, comparing their productivity in 1975 and then again in 1983, and finding that the treatment group experienced a statistically significant decline in both productivity and profitability relative to the control group); Felix R. FitzRoy & Kornelius Kraft, *Co-determination, Efficiency and Productivity*, 43 BRIT. J. INDUSTRIAL REL. 233 (2005) (analyzing a sample of 179 large manufacturing firms in the years 1972-76 and 1981-85, and finding that switching to parity-codetermination was associated with an increase in productivity); Kornelius Kraft, *Productivity and Distribution Effects of Codetermination in an Efficient Bargaining Model*, 59 INT. J. INDUSTRIAL ORG. 2018, 458 (2018) [hereinafter Kraft, *Productivity*] (using a sample of 154 large manufacturing firms and finding no impact on productivity). Other authors have focused on firms' market-to-book ratios as a matter of firm performance. *See, e.g.*, Schmid & Seger, *supra* note 72, at 453 (using a sample of 160 firms, and finding that the introduction of the 1976 Codetermination Act resulted in an 18% decline in market-to-book ratios for treatment group firms).

[74] FitzRoy & Kraft, *Economic Effects*, *supra* note 72, at 374 (finding no statistically significant evidence that the enactment of the 1976 Codetermination Act impacted wages but noting that it may have increased job security); Kraft, *Productivity*, *supra* note 73, at 458 (finding that the 1976 Codetermination Act increased workers' bargaining power vis-à-vis employers).

[75] Observational data are data which are not obtained from an actual experiment. *E.g.*, JEFFREY M. WOOLDRIDGE, INTRODUCTORY ECONOMETRICS: A MODERN APPROACH 2 (4th ed. 2009) [hereinafter WOOLDRIDGE, ECONOMETRICS].

[76] *See, e.g.*, ANGRIST & PISCHKE, *supra* note 68, at 7.

[77] JEFFREY M. WOOLDRIDGE, ECONOMETRIC ANALYSIS OF CROSS SECTION AND PANEL DATA 148 (2nd ed. 2010) [hereinafter WOOLDRIDGE, PANEL DATA] (noting that the treatment event must

unobserved variable that coincided with the treatment event and had a different impact on the treatment group and the control group can mask as a treatment effect.[78] This general weakness of difference-in-difference studies looms large in the context of codetermination. Firms that have enough employees to trigger the application of the 1976 Codetermination Act and are therefore part of the treatment group differ from firms in the control group, which by definition have fewer employees. As a result, any change in the institutional, legal, or economic environment that occurred between the first and the second date of observation and that influences large firms differently compared to small firms can be mistaken for a treatment effect. To name just one example, the year 1979 saw the beginning of the second oil crisis, which was triggered by the Iranian Revolution in 1979 and compounded by the war between Iran and Iraq that began in 1980. There is no reason to believe that the oil crisis impacted larger firms in the exact same way that it affected smaller firms.[79]

not be systematically related to unobserved variables that may affect the dependent variable). Another limitation is that difference-in-differences studies rely on the so-called parallel trend assumption, meaning that the treatment group firms and the control group firms must have developed in a parallel fashion prior to the treatment event. *E.g.*, Ashesh Rambachan & Jonathan Roth, *An Honest Approach to Parallel Trends*, Working Paper, Dec. 18, 2019, at 1, available at https://scholar.harvard.edu/files/jroth/files/roth_jmp_honestparalleltrends_main.pdf.

[78] *Cf.* ANGRIST & PISCHKE, *supra* note 68, at 243 (cautioning that the difference-in-differences approach assumes that any omitted variables are time-invariant and noting that "for many causal questions, the notion that the most important omitted variables are time invariant doesn't seem plausible").

[79] Chun-Li Tsai, *How Do U.S. Stock Returns Respond Differently to Oil Price Shocks Pre-Crisis, Within the Financial Crisis, and Post-Crisis?*, 50 ENERGY ECON. 47, 47-62 (2015), examines how the stocks of U.S. firms respond to oil price shocks before, during, and after the financial crisis that began in 2008. He not only finds that the severity of the reaction depends on firm size, but also notes that the relationship between firm size and adverse stock market reactions to oil prices shocks varies over time.

G. EVENT STUDIES

Event studies focusing on the stock market's short-term reaction to events of interest are the workhorse of empirical corporate finance.[80] Like difference-in-differences studies, event studies require a treatment event, such as the enactment of new legislation. Ideally, that treatment event impacts some firms but not others, creating a treatment group and a control group. As noted above, the 1976 Codetermination Act fits this mold since it only applies to firms with more than 2,000 employees,[81] thereby leaving public firms with 2000 or fewer employees as the control group.

In an event study, a certain period before the event, the so-called estimation window, is used to predict firms' stock price returns during the so-called event window, which often includes the day of the event itself plus one or two days. By subtracting a firm's *predicted* stock return from its *actual* stock return during the event window, one obtains a firm's (cumulative) abnormal stock return. If the treatment group firms experience statistically significant abnormal returns relative to the control group firms, then, in the absence of confounding factors, it stands to reason that this difference is due to the event.

Several studies have used the event-study methodology to explore the impact of codetermination on shareholder wealth.[82] In general, these studies have found no statistically significant results,[83] or they have found that introducing or extending

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[80] *See, e.g.*, Scott E. Harrington & David G. Shrider, *All Events Induce Variance: Analyzing Abnormal Returns When Events Vary Across Firms*, 42 J. FIN. & QUANT. ANALYSIS 229, 229 (2007) (noting that "the short-horizon event study remains a workhorse of empirical finance in general and corporate finance in particular").

[81] Codetermination Act, *supra* note 29, § 1(1)(2).

[82] *E.g.*, Stefan Petry, *Mandatory Worker Representation on the Board and Its Effect on Shareholder Wealth*, 47 FIN. MGMT 25 (2018); Theodor Baums & Bernd Frick, *Co-Determination in Germany: The Impact of Court Decisions on the Market Value of Firms*, 1 ECON. ANALYSIS 143 (1998).

[83] *E.g.*, Baums & Frick, *supra* note 82 (examining stock price reactions to 23 court decisions between 1974 and 1995 which either expanded or limited codetermination, but finding no statistically significant results).

parity codetermination is associated with statistically significant negative abnormal returns.[84]

However, whereas event studies are generally quite suitable to identify the shareholder wealth effects of legislation, they cannot necessarily answer the question of whether codetermination constitutes an efficient choice for German, let alone U.S. corporate law. Part of the problem is that Germany's social, institutional, and legal landscape looks very different now from what it looked like in 1976.[85] The fact that the 1976 Act may have reduced shareholder wealth at the time of its enactment does not necessarily imply that that is still true today.

More importantly, an essential limitation of event studies is that they *only* capture the impact on shareholder wealth but not the impact of workers, even though workers are the intended beneficiaries of codetermination.[86]

Finally, event studies face the challenge that they can only measure an event's impact on existing publicly-traded firms since it is only for these firms that one can ascertain a stock market reaction to the events of interest. By contrast, the stock market's reaction does not allow researchers to estimate an event's impact on privately held firms or firms that will only be formed in the future. To use a simple example, imagine that a country imposes strict fuel standards for the first time. Such legislation may be bad news for existing car manufacturers. Still, it may offer benefits to entrepreneurs forming electric car companies *in response to* the new law, and event studies do not capture these benefits. It is entirely conceivable that

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[84] Stefan Petry analyzes the stock market's reaction to various legislative milestones on the way to the enactment of the 1976 Codetermination Act. Petry, *supra* note 82. He finds an average aggregate response of negative 1.5% in cumulative abnormal returns relative to firms in the control group. Other studies have come to similar conclusions. *Id.*

[85] For an excellent account of the legal and institutional changes that are most pertinent to corporate law *see* Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG*, 63 AM. J. COMP. L. 493 (2015).

[86] The term "event study" is used here to refer to studies that measure the stock market's reaction to certain events. The stock market's reaction captures investors' beliefs about how events impact the value of stock By contrast, the impact that such events have on constituencies other than stockholders is not reflected except to the extent that it also impacts the value of stocks.

codetermination allowed some new firms to flourish and go public that might not otherwise have achieved the same degree of success.

H. INSTRUMENTAL VARIABLES

Another strategy to identify the impact of codetermination is using instrumental variables.[87] The underlying idea is that even though the explanatory variable of interest, e.g. codetermination, may be correlated with the error term, we can sometimes find another variable—the instrumental variable—that is correlated with the explanatory variable of interest but not with other explanatory variables or with the error term.[88] If so, one can establish causation between the explanatory variable of interest (e.g., codetermination) and the outcome variable (e.g., firm performance) by demonstrating a correlation between the instrumental variable and the outcome variable.[89]

The following example, which is taken straight from one of the leading treatises on econometrics,[90] may illustrate this identification strategy: In the 19th century, a scientist named John Snow hypothesized that the disease cholera was transmitted by unclean water. A naïve approach to test this hypothesis would have been to look for a correlation between unclean water consumption and infection with cholera.[91] However, any such correlation could have been due to a variety of other factors since, in practice, the consumption of impure water correlated with poverty.[92] Fortunately, Snow noticed that otherwise similar households were served by different water companies, one of them supplying cleaner water than the other.[93] Because the identity of the water company was correlated with the explanatory

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[87] For a brief explanation of instrumental variables *see, e.g.*, WOOLDRIDGE, PANEL DATA, *supra* note 77, at 112-14.

[88] *E.g.*, WOOLDRIDGE, ECONOMETRICS, *supra* note 75, at 508.

[89] *E.g.*, ANGRIST & PISCHKE, *supra* note 68, at 117.

[90] WILLIAM H. GREENE, ECONOMETRIC ANALYSIS 228 (7th ed. 2012).

[91] *Id.*

[92] *Id.*

[93] *Id.*

variable of interest—water quality—but not with other explanatory variables or with unobserved variables captured in the error term, Snow could use the identity of the water company as an instrument to demonstrate that impure water was in fact causal for cholera infections.[94]

To return to the issue of codetermination, recall that finding a correlation between codetermination and other variables of interest, such as firm productivity, does not tell us much since there may be unobserved variables that cause the firm to hire more employees and thereby trigger the application of parity codetermination, while at the same time causing the firm to be more productive.[95]

One could avoid these biases if it were possible, first, to find a purely exogenous variable that causes the 1976 Act to be applicable provided that, second, the only way in which this exogenous variable can impact firm productivity was through the application of the 1976 Codetermination Act. In that case, a correlation between the exogenous variable and firm performance would suggest that codetermination affects firm performance. However, to the best of our knowledge, no paper to date has identified an instrumental variable for codetermination that satisfies the twin challenges of being correlated with the explanatory variable of interest, while being demonstrably uncorrelated with other explanatory variables and the error term. For example, one paper uses various firm characteristics to predict the number of a firm's employees and then uses that predicted value as an instrument for the applicability of codetermination.[96] However, the problem with this approach is that the firm characteristics used to predict the number of employees may well have an impact on firm performance, implying that the instrument may impact the outcome

[94] *Id.*

[95] It is even conceivable that firm productivity (indirectly) causes the application of the 1976 Codetermination Act rather than the other way around (reverse causality).

[96] Fauver and Fuerst have taken this approach to estimate the impact of codetermination on various variables of interest, most notably firm performance, as measured by Tobin's q. Fauver & Fuerst, *supra* note 66, at 700. They proceed as follows: in a first step, they use several firm characteristics such as a firm's industry to predict the number of a firm's employees. In a second step, they use this predicted value as an instrument for the level of codetermination and find a positive correlation with Tobin's q. *Id.* at 704.

of interest (firm performance) through channels other than codetermination.[97] For example, there are many factors such as a firm's industry, that influence the number of employees and thereby, indirectly, the level of codetermination. However, a firm's industry also impacts a firm's performance regardless of the applicable codetermination regime.[98]

To conclude, decades of empirical research on codetermination's effect on firm productivity lead to a sobering assessment: the results hardly yield a compelling case for or against codetermination.[99] As a consequence, the case for and against codetermination cannot be made by simply pointing to hard empirical evidence. Qualitative arguments that go beyond what is easily measurable are called for. Moreover, empirical studies with data from Germany or other European countries inevitably raise the question of external validity:[100] given different social, regulatory, and institutional environments, one cannot easily assume the results of the relevant studies can be extrapolated to the United States.

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[97] In more technical terms, the instrument (predicted number of employees) may be correlated with the error term.

[98] For example, Fauver & Fuerst, *supra* note 66, at 704, use Tobin's q to measure firm performance. However, for reasons that have nothing to do with codetermination, Tobin's q is known to correlate with industry. *See, e.g.*, Dong Wook Lee et al., *Does Capital Flow More to High Tobin's Q Industries*, Fisher College of Business Working Paper No. 2018-03-008, May 9, 2018, p. 10 (showing that the average difference in median Tobin's q between high funded and low-funded industries is 0.184 and that this difference is statistically significant at the 1% level). The correlation between industry and Tobin's q is unsurprising given that Tobin's q, to a large extent, measures a firm's growth opportunities. Lee et al., *supra*, at 1.

[99] A more recent study by Simon Jaeger, Benjamin Schoefer & Joerg Heining, *Labor in the Boardroom*, MIT Economics (August 25, 2020), available at www.economics.mit.edu/files/17273 (last visited September 14, 2020), makes use of a so-called regression-discontinuity approach. *Id.* at 20. Note, however, that the study finds no effect of moving from one-third codetermination to parity-codetermination for wages and wage structures. *Id.* at 33. The study also fails to find any negative impact of codetermination, though the authors caution that this may be due to data limitations. *Id.* For a simple introduction to regression discontinuity *see, e.g.*, ANGRIST & PISCHKE, *supra* note 68, at 251-67.

[100] The term external validity refers to the "predictive value of [a] study's findings in a different context." ANGRIST & PISCHKE, *supra* note 68, at 151.

IV. THE BENEFITS OF CODETERMINATION

Despite the inconclusive empirical case for and against codetermination, it is quite plausible that codetermination has allowed Germany to reap a number of important monetary and/or non-monetary benefits. However, as shown in this Part, these benefits are unlikely to materialize in the United States to the same extent. As a consequence, and focusing on the benefits of codetermination alone, the case for introducing codetermination in the United States is weaker than in Germany. It gets even weaker when taking into account the costs of codetermination, which we consider in Part V.

I. COLLECTIVE BARGAINING

Henry Hansmann has famously argued that codetermination may yield important efficiency benefits in the context of collective bargaining.[101] Corporate boards typically know more about their companies' financial situation than the labor unions with whom they are bargaining over wages.[102] This informational asymmetry can prevent the bargaining parties from reaching an agreement: Unions may suspect that employers describe their firms' financial prospects too negatively in order to obtain lower wages. Meanwhile, employers may be unable to demonstrate their sincerity in a credible way. Strikes, which can be costly both for the parties involved and for other companies up or down the supply chain, may be the consequence.[103] Codetermination, however, ensures that the employee

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[101] Henry Hansmann, *When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy*, 99 YALE L.J. 1749, 1803 (1990).

[102] *See id.* (noting that without codetermination, "accurate and credible information about the firm . . . would . . . be confined to management").

[103] *See id.* at 1766 (explaining that information asymmetries between management and labor can cause both sides to resort to "bargaining strategies, such as strikes and lockouts, that significantly raise the transaction costs of reaching agreement").

representatives have access to the same information as other board members.[104] As a result, mandatory codetermination can mitigate or eliminate the information asymmetry between employers and workers.[105]

However, the magnitude of this benefit depends on the role that collective bargaining plays in a country's economy.[106] In the United States, this role is far smaller than in Germany, as well as in other European countries (Table 3).[107] In 2015, the most recent year for which coverage rates are available for both the United States and Germany, only 7.2% of private-sector employees in the United States were covered by collective bargaining agreements (Table 3). In contrast, the coverage rate for private-sector employees in Germany was 50.2% (Table 3). Other European countries that provide for mandatory employee representation on corporate boards such as Austria, France, Norway, or Sweden also tend to have much higher coverage rates than the United States (Table 3). Meanwhile, the United Kingdom, where relatively few private-sector workers are covered by collective bargaining agreements (Table 3), requires no form of employee codetermination on corporate boards.[108]

[104] *Cf.* See Bundesgerichtshof (Federal Supreme Court), Judgment of Feb. 25, 1982 (II ZR 145/80), NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1530-31 (1982) (holding that employee representatives and shareholder representatives must be treated equally).

[105] *Id.* The role of codetermination in reducing asymmetric information in the context of collective bargaining is now widely accepted. *E.g.*, Luca Enriques et al., *The Basic Governance Structure; Minority Shareholders and Non-Shareholder Constituencies*, in THE ANATOMY OF CORPORATE LAW at 105 (Reinier Kraakman et al. eds., 3rd ed. 2017); Jens Dammann, *The Mandatory Law Puzzle: Redefining American Exceptionalism in Corporate Law*, 65 HASTINGS L.J. 441, 479 (2014).

[106] To some extent, employees bargaining individually with their company might also benefit from better information. However, even if one assumes that an individual employee has enough leverage to negotiate their salary and even if one further assumes that the employer's economic prospects plays a central role in these negotiations, an individual employee's bargaining generally will prove less disruptive to the company than collective strikes.

[107] Dammann, *Mandatory Law Puzzle*, *supra* note 105, at 480.

[108] Reforms were considered by the former UK government led by Prime Minister Theresa May in 2016-2018. However, no political momentum towards this end could be achieved. *See, e.g.*, Larry Elliott, *Theresa May misses a trick after U-turn on workers on boards*, THE GUARDIAN

Table 3: Percentage of Private Sector Employees Covered by Collective Bargaining Agreements

	Austria	Belgium	France	Denmark	Germany	Norway	Spain	Sweden	U.K.	U.S.
2017	94.0%	N.A.	N.A.	N.A.	N.A.	52.0%	59.0%	N.A.	15.2%	7.3%
2016	N.A.	90.0%	N.A.	74.0%	N.A.	54.0%	62.8%	85.0%	14.9%	7.3%
2015	N.A.	N.A.	90.2	N.A.	51.2%	N.A.	61.2%	84.0%	14.7%	7.4%

Note: All data are obtained from Jelle Visser, ICTWSS: Database on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts in 55 Countries Between 1960 and 2018 (Amsterdams Instituut voor ArbeidsStudies (Amsterdam Inst. for Advanced Labour Studies), Database No. 6.1, 2019), available at http://uva-aias.net/en/ictwss.

Of course, even the United States might benefit from the disclosure function of codetermination law, at least to some extent. However, given the low percentage of private-sector workers covered by collective bargaining agreements, it stands to reason that the relevant benefits would be relatively limited.

J. FIRM-SPECIFIC INVESTMENTS

Scholars have argued that codetermination may encourage employees to make so-called firm-specific investments.[109] The basic idea is simple: Firms can often increase their productivity by persuading employees to acquire skills or knowledge that is useful as long as the employee works for that particular company but has little value anywhere else.[110] For example, a corporation benefits if an engineer becomes acquainted in great detail with the corporation's particular manufacturing processes and patents even though the engineer may not be able or allowed to use that knowledge in subsequent positions at other firms.

(June 10, 2018), https://www.theguardian.com/business/2018/jun/10/theresa-may-misses-a-trick-after-u-turn-over-workers-on-boards.

[109] *See, e.g.*, Erik G. Furubotn, *Codetermination and the Modern Theory of the Firm: A Property-Rights Analysis*, 61 J. BUS. 165, 170-174 (1988).

[110] *See id.* at 168 (noting that "labor's investment in the firm can be understood as a vital input; the capital in question represents nothing less than one part of the total capital stock needed by the firm for production.").

From an employee's perspective, firm-specific investments are potentially risky. After all, the employer knows that the employee cannot take his firm-specific expertise elsewhere.[111] As a result, the employer may encourage employees to make firm-specific investments but then refuse to compensate them for their increased productivity.[112] The prospect of employer opportunism may lead the employee to abstain from making firm-specific investments in the first place, even where such investments would produce positive joint payoffs for the parties. Codetermination, the argument runs, is a mechanism that allows employers to make a credible commitment to reward employees for their firm-specific investments.[113] Given employee representation on the board, employees could anticipate that they would be treated fairly and that loyalty and relationship-specific investments would pay off.

Part of the problem with this theory is that there is no empirical evidence to back it up. We are not aware of any study showing that codetermination makes employees more willing to make firm-specific investments. Furthermore, it is worth noting that Germany has adopted many different rules that protect employees against ex-post expropriation by employers and encourage firm-specific investments. For example, whereas U.S. firms can generally fire employees at will,[114] German employment law adheres to the so-called for-cause termination rule under which employers need a specified (personal or business) reason to end an

[111] *See id.* at 167 (noting that employees typically cannot move without costs or nearly without costs from one employer to another).

[112] *See id.* (noting that employees who have invested in the firm "if unprotected by institutional or contractual safeguards, may be exploited and suffer serious economic injury."

[113] E. Han Kim et al., *Labor Representation in Governance as an Insurance Mechanism*, 22 REV. FIN. 1251, 1256 (2018) (noting that "[w]orkers often have to . . . make investments in firm-specific human capital . . . , which makes them vulnerable to breaches of implicit contracts" and arguing that "parity-codetermination serves as a commitment device by allowing workers to influence employment decisions").

[114] Dammann, *Mandatory*, *supra* note 105, at 480; Julie C. Suk, *Discrimination at Will: Job Security Protections and Equal Employment Opportunity in Conflict*, 60 STAN. L. REV. 73, 78-79 (2007).

employment relationship.[115] Furthermore, many employees are covered by collective bargaining agreements that aim at providing employees with fair wages (cf. Table 1).

Additionally, German labor law does not just give employees a voice in the supervisory board. It also imposes an entirely distinct institutional structure, the so-called "works councils" that are designed to safeguard the rights of employees. Employees in companies with five or more employees have the right to elect a works council,[116] and employers are required by law to either inform the works council or even seek its approval on many important managerial issues.[117] In their entirety, these rules offer a high level of protection to German employees, and it shows. For instance, for male workers between the ages of 18 and 60, the average job tenure is about four years in the United States versus seven years in Germany.[118]

Adopting a German-style system of codetermination may be one step towards encouraging more firm-specific investment. However, it is not at all clear that mandatory codetermination is an important or even the most important factor to

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[115] Kündigungsschutzgesetz [KSchG] [Protection Against Termination Act], Aug. 25, 1969, BGBl I at 1317, last amended by Gesetz [G], July 17, 2017, BGBl I at 1317, §1 (Ger.) (prohibiting terminations without cause).

[116] Betriebsverfassungsgesetz (Works Council Act) of October 11, 1952, BGBl I at 681, last amended by Gesetz [G], Dec. 8, 2018, BGBl I, at 2651, § 1(1)(1). Note, though, that the obligation to create a works council arises only if at least five of the company's employees are at least 18 years old. *See id.* at § 1(1)(1) (requiring five employees that have the right to vote in works council elections), § 7 (1) (providing that employees have the right to vote in works council elections if they are at least 18 years old). Furthermore, at least three of the five employees must be electable, *id.* at § 1 (1) (1), which generally requires that they have worked for the employer for at least six months, *id.* at § 8 (1) (1).

[117] *See id.* §§ 81, 90 (listing matters in which the employer has to inform the works council), §§ 87, 91 (listing matters in which the works council has a co-decision right).

[118] Kenneth A. Couch, *Tenure, Turnover, and Earnings Profiles in Germany and the United States*, 1 J. BUS. & ECON. RES. 1, 3 (2011). *See* U.S. BUREAU OF LABOR STATISTICS, Economic News Release: Employee Tenure Summary, USDL-18-1500, https://www.bls.gov/news.release/tenure.nr0.htm (stating that the median number of years that U.S. workers had been with their current employer was 4.2).

achieve this end and that adopting mandatory codetermination in isolation will make much of a difference.

K. EMPLOYEE INTERESTS

Codetermination on corporate boards may have benefits which are harder to quantify in addition to more tangible benefits which can easily be monetized. Employees could derive satisfaction from having a say in how a company is run or from feeling at least partly in control of their own fate.[119] Even though such benefits are hard to quantify, they should nevertheless be accounted for in a cost/benefit analysis which otherwise would be seriously incomplete.

At first glance, benefits of this type which can be derived from a codetermination regime should be universal in character and should not depend significantly on the institutional fabric of a specific jurisdiction. We do not attempt to verify or falsify this claim. However, in the following we demonstrate that, whatever non-tangible benefit employees derive from a codetermination regime, it is probably very small or even immaterial compared to the very real interest of employees to have a secure and well-paying job.

When the discussion on board codetermination took shape in post-war Germany in the late 1940s, "[t]he prevailing view at the time was that political democracy must be combined with social constraints over the use of private capital, a concept that has been termed 'economic democracy' (Wirtschaftsdemokratie)."[120] Potential

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[119] Hansmann, *supra* note 101, at 1769 (pointing out that "individual workers might enjoy the process of collective decision-making as a communal activity that is satisfying in itself quite apart from the character of the decisions reached" but also noting that the distribution of employee-owned firms, which tend to arise in industries "where firms are relatively small and have relatively homogeneous work forces with little hierarchy" suggests that alienation may not be an important factor).

[120] Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, in EMPLOYEES AND CORPORATE GOVERNANCE 163, 167 (Margaret M. Blair and Mark J. Roe eds. 1999).

benefits of codetermination were seen in a "democratization" of political and business life, going much beyond Corporate Governance-related improvements.

One aspect of this goal related to the protection of human dignity which reflects a fundamental human right (and interest). Article 1(1) of the German Constitution (*Grundgesetz* ("Basic Law")) stipulates that "Human dignity shall be inviolable."[121] Scholars argued that board codetermination would protect employees from becoming mere objects of business decisions that they cannot influence, let alone control.[122] Furthermore, the proponents of codetermination argued that the 1976 Act would lead employees to engage more with the affairs of their firm and develop a sense of responsibility—traits that were said to strengthen democracy.[123] Such effects could be interpreted as employees putting a value on the protections afforded by codetermination.

These are views on which reasonable minds can differ. Whatever the merits of the argument that, without codetermination, employees are relegated to being mere objects of decisions taken by others, it seems clear to us that board codetermination would not address the main concern of employees working today. Their main concern is not being treated in a dehumanizing fashion at their workplace in a (large) corporation. Rather, it is losing their job entirely or having to move into the precarious position of a (seemingly) independent contractor in the gig economy.[124] This concern has become even more acute because of the COVID 19-pandemic. (Seemingly) independent contractors all over the world, including the US in particular, are facing the (economic) abyss. Of course, corporations are hit by the

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[121] An officially authorized English language version of the *Grundgesetz* can be accessed at https://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html#p0019 (last visited on 23 March 2020).

[122] *See* Thomas Raiser, *Paritätische Mitbestimmung in einer freiheitlichen Wirtschaftsordnung* [*Parity Codetermination in a Free Market System*], 29 JURISTENZEITUNG [JZ] 273, 276 (1974).

[123] *Id*.

[124] For a balanced account of this development see JEREMIAS PRASSL, HUMANS AS A SERVICE: THE PROMISE AND PERILS OF WORK IN THE GIG ECONOMY (2018).

crisis, too.[125] However, at least large corporations operate as a kind of firewall between the crisis and the individual worker: it is a well-documented phenomenon that wages prove somewhat "sticky" during bad economic times, meaning that even as employment falls, employers tend to abstain from lowering wages.[126]

The underlying logic is well-recognized in labor economics. Assuming that firms are risk-neutral, whereas employees are generally risk-averse, it makes economic sense to shift the risk of labor market fluctuations from employees to the corporation.[127] Under this model, a firm and its employees enter into an implicit contract under which employees accept lower wages in exchange for the implicit promise that the firm will refrain from lowering his or her wages during bad times[128] Empirical evidence from labor markets is consistent with this model.[129]

Independent contractors do not have the benefit of this buffer. In addition, empirical research has demonstrated that employees in large corporations are paid better than those working in SMEs,[130] although that difference has been shrinking

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[125] Patrick Mathurin, *Pandemic Triggers Wave of Billion-Dollar U.S. Bankruptcies*, FIN. TIMES, August 21, 2020, https://www.ft.com/content/277dc354-a870-4160-9117-b5b0dece5360 (reporting that as of August 17, 45 companies with assets in excess of $ 1 billion have filed for bankruptcy under Chapter 11 compared to 18 such companies during the same period in 2019 and compared to 38 during the same period in 2009 during the financial crisis).

[126] Ernst Fehr & Armin Falk, *Wage Rigidity in a Competitive Incomplete Contract Market*, 107 J. POL. ECON. 106, 107 (1999) (noting that "[r]ecently performed questionnaire studies with owners and managers of firms suggest that employers are unwilling to cut wages in the presence of unemployment); Robert E. Hall, *Employment Fluctuations and Wage Rigidity*, 1980 Brookings Papers on Economic Activity 9, 9 (1980) (noting that "[d]uring the past decade, two facts about the U.S. labor market became more apparent than ever before: the large magnitude of fluctuations in employment and the lack of any strong response of wages to these fluctuations").

[127] Oliver Hart, *Optimal Labour Contracts Under Asymmetric Information: An Introduction*, 50 REV. ECON. STUD. 3, 3 (1983); Edward N. Gamber, *Long-Term Risk-sharing Wage Contracts in an Economy Subject to Permanent and Temporary Shocks*, 6 J. LABOR ECON. 83, 83-84 (1988).

[128] *Id.*

[129] *See* Gamber, *supra* note, 127, at 96 (providing empirical evidence that wages respond more strongly to permanent then to temporary shocks, which is consistent with an income smoothing function of employment).

[130] *See, e.g.*, Christoph M. Schmidt & Klaus F. Zimmermann, *Work Characteristics, Firm Size, and Wages*, 73 REV. ECON & STAT. 705, 705 (1991) (noting that there is "substantial evidence from

somewhat in recent years.[131] Against this background, advocating board codetermination in large corporations on the basis that this measure would help humanize and "dignify" workplace conditions in such corporations is beside the point.

V. THE COSTS OF CODETERMINATION

Codetermination has costs as well as benefits. These costs are bound to arise in any country that adopts mandatory codetermination. However, as shown below, they are likely to be much greater in the United States than they are in Germany. As a consequence, and taking into account that any benefits of codetermination would be significantly smaller in the United States than in Germany, the case for introducing mandatory codetermination in the United States is extremely weak.

A. THE FUNCTIONING OF THE BOARD

One of the core challenges of mandatory codetermination is that it guarantees divided loyalties within the board: the shareholder representatives know that they must please the shareholders to get reelected, whereas the worker representatives know that their reelection depends on keeping employees satisfied.[132] These

many countries" that larger firms pay higher wages than smaller firms); Nicholas Bloom et al., *The Disappearing Large-Firm Wage Premium*, 108 AEA PAPERS & PROC. 317, 317 (2018) (noting that "[l]arge firms pay higher wages than smaller firms even after controlling for the quality of a worker").

[131] Bloom et al., *supra* note 130, at 317 (finding that the average wage premium that workers in firms with at least 10,000 employees earn compared to firms with 100 or fewer employees has declined from 47% in the early 1990s to 20% by the early 2010s)

[132] *See* Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INTL. REV. L. & ECON. 203, 206 (1994) (noting that "the conflict of interests problem is considered to be serious" and explaining that "[i]t is clear that the expectations of the workers and the unions set into 'their' representatives are irreconcilable with … a neutral role").

different perspectives can make it harder for boards to work constructively towards the same end.[133]

Of course, there now exists a rich literature emphasizing the benefits of diverse boards. In particular, having directors with different experiences and viewpoints can, in principle, avoid problems like groupthink and thereby improve decision-making.[134] Against this background, skeptics may be tempted to dismiss our reasoning by arguing as ignoring the benefits of viewpoint diversity. However, this objection would misunderstand the argument we are making. We do not question the value of board diversity. Instead, we would like to point out that corporations can reap the benefits of diversity without the downside of having directors with fundamentally different goals.[135]

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[133] *See, e.g.*, Mark J. Roe, *German Codetermination and German Securities Markets*, 1998 COLUM. BUS. L. REV. 167, 168 (1998) (noting that "low conflicts of interest" are one of the factors that make boards effective). In fact, because workers often have very heterogenous interests depending on their jobs, age, seniority, and salaries, conflicts of interests among board members would be often substantial even if the board consisted solely of employee representatives. *Cf.* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 89-91 (1996) (explaining how different groups of employees have different interests and how these different interests substantially increase the costs of collective decision-making). The problem that different goals reduce the effectiveness of boards subject to codetermination will continue to apply even if, at some point, humans on corporate boards are substituted by (artificially intelligent) autonomous machines. On the technological developments in this area and Corporate Governance implications see John Armour & Horst Eidenmüller, *Self-Driving Corporations?*, 10 HARV. BUS. L. REV. (2020) (forthcoming). The key Corporate Governance issue in an AI-driven corporation will become setting the corporation's goal function. This is easier if the goal function is shareholder value maximization and not some mix of goals or perspectives.

[134] The legal literature now also recognizes the importance of diversity for the quality of decision-making. In particular, advocates of greater board diversity stress that such diversity reduces the danger of group think. *E.g.*, DOUGLAS M. BRANSON, NO SEAT AT THE TABLE: HOW CORPORATE GOVERNANCE AND LAW KEEP WOMEN OUT OF THE BOARDROOM 177, 178 (2007); Seletha R. Butler, *All on Board! Strategies for Constructing Diverse Boards of Directors*, 7 VA. L. & BUS. REV. 61, 76 (2012); Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 277 (2012).

[135] Note that California has enacted legislation imposing a gender quota for the boards of California-based public corporations. CAL. CORP. CODE ANN. § 301.3 (West 2020). The gender quota introduced by S.B. 826. It took effect on January 1, 2019. *See* An Act to Add Sections 301.3 and 2115.5 to the Corporations Code, Relating to Corporations, S. B. 826, 2017-2018 Leg., Reg.

The beneficiaries of a less functional board might be a corporation's managers. If employee representatives and shareholder representatives on the board cannot agree on goals, strategies, or supervisory measures, managers are likely to gain more leeway in pursuing self-interested actions—to the detriment of both shareholders and employees. Agency costs in the form of managerial opportunism would be a likely result.[136] For example, as the intensity with which boards monitor managers declines, managers may exploit their resulting leeway to shirk to waste corporate resources on unprofitable "pet projects"[137] or "empire-building."[138]

The rise and fall of cumulative voting illustrates the importance of board collegiality.[139] Cumulative voting can help minority shareholders elect some of their representatives to the board.[140] Despite the potential salutary effect of minority shareholder representation on monitoring,[141] and even though minority and majority shareholders typically share the basic goal of maximizing shareholder

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Sess. § 2 (Cal. 2018). By the end of the year 2019, publicly traded corporations whose principal offices are located in California had to have at least one female director. CAL. CORP. CODE § 301.3(a)-(b). For a discussion of the implications of this statute for state competition in corporate law see Jens Dammann, *State Competition for Corporate Headquarters and Corporate Law: An Empirical Analysis*, Md. L. Rev. (forthcoming 2021).

[136] On the agency costs associated with the separation of ownership and control see also *infra* Section B. On monitoring as the key function of the board see STEPHEN M. BAINBRIDGE & M. TODD HENDERSON, OUTSOURCING THE BOARD 45-48 (2018).

[137] *See, e.g.,* Simone M. Sepe, *Intruders in the Boardroom: The Case of Constituency Directors*, 91 WASH. U. L. REV. 309, 319 (2013) (mentioning pet projects as an instance of managerial agency costs).

[138] For a discussion of empire building, see, e.g., Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1915 (2013).

[139] Cumulative voting enjoyed such recognition that many states made cumulative voting mandatory. *See* Jeffrey N. Gordon, *Institutions As Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 145 (1994) (noting that in the 1940's, no fewer than 22 states had mandatory rules requiring cumulative voting in corporate elections).

[140] *See, e.g.*, John F. Coyle, *Altering Rules, Cumulative Voting, and Venture Capital*, 2016 UTAH L. REV. 595, 597–98 (2016) (explaining, by way of an example, how cumulative voting can help minority shareholders elect their favored candidates to the board even if the majority is opposed).

[141] For a relatively recent endorsement of cumulative voting see Gordon, *supra.* at 127 (arguing that institutional investors should revive cumulative voting).

wealth,[142] practitioners viewed the resulting board composition as so detrimental to collegiality[143] that state lawmakers and corporate charters have largely turned their backs on it.[144] This modern practice finds empirical support in more recent empirical studies, which provide evidence that cumulative voting reduces firm value.[145] Cumulative voting rules are very different from codetermination. However, the lesson from cumulative voting at the very least demonstrates that the issue of board collegiality needs to be taken seriously when considering codetermination's potential costs.

Of course, the problem that mandatory codetermination may undermine board collegiality is not limited to the United States. It exists in Germany as well.[146]

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[142] *E.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 70 (1991) (noting that shareholders have relatively homogenous interests in that they want to maximize shareholder wealth); HANSMANN, ENTERPRISE, *supra* at 62 (asserting that the owners of investor-owned firms have the important advantage that their owners generally share a single well-defined objective: to maximize the net present value of the firm's earnings").

[143] Charles W. Steadman & George D. Gibson, *Should Cumulative Voting for Directors Be Mandatory? —A Debate*, 11 BUS. LAW. 9, 26-29 (1955).

[144] *See* Gordon, *supra* note 139 at 181 (listing numerous states that introduced mandatory cumulative voting but later repealed the relevant provisions). California and Hawaii still retain mandatory cumulative voting, but only for unlisted corporations. *See* CAL. CORP. CODE ANN. §§ 301.5, 708(a) (West) (mandating cumulative voting for unlisted corporations, while allowing listed corporations to opt out in their articles of incorporation or bylaws); HAW. REV. STAT. ANN. § 414-149 (Lexis) (mandating cumulative voting, but allowing public corporations to opt out).

[145] *See* Stuart L. Gillan & Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors*, 57 J. FIN. ECON. 275, 299–300 (2000) (finding that the rejection of shareholder proposals calling for cumulative voting was associated with statistically significant positive abnormal returns); James Nelson, *Corporate Governance Practices, CEO Characteristics and Firm Performance*, 11 J. CORP. FIN. 197, 220 –221 (2005) (finding that firms' decision to abolish cumulative voting was associated with positive long-term abnormal returns, whereas the decision to adopt cumulative voting was associated with negative long-term abnormal returns). *But see* Sanjai Bhagat & James A. Brickley, *Cumulative Voting: The Value of Minority Shareholder Voting Rights*, 27 J.L. & ECON. 339, 353–55 (1984) (finding that charter amendments which eliminated cumulative voting were associated with negative abnormal returns).

[146] In practice, problems appear to arise in particular with those employee directors who represent the trade unions. *See, e.g.*, Klaus Hopt, *The German Two-Tier Board: Experience, Theories, Reforms, in* COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH 227, 235 (Klaus J. Hopt et al., eds. 1998) (noting that those employee

However, German corporate law provides for a two-tier board structure and charges the managing board rather than the supervisory board with the day-to-day management of the company.[147] In addition, unlike the supervisory board, the management board is not subject to mandatory codetermination requirements.[148] Perhaps for this reason, in practice, employee and shareholder directors often work together relatively smoothly.[149]

B. REMOVAL OF DIRECTORS

One of the most obvious problems in corporate law lies in the agency conflict between directors and the corporation, which we mentioned already in the previous section.[150] Directors are fiduciaries who are supposed to act in the best interest of the corporation.[151] Traditionally, that has meant that directors are supposed to act in the best interest of shareholders.[152] In a stakeholder model, it means that directors must act in the best interest of multiple constituencies.[153] But the problem remains the same: directors may be tempted to put their own interests ahead of those that

directors that represent trade unions "are considered outsiders in the enterprise and behave as such, making consensus more difficult.").

[147] German Stock Corporation Act, *supra* note 32, at § 76(1).

[148] *Cf.* Codetermination Act, *supra* note 29, § 7(1) (providing that the employees shall elect half of the supervisory board's members).

[149] *See, e.g.*, John W. Cioffi, *State of the Art: A Review Essay on Comparative Corporate Governance: The State of the Art and Emerging Research*, 48 AM. J. COMP. L. 501, 526–527 (2000)(noting that "one sees surprisingly little conflict between managers and shareholders and employees in German corporate governance").

[150] *Supra* text accompanying note 136.

[151] *E.g.*, N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007).

[152] *Id.*; Allen v. El Paso Pipeline GP Co., L.L.C., 113 A.3d 167, 180 (Del. Ch. 2014), judgment entered, (Del. Ch. 2014), *aff'd*, 399, 2014, 2015 WL 803053 (Del. Feb. 26, 2015).

[153] Note that Senator Warren's Accountable Capitalism Act defines the directors' duties accordingly. See Accountable Capitalism Act, *supra* note 8, § 5 (c) (defining the standard of conduct for directors and requiring directors to manage the corporation in a manner that "balances the pecuniary interests of the shareholders … with the best interests of persons that are materially affected by the conduct of the United States corporation").

they are meant to serve. For example, directors may use their influence to obtain excessive salaries;[154] they may engage in empire-building,[155] or they may entrench themselves in office,[156] thereby preventing the corporation from getting better managers.

Corporate law and private ordering offer various ways in which corporations can minimize agency costs. These include performance-based compensation,[157] an active market for corporate control,[158] or active monitoring by institutional investors.[159] Shareholders can also discipline directors through the threat of removal.[160] Admittedly, Delaware law allows corporations to blunt that threat by classifying ("staggering") boards. If the board is classified, directors can only be removed for cause,[161] and, among publicly traded corporations, classified boards

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[154] *See, e.g.*, Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 749 (2006) (noting that excessive compensation is one example of agency costs). For a thorough analysis of the problem of excessive CEO compensation see Lucian Bebchuck & Jesse Fried, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

[155] *See* Oliver Hart & John Moore, *Debt and Seniority: An Analysis of the Role of Hard Claims in Constraining Management*, 85 AM. ECON. REV. 567, 568-69 (1995) (discussing managers' incentives to engage in empire-building).

[156] Robert K. Rasmussen, *The Ex Ante Effects of Bankruptcy Reform on Investment Incentives*, 72 WASH. U.L.Q. 1159, 1176 (1994)(categorizing managerial entrenchment as an agency cost).

[157] *E.g.*, Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877, 890 (2007); George G. Triantis, *Slack Policy and the Laws of Secured* Transactions, 29 J. LEG. STUD. 35, 39 (2000).

[158] Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 831, 850–52 (1993); Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey's Kiss-Off*, 108 COLUM. L. REV. 749, 787–89 (2008); Triantis, *supra* note 157, at 39.

[159] Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 813–14 (1992); Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 785 (2003).

[160] *See, e.g.*, Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U. C. DAVIS L. REV. 407, 451 (2006) (noting that the threat of removal is what ultimately "prevents directors from ignoring shareholders").

[161] DEL. CODE ANN. tit. 8, § 141(k) (West).

used to be the rule rather than the exception.[162] Recently however, in one of the more significant developments in corporate governance, shareholders have managed to push back against the proliferation of classified boards. As Marcel Kahan and Ed Rock have shown, between 2003 and 2009 the percentage of S&P 100 corporations with classified boards declined from 44% to 16%.[163] There are good reasons why shareholders dislike classified boards. A substantial number of empirical studies have examined the impact of classified boards and have found that they tend to reduce firm value.[164]

Against this background, the question arises whether codetermination facilitates the removal of directors or makes it more difficult. Germany's 1976 Codetermination Act allows for the removal of employee representatives (on the supervisory board) but requires a three-fourths majority of the employees to vote in favor of removal.[165] However, the existence of an incompetent board member may not be excessively harmful, given that the supervisory board is not entrusted with the day-to-day management of the corporation.

Sanders's proposal does not mention the rules that would govern the removal of employee representatives, and neither does Warren's Accountable Capitalism

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[162] Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1335 (2013) (examining a random sample of 373 IPO charters of firms that went public between 2000 and 2012 and finding that "65.6% of firms with large customers . . . and 60.6% of firms without large customers" have classified boards).

[163] Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 1008–09 (2010).

[164] *E.g.*, Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 430 (2005) (concluding that staggered boards are associated with a lower Tobin's q); Alma Cohen & Charles C. Y. Wang, *How Do Staggered Boards Affect Shareholder Value: Evidence From a Natural Experiment*¸ 110 J. FIN. ECON. 627, 640–41 (2013) (finding that staggered boards reduce firm value). Some researchers have questioned the claim that staggered boards reduce firm value. *See, e.g.*, Yakov Amihud & Stoyan Stoyanov, *Do Staggered Boards Harm Shareholders?*, 123 J. FIN. ECON. 432, 438 (2017) (examining the results by Cohen & Wang, *supra*, and claiming that their results become statistically insignificant once one controls for penny stocks, OTC stocks, and stocks of firms with a market capitalization of less than $10 million). For a rebuttal of this critique see Alma Cohen & Charles C.Y. Wang, *Reexamining Staggered Boards and Shareholder Value*, 125 J. FIN. ECON. 637, 637 (2017) (defending the results from their 2013 article).

[165] Codetermination Act 1976, *supra* note 29, § 23.

Act.[166] The obvious challenge is that any procedure allowing the removal of an employee-elected board member will necessarily be clumsy. The removal decision has to be left to the employees, or else their right to elect representatives would be undermined. Employees would face the same collective action problem that shareholders do when it comes to getting informed and voting. Crucially, however, whereas the existence of institutional investors greatly reduces the collective action problem with respect to shareholder voting,[167] this solution is unavailable to employees: unlike shareholders, an individual worker is limited to one vote.

In sum, it seems highly likely that mandatory codetermination would at the very least make the removal of employee directors very difficult. Because of America's single-tier board structure, this problem would be much more severe in the United States than it is in Germany.

C. BANKRUPTCY GOVERNANCE

Mandatory codetermination might also have a significant impact on "bankruptcy governance," complicating decision-making processes, especially in a Chapter 11 restructuring in the US.[168]

The starting principle in both US and German corporate bankruptcy laws is creditor governance.[169] Key decisions, such as the approval of a restructuring plan,

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[166] See sources cited *supra* note 8.

[167] *E.g.*, Eric L. Johnson, *Waste Not, Want Not: An Analysis of Stock Option Plans, Executive Compensation, and the Proper Standard of Waste*, 26 J. CORP. L. 145, 169 (2000); John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837, 860 (1999); William W. Bratton & Joseph A. McCahery, *The Equilibrium Content of Corporate Federalism*, 41 WAKE FOREST L. REV. 619, 689 (2006).

[168] On "bankruptcy governance" *see*, e.g., Kenneth M. Ayotte, Edith S. Hotchkiss & Karin S. Thomburn, *Governance in Financial Distress and Bankruptcy*, in OXFORD HANDBOOK OF CORPORATE GOVERNANCE 489 (Douglas Michael Wright, Donald S. Siegel, Kevin Keasey & Igor Filatotchev eds. 2013).

[169] *See, e.g.*, Horst Eidenmüller, *Comparative Corporate Insolvency Law*, in THE OXFORD HANDBOOK ON CORPORATE LAW AND GOVERNANCE 1003, 1018-20 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018).

require the consent of (a majority of) the creditors.[170] This is because their money is on the line. As the new residual claimants on the distressed corporation's income stream, creditors should have a decisive say on how the corporation's assets are to be used post-bankruptcy.

Codetermination on corporate boards complicates bankruptcy governance. On the one hand, one could argue that employee involvement in the strategic decision-making of a corporation is important especially in bankruptcy. After all, it is not only the creditors' money that is on the line but also the employees' jobs. Difficult decisions on the future of the distressed firm should be put on a broad foundation, if possible. On the other hand, bankruptcy requires swift decision-making and action. Firms lose value while subject to a bankruptcy process, day by day,[171] and codetermination inevitably slows down decision-making.

Against this background, under German bankruptcy law, the codetermination scheme that applies outside bankruptcy does not apply in court-supervised bankruptcy proceedings. Typically, an insolvency administrator is appointed who has all the powers to manage the firm's assets that—outside bankruptcy—would be exercised by the management and the supervisory board.[172] This includes going concern sales. German bankruptcy law has Debtor-In-Possession (DIP) proceedings similar to the US.[173] However, even in corporate restructurings these are rarely used. In the period from March 2012 to March 2017, DIP proceedings were running in less than 3.5% of all company insolvency proceedings.[174] Hence,

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[170] *Id*. at 1026-1027.

[171] On the costs of bankruptcy proceedings see, *e.g*., Michelle J. White, *The Costs of Corporate Bankruptcy: A U.S.—European Comparison, in* CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES 467 (Jagdeep S. Bhandari & Lawrence A. Weiss eds., 1996).

[172] See Section 80 of the German Insolvency Code, the "|Insolvenzordnung" (InsO)..

[173] See *Id*. §§ 270-285

[174] See FLORAN JACOBY ET AL., EVALUIERUNG: GESETZ ZUR WEITEREN ERLEICHTERUNG DER SANIERUNG VON UNTERNEHMEN V. 7. DEZEMBER 2011, at 8 (2017), https://www.bmjv.de/SharedDocs/Downloads/DE/News/Artikel/101018_Gesamtbericht_Evaluierung_ESUG.pdf?__blob=publicationFile&v=2 (last visited on September 10, 2020).

codetermination on corporate boards is practically irrelevant in German corporate restructurings, allowing the insolvency administrator to take swift decisions.

The adoption of either the Sanders or the Warren proposal would shift U.S. bankruptcy law and practice away from this framework.[175] Chapter 11 corporate restructurings are almost always DIP proceedings.[176] Not even in the Enron bankruptcy was a trustee appointed. The consequence is simple: in principle, the governance system which applies outside of bankruptcy continues to apply in bankruptcy.[177] With respect to codetermination, this means that the debtor's decision-making process on proposing a restructuring plan would be fraught with difficult discussions between shareholder and employee representatives. For example, shareholder and employee representatives typically have very different views on the necessity, size and timing of layoffs, the sale or closure of certain business units etc. Such differences inevitably complicate and delay decision making on a restructuring plan, creating additional transaction and opportunity costs. This would surely be a significant economic downside of the codetermination regime were it introduced in the United States.

Of course, bankruptcy practice in the U.S. could change. For example, more creditors might move to appoint a trustee under 11 U.S.C. § 1104(a), and courts might be more open to such motions. Similarly, the 11 U.S.C. § 1107(a) duties of a DIP as a trustee might discipline conflicts between different corporate stakeholder groups. At the same time, such developments would not undo the significant structural differences between the German and the U.S. bankruptcy system, and they would only reduce but not eliminate the frictions created by introducing codetermination to the governance of large U.S corporations. Another assessment

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[175] Neither proposal purports to change U.S. bankruptcy law. However, as we explain in the text, "bankruptcy governance" in a Chapter 11 proceedings would be severely impacted on the basis of the existing bankruptcy law if these proposals were implemented.

[176] *See, e.g.*, A. Mechele Dickerson, *A Behavioral Approach to Analyzing Corporate Failures*, 38 WAKE FOREST L. REV. 1, 37 n.136 (2003) (pointing out that in most Chapter 11 cases, the debtor remains in control of the firm as a DIP).

[177] Of course, the debtor is now subject to fiduciary duties which it did not have outside of bankruptcy. But the overall governance structure remains unchanged.

could be warranted if Congress were to move from a DIP bankruptcy system to one with the appointment of an insolvency administrator as the default. However, we believe that this is a highly unlikely scenario.

D. THE MARKET FOR CORPORATE CONTROL

Codetermination may also weaken the market for corporate control. The threat of hostile takeovers is an important mechanism to prevent managerial opportunism.[178] However, mergers also come with the prospect of workforce reductions,[179] which means that employee representatives are likely to oppose

[178] Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1465 (2019); Klick & Sitkoff, *supra* note 158, at 787-88. The empirical evidence largely supports the view that the market for corporate control helps to reduce agency costs. *See, e.g.*, Scott B. Smart et al., *What's in a Vote? The Short- and Long-Run Impact of Dual-Class Equity on IPO Firm Values*, 45 J. ACCT. & ECON. 94, 113 (2008) (providing evidence that the use of dual-class shares is associated with lower firm value and suggesting that the reduction in firm value is due to the fact that dual-class shares "makes it more difficult for outsiders to replace incumbents"). Furthermore, several studies have shown that classified boards, which help to reduce the threat of hostile takeovers, are associated with lower firm value. *See* the sources cited *supra* note 164.

[179] *See*, e.g., Andrei Shleifer & Robert W. Vishny, *The Takeover Wave of the 1980s*, 249 SCIENCE 745, 747 (1990) (noting that "layoffs rise after hostile takeovers" and that "[a]mong the 62 targets of hostile takeovers between 1984 and 1986, the total post takeover layoffs were about 26,000 people, which amounts to about 2.5% of the labor force of an average target firm"); Jiwook Jung, *Shareholder Value and Workforce Downsizing: 1981-2006*, 93 SOCIAL FORCES 1335, 1345 (discussing an example of post-takeover downsizing and concluding that "[t]his and many other similar cases suggest that downsizing is likely to occur as part of post-M&A restructuring"); Jun-Koo Kang et al., *Post-takeover Restructuring and the Sources of Gains in Foreign Takeovers: Evidence from U.S. Targets*, 79 J. BUS. 2503, 2514-5 tbl.5 (2006) (reporting average number for takeovers involving U.S. targets at a purchase price of at least $50 million and distinguishing, based on the acquiring firm, between "foreign" and "domestic" takeovers).

them.[180] This is consistent with the experience in Germany, where codetermination is generally viewed as an obstacle to the market for corporate control.[181]

Of course, such opposition can be efficiency-enhancing to the extent that the merger's benefits to the shareholders are outweighed by externalities that the merger imposes on the merging firms' employees. However, we know of no empirical evidence showing that this is typically the case.[182] More importantly, assuming that employee representatives seek to maximize their chances of reelection, there is no reason to believe that they will take into account the benefits accruing to shareholders when deciding whether to oppose a merger. Rather, as long as the merger threatens to reduce employment, a utility-maximizing employee representative is likely to vote against it regardless of whether the benefits to the shareholders outweigh the costs to the employees.

In principle, this conflict of interests exists in Germany as well as in the United States. However, there are compelling reasons to think that opposition to takeovers is much less of a problem in Germany. The main reason is that there have traditionally been very few hostile takeovers in Germany. A 2017 study that examined all German takeovers between 1981 and 2010 in which the acquirer was

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[180] *Cf.* Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 YALE L.J. 1927, 1970 (1993) (arguing that codetermination makes takeovers "more difficult" since employee representatives oppose takeovers "that would disrupt employment").

[181] *See, e.g.*, NICO RAABE, DIE MITBESTIMMUNG IM AUFSICHTSRAT [CODETERMINATION IN SUPERVISORY BOARDS] 177 (2010) (comparing the German codetermination regime to a poison pill).

[182] In fact, economists tend to argue that the benefits that takeovers bestow on shareholders outweigh the costs imposed on employees. *See, e.g.*, Shleifer & Vishny, *supra* note 179, at 748 (claiming that "transfers from employees clearly do take place after hostile takeovers, but their magnitude is small relative to the wealth gains of the shareholders"). Note that we do not embrace this latter claim either, since the underlying evidence seems less than compelling. For example, Shleifer and Vishny point out that post-takeover layoffs seem to impact mostly "high-level white-collar workers" and argue that "[i]t is hard to worry too much about these layoffs, since unemployment among educated white-collar workers barely exists in the United States". *Id.* at 747. At the very least, this reasoning seems contingent on assumptions about unemployment-levels in the United States.

a public company identified only five hostile takeovers in total.[183] The same study showed that the overall level of takeover activity was quite low. Between 1981 and 2010, there were 338 acquisitions in total; in 2010, the most recent year included in the study, the authors found a total of eight mergers.[184] Of course, these numbers could be higher if it were not for codetermination. However, there are many other obstacles to the development of an active takeover market. For example, even though share ownership is now more dispersed in Germany than it was even twenty years ago, many public corporations still have shareholders with ownership stakes exceeding 25%.[185] That makes hostile takeovers quite difficult.[186] In other words, while Germany's codetermination regime may render hostile takeovers more challenging, it is not clear that the number of hostile takeovers would be much higher in its absence. Herein lies a major difference between Germany and the United States. For example, between 1981 and 2010, the United States saw 60,244 mergers in which the acquirer and the target were publicly traded corporations.[187]

[183] Ferdinand Mager & Martin Feyer-Fackler, *Mergers and Acquisitions in Germany: 1981-2010*, 34 GLOBAL FIN. J. 32, 35 (2017). Note that this number excludes financial firms and focuses on M&A deals in which the acquirer was a German public company. *Id.* at 34. Furthermore, note that the study includes transactions where the acquirer's ownership stake after the transaction was at least 25%. *Id.*

[184] *Id*. at 35 tbl.1.

[185] *See* Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG*, 63 AM. J. COMP. L. 493, 510-15 tbl.1 (2015) (listing the corporations that constitute the DAX 30 and their largest shareholders).

[186] *Cf.* Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEX. INTL. L.J. 171, 179 (2006) (noting that shareholders with formal or de facto control "can entrench their positions to thwart possible hostile takeovers"). The reason for why controlling shareholders make hostile takeovers more difficult is that even if the controlling shareholder holds less than 50%, his decision to hold on to his stake makes it more challenging for the hostile acquirer to buy up enough of the remaining shares to gain control of the corporation.

[187] Statement based on data on completed mergers from Refinitiv SDC Platinum, https://www.refinitiv.com/en/products/sdc-platinum-financial-securities.

The United States thus has a particularly vigorous market for corporate control and thus stands to lose much more from imposing codetermination.[188]

E. MANDATORY CORPORATE LAW

One of the less obvious costs of codetermination lies in the need to reduce the flexibility of corporate law to prevent regulatory arbitrage. Corporations may seek to find some way around the mandatory codetermination rules, and thus lawmakers need to adopt additional mandatory rules to prevent the codetermination regime from being circumvented. This problem exists in both Germany and the United States. However, as we show in this Section, the costs of adding mandatory law are likely to be much higher in the United States than they are in Germany.

1. Preventing Circumvention

Regulatory arbitrage can occur in one of several ways. Corporations can reincorporate offshore, they can convert into domestic entities such as partnerships to which the codetermination rules do not apply, or they can amend their charters and bylaws in ways that minimize the impact of codetermination. We address these different approaches in turn.

a) Reincorporation

Firms seeking to avoid codetermination can (re)incorporate in a foreign jurisdiction that does not impose any codetermination requirement. The German experience with this problem is telling. Based on the so-called "Freedom of Establishment" guaranteed by the Treaty on the Functioning of the European Union,[189] German entrepreneurs are free to incorporate or reincorporate in another

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[188] Codetermination could also reduce the amount of (beneficial) shareholder activism. Boards would likely become larger (and less efficient), and activist investors might find it more difficult to successfully run a short slate campaign as shareholders might fear a (further) balkanization of the board. A proper analysis of these issues is beyond the scope of this article.

[189] Consolidated Version of the Treaty on the Functioning of the European Union arts. 49 (granting freedom of establishment), 54 (extending the freedom of establishment to corporations),

Member State, adopting a non-domestic corporate form.[190] Even more importantly, in our context, since 2004, corporations incorporated in one of the European Union (EU) Member States can transform into a European *Societas Europaea* (SE), a European stock corporation.[191] An SE is governed, in the first instance, by the rules of the European SE Regulation.[192] In addition, the laws on stock corporations of the jurisdictions in which the SE is incorporated apply to the extent that the SE Regulation has gaps or permits this.[193] Unlike under German law, an SE can have either a one-tier (administrative board) or two-tier board structure (management board and supervisory board).[194]

Issues of employee involvement in an SE, including employee representation on the board, are governed by a separate legal instrument, a European Directive.[195] When an SE is formed, shareholder and employee representatives must negotiate the terms of employee involvement.[196] Crucially, if these negotiations fail, the most

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Mar. 3, 2010, 2010 O.J. (C 83) 47 [hereinafter TFEU]. For a discussion of the role of the freedom of establishment in allowing entrepreneurs to incorporate in other member states of the European Union see Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INTL. L. 477, 483-86 (2004).

[190] Jens Dammann, *Homogeneity Effects in Corporate Law*, 46 ARIZ. ST. L.J. 1103, 1143 (2014).

[191] *See* Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [hereinafter SE-Regulation], 2001 O.J. (L 294), 3-6 (detailing several ways in which companies can change into a European company). One particularly simply way is described in Art. 2(4) of the SE-Regulation. Under this provision, a public-limited liability company can transform into a European Company if it has had a subsidiary governed by the law of another Member State for at least two years. *Id.* at art. 2, §4.. The term “public limited liability company” is defined in Annex II of the SE-Regulation and covers the various European Equivalents of the stock corporation such as the French Société Anonyme or the German Aktiengesellschaft. *Id. at* annex II (listing the relevant entity types).

[192] *See* SE-Regulation, *supra* note 191.

[193] *Id.* at art. 9.

[194] *Id.* at art. 38(b).

[195] Council Directive 2001/86/EC of 8 October 2001 Supplementing the Statute for a European Company With Regard to the Involvement of Employees [hereinafter SE Directive], 2001 O.J. (L 294) 22.

[196] *Id.* §II.

stringent participation regime of one of the entities involved in forming the SE will be implemented in the governance structure of the SE.[197]

After a slow start, the SE has become very popular amongst European firms. As of September 22, 2020, 3,338 SEs existed in the EU.[198] These comprise leading Eurozone companies such as Airbus, Allianz, BASF, E.ON, Fresenius, LVMH Moët Hennessy Louis Vuitton, SAP, Schneider Electric and Unibail-Rodamco, but also many SMEs.

As a corporate form, the SE is popular especially amongst German and Czech firms. As of March 13, 2018, 2,054 SEs had been established in the Czech Republic and 491 in Germany.[199] Most of the Czech SEs are not operative, and the operative ones chose the SE form primarily to downsize the board.[200] The key drivers for German SE formations are different. German firms reincorporate as SEs primarily to avoid board codetermination or mitigate its effects.[201] If a firm reincorporates as an SE before it crosses the 500-employee threshold, it can avoid board codetermination altogether. If it reincorporates before it crosses the 2,000-employee threshold, it can freeze the level of codetermination at one third of the members of the supervisory board. And even if it already has more than 2,000 employees, it can downsize the (supervisory) board and achieve an international composition of the employee representatives on the board.[202] The shareholders now have fewer and more diverse employee representatives to negotiate with, which is an advantage—the former can "divide and rule" (*divide et impera*). For example,

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[197] *Id.* at art. 7 & annex pt. 3.

[198] European Company (SE) Database – ECDB (Sep. 22, 2020), http://ecdb.worker-participation.eu/.

[199] Anders Carlson, *SE Companies – Bologna 2018-03-12/13 at 3, SEEurope (Mar. 13, 2018),* http://www.worker-participation.eu/European-Company-SE/Facts-Figures.

[200] Horst Eidenmüller & Jan Lasák, *The Czech Societas Europaea Puzzle*, 12 J. CORP. L. STUD. 237 (2012).

[201] Horst Eidenmüller, Andreas Engert & Lars Hornuf, *Incorporating Under European Law: The Societas Europaea as a Vehicle for Legal Arbitrage*, 10 EUR. BUS. ORG. L. REV. 1 (2009).

[202] *See* Horst Eidenmueller, Lars Hornuf & Markus Reps, *Contracting Employee Involvement: An Analysis of Bargaining Over Employee Involvement Rules for a Societas Europaea*, 12 J. CORP. L. STUD. 201, 208 (2012).

the shareholders/managers can play off the employee representatives of different countries against each other when a decision on the localization of (dis)investments must be taken.

In summary, the possibility of reincorporating as an SE has been used by many German firms to avoid or mitigate the effects of domestic codetermination laws. Crucially, there is nothing that the German lawmaker can do about this development. European law is superior to Member States' laws.

In the United States, the danger that firms reincorporate in foreign jurisdictions exists as well, and the consequences are potentially worse. U.S. tax law already creates substantial incentives to incorporate offshore. The reason is that if a corporation is incorporated in the United States, it is deemed to be a U.S. resident for tax purposes.[203] This means that, in principle, the corporation will have to pay taxes in the United States on its worldwide income.[204] By contrast, if the corporation reincorporates in a foreign jurisdiction, the situation changes. The corporation will still have to pay taxes in the United States, but only on its U.S. income, not on its worldwide income.[205] Accordingly, corporations that do business in multiple countries may find it cheaper to incorporate in a foreign low-tax jurisdiction, thereby lowering their U.S. tax burden.[206] This opportunity for tax arbitrage has given rise to so-called "corporate inversions," in which U.S. corporations merge into a foreign subsidiary, thereby shifting their place of incorporation abroad.[207]

Until now, corporate law has provided U.S. corporations with an important reason not to follow this approach: incorporating abroad means accepting a foreign

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[203] I.R.C. § 7701(a)(4) (2018).

[204] *E.g.*, Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 VA. L. REV. 1649, 1661 (2015).

[205] *Cf. id.* at 1663-64 (working through a concrete example).

[206] *Id.* at 1650-51.

[207] *Id.*

jurisdiction's corporate law, and many firms prefer U.S. corporate law,[208] which offers enormous flexibility.[209] However, if the United States were to enact a mandatory codetermination regime, this situation might well reverse. Rather than persuading U.S. firms to stay incorporated locally, such legislation could prompt them to reincorporate abroad in greater numbers than before. Moreover, the consequences would be more severe than in Europe. Not only would such firms escape the reach of corporate law, but they would also pay fewer taxes in the United States. Europe avoids the latter consequence due to a different approach to international taxation.[210] To prevent corporations from avoiding codetermination

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[208] *Id.* at 1652 (arguing that even though U.S. multinational corporations would prefer lower taxes, they have a preference for Delaware corporate law and governance, which provides an important incentive not to reincorporate offshore).

[209] *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 888 (2005) (noting that "U.S. corporate law follows a clear and consistent 'enabling' approach"); Margaret M. Blair & Lynn A. Stout, *Specific Investment: Explaining Anomalies in Corporate Law*, 31 J. CORP. L. 719, 742 (2006) (stressing that "U.S. corporate law is comprised mostly of 'default rules'"); Curtis J. Milhaupt, *The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate*, 91 NW. U. L. REV. 865, 893 (1997) (emphasizing the "prevalence of flexible enabling statutes in U.S. corporate law"); Troy A. Paredes, *A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't the Answer*, 45 WM. & MARY L. REV. 1055, 1058 (2004) (pointing out that "U.S. corporate law, and Delaware corporate law in particular, reflect an enabling approach to corporate law made up largely of default rules"); Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L.J. 2021, 2023 (1993) (pointing the "enabling approach of U.S. corporate law").

[210] The bilateral tax treaties between EU Member States generally correspond to the Model Double Taxation Convention on Income and Capital (MDTC) of the Organisation for Economic Co-operation and Development (OECD) (hereinafter OECD Model). Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNATL. L. 51, 71 (2005) [hereinafter Dammann, *Approach*). The OECD model provides that both a corporation's place of incorporation and its place of management are sufficient to establish tax residency. OECD Model, *supra*, arts. 7(1). However, if these two criteria diverge, the place of management determines a corporation's tax residency. *Id.* art. 4(3). As a result, if a corporation is headquartered in one Member State and moves its place of incorporation to another Member State, this move does not impact its tax status. Dammann, *Approach,* at 71-72. The text of the various tax treaties between the Member States is available at https://ec.europa.eu/taxation_customs/individuals/personal-taxation/treaties-avoidance-double-taxation-concluded-member-states_en.

by reincorporating abroad, federal law would likely have to provide that the U.S. rules on codetermination apply to all firms that are headquartered in the United States. Achieving compliance with such a fact-sensitive mandate would trigger substantial transaction costs.

b) Conversion

Corporations seeking to avoid codetermination could also convert into different entity types before reaching the quantitative thresholds that trigger the application of codetermination legislation or—in case of corporations that are already large enough to fall under the pertinent federal legislation—before the relevant legislation enters into effect.[211] U.S. corporate law offers a variety of non-corporate entity types that offer limited liability, a large degree of flexibility regarding governance arrangements, and the option of becoming publicly traded. Entities offering these features particularly include limited liability companies and limited partnerships.[212] Currently, the use of these forms for publicly traded entities is the

[211] Additionally, even once the pertinent federal legislation has taken effect, it may not require corporations to comply with the legislation immediately. For example, under Senator Warren's Accountable Capitalism Act, corporations that do not become large entities until after the Act has taken effect, have one year to obtain a federal charter under the Act. Accountable Capitalism Act, *supra* note 8, § 4(a)(1)(B). If a corporation is a large entity at the time that the Act takes effect, the corporation has two years to obtain a federal charter. *Id.* § 4(a)(1)(A).

[212] Limited liability companies offer limited liability to the owners. *See* DEL. CODE ANN. tit. 6, § 18-303(a)(providing that members of the limited liability company shall not be liable for its debts). They also offer flexible governance arrangements. *See, e.g.*, Joseph A. McCahery, *Comparative Perspectives on the Evolution of the Unincorporated Firm: An Introduction*, 26 J. CORP. L. 803, 803 (2001)(noting that LLCs offer "limited liability, a flexible governance structure, and preferential tax treatment"); Matthew T. Bodie, *Employment As Fiduciary Relationship*, 105 GEO. L.J. 819, 863 (2017)(noting the "flexible governance structure" of limited liability companies). Limited liability partnerships also offer the advantage of flexible governance structure. *See, e.g.*, Larry E. Ribstein, *The Uncorporation and Corporate Indeterminacy*, 2009 U. ILL. L. REV. 131, 156 (2009)(noting that "[l]imited partnerships […] offer contractual flexibility with few statutory constraints"). Limited partnerships offer limited liability to limited partners. DEL. CODE ANN. tit. 6, § 17-303 (a) (providing that limited partners are not liable for the partnership's debts unless they are also general partners or participate in the control of the business). By contrast, general partners are personally liable for the partnership's debts. *Id.* § 17-403(b) (providing that the general partner in a

exception rather than the rule.[213] For example, publicly traded LLCs and partnerships can mainly be found in the energy sector, where, under certain conditions, they offer the benefit of pass-through taxation.[214] However, if federal law subjected corporations to codetermination while imposing no such requirement on other entity types, the popularity of non-corporate entities could skyrocket. Unlike Senator Sanders's proposal, Senator Warren's Accountable Capitalism Act partially addresses this problem in that it applies to limited liability companies as well as to corporations.[215] However, neither proposal applies to limited partnerships, let alone entity types such as trusts or limited liability partnerships.[216].

limited partnership has the same liabilities to third parties as a general partner under Delaware's Uniform Partnership Law), DEL. CODE ANN. tit. 6, § 15-306(a)(providing that partners in a Delaware partnership are jointly and severally liable for the partnership's obligations). However, by using a corporation or limited liability company as the general partner, limited liability partnerships can be used to combine the benefit of limited liability with the partnership form. Both limited partnerships and limited liability companies can be—and sometimes are—publicly traded. *See* sources cited *infra* note 213. Note that limited partnerships that are publicly traded are typically referred to as MLPs or Master Limited Partnerships. *See, e.g.*, John Goodgame, *Master Limited Partnership Governance*, 60 BUS. LAW. 471, 471 (2005)(noting that an "MLP is a limited partnership, the limited partnership interests of which are publicly traded").

[213] *See, e.g.*, Suren Gomtsian, *The Governance of Publicly Traded Limited Liability Companies*, 40 DEL. J. CORP. L. 207, 222 (2015) (searching SEC filings and concluding that as of 2013, only twenty LLCs were publicly traded); Mohsen Manesh, *Contractual Freedom Under Delaware Alternative Entity Law: Evidence from Publicly Traded Lps and Llcs*, 37 J. CORP. L. 555, 567 (2012) (searching SEC filings as of 2011 and finding 12 LLCs and 73 limited partnerships).

[214] As a general rule, publicly traded partnerships and limited liability companies are treated like C-corporations for tax purposes, meaning that they are subject to corporate income taxation. I.R.C. § 7704(a) (2018). However, publicly traded partnerships and LLCs avoid this consequence and retain pass-through taxation if they make at least 90% of their income from certain sources including, in particular, income from exploration and mining of natural resources such as oil or gas. *Id.* § 7704 (c)-(d).

[215] Accountable Capitalism Act, *supra* note 8, § 2 (2) (A) (i) (defining the term large entity to include limited liability companies); § 4(a)(1)(requiring large entities to obtain a federal charter under the Accountable Capitalism Act).

[216] *See id.* § 2 (2) (A) (i) (defining a "large entity" as "an entity that . . . is organized under the laws of a State as a corporation, body corporate, body politic, joint stock company, or limited liability company"); § 4(a)(1)(requiring large entities to obtain a federal charter under the

Yet in order to prevent the rules on mandatory law from being circumvented, they would have to apply to such other entities as well.

c) *Corporate Charters and Bylaws*

Even corporations that do not change their state of incorporation or their entity type may take measures to minimize the impact of codetermination. For example, the corporation can shift responsibilities from the board of directors as a whole to particular board committees of which the employee representatives are not part.[217] Furthermore, the corporation can adopt bylaws that adjust quorum and majority requirements for board decisions in such a way as to reduce the de facto role of workers' representatives. For example, if a board has traditionally adhered to a supermajority requirement for board decisions,[218] that corporation may shift back to simple majority requirement. As long as the shareholder representatives account for a majority of board members—as they would under both Senator Warren's and Senator Sander's proposals,[219] a simple-majority rule, which in Delaware corresponds to the legal default anyway,[220] will allow the shareholder representatives to take decisions against the will of the employee representatives.

Accountable Capitalism Act); Sanders, Accountability, *supra* note 8 (proposing codetermination for large corporations).

[217] *Cf.* DEL. CODE ANN. tit. 8, § 141(c)(allowing the board to establish committees by board resolution).

[218] Under Delaware law, supermajority requirements for board decisions can either be included in the certificate of incorporation or in the bylaws. *See id.* § 102(b)(4)(allowing the certificate of incorporation to impose supermajority requirements for board and shareholder decisions), § 141 (b) (providing that at meetings satisfying the quorum requirement, decisions can be taken with a simple majority vote of the directors "unless the certificate of incorporation or the bylaws shall require a vote of a greater number").

[219] *See* Accountable Capitalism Act, *supra* note 8, § 6 (b) (1) (providing that employees of large entities shall elect 40% of the board members); Sanders, Accountability, *supra* note 8 (proposing that employees shall elect 45% of the board members).

[220] DEL. CODE ANN. tit. 8, § 141(b) (allowing the board to take decisions by simple majority as long as the quorum requirement is satisfied and as long as no greater number of affirmative votes is required by the bylaws or the certificate of incorporation).

To prevent firms from blunting the impact of codetermination by the charter or bylaw provisions, a federal statute would have to impose minimum requirements regarding the decision-making process of corporate boards. German law has, in fact, taken this approach. For example, German law requires that employee representatives and shareholder representatives must be treated equally.[221] Furthermore, the German Stock Corporation Act sharply limits the supervisory board's ability to delegate matters to committees. Numerous essential responsibilities, such as the appointment or removal of officers, the calling of a shareholder meeting, or the approval of financial statements, cannot be assigned to committees at all.[222]

2. *The Cost of Preventing Regulatory Arbitrage*

There is no question that federal law could be designed to address the various opportunities for circumvention outlined above.[223] However, the costs of doing so would very likely be much greater in the United States than they are in Germany. The reason is that U.S. corporate law and German corporate law pursue very different regulatory strategies. For instance, U.S. corporate law is far more flexible than German corporate law[224] as it consists largely of default rules.[225] By contrast, the provisions of the German Stock Corporation Act are mandatory unless provided otherwise.[226]

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[221] See Bundesgerichtshof (Federal Supreme Court), Judgment of Feb. 25, 1982 (II ZR 145/80), NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1530-31 (1982).

[222] German Stock Corporation Act, *supra* note 33, at 107(3).

[223] In order to be consistent, the U.S. lawmaker would need to adopt such measures even if the goal of introducing codetermination--as evidenced by the Sanders and Warren proposals--is more limited than in Germany in the sense of being restricted to giving employees a voice in corporate decision-making as opposed to allowing them to actually take such decisions or at least block them as in a system of "parity codetermination".

[224] Dammann, *Mandatory Law Puzzle*, *supra* note 105, at 448-55.

[225] See sourced cited *supra* note 209.

[226] German Stock Corporation Act, *supra* note 33, § 23(5).

A 2003 study by Katharina Pistor, Yoram Kleinan, Jan Kleinheisterkam, and Mark West is revealing in this context.[227] The study compares the corporate law regimes of Chile, Colombia, Delaware, France, Germany, Israel, Japan, Malaysia, and Spain.[228] Of all these jurisdictions, the study concludes, Delaware has the most flexible law by far.[229] Accordingly, Delaware corporate law is praised for its flexibility.[230]

The flexibility of U.S. corporate law implies, however, that the United States would face a fundamental transformation of its approach to corporate law if it were to embrace a more mandatory system of corporate law. German corporate law heavily relies on mandatory law anyway, so preventing corporate charters and bylaws from circumventing codetermination creates little or no extra costs.

We are not arguing that either of these regulatory strategies is superior to the other, *i.e.*, that corporate laws should be primarily based on defaults or that, conversely, they should consist primarily of mandatory rules. Our point simply is that the latter system can accommodate mandatory rules to prevent legal arbitrage much more easily than the former. Even if the changes necessary to achieve this goal are fairly limited, they might well have significant structural spillover effects, impacting on corporate laws' basic architecture.

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[227] Katharina Pistor et al., *Innovation in Corporate Law*, 31 J. COMP. ECON. 676 (2003).

[228] *Id.* at 689-91.

[229] *Id.* at 689.

[230] Janet E. Kerr, *Sustainability Meets Profitability: The Convenient Truth of How the Business Judgment Rule Protects A Board's Decision to Engage in Social Entrepreneurship*, 29 CARDOZO L. REV. 623, 668 n.79 (2007)(citing the flexibility of Delaware corporate law as one reason why corporations choose Delaware). Empirical studies have shown that U.S. corporations prefer flexible corporate law. *See, e.g.*, Brian Broughman et. al., *Delaware Law As Lingua Franca: Theory and Evidence*, 57 J.L. & ECONS. 865, 869 (2014) (exploiting "a sample of 1,850 start-up firms " and finding that states with "more flexible corporate law" were "somewhat more likely to retain in-state corporations"); Marcel Kahan, *The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?*, 22 J. L. ECON. & ORG. 340 (341) (exploiting a sample of 3807 firm observations and finding "substantial evidence that firms are more likely to incorporate in states with corporate law rules that offer firms flexibility to devise their governance arrangement in areas unrelated to takeovers").

F. RISK-TAKING

Codetermination law also discourages certain types of risk-taking.[231] This incentive can be troublesome for any country, but it promises to be particularly daunting for the United States. That is because the United States economy relies particularly heavily on radical innovation and hence on risk taking.[232] Accordingly, it has more to lose from a corporate governance mechanism such as codetermination, which discourages such risk-taking.[233]

1. Codetermination and Risk-Taking

It is a well-established principle in corporate finance that, given efficient capital markets, a corporation seeking to maximize shareholder wealth should choose the most profitable investment, defined as the investment with the highest net present value, regardless of the investment-specific or firm-specific risk involved.[234] The reason is that shareholders can easily eliminate investment- and firm-specific risks by diversifying their investment across firms.[235] Hence, rational shareholders will be unwilling to accept lower profits in exchange for lower firm-specific risk. After all, why pay for a reduction in firm- or investment-specific risk by accepting lower profits if the shareholder themselves can eliminate such risks without incurring any costs by simple diversification?

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[231] *Infra* Section 1.

[232] *Infra* Section 2.

[233] A similar concern has been voiced by Andreas Kokkinis and Konstantinos Sergakis in the UK context. *See* Andreas Kokkinis & Konstantinos Sergakis, *A flexible model for efficient employee participation in UK companies*, 20 J. CORP. LAW STUD. (forthcoming 2020) (arguing that introducing German-style codetermination in the UK would disrupt the ability of firms in the UK to innovate).

[234] *E.g.*, RICHARD A. BREALY, STEWART C. MYERS, & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 645 (10th ed. 2011).

[235] *Id.* at 646.

Employees, on the other hand, are in a very different situation. They cannot easily protect themselves against firm-specific risks.[236] In the famous words of Branko Horvat, "[t]he owner can spread risk by acquiring a diversified portfolio of shares, while the worker has just . . . one job."[237] If the firm goes bankrupt, employees who lose their jobs may not easily find adequate new employment.[238] The reasons are myriad. For example, an employee may have invested heavily in firm-specific expertise that is without value to other firms.[239] Some employees may find it difficult to move because of their family.[240] And of course, potential employers may have insufficient information about job applicants and may, therefore, refrain from offering them positions and salaries that are in line with the value they can add.[241]

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[236] *E.g.*, Jeffrey N. Gordon, *The Shaping Force of Corporate Law in the New Economic Order*, 31 U. RICH. L. REV. 1473, 1480 (1997); Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69(4) N.C. L. REV. 1189, 1211 (1991); Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 882 (1984); David Arthur Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461, 472 n.37 (1992).

[237] BRANKO HORVAT, THE POLITICAL ECONOMY OF SOCIALISM: A MARXIST SOCIAL THEORY 447 (1982).

[238] *See, e.g.*, Ronald J. Gilson & Mark J. Roe, *Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance*, 99 COLUM. L. REV. 508, 533 n.88 (1999) (noting that "[i]nformation asymmetries between firms and employees render real-world labor markets imperfect and, hence, employees cannot depend on a perfectly fluid labor market").

[239] MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 230-31, 238-39 (1995) (explaining that employees may acquire firm-specific expertise which makes it more difficult for them to change employers).

[240] *Cf., e.g.*, Lisa B. Bingham, *Employee Free Speech in the Workplace: Using the First Amendment as Public Policy for Wrongful Discharge Actions*, 55 OHIO ST. L.J. 341, 356 (1994) (noting that "the advent of two-career families" is limiting employee mobility).

[241] *Cf.* Eliakim Katz & Adrian Ziderman, *Investment in General Training: The Role of Information and Labour Mobility*, 100 ECON. J. 1147, 1150-53 (1990) (explaining why, if an employee's type and level of training is not easily observable, firms may be unwilling to recruit the employee for a position requiring training and even if it does, the firm may underpay the employee given that he does not reliably know his outside options).

Moreover, whereas employees stand to lose much if a firm goes bankrupt, at least for rank-and-file employees, the upside from a particularly profitable investment is typically limited.[242]

Given that employees suffer disproportionately if a firm goes bankrupt, yet stand to reap only a small fraction of the upside if the firm does particularly well, one cannot fault employees for caring about the risks inherent in the firm's investments.[243] Specifically, employees will want their firms to refrain from making investments that are so risky as to jeopardize the survival of the firm. Codetermination ensures that employees' attitude towards risk is reflected in the decision-making process at the board-level.[244] Employee representatives who are seeking to get reelected will hardly want to jeopardize their prospects by agreeing

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[242] This outcome is no accident. Rather, "income-smoothing"—ensuring a regular income for employees over time—is generally considered a key advantage of employment relationships, given employees need to put food on their family's table each and every day. *See, e.g.*, Hall, *supra* note 126, at 100 (noting that "[u]nder the reasonable assumptions that firms can borrow and lend and deal with uncertainty more effectively than can individual workers, it makes good economic sense for firms to be financial intermediaries for their employees, spreading total compensation over the duration of the labor contract in a smooth, predictable way"). Of course, working for a profitable firm can have some benefits. If a firm continues to be particularly profitable, employees may be more likely to obtain higher wages or promotions.

[243] The fact that employees below the managerial level tend to be risk-averse is generally recognized. *See, e.g.*, Timothy P. Glynn, *Beyond "Unlimiting" Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 410 (2004) (noting that both lower-level officers and employees – who have firm-specific investments of human capital, limited bargaining power, and limited wealth – are risk averse"); Sharon Hannes, *Reverse Monitoring: On the Hidden Role of Employee Stock-Based Compensation*, 105 MICH. L. REV. 1421, 1432 (2007) (noting that "employees tend to be risk-averse"); Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189, 1205 (1991) (noting that employees are risk-averse and "cannot diversify their risk because they usually have only one job").

[244] Franklin Allen, Elena Carletti, & Robert Marquez, *Stakeholder Governance, Competition, and Firm Value*, 19 REV. FIN. 1315, 1317 (2015) (arguing that "stakeholder firms are more concerned with avoiding bankruptcy since this prevents their stakeholders from enjoying their benefits"). *Cf.* Michael A. Gurdon & Anoop Rai, *Codetermination and Enterprise Performance: Empirical Evidence from West Germany*, 42 J. ECON. BUS. 289, 290 (1990) (pointing out that employees may be more interested in maintaining stable employment than in maximizing profits).

to investments that workers oppose. Thus, it is reasonable to think that employee representatives will generally try to prevent corporate boards from "betting the farm." The empirical evidence is consistent with this narrative: German firms with parity-codetermination, as opposed to one-third codetermination, show lower idiosyncratic risk and more stable cash flows.[245]

2. *Risk-Taking and Radical Innovation as a U.S. Specialty*

Making firm-jeopardizing investments is not the only way to foster innovation. The economic literature on innovation distinguishes between different types of innovation,[246] one common distinction being between incremental and radical innovation.[247] Incremental innovation "build[s] on what is already there," and modifies existing practices.[248] Radical innovation brings fundamental change and "create[s] new industries, products, or markets," thereby making existing products or markets disappear.[249] Unsurprisingly, radical innovation is associated with greater risk-taking.[250]

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[245] *See, e.g.*, Chen Lin, Thomas Schmid, & Yuhai Xuan, *Employee Representation and Financial Leverage*, 127 J. FIN. ECON. 303, 321 (2018) (using a regression discontinuity design to show that firms with parity codetermination, as opposed to one-third codetermination, "conduct fewer and better M&A deals, have more stable cash flows and profits, and have lower idiosyncratic risk").

[246] There now exists a rich economic literature on different innovation styles. *See, e.g.*, Torsten Ringberg, Markus Reihlen, & Pernille Rydén, *The Technology-Mindset Interactions: Leading to Incremental, Radical or Revolutionary Innovations*, 79 IND. MKTG. MGMT. 102, 103 (2019) (discussing different innovation styles and analyzing the relationship between managerial mindset and innovation style); Christine S. Koberg, Dawn R. Detienne, & Kurt A. Heppard, *An Empirical Test of Environmental, Organizational, and Process Factors Affecting Incremental and Radical Innovation*, 14 J. HIGH TECH. MGMT. RES. 21, 22 (2003) (examining the role of environmental, organizational, and process factors in the choice of innovation style).

[247] *E.g.*, Ringberg et al., *supra* note 246, at 103; Koberg, *supra* note 246, at 23.

[248] Koberg et al., *supra* note 246, at 23 (providing a survey over various definitions).

[249] *See id.*

[250] *See, e.g.*, Álvaro López Cabrales et al., *Managing Functional Diversity, Risk Taking, and Incentives for Teams to Achieve Radical Innovations*, 38 R & D MGMT. 35, 35-7 (2008) (providing evidence showing an association between a risk-taking mindset and radical innovation); Michael A. Witt & Gregory Jackson, *Varieties of Capitalism and Institutional Comparative Advantage: A Test*

The type of innovation that each country excels at is influenced by different institutional and legal structures. Some countries have liberal market economies (LMEs), in which "firms coordinate their activities primarily via hierarchies and competitive market arrangements."[251] Other countries have coordinated market economies (CMEs), in which "firms depend more heavily on non-market relationships to coordinate their endeavors with other actors and to construct their core competencies."[252] Both theoretical considerations and the available empirical evidence suggest that, relatively, CMEs tend to be better at incremental innovation, whereas LMEs market economies are better at radical innovation.[253]

In this typology, the United States constitutes a LME,[254] whereas Germany is either categorized as a prototype of a CME[255] or, in more recent literature, as a combination of both types.[256] Moreover, in line with the general findings on the relationship between economy and innovation type, the United States relies more

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and Reinterpretation, 47 J. INT. BUS. STUD. 778, 784 (2016) (arguing that a reluctance to take risks may be compatible with incremental innovation but not with radical innovation).

[251] Peter A. Hall & David Soskice, VARIETIES OF CAPITALISM 8 (Peter A. Hall & David Soskice, eds. 2001).

[252] *Id.*

[253] Witt & Jackson, *supra* note 250, at 804 tbl.A2 (showing that the variable measuring radical innovation ("radicality") is negatively correlated with the variable measuring coordination ("Coordination index") and that this relationship is statistically significant at the 1% level); Hall & Soskice, *supra* note 251, at 41 (arguing that "the institutional framework of liberal market economies provide companies with better capacities for radical innovation, while those of coordinated market economies provide superior capacities for incremental innovation"). *But see* Mark Zachary Taylor, *Empirical Evidence Against Varieties of Capitalism's Theory of Technological Innovation*, 58 INT'L ORG. 601, 625 (2004) (arguing that empirical data do not support the predictions that the theory of different varieties of capitalism makes regarding innovation).

[254] Hall & Soskice, *supra* note 251, at 19 & 20 tbl.1.1.

[255] *Id.*

[256] Witt & Jackson, *supra* note 250, at 779 (arguing that "Germany, for instance, has evolved away from the pure-type coordinated market economy that it is commonly believed to represent"), 803 tbl.A1 (displaying a coordination index for 22 OECD).

on radical innovation, whereas Germany, by and large focuses more on incremental innovation:

> Germany specializes on technological developments that are just the reverse of those in the USA. . . . Firms in Germany have been more active innovators in fields predominantly characterized by incremental innovation, including mechanical engineering, product handling, transport, consumer durables, and machine tools, while firms in the United States innovate disproportionately in fields where radical innovation is important such as medical engineering, biotechnology, semiconductors, and telecommunication.[257]

Other studies in economic and financial literature on entrepreneurship and risk-taking are also broadly consistent with the view that the U.S. economy specializes in risk-taking and radical innovation. Compared to other countries, the United States has very active environment for startups,[258] which ought to facilitate radical innovation. Furthermore, the United States has the most developed capital market in the world and is thus able to quickly infuse new firms with massive amounts of capital.[259]

Moreover, there is substantial evidence that risk-taking is more prevalent in the United States than in other countries. For example, a 2008 study of risk-taking at the firm-level in 39 different countries finds that, on average, risk-taking is highest in the United States and Canada, and much lower in Germany.[260] Moreover, firms

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[257] Hall & Soskice, *supra* note 251, at 43-44.

[258] Stefano Breschi, Julie Lassébie, & Carlo Menon, *A Portrait of Innovative Start-ups Across Countries* 19 fig.1 Panel A (OECD Sci., Tech. & Indus. Working Papers, No. 2018/02), https://doi.org/10.1787/f9ff02f4-en (showing the number of startups by country).

[259] *See* Dammann, *Mandatory Law Puzzle*, *supra* note 105, at 489-90 fig.2 (listing the world's top stock exchanges by total market capitalization).

[260] Kose John, Lubomir Litov, & Bernard Yeung, *Corporate Governance and Risk-Taking*, 63 J. FIN. 1679, 1681 (2008) (examines the relationship between corporate governance and firm risk-taking, using a sample including firms from 39 countries). One of their variables, RISK2, captures the country-level average of their company risk-taking proxy (RISK1). *Id.* at 1688 tbl.I. It is noteworthy that the country-level RIKS variable is highest for U.S. and Canadian firms (0.09) and

in the United States, on average, face a higher probability of bankruptcy than firms in stakeholder countries such as Germany,[261] which is consistent with the assumption that they take more risks.

Finally, it stands to the reason that the sheer size of the U.S. economy puts the United States in a particularly good position to weather the potential downside of high-risk investments at the firm-level. For small countries, the loss of even a single firm can be devastating. For example, before its decline, the Finnish mobile phone producer Nokia contributed about four percent to the country's total GDP.[262] By contrast, the U.S. economy is large enough to easily weather the collapse of even large firms.[263] The implosion of Enron, for example, had tragic consequences for its employees, many of whom also owned Enron stock.[264] However, Enron's employees accounted for only a tiny fraction of the U.S. workforce.[265] Admittedly,

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substantially lower firms Germany (0.06), France (0.044), Denmark (0.05), Finland (0.047), Austria (0.041), and Norway (0.052). *Id.* at 1697-98 tabl.II. Interestingly, one of the traditional codetermination countries, Sweden, has a rather high RISK2 value (0.08). *Id.*

[261] Franklin Allen, Elena Carletti, & Robert Marquez, *Stakeholder Governance, Competition, and Firm Value*, 19 REV. FIN. 1315, 1319 (2015) (using the so-called Black-Scholes-Merton model to calculate the probability of a default for each public corporation and finding that the risk of a default is almost twice as high for U.S. corporations (10.4%) as for German firms (6.6%)).

[262] Derek Scally, *Finland Struggling to Find Way in Post-Nokia World; Microsoft's Takeover Felt Like Your Parents Had Sold a Sibling To Pay The Bills*, IRISH TIMES, April 17, 2015, at F.6, https://www.irishtimes.com/business/technology/finland-struggling-to-find-way-in-post-nokia-world-1.2178606.

[263] Note, however, that, even in the United States, some firms, particularly banks, are considered too big to fail in the sense that their collapse would have severe repercussions. John C. Coffee Jr., *Political Economy of Dodd-Frank: Why Financial Reform Tends to be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1057 (2012). For an excellent discussion of this topic and possible solutions see Saule T. Omarova, *The "Too Big to Fail" Problem*, 103 MINN. L. REV. 2495 (2019).

[264] Paul J. Lim, *Don't Paint Nest Eggs in Company Colors*, N.Y. TIMES, March 30, 2008, at BU.5, https://www.nytimes.com/2008/03/30/business/30fund.html?auth=login-email&login=email. *See* Gretchen Morgenson, *Lopsided 401(k)'s, All Too Common*, N.Y. TIMES, Oct. 5, 2003 at 3.1 (noting that the Enron 401(k) plan had invested 60% of its total assets in Enron's stock).

[265] Prior to its bankruptcy, Enron had about 21,000 employees. *E.g.*, Justin R. Kaufman, *Halting the Enron Train Wreck: Using the Bankruptcy Code to Rescue Retirement Plans*, 76 TEMP. L. REV.

Germany is hardly at the other end of the spectrum. Currently, Germany is the fourth-largest economy in the world.[266] Its industrial giants are spread across different fields, including car manufacturing (BMW, Daimler, Volkswagen), machinery (Siemens, KION), software (SAP) and pharmaceutical (Bayer, Boehringer-Ingelheim, Merck). However, this does not change that the fact that the German economy is far smaller than that of the United States.

CONCLUSION

Critics have long scrutinized the idea that corporations ought to be managed primarily in the best interest of shareholders. The business judgment rule gives managers substantial leeway in protecting other stakeholders.[267] However, managerial autonomy is limited by the basic governance structure of U.S. corporations. As long as shareholders retain the right to select corporate managers, corporations will ultimately be managed in the shareholder's interest. Moreover, there is little reason to believe that the commitment to shareholder wealth maximization has weakened. Over the last decades, the rise of institutional

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595, 596 (2003). In the fourth quarter of that same year, total nonfarm employment in the United States was about 131,502,000. David S. Langdon, *Terence M. McMenamin, & Thomas J. Krolik*, *U.S. Labor Market in 2001: Economy Enters a Recession*, MONTHLY LAB. REV. 1, 5 tbl.1 (Feb. 2002). Thus, Enron accounted for about 0.015% of nonfarm employment in the United States.

[266] The World Bank, *World Development Indicators: Table 4.2: Structure of Output*, http://wdi.worldbank.org/table/4.2 (last visited March 24, 2020) (displaying information on 2018 GDP by country).

[267] *See, e.g.*, D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 279-80 (1998) (noting that "[o]utside the takeover context, . . . application of the shareholder primacy norm to publicly traded corporations is muted by the business judgment rule"); Fisch, *supra* note 2, at 652 (noting that "[t]he business judgment rule provides a corporation's officers and directors with broad discretion to consider the interests of other stakeholders"); William W. Bratton, *Confronting the Ethical Case Against the Ethical Case for Constituency Rights*, 50 WASH. & LEE L. REV. 1449, 1457 (1993) (explaining that as a result of the business judgment rule, "management gets considerable latitude to derogate from the shareholder primacy norm as it makes decisions respecting investment, financing, and operations").

investors and legal reforms, such as say-on-pay and proxy-access, have arguably increased shareholders' power over corporations.[268]

Now, however, important voices advocate for a fundamental shift away from the shareholder primacy model and towards a more stakeholder-oriented approach to corporate governance. Two of the most influential figures on the political left, Senator Elizabeth Warren of Massachusetts and Senator Bernie Sanders of Vermont, put forth proposals that would allow the employees of large corporations to elect 40% or even 45% of all corporate directors.[269] These proposals are broadly similar to the German system of codetermination, in which employees of large companies can elect one-third or one-half of all board members, depending on the size of the company.[270]

This Article illustrates that such a move would be ill-conceived. We do not question that Germany has fared well with codetermination. On the contrary, Germany has enjoyed many decades of prosperity, technical innovation, and social peace. Codetermination has either furthered Germany's progress or at least not prevented it. This achievement is all the more remarkable considering Germany weathered an unusual shock in the form of German unification. Any corporate law system that allows a major economy to flourish for many decades cannot be entirely bad.

However, we argued that while mandatory codetermination may be an efficient choice for German firms, there are compelling reasons to believe that its adoption would be less desirable for firms in the United States. Given the different institutional, social, and economic environment, some core benefits of codetermination are unlikely to materialize in the United States. At the same time,

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[268] For an excellent account of how shareholder power vis-à-vis CEOs has substantially increased see Marcel Kahan, Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987 (2010). As Kahan and Rock point out, "the balance of power between CEOs, boards, and shareholders has shifted notably in the last decade away from CEOs towards outside directors and shareholders." *Id.* at 1051. *See also* Rock, *supra* note 138, at 1910 (arguing that "since the early 1980s, the U.S. system has shifted from a manager-centric system to a shareholder-centric system").

[269] See sources cited *supra* notes 224 and 225.

[270] *Supra* Part I Sections A & B.

some of the indisputable costs of codetermination would likely be much higher in the United States than they are in Germany.

Of course, it is conceivable that the pertinent institutional economic and social differences diminish over time. For example, perhaps labor unions will once again play a dominant role in setting U.S. wages, which would allow codetermination to play an important role in avoiding conflicts between unions and employers. Perhaps U.S. securities law and capital markets will become less effective at allowing investors to monitor corporations, which would render codetermination more attractive as an alternative monitoring mechanism.

At this point, however, there is no reason to believe that these and other relevant changes will occur anytime soon. For the foreseeable future, therefore, proposals seeking to import mandatory codetermination will likely come with substantial economic costs. Consequently, the case for introducing codetermination in the United States would have to be made on non-economic grounds.

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