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## **Abstract**

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## **Keywords**

EEC, Fifth Directive, industrial democracy, company law

## **Cover Page Footnote**

The writer is an undergraduate student at Bond University. He would like to thank Professor Len Sealy and David Roche for their comments on this paper.

## Comments and Notes

### THE EEC'S FIFTH DIRECTIVE: SHOULD AUSTRALIAN COMPANY LAW FOLLOW THIS DEVELOPMENT IN INDUSTRIAL DEMOCRACY?

by

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#### Introduction

This note describes the four possible options under the EEC's Fifth Directive, and considers whether similar proposals are suitable for introduction in Australia. It considers the options of employee representation on company boards and the system of 'works councils'.

It attempts to question the suitability of implementing such initiatives in Australia in light of problems of parity of representation, frustration in the decision making process, increased scope of conflicts of interest, problems of board secrecy and lower dividends pay-outs for companies with employees on the board.

This note concludes that such difficulties are resolvable; that industrial democracy is justified by the desire to reduce industrial tension, boost productivity and improve workers' conditions generally. Thus, the writer will argue similar proposals are justified in the interests of both Australian industry and the wider community.

#### The Fifth Directive

The Fifth Directive is a proposal by the European Economic Community to allow employees in the companies of Member States to participate in the supervision of strategic development of their corporate employers.<sup>1</sup> If implemented, the employing company will have four possible means of involving employees in its decision making process.

The first option is to actually allow employee elected representatives onto

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1 Pursuant to 54(3)(g), of the European Economic Community Treaty.

the board of directors if the company is operating under the single board system (common in England and Australia). Alternatively, if the company has two boards (an approach favoured on the continent), the employees are elected onto the supervisory or administrative board of the organisation. Under this option the board may co-opt an employee provided a right of veto is retained by his associates. A second option is to create an employee representative body with extensive rights to information and consultation. A third is to arrive at some other means of representation established by collective agreement with at least the rights in the second alternative, and finally, the company may choose to implement a standard model provided by its home country legislature.<sup>2</sup>

Contrasting this initiative, Australian legislatures are proposing no such changes to Australian company law, and real reform does not appear to be close.<sup>3</sup> The idea has, however, often been considered. Indicative of this is the number of articles relating to the concept of industrial democracy published: 857 for the period 1970-1982.<sup>4</sup> Furthermore, in 1986, the Australian Department of Employment and Industrial Relations (as it then was) published an extensive discussion paper on industrial democracy and employee participation, concluding reform of legislation for industrial democracy to be:

a major Government priority...[and] essential to a successful response to the significant challenges of the present time.

However, the report was in many ways vague, particularly lacking in detail, so to date no serious legislative proposals have been published for debate. With the government's reformist zeal waning, the report is gathering dust amongst the parliamentary papers.

## Employee Representation on Boards

The first mechanism for employee participation provided by the Fifth Directive is for employees to be represented on boards of directors. This approach strikes at the heart of the corporation's decision making system, and is guaranteed to spark vigorous debate if ever proposed in Australia. Corkery describes how this idea emerged from the ruins of war torn West Germany. Following its defeat:

the allies were anxious to make it more difficult for a dictatorial power to dominate German business for undemocratic purposes. [Subsequently] since the early 1950's, elected employee representatives have taken up to one-half of the places on the supervisory and even management boards of large companies.<sup>5</sup>

The pre-eminence that West German corporations have enjoyed must be at

2 Dine J, 'The Company Lawyer', Vol 11, No 11 (1990) at 212.

3 See Vaughn E, 'Industrial Democracy in Australia; Some Day Still Far Away' in *Democracy and Control in the Workplace* at 31.

4 See generally Jones G (ed), *Worker Participation in Management*, 2nd ed, College of Advanced Education 1982.

5 Corkery J, *Directors' Powers and Duties*, 1987 at 6.

least partially attributable to the cooperative nature of the country's company and labour laws. However, Hopt cautions against attributing too much of the West German success story to its process of industrial democracy, warning that if German unions turn hostile to the employee participation process, or if the country experiences a major economic downturn, an uglier side to co-determination may emerge.<sup>6</sup>

Employee participation invariably dilutes management's power, by creating an additional layer of control. This may manifest itself as a significant impediment to the process of decision making. Indeed, the Biedenkopf report into co-determination in Germany, found this to be the most popular complaint by shareholders and board members.<sup>7</sup> One solution is to allow the worker director the same amount of time given any other board representative. Duly elected or appointed, the labour representative should have the power to speak and vote on his constituents' behalf. Only where the board has intentionally or negligently withheld information should there be cause for exception.

The parity problem, or the difficulty in balancing the proportion of labour and shareholder representatives on the board, is said to be the most controversial policy issue of boardroom co-determination in Germany.<sup>8</sup> The conventional view is that as investors bear the entrepreneurial risk they should have the greatest influence in decision making. In purely monetary terms this is invariably so. However, the hardship caused by losing one's sole means of income may match the effects of an investor's loss of equity.

### Broadened Scope for Conflicts of Interest?

Under existing Australian common law, directors almost exclusively owe a fiduciary duty to the company. The scope of what makes up a 'company' is unclear.<sup>9</sup> Under a narrow definition that excludes employees, legislation may be needed to allow labour officers to represent their constituents, however, a wider reading encompassing employees into the group to whom he owes a fiduciary duty would find the director serving the interests of the company without significant change in the law. Under the latter approach:

the interests of the corporation in terms of long-run profit maximisation permits the board of directors to consider the needs of employees in order to promote the long term health of the corporation. Not only is employee representation permissible under this view, but it affirmatively promotes corporate interests.<sup>10</sup>

6 Hopt K, 'New Ways in Corporate Governance: European Experiments with Labour Representation on Corporate Boards' (1984) 82 Mich LR at 1357.

7 'The Biedenkopf Report on Co-determination in Germany' 1970, (translated in 1977) pt III, No 32.

8 Hopt K, above n 6 at 1352.

9 See *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] 3 WLR 492, but see *Walker v Wimborne* (1976) 137 CLR 1, *Ring v Sutton* (1980) 5 ACLR 546, *Kinsela v Russell Kinsela Pty in Liq* (1983) 8 ACLR 384.

10 Hamer B, 'Serving Two Masters: Union Representation on Corporate Boards of Directors', (1981) 81 Colum L Rev at 639.

## The Conflicts

Should the labour director vote on questions of wages policy, or participate in industrial action against the corporation? In Denmark and Ireland they would be barred by statute from doing so, and in other jurisdictions, the delineation between what is permissible and what is not is highly controversial.<sup>11</sup>

An approach used in the US is that an employee representative only violates his fiduciary duty to the company, if his actions are opposed by a majority of employees or if he attempts to profit personally from his position.<sup>12</sup> Ultimately, however, Australian company law can only be improved by the widening of directors' duties to include employees. Company law should not exist solely as a shield for capital interests but as a protection for all participants in an enterprise.

## Business Secrets: Different Rules for Employees?

The Fifth Directive requires that there be equal access to information about the company's prospects and activities for both shareholders' and workers' representatives. (This requirement under European company law may be further reinforced by the proposed 'Vredeling Directive' on procedures for informing and consulting employees).

Arguably, it is easier for shareholders' representatives to maintain board secrecy than it is for workers' representatives, partly because of the demands made by the constituent works council or union. In West Germany, there have been clear cases of information relating to the sale of unprofitable subsidiaries, planned cutbacks, and reorganisation measures, released prematurely.<sup>13</sup>

Determining what is secret, however, is a significant difficulty. For instance, in the example of a company considering closing down an unprofitable subsidiary, arguments of strategic importance must compete with the suggestions that employees need fair warning to allow them to find alternative employment. In Sweden, the problem is tackled by extending collective bargaining to the question of what board matters shall be kept secret. In Germany, the issue of confidentiality is debated by both shareholder and worker representatives, with the resulting decision binding on all members.<sup>14</sup>

## Lower Dividends and Higher Wages?

The Biedenkopf Report also noted that under co-determination worker representatives tend to favour higher salaries and social benefits for the workers before dividend payments to shareholders. This has reinforced a tendency in German corporations to keep dividends at a relatively low and

11 See Davies P & Wedderburn of Charlton, 'The land of Industrial Democracy', (1977) 6 *Indus LJ* 197.

12 *Ibid* n 10.

13 Hopt K, above n 6 at 1361.

14 *Ibid* at 1362.

constant level, rather than changing dividend pay-outs according to the year's profits.<sup>15</sup> Superficially, this may lower the value of the company's shares on capital markets, however, the long term effect of higher salaries (and their ability to attract workers with superior skills) and steady dividend payments is difficult to judge.

## Works Councils

The second option of the Fifth Directive provides for bodies often referred to as 'works councils': elected committees of workers and management representatives, with participatory rights varying from informal worker get-togethers to bodies with a right of veto in major decisions.<sup>16</sup> In the Netherlands, for example, under statutory powers, works councils have access to meaningful company information and regular consultation with management boards. The courts may even interfere where their advice is not followed, however, this recourse is rarely needed.<sup>17</sup>

Such programmes for consultation have reduced the level of conflict between capital and labour and have enabled unions to be more co-operative and responsive.<sup>18</sup> As Gower explains, employee participation provides an avenue for worker expression which may in turn diminish the need for industrial action:

The fact that the worker owed his rights to collective bargaining, backed in the last resort by industrial action helped to induce a 'we-they' attitude to undermine his feeling of loyalty to the firms, and to contribute to industrial unrest.<sup>19</sup>

Aside from the obvious benefits of improved corporate performance, Hopt argues co-determination has led to greater consideration of the social impact of enterprise decisions, citing the example of German worker-directors at Volkswagen successfully restricting the geographical transfer of work to the US.<sup>20</sup> Arguably, however, this was not so much out of a concern for the wider community but a decision inspired by self-interest to the long-term detriment of workers globally.

This is not to say that there are not sound social reasons for implementing industrially democratic reforms. To illustrate the iniquitous state of current voting arrangements in companies, an analogy can perhaps be drawn with the former Australian electoral practice of issuing votes according to the size of a person's landholding. Before this system was abandoned, similar arguments to those now being made by investors were made by landholders: that voting power should be directly related to one's financial contribution to the community or enterprise. It is submitted, however, that the movement today is away from such concepts of vote weighting to the principle of 'one

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15 Above n 7 at 36.

16 Hopt K, above n 6 at 1349.

17 See Sanders P, 'Employee Participation in the Netherlands' (1977) JBL at 209.

18 Lutter M, 'The German System of Worker Participation in Practice' [1982] JBL 154.

19 Gower L, *Gower's Principles of Modern Company Law*, 4th ed 1979 Stevens & Sons, London at 66.

20 Hopt K, above n 6 at 1355.

vote, one value'. In the industrial context, this may suggest that greater voting rights for workers are inevitable. They are certainly due.

## Voluntary Implementation v Statutory Regulation

The British government was opposed to the introduction of compulsory measures of employee participation believing that they would best be promoted voluntarily. This sentiment was echoed in Australia by the Confederation of Australian Industry, submitting to the Government's 1986 discussion paper:

Implementation of employee participation schemes should be on a voluntary and co-operative basis, with the parties who are to implement the scheme being free to work out the approach that is acceptable to them... Because employee participation can and does take many forms, regulation by prescription is unworkable.<sup>21</sup>

However, meaningful schemes appear to be very rarely implemented voluntarily. The same report found that in Australia there was:

...little evidence of any widespread application of employee participation. Although a range of formal schemes were identified, in few cases did these involve either workers or their representatives having any significant influence on major decision making.<sup>22</sup>

Mindful that industrial democracy necessarily devolves power from management, it should come as no surprise to hear expressions of concern from industry bodies. Whether or not these concerns are justified, the prospect of overseas firms abandoning plans to establish or expand facilities in Australia is a real concern. The Dutch avoided this problem by providing transnational enterprises extensive exemptions from co-determination, but West Germany refused to, hoping that other nations would follow suit.<sup>23</sup> Such leadership, has in hindsight been vindicated, and Australia would do well to emulate such legislative initiative.

## Constitutional Difficulties

Finally, it should be made clear that a significant impediment to the introduction of industrial democracy legislation would be Australia's Constitution, or more specifically, the Commonwealth's inability to comprehensively regulate corporate activity. The Commonwealth can only act if it has the co-operative support of the states, or a referral of State power under s 51 [xxxvii] of the Commonwealth Constitution.<sup>24</sup> First, given that the Fifth directive was first released in Europe in 1972 and has had to undergo substantial redrafting, and second, following the Commonwealth's difficulty in drawing sufficient support for the *Corporations Act* (1990), one may assume an equivalent Australian Bill would find passage through the

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21 Above n 21 at 110.

22 Ibid, at 65-70.

23 Hopt K, above n 6, at 1363; see Germany's Co-determination Act (1976)

24 Department of Employment and Industrial Relations, 'Policy Discussion Paper: Industrial democracy and employee participation', Appendix 5.



legislature challenging, unless it had the endorsement of the states.

One option may be the granting of tied grants to the States to meet the costs of implementing employee participation, although this option may be seen as inconsistent with the spirit of 'new federalism'. However, the question is both serious and common: is our constitution hampering our ability to introduce effective corporations laws? If the answer is yes, it should provide us with further impetus to work towards adopting a new Constitution in 2001. Worker participation in corporate decision making is but one example of why a new federal framework for Australia's company laws is needed.

## **Conclusion**

In conclusion, there are certainly complications inherent in implementing the type of industrial democracy prescribed in the Fifth Directive. These problems include issues of parity, business secrecy and constitutional challenges. However, Australia must forge ahead with resolve, for mechanisms of industrial democracy are ultimately an economic and social imperative. The alternative is to adopt the languid 'wait and see' attitude that has characterised industrial policy over the last two decades. Inactivity, however, will surely condemn this nation to industrial and social mediocrity.