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# Boards and Sustainable Value Creation: The Legal Entity, Co-Determination and Other Means

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## Abstract

Boards of directors face growing pressures to engage with systemic risks and sustainable value creation. In this article I explore how an entity view in company law provides a consideration of the status, architecture and purpose of the modern corporation that theoretically offers the capacity to integrate such issues in corporate strategy. I also explore how specific models of corporate architecture such as co-determination relate to such an entity view. Exploring different perspectives on the VW case I show how a dominant view of corporate governance conflicts with the assumptions underlying co-determination. In relation to these issues I argue that the entity view and co-determination do not provide panacea for the reform of corporate governance theory and practice, but provide conceptual building blocks that may be used to engage in a creative way with notions of status, architecture and purpose in order to enhance the capacity for company directors to engage with systemic risks and sustainable value creation in corporate strategy.

## Keywords

Corporate governance, sustainable value creation, long-termism, sustainability, corporate architecture, corporate purpose, co-determination, separate legal entity, entity view, systemic risk, Volkswagen scandal

## 1. Introduction

Growing numbers of regulators, business leaders, academics and pundits argue that a dominant model for corporate governance that focuses attention exclusively on short-term oriented shareholders and managerial executives lies at the heart of a broad set of risks. These risks include reputational, litigation, insurance, finance, operational, innovation and market risks as well as systemic risks such as resource depletion, climate change, market instability, the reshaping of labour markets and growing

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social inequality.<sup>1</sup> In turn, this spectrum of risks is perceived to lead to a decline of public trust in corporations and a potential increase in regulatory responses.<sup>2</sup> Despite the development of a broad range of responses such as corporate social responsibility (CSR) and corporate citizenship initiatives; the United Nations Sustainable Development Goals (UNSDGs); stewardship initiatives for institutional investors; industry platform initiatives to enable sustainable development; and regulatory interventions like ESG reporting and due diligence in value chains, only limited change may be observed. And there is a pervasive sense in relevant actor communities, including corporate directors, investors and regulators that, despite their constitutive roles in the field, these actor communities consider themselves only limitedly capable to reshape the factors that condition how much space they have to engage with such risks.<sup>3</sup>

In this article I argue that at least part of this lack of progress and sense of incapacity may be attributed to the continued adoption and application of a theory of corporate governance, which conceives of the status, architecture<sup>4</sup> and purpose of the modern corporation in a highly stylized and very limited way. The adoption of this theory is constitutive for the extent to which interests and risks pertaining to actors and time-frames may be considered in corporate strategy. To engage with the issues posed by the dominance of this theoretical setup, I will take a closer look at how competing theories perceive of corporate status, architecture and purpose; how such competing views frame the role, position, and discretionary space for corporate boards and, ultimately, how such competing views allow the corporate board to engage with risks and interests pertaining to broader actors, interests, and time-frames than short-term oriented shareholders and managerial executives alone.

In section two I start with the exploration of an ‘entity view’, which, in principle, allows for the inclusion of a broad definition of actors, interests and risks, and time-frames. I explore how such an entity view provides the basis for the development of ideas of corporate architecture, including a co-determination model. I then discuss how the dominant theory of corporate governance comprehensively reimagines the status, architecture and purpose of the modern corporation and thereby prioritizes the interests of short-term market value-oriented shareholders and executive managers,

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<sup>1</sup> John Kay, *Other People's Money: The Real Business of Finance* (New York: Public Affairs, 2015); Kate Raworth, *Doughnut Economics: Seven Ways to Think Like a 21st-Century Economist* (London: Random House, 2017); Leo E Strine Jr., *Making It Easier for Directors to Do the Right Thing* 4 Harv. Bus.L.Rev. 235 (2014); Jeroen Veldman, Paige Morrow, Filip Gregor, *Corporate Governance for a Changing World: Final Report of a Global Roundtable Series* (Brussels and London: Frank Bold and Cass Business School, 2016); at <<https://www.economist.com/business/2017/08/31/the-parable-of-st-paul>>.

<sup>2</sup> Robert B Reich, *Saving Capitalism: For the Many, Not the Few* (London: Icon Books, 2016).

<sup>3</sup> Jeroen Veldman, Paige Morrow, Filip Gregor, *Corporate Governance for a Changing World: Final Report of a Global Roundtable Series* (Brussels and London: Frank Bold and Cass Business School, 2016).

<sup>4</sup> Jeroen Veldman and Hugh Willmott, *Social Ontology and the Modern Corporation* 41 Cambridge Journal of Economics (2017); Brian Cheffins, *History and the Global Corporate Governance Revolution: The UK Perspective* 43 Business History 92 (2001).

while relegating the risks and interests of broader actors and time-frames to the status of ‘externalities’.

In section three I apply these competing views to the VW scandal, exploring how these competing views can be used to provide two very different assessments of this case, either as a case that exemplifies a failure of governance induced by a multiplicity of goals and interests in corporate strategizing, or as a case in which the tenets of the dominant view of corporate governance themselves provided the basis for ignoring the corporate and societal risks involved in the business model adopted at VW.

In the discussion I then assess the potential for the entity view and a model for corporate architecture like co-determination to provide a comprehensive alternative to the currently dominant conception of corporate governance. I argue that the entity view provides a theoretical point of departure that allows to significantly expand the perception of discretionary space and the scope for directors’ duties, but that it suffers from a number of problems, including the fact that it does not provide a positive conception of purpose. Similarly, co-determination provides an elegant and effective conceptualization of corporate architecture that enables the inclusion of the interests and risks of broader actors and time-frames into corporate architectures, but a successful implementation of co-determination is path-dependent and contingent upon a continuing close fit with both corporate-level and state-level arrangements. Given these issues, I argue that neither the entity theory nor a corporate architecture based on co-determination provide panacea for the redevelopment of corporate governance theory and practice. Rather, consideration of these ideas provides building blocks for the further development of notions of status, architecture and purpose that allow to strengthen and support the capacity for boards to consider risks and interests of broader actors and time-frames in corporate governance.

## 2. Entity, Architecture, and Purpose

At the end of 2012 VW received an ‘Ethics in Business Award’ from the World Forum for Ethics in Business because of Volkswagen’s admirable efforts in the fields of environmental management and corporate social responsibility. And the CEO of VW Winterkorn wrote in the VW 2014 Sustainability Report that “sustainability, environmental protection, and social responsibility can be powerful value drivers.”<sup>5</sup> As the subsequent scandal makes assumptions about the prevalence of ethics, culture and ‘tone from the top’ as ‘powerful value drivers’ rather problematic, I turn to the field of corporate governance to explore how the historical development of the modern corporation as a social construct provided changing conceptions of status, architecture and purpose and that provided different framings for boards to consider the interests and risks of actors, interests, and time-frames in corporate strategy.

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<sup>5</sup> Carl Rhodes, *Democratic Business Ethics: Volkswagen’s Emissions Scandal and the Disruption of Corporate Sovereignty* 37 *Organization Studies* 1503 (2016).

In this respect it is noticeable that company law in every jurisdiction around the world perceives of the status and architecture of public corporations as different from other types of legal and organizational representations, including the unlimited liability partnership that provided the dominant model for the organization of private business ventures until the start of the nineteenth century<sup>6</sup>. In the unlimited liability partnership, the position of shareholders was characterized by unlimited liability, which meant that those investing their money accepted a considerable amount of risk and, therefore, had a direct interest in their involvement in the management function<sup>7</sup>. The modern public corporation, by contrast, is premised on a very different architecture.

During the 19th century, the development of the public corporation led to the dispersal of shareholdings and an increasing de facto externalization of shareholders from the management of the corporation. This externalization of the shareholders provided two interconnected reasons for the development of a professional and independent corporate board with duties directed toward a corporate 'entity'.

First, the separation of shareholders from the management function was the condition by which a fully reified separate legal entity with its own, separate, attributions of ownership, liabilities and agency could develop. The reification of this entity, in turn, allowed for the development of a specific 'architecture' for the public corporation that provided considerable capacities, privileges and protections to rentier shareholders specifically.<sup>8</sup> A full separation of the shareholder constituency from the management function was, therefore, a structural condition that enabled considerable differential outcomes for shareholders as a reconstituted constituency.

Second, the distancing of shareholders from the management function created the potential for the formation of a professional board, rather than one necessarily composed out of shareholders as in the unlimited liability partnership. However, the formation of such a professional board introduced considerable difficulties in terms of establishing a clear objective. Considering the broad varieties of types of shareholders and shareholder interests, and considering the considerable potential for majority and controlling shareholders to expropriate dispersed shareholders in these public corporations<sup>9</sup>, it was a logical step to direct the duties of the board toward the

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<sup>6</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 13 (2014).

<sup>7</sup> Mark Freeman, Robin Pearson and James Taylor, *Shareholder Democracies?: Corporate Governance in Britain and Ireland before 1850* (Chicago: University of Chicago Press, 2011); Paul Johnson. *Making the Market: Victorian Origins of Corporate Capitalism* (Cambridge: Cambridge University Press, 2010).

<sup>8</sup> These include perpetual time horizons, limited liability, protection against expropriation by majority shareholders, professional management and a secondary share market. See Jeroen Veldman and Hugh Willmott, *Social Ontology and the Modern Corporation* 41 *Cambridge Journal of Economics* 1492 (2017)

<sup>9</sup> Mark Freeman, Robin Pearson and James Taylor, *Shareholder Democracies?: Corporate Governance in Britain and Ireland before 1850* (Chicago: University of Chicago Press, 2011); Paul Johnson. *Making the Market: Victorian Origins of Corporate Capitalism* (Cambridge: Cambridge University Press, 2010).

‘entity’, rather than toward a body of shareholders with diverse interests that was de facto and de jure separated from the management function.<sup>10</sup>

The combination of conceptual developments sketched here provides the basis for the development of a new and distinctly corporate architecture. As the shareholders shift to the status of an external constituency in order to receive significant differential advantages from a new architectural setup, and as the role and position of the corporate board is reconceived in relation to a fully reified separate legal entity to which the board owes its duties, it becomes apparent that both the status and the relative capacity of corporate constituencies to exercise rights and claims is now established in relation to a corporate architecture that revolves around the separate legal entity. The development of this new corporate architecture has significant effects for the position and role of the corporate board.

In this new corporate architecture, the corporate board is conceived as an ‘independent institution’, a corporate constituency or ‘organ’<sup>11</sup> with a status distinct from the shareholders: “[u]nder the received legal model ... no one acts as agent of the shareholders ... . The officers are agents of the board. The board, in turn, is conceived to be an independent institution, not directly responsible to shareholders in the manner of an agent.”<sup>12</sup> And as the board in this position is conceived as an ‘autonomous fiduciary’<sup>13</sup> that stands at the ‘apex’<sup>14</sup> of the corporation with its duties directed to the best interests of ‘the entity’, it enjoys broad discretionary space and may reject *a priori* claims by any particular constituency<sup>15</sup>. In effect, the board comes to operate in the role of a ‘mediating hierarch’, adjudicating between all actors, interests and time-frames that make up the corporation *in toto*.<sup>16</sup>

In sum, the notion of a fully reified separate legal entity provides the basis for a new organizational architecture, in which the status of all corporate constituencies is both formally and functionally reconceptualized. It is in relation to this comprehensive reconceptualization that the corporate board attains a duty toward the ‘entity’, rather

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<sup>10</sup> Jeroen Veldman and Hugh Willmott, *The Corporation in Management Studies* in Grietje Baars and Andre Spicer (eds.), *Critical Corporation Handbook*, 198-199 (Cambridge: Cambridge University Press, 2017).

<sup>11</sup> KJM Cremers and Simone M Sepe, *The Shareholder Value of Empowered Boards* 68 *Stanford Law Review* 67, 84 (2016); Antoine Rebérioux, *Does Shareholder Primacy Lead to a Decline in Managerial Accountability?* 31 *Cambridge Journal of Economics* (2007).

<sup>12</sup> Melvin A Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking* 57 *California Law Review* 5 (1969).

<sup>13</sup> Luh L Lan and Loizos Heracleous, *Rethinking Agency Theory: The View from Law* 35 *Academy of Management Review* (2010)

<sup>14</sup> Donald Nordberg and Terry McNulty, *Creating Better Boards Through Codification: Possibilities and Limitations in UK Corporate Governance, 1992-2010* 55 *Business History* 359 (2013).

<sup>15</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 25 (2014)

<sup>16</sup> Adolf A Berle, *Modern Functions of the Corporate System* 62 *Columbia Law Review* 433 (1962).; David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 25 (2014); Margaret M Blair and Lynn A Stout, *A Team Production Theory of Corporate Law* 85 *Virginia Law Review* (1999); EM Dodd Jr., *For Whom are Corporate Managers Trustees* 45 *Harvard Law Review* (1931).

than the shareholders; and, as a distinct and independent corporate organ, the discretionary space to fulfill this duty.

As the development of this new architecture provided significant economic effects, and as these effects were connected to significant differential effects for shareholders, company law statutes in jurisdictions worldwide to this day adopt conceptions of status, architecture and purpose developed in relation to this ‘entity view’. This can be witnessed in the fact that Delaware courts do not mandate the provision of shareholder value as the primary or only purpose of the public corporation<sup>17</sup>. Similarly “German corporate law requires that directors and executives take into consideration the interests of all parties (shareholders, employees, creditors, and business partners) participating in the running of the corporation – thereby militating against some forms of shareholder value.”<sup>18</sup> As a result, German courts have supported the decisions of corporate officials (and of large shareholders) to override the demands of investors if they negatively affect the position of employees or threaten the existence of the corporation.

In the Netherlands, the Corporate Governance Code is predicated on the notion that ‘a company is a long-term alliance between the various parties involved in the company’<sup>19</sup>. Principle 1.1 of the Code states: ‘The management board focuses on long-term value creation for the company and its affiliated enterprise, and takes into account the stakeholder interests that are relevant in this context.’ And under conditions of M&A there is an explicit provision that “the target board should ultimately be guided by the interests of the (long-term) continuity of the company and its various stakeholders, and thus not only by the interests of the shareholders.”<sup>20</sup> This direction is reinforced by Dutch case law, as the Supreme Court argued that “The management board of a company, when fulfilling its obligations under statutory law or the articles, shall give precedence to the best interests of the company and the undertaking connected with it and shall in its decision-making take into account the interests of all stakeholders, among whom the shareholders are to be reckoned.”<sup>21</sup> Discretionary space for weighing these various interests is provided by a reasonable director standard<sup>22</sup> enshrined in company law: “... the supervisory board is to act in the interest of the company and its enterprise, which is understood to mean to act in the interest of all stakeholders.”<sup>23</sup>

<sup>17</sup> David Millon, *Radical Shareholder Primacy* 10 University of St. Thomas Law Journal 4 (2014) quoting the Delaware corporate statute: “A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes.”

<sup>18</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 89 (Oxford: Oxford University Press, 2011).

<sup>19</sup> Jaron Van Bekkum, Steven Hijink, Michael C Schouten and Jaap W Winter, *Corporate Governance in the Netherlands* 14 Electronic Journal of Comparative Law 1, 14 (2010)

<sup>20</sup> Above at 23.

<sup>21</sup> Netherlands Supreme Court 9 July 2009 (ASMI), para. 4.4.1 in Jaron Van Bekkum, Steven Hijink, Michael C Schouten and Jaap W Winter, *Corporate Governance in the Netherlands* 14 Electronic Journal of Comparative Law 1, 4 (2010).

<sup>22</sup> Bekkum, Hijink, Schouten and Winter (2010) above at 7.

<sup>23</sup> Art. 140 Book 2 DCC in above at 4.

In addition, the Netherlands has instituted an ‘Enterprise chamber’ as part of the Amsterdam Court of Appeal. In relation to the argument that “setting the strategy of the company is the authority of the management board subject to the approval of the supervisory board and is not the power of the general meeting”,<sup>24</sup> the Enterprise Chamber is charged with the capacity to provide the capacity for adjudication in the case of disagreement between shareholders, the board and/or the employee representatives. If no agreement can be reached between corporate constituencies it may provide far-reaching remedies, including “(i) nullification of one or more resolutions of a corporate body of the company; (ii) suspension or dismissal of one or more managing or supervisory directors; (iii) appointment of one or more temporary managing or supervisory directors; (iv) temporary deviation from one or more provisions of the articles of association of the company; (v) temporary transfer of shares; and (vi) dissolution of the company (Article 356 Book 2 DCC).”<sup>25</sup> The Enterprise Chamber thus provides an example of an institution that gives standing and the capacity to seek redress to all parties involved in corporate governance, including employees,<sup>26</sup> as separate corporate constituencies or ‘organs’.

The entity view has found further application in co-determination models. In the Dutch and German corporate governance systems the employees, either directly or through a representative body like the works councils or trade unions, may elect or nominate directors for the supervisory board. In addition, they need to provide consent for decisions that affect them, such as pensions, working hours, remuneration systems and employment conditions.<sup>27</sup> By conceiving of the employee constituency as a corporate ‘organ’ with standing within the governance structure of the corporation, this conceptual setup reinforces the notion of corporate architecture provided by the entity view.

The examples provided show how an ‘entity view’ relates to the development of corporate architectures that allow, for the inclusion of interests and risks of broader actors and time-frames;<sup>28</sup> for the development of institutions that may act as a forum for grievances; and for the development of comprehensive corporate governance models such as co-determination. Despite the appeal of the entity view, however, its adoption and implementation is impeded by three factors.

First, an entity view does not provide a positive conception of directors’ duties and does not provide guidance to the weighing of relative interests. Of course, one might argue that the capacity to establish and adjust corporate purpose under shifting circumstances, to mediate between competing interests, and to make decisions in the absence of an external yardstick is the hallmark of the professionalism and maturity

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<sup>24</sup> Above at 14.

<sup>25</sup> Above at 30.

<sup>26</sup> Above at 16.

<sup>27</sup> Above at 16.

<sup>28</sup> Frank Jan De Graaf and Cor A Herkstroeter, *How Corporate Social Performance is Institutionalised Within the Governance Structure* 74 *Journal of Business Ethics* 180 (2007).



of any professional board member.<sup>29</sup> Nevertheless, the argument that the absence of a positive conception of corporate purpose and directors' duties unduly complicates the task and focus of the corporate board<sup>30</sup> makes the adoption of a simple yardstick, such as shareholder primacy, seductive.<sup>31</sup>

The second issue is that in most jurisdictions shareholders retain the (qualified) right to appoint and dismiss directors at the AGM without cause;<sup>32</sup> have a right of access to corporate books and records including the list of shareholders; and may bring derivative lawsuits against directors or officers in cases of harm done to 'the corporation'.<sup>33</sup> Although the existence of these legal rights does not provide shareholders with direct claims to ownership or control,<sup>34</sup> although commentators in the field of company law have argued that these rights are mostly the result of historical accident and oversight<sup>35</sup>; although many jurisdictions qualify these rights to a very considerable extent,<sup>36</sup> and although in a two-tier board system the right to dismiss executive board members may be delegated to the supervisory board,<sup>37</sup> the fact that these rights continue to be attributed to the shareholder constituency provides at least the basis for a suggestion that a prioritised position for shareholders in public corporations finds support in company law<sup>38</sup>.

The third issue complicating the adoption and implementation of an entity view is the development of a new theory of corporate governance that emerged from the Chicago Schools of Law and Economics. This new theory redefined the *status* of the modern corporation as a nexus of contracts, rather than as an entity; reimagined corporate *architecture* as an exclusive dyadic and contractual arrangement between 'principals' and 'agents'; and reinterpreted corporate *purpose* exclusively as the pro-

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<sup>29</sup> Adrian Cadbury, *Corporate Governance and Chairmanship: A Personal View* (Oxford: Oxford University Press, 2002); Bob Garratt, *Stop the Rot: Reframing Governance for Directors and Politicians* (Abingdon: Routledge, 2017); Robert I Tricker, *Corporate Governance: Principles, Policies, and Practices*, 489 (Oxford: Oxford University Press, 2015).

<sup>30</sup> Andrew Keay, *Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors* 66 *Modern Law Review* (2003); Ruth V Aguilera and Gregory Jackson, *Comparative and International Corporate Governance* 4 *Academy of Management Annals* 485, 500 (2010); but see Andrew Keay, *Ascertaining The Corporate Objective: An Entity Maximisation and Sustainability Model* 71 *Modern Law Review* 687 (2008).

<sup>31</sup> KJM Cremers and Simone M Sepe, *The Shareholder Value of Empowered Boards* 68 *Stanford Law Review* 67 (2016).

<sup>32</sup> Kevin Levillain, Simon Parker, Rory Ridley-Duff, Blanche Segrestin, Jeroen Veldman and Hugh Willmott, *Protecting Long-Term Commitment: Legal and Organizational Means* in C Driver and G Thompson (eds.), *Corporate Governance in Contention*, 44 (Oxford: Oxford University Press, 2018).

<sup>33</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 13 (2014).

<sup>34</sup> Michel Aglietta and Antoine Rebérioux, *Corporate Governance Adrift: A Critique of Shareholder Value* (Cheltenham: Edward Elgar Publishing, 2005).

<sup>35</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 13 (2014);

<sup>36</sup> Jaron Van Bekkum, Steven Hijink, Michael C Schouten and Jaap W Winter, *Corporate Governance in the Netherlands* 14 *Electronic Journal of Comparative Law* 1, 30 (2010).

<sup>37</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 13 (2014).

<sup>38</sup> Blanche Segrestin and Armand Hatchuel, *Beyond Agency Theory, a Post-Crisis View of Corporate Law* 22 *British Journal of Management* 490 (2011).

duction of shareholder value<sup>39</sup>. Although the resulting shareholder primacy norm has been classified as a social norm, rather than as legal theory<sup>40</sup>, and although the conceptual basis of this type of corporate governance theory has been criticised<sup>41</sup> as “aspirational rather than grounded in corporate law”<sup>42</sup>, this new normative theory<sup>43</sup> with its stylistic reinterpretations of corporate status, architecture and purpose was highly successful in displacing entity view-based notions. The provision of a clear and unitary positive conception of corporate purpose in the form of the production of shareholder value, combined with a claim that adopting such a purpose would provide efficiencies and optimal social and economic utility, both for corporations and for societies, was quickly picked up and provided the basis for the development of corporate governance institutions from the 1970s onwards.

In sum, the absence of a positive identification of purpose in entity theory; the perceived presence of prioritized rights to the shareholder constituency in company law; and strong, but unsubstantiated claims about the provision of greater efficiencies and associated overall social utility<sup>44</sup> together provided the basis for the development and adoption of a new theory of corporate governance. These stylized ideas of status and architecture and reductive ideas of purpose in the form of shareholder primacy provided by this new theory became the basis for the development of institutions in the field of corporate governance, including business and law school curricula. The recognition by directors and executive managers that these normative assumptions, whether correct or not, guided their career fortunes and were central to their perceived capacity to deal with uncertainty and (litigation) risk, meant that from the 1970s onwards the entity view gradually lost terrain, while an exclusive and undivided directedness of executive managers’ and directors’ attention to shareholders’ interests

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<sup>39</sup> MC Jensen & WH Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* 3(4) *Journal of Financial Economics* (1976); see also Michel Aglietta and Antoine Rebérioux, *Corporate Governance Adrift: A Critique of Shareholder Value* (Cheltenham: Edward Elgar Publishing, 2005).

<sup>40</sup> Millon (2014) finds that “However accurate it might have been in the earlier nineteenth century in an age of closely held firms, an agency characterization of management’s relation to the shareholders has been completely inaccurate as a descriptive matter since the turn of the twentieth century and was still so in the later 1970s when corporate law academics first began to insist on it. Against this backdrop, the emergence of the agency claim and its widespread embrace as an assumed legal requirement are nothing short of astonishing.” David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 32-33 (2014); see also Luh L Lan and Loizos Heracleous, *Rethinking Agency Theory: The View from Law* 35 *Academy of Management Review* (2010).

<sup>41</sup> Cremers and Sepe (2016) above at 142; Aguilera and Jackson (2010) above.

<sup>42</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 33 (2014).

<sup>43</sup> Andreas Jansson, Ulf Larsson Olaison, Jeroen Veldman and A Beverungen. *Editorial: The Political Economy of Corporate Governance* 16 *Ehemera* (2016); H Hansmann, & R Kraakman, *The End of History for Corporate Law* 89 *Georgetown Law Journal* 439 (2001).

<sup>44</sup> H Hansmann, & R Kraakman, *The End of History for Corporate Law* 89 *Georgetown Law Journal* 439 (2001).

as the basis for corporate strategy gradually became an almost unavoidable social (rather than legal) norm<sup>45</sup>.

In the next section I explore the relevance of these views of corporate governance in relation to differing assessments of the causes and implications of the Volkswagen scandal.

### 3. The Volkswagen Scandal

The Volkswagen (VW) case provides an interesting example of the application of the new theory of corporate governance. Arguably, the VW case provides an egregious example of the failure of a corporation with a co-determination system in place, with massive costs to the corporation and to society as a result.<sup>46</sup> For Elson et al. (2015), it is clear that the co-determination system per se was to blame for the emergence of the scandal at VW. They find that the issues at VW “can be explained in large part by problems arising from the composition and functioning of the company’s two-tier board (including the principle of “co-determination”) which “may have undermined the oversight function, and reduced attention to appropriate legal compliance.”<sup>47</sup> and made “large-scale consideration of the company’s ethical posture ... secondary.”<sup>48</sup> In their analysis the conditions in which governance at VW could derail were “... inherent in the structure of the VW board”<sup>49</sup> as co-determination as a governance system<sup>50</sup> is seen to produce a “conflict of interests and incentives inherent in the German model”<sup>51</sup> that draw undue attention to “the individual interests of each party ... represented on the board”.<sup>52</sup> It may then be surmised that “the German corporate organizational governance structure of co-determination creates an environment in which a corporation must juggle the conflicting interests of the shareholder and the labor representatives, thereby limiting the prospects for long-term corporate success.”<sup>53</sup> To determine whether such broad conclusions about the German co-determination system are warranted, I first take a look at these claims in the context of the VW case, and then take a look at the broader functioning of co-determination as a governance system.

<sup>45</sup> R Khurana, *From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession* (Princeton: Princeton University Press, 2007).

<sup>46</sup> <<http://www.euronews.com/2018/05/04/25-billion-euros-paid-out-in-dieseldgate-scandal-and-the-bill-is-still-rising>>; <<http://www.handelsblatt.com/unternehmen/industrie/dieselskandal-die-wut-der-mitarbeiter-auf-die-vw-fuehrung-waechst/20965042.html>>.

<sup>47</sup> Charles M Elson, Craig K Ferrere and Nicholas J Goossen, *The Bug at Volkswagen: Lessons in Co-Determination, Ownership, and Board Structure* 27 *Journal of Applied Corporate Finance* 36 (2015).

<sup>48</sup> above.

<sup>49</sup> above.

<sup>50</sup> above.

<sup>51</sup> above.

<sup>52</sup> above. The main parties are identified as “... a dual-class controlling shareholder, the government as a major equity-holder, and labour representation.”

<sup>53</sup> above.

At VW, it was Piëch's<sup>54</sup> ambition to pursue a growth and profitability strategy with the stated ambition to make VW the No.1 in the world by conquering the US and selling 10 million cars per year by 2018<sup>55</sup>. This strategy connected to a shared rationale in the car industry, where economies of scale and the positives of market dominance are huge. As the adoption of this strategy was accompanied by strong quarterly growth and profit figures<sup>56</sup>, the direction chosen by Piëch was not contested by any party in the governance structure, including the Qatari Holding Sovereign Wealth Fund and the government of Lower Saxony as shareholders, the supervisory board, the CEO, the executives,<sup>57</sup> and the unions.<sup>58</sup> In addition, it was an open secret<sup>59</sup> for automotive companies and for European regulators<sup>60</sup> that emission tests were being gamed across the industry and that regulators in Germany, France and the UK<sup>61</sup> had been noticeably slow<sup>62</sup> in the implementation of more stringent rules for emissions testing. Both the government of Lower Saxony and the German federal government<sup>63</sup> lobbied against the development of stricter EU emission tests for years leading up to the governance crisis and even after the VW scandal hit, a strong lobby managed to considerably water down initial proposals to strengthen regulation<sup>64</sup> and to raise significantly the amount that could be legally emitted under new tests<sup>65</sup>.

Given the industry-wide gaming of tests, and given the lax behaviour exhibited by regulators, it seems safe to argue that there was little reason for engineers to think

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<sup>54</sup> Ferdinand Piëch, chairman of the executive board of Volkswagen Group, 1993-2002 and chairman of the supervisory board of Volkswagen Group, 2002-2015.

<sup>55</sup> Carl Rhodes, *Democratic Business Ethics: Volkswagen's Emissions Scandal and the Disruption of Corporate Sovereignty* 37 Organization Studies 1502 (2016).

<sup>56</sup> At <https://organizationsandsocialchange.wordpress.com/2015/10/05/is-the-volkswagen-scandal-surprising-how-profitability-pressures-drive-corporate-misconduct/#more-666>.

<sup>57</sup> See <http://www.ft.com/cms/s/0/fe07b240-7645-11e5-933d-efcdc3c11c89.html#axzz3qhKmDW3M>; <http://www.ft.com/cms/s/0/54eb7548-636c-11e5-9846-de406ccb37f2.html#axzz3rB7Zeb1i>; <http://www.ft.com/cms/s/0/41b1a0d6-65f8-11e5-97d0-1456a776a4f5.html#axzz3nDugtHli>; <http://money.cnn.com/2015/09/23/news/companies/volkswagen-emissions-crisis/index.html>.

<sup>58</sup> Elson, Ferrere and Goossen (2015) above.

<sup>59</sup> At <http://www.autoexpress.co.uk/car-news/consumer-news/93030/exclusive-car-makers-cant-meet-euro6-emissions-targets>.

<sup>60</sup> See <http://www.ft.com/cms/s/0/d593256c-78c8-11e5-a95a-27d368e1ddf7.html#axzz3pfHbIHds>.

<sup>61</sup> At <http://www.theguardian.com/environment/2015/sep/24/uk-france-and-germany-lobbied-for-flawed-car-emissions-tests-documents-reveal%20>; <http://news.bbc.co.uk/1/hi/world/europe/6527547.stm>.

<sup>62</sup> At [http://www.theglobeandmail.com/report-on-business/rob-commentary/volkswagen-corruption-crisis-isnt-a-scandal-its-a-syndrome/article26479332/?utm\\_medium=email&utm\\_source=other&utm\\_campaign=notifications.auto.uo\\_5KnOfEeW-aBJWzh2UsQ](http://www.theglobeandmail.com/report-on-business/rob-commentary/volkswagen-corruption-crisis-isnt-a-scandal-its-a-syndrome/article26479332/?utm_medium=email&utm_source=other&utm_campaign=notifications.auto.uo_5KnOfEeW-aBJWzh2UsQ).

<sup>63</sup> At <http://www.theguardian.com/environment/2015/sep/30/emissions-scandal-how-the-drive-for-diesel-ran-out-of-gas>.

<sup>64</sup> At [http://www.nytimes.com/2015/10/03/business/automakers-ask-europe-for-leniency-in-emissions-testing.html?\\_r=0#](http://www.nytimes.com/2015/10/03/business/automakers-ask-europe-for-leniency-in-emissions-testing.html?_r=0#); <http://www.ft.com/intl/cms/s/0/4a6cac80-83c5-11e5-8095-ed1a37d1e096.html?ftcamp=crm/email/2015116/nbe/EuropeMorningHeadlines/product#axzz3qhKmDW3M>; [http://www.nytimes.com/2015/11/09/business/energy-environment/epa-expands-on-road-emissions-testing-to-all-diesel-models.html?\\_r=0](http://www.nytimes.com/2015/11/09/business/energy-environment/epa-expands-on-road-emissions-testing-to-all-diesel-models.html?_r=0).

<sup>65</sup> At <http://www.ft.com/intl/cms/s/0/4a6cac80-83c5-11e5-8095-ed1a37d1e096.html?ftcamp=crm/email/2015116/nbe/EuropeMorningHeadlines/product#axzz3qhKmDW3M>.

they wouldn't get away with writing some code rather than adopt a proven technology that would have added considerable cost per vehicle. And given the perceived success of a focus on market dominance and the acceptance of this rationale by all parties present in board proceedings there also seems to have been little incentive for board members to control the exact choices of individual engineers. To the extent that the VW case shows, a pervasive conception of corporate purpose driven by overweening executive ambition and intense competitive pressures; a strategy directed to and evaluated by short-term indicators of profitability and growth; the avoidance of searching questions by *all* parties in the supervisory board; and a lack of engagement with the choices of operatives in order to continue 'business as usual', it seems that the VW case may exemplify not so much a failure of the co-determination structure, but rather the *similarity of factors* that make corporate governance systems malfunction around the world.

The perspective that the VW scandal may be understood as an effect of the acceptance of a well-accepted rationale for directing a company, rather than as the effect of co-determination, allows to engage with some of the broader claims about co-determination as a governance model. According to Elson et al. "... the German co-determined firm appears to run the risk of becoming something of a headless state ... with policy largely determined in the confluence of each interest."<sup>66</sup> An entity view lens on corporate governance provides two types of arguments to put this statement in perspective.

First, the modern public corporation intrinsically relates to a multiplicity of interests. In the shareholder constituency, a large diversity of types of shareholders (e.g. retail, minority and majority, as well as controlling and non-controlling) with a multiplicity of interests and time-horizons<sup>67</sup> may be identified. As argued above, it is precisely because the choice for the identification of a dominant notion of a 'shareholder' interest imposes the possibility of an agency problem *between shareholders*<sup>68</sup> that company law statutes worldwide typically direct the fiduciary duties of any board member toward the interests of the entity and conceive of the board as a mediating institution with the capacity to weigh and balance conflicting interests and time-frames<sup>69</sup>. Hence, although it is clear that contradicting interests and time-frames may exist in a co-determination system, an entity view lens suggests that the presence of

<sup>66</sup> Elson, Ferrere and Goossen (2015) above at 41.

<sup>67</sup> Aguilera and Jackson (2010) above at 521.

<sup>68</sup> For this reason, in Germany "... noncurrent transactions between a firm and an interested party – such as a large shareholder – must be approved by the board of directors." and "The actions of corporate officials that would impair the interests of shareholders – or that would favor the interests of some shareholders at the expense of others – constitute a breach of the duty of care." Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 87 (Oxford: Oxford University Press: 2011); see also Mark Freeman, Robin Pearson and James Taylor, *Shareholder Democracies?: Corporate Governance in Britain and Ireland before 1850* (Chicago: University of Chicago Press, 2011); Paul Johnson, *Making the Market: Victorian Origins of Corporate Capitalism* (Cambridge: Cambridge University Press, 2010).

<sup>69</sup> See KJM Cremers and Simone M Sepe, *The Shareholder Value of Empowered Boards* 68 *Stanford Law Review* 67 (2016); Jaron Van Bakkum, Steven Hijink, Michael C Schouten and Jaap

such contradicting issues is endemic to the architecture of the modern public corporation, while the capacity to deal with such contradictions is the *raison d'être* for the position, role, and duties of the corporate board.

Second, and relatedly, the conclusion that “the German corporate organizational governance structure of co-determination creates an environment in which a corporation must juggle the conflicting interests of the shareholder and the labor representatives, *thereby limiting the prospects for long-term corporate success*”<sup>70</sup> seems to apply a lens that focuses one-sidedly on perceived negatives of a co-determination model without taking its underlying tradeoffs and potential benefits into account. If a principal-agent theory lens is adopted the objective of the directors and executive managers, conceived as ‘agents’, is to exclusively serve the interests of the shareholders as an undivided ‘principal’<sup>71</sup>. Arguably, from this perspective issues like expected complications with regard to takeover and merger negotiations<sup>72</sup>; the mandatory nature of information, consultation and negotiation rights in the case of large-scale layoffs and plant closures<sup>73</sup>; the necessity for supervisory board members to take into account the interests and risks for broad sets of actors and time-frames and to acknowledge tradeoffs and constraints; limits on the power of particular types of shareholders to engage; and the incapacity of executive managers to act unilaterally<sup>74</sup> may be perceived to introduce direct and indirect costs<sup>75</sup> and to weaken the level of influence and control that may be exercised by capital market actors<sup>76</sup>.

However, the cost-benefit analysis presented by a co-determination system looks very different if the status of the corporation is not reduced to a nexus of contracts; if the architecture is not reduced to a dyadic, exclusive and autocratic setup between stylized conceptions of ‘agents’ and principals’ with undivided interests; and if corporate purpose is not viewed in terms of the exclusive production of shareholder value. As shown above, the entity view allows to conceive of corporate architecture as a confluence of interests, rights and claims for corporate constituencies that are embedded and protected through qualified, rather than absolute claims and protec-

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W Winter, *Corporate Governance in the Netherlands* 14 *Electronic Journal of Comparative Law* 1, 14 (2010).

<sup>70</sup> Elson, Ferrere and Goossen (2015) above (emphasis added) at 42.

<sup>71</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 7 (2014).

<sup>72</sup> Sigurt Vitols, *Negotiated Shareholder Value: The German Variant of an Anglo-American Practice* 8 *Competition and Change* 331, 370 (2004).

<sup>73</sup> Above at 359.

<sup>74</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 137 (Oxford: Oxford University Press: 2011); Vitols (2004) above at 368.

<sup>75</sup> Gregory Jackson, *Stakeholders under Pressure: Corporate Governance and Labour Management in Germany and Japan* 13 *Corporate Governance: An International Review* 419, 421 (2005).; Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context* (Heidelberg: Springer, 2012).

<sup>76</sup> Aguilera and Jackson (2010) above at 526; Christine Windbichler, *Cheers and Boos for Employee Involvement: Co-Determination as Corporate Governance Conundrum* 6 *European Business Organization Law Review* (2005).

tions. The effects of such a qualified view of claims and protections shows itself in all aspects of co-determination and its institutional embedding.

To start with, the capacity to nominate directors is typically not absolute. In the Netherlands, the 'structure regime' stipulates that only corporations with at least 100 employees in the Netherlands and 16 million euros in assets allow works councils enhanced right of recommendation with respect to one-third of the members of the supervisory board. Nomination of the full board of directors may be vetoed at the AGM by a simple majority of the votes cast representing at least one-third of the issued share capital.<sup>77</sup> Similarly, in Germany, only one version of co-determination mandates that "an equal number of representatives are appointed by the employees or their representatives and the shareholders."<sup>78</sup> However, even in this version shareholders retain 50% of the vote and the chair retains the right to cast a decisive vote,<sup>79</sup> providing an ultimate advantage for shareholder-nominated members of the board.<sup>80</sup>

Co-determination rights are similarly qualified, rather than absolute<sup>81</sup>. Because such qualified powers work best if positive relationships are maintained, all parties involved in the co-determination structure, including employee representatives, have an interest to focus on the strategic and long-term use of such rights and claims, rather than engage in short-term antagonistic engagement.<sup>82</sup> The presence of such a focus was exemplified when in Germany, after the GFC, unions and employers worked together to keep costs down, for instance by using overtime to pay for a four-day workweek.<sup>83</sup> In the light of the willingness of employee representatives to cooperate with management to find mutually beneficial and cooperative solutions in order to safeguard a companies' viability and thereby prevent job losses,<sup>84</sup> Goyer argues that labour representatives on boards in Germany have effectively become "... co-manag-

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<sup>77</sup> See Frank J De Graaf and Cor A Herkstroeter, *How Corporate Social Performance Is Institutionalised Within the Governance Structure* 74 *Journal of Business Ethics* 181 (2007); Jaron Van Bekkum, Steven Hijink, Michael C Schouten and Jaap W Winter, *Corporate Governance in the Netherlands* 14 *Electronic Journal of Comparative Law* 1, 17 (2010).

<sup>78</sup> Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 94 (Heidelberg: Springer, 2012).

<sup>79</sup> Above.

<sup>80</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 32, 136, 137 (Oxford: Oxford University Press, 2011); Henry Hansmann and Reinier Kraakman, *Reflections on the End of History for Corporate Law* in Rasheed A Abdul and T Yoshikawa (eds.), *The Convergence of Corporate Governance* (Houndmills and New York: Springer, 2012).

<sup>81</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 137 (Oxford: Oxford University Press, 2011).

<sup>82</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 137 (Oxford: Oxford University Press: 2011).

<sup>83</sup> Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 191, 271 (Heidelberg: Springer, 2012); <http://www.waz-online.de/Wolfsburg/Volkswagen/Vor-20-Jahren-Vier-Tage-Woche-rettete-30.000-VW-Arbeitsplaetze>; [https://www.boeckler.de/wsi-tarifarchiv\\_3267.htm](https://www.boeckler.de/wsi-tarifarchiv_3267.htm).

<sup>84</sup> Vitols (2004), above at 368.

ers” of the firm in the implementation of painful restructuring measures and the elaboration of new strategic business decisions.”<sup>85</sup> and “... management [in Germany] seeks to incorporate works councils in restructuring schemes from the beginning.”<sup>86</sup>

Finally, a qualified notion of constituency rights allows to recognize that co-determination is oriented toward the provision of nomination, information and consultation rights to corporate constituencies. Although nomination rights are the most ‘visible’ of these rights, it is specifically information and consultation rights that are considered important,<sup>87</sup> and specifically so in the context of changes in economic context or the ownership structure<sup>88</sup> that potentially provide a significant threat to incomplete aspects of contracts<sup>89</sup> and any prior commitments made with regard to engagement with broader actors, interests and time-frames.<sup>90</sup>

Further support for the adoption of a co-determination model is provided by a broader economic analysis. While a negative relation between employee voice and share prices has not been corroborated,<sup>91</sup> it has been reported that at the firm level the provision of institutional protections for illiquid, non-diversifiable and firm-specific investments by employees is linked to the improvement of stable employment relations,<sup>92</sup> improved productivity, employee commitment and reduced labor turnover<sup>93</sup>, the preservation of firm-specific human capital<sup>94</sup> and the effective implementation of quick turnarounds<sup>95</sup>. For such reasons, Fauver and Fuerst (2006:703) note that: “prudent levels of employee representation on corporate boards can increase firm efficiency and market value”<sup>96</sup>. Beyond companies, the presence of an effective co-determination system in a jurisdiction has been linked to maintaining an emphasis

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<sup>85</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 138 (Oxford: Oxford University Press, 2011); see also Gregory Jackson, *Stakeholders under Pressure: Corporate Governance and Labour Management in Germany and Japan* 13 *Corporate Governance: An International Review* 419, 425 (2005).

<sup>86</sup> Goyer (2011) above at 138.

<sup>87</sup> Van Bekkum, Hijink, Schouten and Winter (2010) at 18; Vitols (2004) above at 362.

<sup>88</sup> Van Bekkum, Hijink, Schouten and Winter (2010) at 16.

<sup>89</sup> Andrei Shleifer, and Lawrence H Summers, *Breach of Trust in Hostile Takeovers* in Alan J Auerbach (ed.), *Corporate Takeovers: Causes and Consequences* (Chicago: University of Chicago Press, 1988); Georgina Tsagas, *A Long-Term Vision for UK Firms? Revisiting the Target Director’s Advisory Role Since the Takeover of Cadbury’s PLC* 14 *Journal of Corporate Law Studies* (2014).

<sup>90</sup> Sanford M Jacoby, *The Embedded Corporation: Corporate Governance and Employment Relations in Japan and the United States* (Princeton: Princeton University Press, 2005).

<sup>91</sup> Aguilera and Jackson (2010) above at 526.

<sup>92</sup> Jackson (2005) above at 421.

<sup>93</sup> Aguilera and Jackson (2010) above at 526.

<sup>94</sup> Aguilera and Jackson (2010) above at 526. See also Konstantin Bottenberg, Anja Tuschke and Miriam Flickinger, *Corporate Governance Between Shareholder and Stakeholder Orientation: Lessons from Germany* 26 *Journal of Management Inquiry* (2017).

<sup>95</sup> Aguilera and Jackson (2010) above at 499.

<sup>96</sup> Larry Fauver and Michael E Fuerst, *Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards* 82 *Journal of Financial Economics* 703 (2006).



on training and skilled work and the lessening of conflictual industrial relations and industrial action<sup>97</sup>.

Such positive associations with co-determination provide the basis for a continuing support in policy circles. The co-determination system has been hailed as a "... fundamental achievement in German socio-economic legislation"<sup>98</sup> which is considered a source of pride for many parties, including managers and politicians<sup>99</sup>. The German Supreme Court in Civil Matters stated in 1982 that "The Co-determination Act of 1976 stretches beyond the interests of the persons immediately affected by it, the Co-determination Act of 1976 does indeed serve the common weal of the community (...)"<sup>100</sup>. And in the aftermath of the GFC the presence of a "decade old consensus-building management system" that allowed for the development of consensual programs was still touted as particularly beneficial<sup>101</sup>. Positive views on co-determination have also traveled further as the EU SE "Employees' Directive clearly follows the German co-determination model"<sup>102</sup> and UK Prime Minister Theresa May briefly called for the inclusion of both employees and customers on boards in the UK<sup>103</sup>.

The discussion in this section shows how the application of a principal-agent theory lens might lead to the depiction of a co-determination system as the creation of a 'headless state' with the potential to introduce structural antagonism in the board and significant costs to shareholders. The application of an entity view, in contrast, allows to approach co-determination as an architecture that fits well within the history of ideas that shaped the specific ideas of status, architecture, and purpose that enabled the effects of the modern corporation. In relation to an entity view, it makes sense that a (supervisory) board is endowed with discretionary space and duties toward the corporation *in toto*; that corporate constituencies viewed as 'organs' receive qualified claims, protections and information, nomination and consultation rights<sup>104</sup> and that the resulting organizational architecture provides a system of institutionalised checks and balances. From the perspective that all corporate 'organs' stand to gain from continued cooperation within such an architecture, the provision of such an institu-

<sup>97</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 138 (Oxford: Oxford University Press, 2011); Frank J De Graaf and Cor A Herkstroeter, *How Corporate Social Performance is Institutionalised Within the Governance Structure* 74 *Journal of Business Ethics* (2007); Sanford M Jacoby, *The Embedded Corporation: Corporate Governance and Employment Relations in Japan and the United States* (Princeton: Princeton University Press, 2005).

<sup>98</sup> Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 165 (Heidelberg: Springer, 2012).

<sup>99</sup> Above at 13, 14, 191.

<sup>100</sup> Above at 166.

<sup>101</sup> Above at 191, 271.

<sup>102</sup> Above at 233.

<sup>103</sup> At <<https://www.theguardian.com/business/2016/nov/21/theresa-may-force-firms-appoint-workers-boards-cbi>>; <<https://www.theguardian.com/politics/nils-pratley-on-finance/2016/jul/11/theresa-may-plan-workers-boardroom-reform-extraordinary-tories>>.

<sup>104</sup> Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 18 (Heidelberg: Springer, 2012).

tional structure prevents, rather than induces, antagonistic, rash, or one-sided decision-making.<sup>105</sup> Co-determination thus provides an example of a corporate architecture based on an entity view that can provide significant organizational and economic benefits.

#### 4. Discussion: The Entity View, Co-Determination, and Beyond

To understand the conditions that frame whether corporate boards may include broader actors, interests, and time-frames in corporate strategy, I have explored the potential of an entity view and co-determination. I showed how an entity view provides a specific view of corporate architecture that endows the board, as a corporate organ, with the discretionary space to take into account all actors, risks and interests and time-frames that affect the corporation. In relation to such a view of corporate architecture, external institutions may be granted the capacity to adjudicate between corporate constituencies and to remind the board of their duties toward broader actors, interests and time-frames. I then showed how co-determination fits well within a history of ideas that underpins the entity view and may serve as an example of a corporate architecture that provides institutionalised checks and balances through which antagonistic, rash, or one-sided decision-making may be prevented. Together, these approaches provide both a theoretical and a practical basis to critique a dominant view of corporate governance as a dyadic, exclusive and autocratic setup between stylized conceptions of key actors that excludes consideration of broad sets of corporate and societal risks and, instead, to develop polycentric and multi-level models and institutions in the field of corporate governance<sup>106</sup> that may help to include the interests and risks of broader sets of actors, interests, and time-frames in corporate strategy.

Despite their merits, however, the discussion in this article provided good reasons to treat neither the entity view nor co-determination as a panacea. I explored in section two how the absence of a positive identification of purpose in combination with the perceived presence of prioritized rights to the shareholder constituency in company law limited the capacity to counter the displacement of entity view-based notions with a new theory of corporate governance based on stylized and reductive social norms of status, architecture and purpose. And as these notions of status, architecture and purpose continue to be inserted into standards, norms, and 'best practices' in national and transnational institutions such as corporate governance codes, competi-

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<sup>105</sup> The object of the Enterprise Chamber is, similarly, to provide the means by which a reasonable solution may be effectuated: "through a process of preserving the status quo, denying management and shareholders from taking irreversible acts and instructing the parties to continue to find a solution, where necessary aided by independent outsiders." in Van Bekkum, Hijink, Schouten and Winter (2010) above at 14.

<sup>106</sup> See Peer Zumbansen and Daniel Saam, *The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capitalism* 8 German LJ (2007).; Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 5 (Heidelberg: Springer, 2012); Lorraine Talbot, *Critical Company Law* (Abingdon: Routledge, 2008).

tion law and accounting standards,<sup>107</sup> they continue to have an impact on the institutional contexts in which co-determination systems are embedded,<sup>108</sup> including in the countries in Continental Europe where different models for corporate architecture used to be prevalent.

Another reason to think beyond the entity view and co-determination is that the provision of an architecture like co-determination institutionalizes checks and safeguards at a systemic level, but does not by itself provide guarantees for the behaviour of specific actors. In the VW case, the government of Lower Saxony and the Qatari SWF<sup>109</sup> held 12.4% and 15.4% of the shares respectively. The failure of such sophisticated shareholders with considerable positions, good access to information and broad incentives and capacities to control and engage<sup>110</sup> in a timely and efficient manner with the conditions that led to the VW scandal is problematic, both in terms of their lack of fulfillment of their oversight role as prudent self-interested investors with board representation and in terms of the lack of fulfillment of a ‘stewardship’ role attributed to these institutional investors. Likewise, reports indicate that labour representatives in the VW board ‘succumbed to the temptations of patronage and privilege’<sup>111</sup>, giving cause to question how and why these labour nominated directors became coopted and what role this played in their lack of engagement. Finally, to the extent that both state and federal governments acted as loyal proponents of VWs strategy,<sup>112</sup> they failed to act and control for broader interests than just VW’s. The fact that *all* parties present in the VW board failed to engage sufficiently with the

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<sup>107</sup> Goyer identifies “an industry of best corporate governance practices – most notably in the form of codes” in which best practice with regard to the use of specific elements and arrangements is directly linked to unlocking shareholder value, such as “boards of directors composed of nonexecutive/independent directors; sub-board committees (audit, nomination, and remuneration) dominated by independent directors; voting rights characterized by the one-share-one-vote principle; extensive range of issues for which shareholder approval is needed; heightened financial transparency that enables shareholders to evaluate the situation of listed companies; and extensive pay disclosure of executives that is comprised of a significant variable components.” Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 92-93 (Oxford: Oxford University Press: 2011). For a broader overview of the pervasiveness of the introduction of such notions into transnational institutions see Cremers and Sepe (2016) above at 136; Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 5 (Heidelberg: Springer, 2012); Umakanth Varottil, *Corporate Governance in India: The Transition from Code to Statute* in JJ du Plessis and CK Low (eds.), *Corporate Governance Codes for the 21st Century: International Perspectives and Critical Analyses* (Cham: Springer, 2017); Jeroen Veldman, *Self-Regulation in International Corporate Governance Codes* in Du Plessis and Low (2017) above.

<sup>108</sup> P Ireland, *Shareholder Primacy and the Distribution of Wealth* 68 *The Modern Law Review* 49-50 (2005); Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 93 (Oxford: Oxford University Press: 2011).

<sup>109</sup> Elson, Ferrere and Goossen (2015) above.

<sup>110</sup> See Cremers and Sepe (2016) above at 125.

<sup>111</sup> At <<http://www.theguardian.com/business/2015/sep/23/volkswagen-temptations-patronage-privilege-martin-winterkorn>>; See also Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context* (Heidelberg: Springer, 2012).

<sup>112</sup> <<http://www.bbc.com/news/business-34400305>>.

corporate and systemic risks related to the emissions scandal exemplifies the fact that the implementation of a co-determination model may provide a structure that amplifies the possibility for outcomes at a systemic level. But at an operational level the presence of a co-determination model is, in itself, neither a determinant nor a guarantor for adequate behavior by parties in the board or in the broader institutional system in which co-determination is embedded.

A more general reason to think beyond the entity view is that the successful implementation and operation of a co-determination system relies on idiosyncratic and path-dependent factors.<sup>113</sup> In a comparison between France and Germany, Goyer shows how the capacity to keep the influence of (short-term) types of investors and investor strategies at bay must not be sought in formal ownership and control structures,<sup>114</sup> including blockholding control and co-determination. Rather, this capacity must be sought in the capacity for factual control<sup>115</sup> that is embedded in the organization in specific arrangements of “structures of authority at the firm-level.”<sup>116</sup> In addition, a variety of groups at the national level, notably labour unions, political elites, and business elites need to provide ongoing support<sup>117</sup> to sustain this type of corporate governance model. The successful implementation and maintainance of a co-determination system thus needs a continuous ‘fit’ with systems of rights and obligations both at the workplace level<sup>118</sup> and at a jurisdictional level,<sup>119</sup> which asks for the development of idiosyncratic solutions that fit the existing and evolving institutions in a jurisdiction. The combination of path-dependency and idiosyncrasy draws attention to the fact that transplantation or emulation of a successful model for co-determination may be more complicated than a simple transplantation of legal rules<sup>120</sup> and potentially provides an explanation for why co-determination systems have provided mixed results in European jurisdictions.<sup>121</sup>

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<sup>113</sup> Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 473 (Heidelberg: Springer, 2012); Frank J De Graaf and Cor A Herkstroeter, *How Corporate Social Performance is Institutionalised Within the Governance Structure* 74 *Journal of Business Ethics* 179 (2007); Aguilera and Jackson (2010) above at 530.

<sup>114</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 164 (Oxford: Oxford University Press: 2011).

<sup>115</sup> Michel Goyer, *Contingent Capital: Short-Term Investors and the Evolution of Corporate Governance in France and Germany*, 164 (Oxford: Oxford University Press: 2011)

<sup>116</sup> Above at 160.

<sup>117</sup> Frank J De Graaf and Cor A Herkstroeter, *How Corporate Social Performance is Institutionalised Within the Governance Structure* 74 *Journal of Business Ethics* (2007); Goyer (2011) above.

<sup>118</sup> Jackson (2005) above at 426; Aguilera and Jackson (2010) at 500.

<sup>119</sup> De Graaf and Herkstroeter (2007) above at 188; J Du Plessis and A Rühmkorf, *New Trends Regarding Sustainability and Integrated Reporting for Companies: What Protection Do Directors Have?* 36 *Company Lawyer* 51 (2015).

<sup>120</sup> Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Matthias Casper, *German Corporate Governance in International and European Context*, 13 (Heidelberg: Springer, 2012); Umakanth Varottil, *Corporate Governance in India: The Transition from Code to Statute* in JJ du Plessis and CK Low (eds.), *Corporate Governance Codes for the 21st Century: International Perspectives and Critical Analyses* (Cham: Springer, 2017).

<sup>121</sup> Jean J Du Plessis, Bernhard Grossfeld, Claus Luttermann, Ingo Saenger, Otto Sandrock and Mat-

The combination of an absence of positive purpose and a related weak position in relation to the development of alternative theories and their insertion into transnational institutions; an effective operation at systemic, rather than operational level and, hence, a vulnerability to legitimization issues in response to individual cases like VW; and path-dependence with idiosyncrasy as a result means that neither the entity theory nor co-determination can be treated as panacea for the redevelopment of corporate governance theory and practice. Rather, they provide points of departure that help conceive of a more 'open' and empirical approach to the development of corporate governance.<sup>122</sup> Such an open approach may draw further inspiration from multiple legal models for organisational and legal representation, for instance from closely held or family firms, cooperatives, benefit corporations, trusts, partnerships, SOEs as well as models developed in the Social Enterprise literature, including the Benefit Corporation, Social Purpose Corporation, cooperatives and fairshares.<sup>123</sup> I will briefly consider how particular aspects of the elements and architectures underlying corporate governance may be strengthened and rearranged in order to recognise, embed and enforce a positive conception of organizational purpose.

Governance documents including constitutional documents such as articles of association<sup>124</sup> provide one means by which a positive conception of purpose may be embedded and made enforceable for broader constituencies.<sup>125</sup> Following the Profit with Purpose approach, commitment to purpose may be strengthened by requiring super-majoritarian shareholders' approval for the change or repeal of the purpose. In addition, some stakeholders may be granted the right to enforce the specified purpose, and to sue the corporation for breaches of commitment<sup>126</sup>. A broader conception of purpose and the interests and risks involved, including those that are ESG related, can also be translated into concrete policy goals that, in turn, can be coupled to KPIs and executive remuneration structures<sup>127</sup>. Finally, the standing given to corporate

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tias Casper, *German Corporate Governance in International and European Context*, 13 (Heidelberg: Springer, 2012); Christine Windbichler, *Cheers and Boos for Employee Involvement: Co-Determination as Corporate Governance Conundrum* 6 *European Business Organization Law Review* (2005).

<sup>122</sup> Kevin Levillain, Simon Parker, Rory Ridley-Duff, Blanche Segrestin, Jeroen Veldman and Hugh Willmott, *Protecting Long-Term Commitment: Legal and Organizational Means* in C Driver and G Thompson (eds.), *Corporate Governance in Contention*, 44 (Oxford: Oxford University Press, 2018).

<sup>123</sup> See Andrew R Keay and Jingchen Zhao, *Ascertaining the Notion of Board Accountability in Chinese Listed Companies* 46 *Hong Kong Law Journal* (2015); B Cheffins, *History and the Global Corporate Governance Revolution: The UK Perspective* 43 *Business History* 92 (2001); Rory Ridley-Duff and Mike Bull, *Understanding Social Enterprise: Theory and Practice* (London: Sage, 2015).

<sup>124</sup> De Graaf and Herkstroeter (2007) above at 188; Lorraine Talbot, *Critical Company Law* (Abingdon: Routledge, 2008).

<sup>125</sup> De Graaf and Herkstroeter (2007) above at 188; Nicole Notat and Jean-Dominique Senard, *L'entreprise, objet d'intérêt collectif* (2018), retrieved 12-6-2018 at [https://www.economie.gouv.fr/files/files/PDF/2018/entreprise\\_objet\\_interet\\_collectif.pdf](https://www.economie.gouv.fr/files/files/PDF/2018/entreprise_objet_interet_collectif.pdf).

<sup>126</sup> Kevin Levillain, Simon Parker, Rory Ridley-Duff, Blanche Segrestin, Jeroen Veldman and Hugh Willmott, *Protecting Long-Term Commitment: Legal and Organizational Means* in C Driver and G Thompson (eds.), *Corporate Governance in Contention*, 58 (Oxford: Oxford University Press, 2018).

<sup>127</sup> Jeroen Veldman, Paige Morrow and Filip Gregor, *Corporate Governance for a Changing World*.

'organs' by an institution like the Enterprise chamber in the Netherlands<sup>128</sup> could conceivably be expanded to include relevant actors representing broader sets of actors, interests, and timeframes.

The role and influence of different types of shareholders may also be reconsidered. Principal-agent theory identifies a 'principal', i.e. a unitary body of shareholders with an undivided interest,<sup>129</sup> typically interpreted as the interest of a trader interested in short-term market-value optimization.<sup>130</sup> The resulting view of shareholders as an undivided body and of short-term market value optimization as the exclusive object for managerial agency strongly affects the capacity for boards to consider actors, interests, and time-frames beyond these stylized conceptions and enhances the capacity to renege on commitments to such other actors, interests and time-frames: "Shareholders, attempting to maximize the value of their holdings, cannot credibly commit to not remove the board or dump their shares upon an early drop in performance ... directors and managers tend to develop short-termist incentives – and much more pervasively than shareholder advocates have previously acknowledged."<sup>131</sup> According to Cremers and Sepe<sup>132</sup> this has consequences beyond the public corporation: "weaker boards and stronger shareholders are likely to exacerbate the shareholders' limited-commitment problem, with detrimental effects for both shareholders and society as a whole."

Both the theoretical misconception of the status and role of the shareholder constituency and the board<sup>133</sup> and the broad effects of this stylistic reinterpretation may provide the basis for developing a more empirical approach to the wide heterogeneity of interests and time-frames related to differing share positions, share rights and capacity for engagement<sup>134</sup>. A reconsideration of the notion that "... shareholders do not constitute a homogeneous block, and the identities, interests, and policy agendas of shareholders may themselves change over time"<sup>135</sup> provides a first step to reconsider both the relevance of the multiple interests and risks related to multiple actors and time-frames from a shareholder perspective and of board discretion in relation to the uptake of such interests and risks. By extension, such an approach allows to consider how directors engaging with such broader risks and interests may be protected against derivative actions<sup>136</sup> by shareholders with a much narrower interest; how the

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*Final Report of a Global Roundtable Series 71* (London and Brussels: Frank Bold and Cass Business School, 2016).

<sup>128</sup> Van Bekkum, Hijink, Schouten and Winter (2010) above at 11.

<sup>129</sup> David Millon, *Radical Shareholder Primacy* 10 *University of St. Thomas Law Journal* 7 (2014).

<sup>130</sup> Cremers and Sepe (2016) above at 142; Paddy Ireland, *Shareholder Primacy and the Distribution of Wealth* 68 *Modern Law Review* 49-50 (2005).

<sup>131</sup> Cremers and Sepe (2016) above at 74.

<sup>132</sup> Cremers and Sepe (2016) above at 135-136.

<sup>133</sup> Cremers and Sepe (2016) above at 141.

<sup>134</sup> Vitols (2004) above at 358; Leo E Strine Jr., *Making It Easier for Directors to Do the Right Thing* 4 *Harv. Bus. L. Rev.* 235 (2014).

<sup>135</sup> Aguilera and Jackson (2010) above at 521.

<sup>136</sup> J Du Plessis and A Rühmkorf, *New Trends Regarding Sustainability and Integrated Reporting for Companies: What Protection Do Directors Have?* 36 *Company Lawyer* 51 (2015).

embedding of a specific purpose in corporate structure can be strengthened by the appraisal and selection of shareholders; and how differentiated engagement rights can be accorded to shareholders with different holding periods.<sup>137</sup>

The development of these means is interesting, as they allow to legitimize and protect directors adopting a positive conception of corporate purpose and yet maintain a high degree of managerial accountability. In combination with a reconsideration of the entity view such means can strengthen the combined capacity of directors, investors, and regulators to determine and engage with a positive purpose; to monitor corporate strategy in relation to the interests and risks of broad actors and time-frames; and to engage with the risks of excessive risk-taking to the long-term value creation potential of the modern corporation.<sup>138</sup>

## 5. Conclusions

The capacity to consider specific actors, interests and time-frames in the strategy of the modern public corporation is centrally related to the way the status, architecture and purpose of the modern corporation as a social construct are conceived and stabilized. The VW scandal as well as the Global Financial Crisis and its aftermath made it abundantly clear<sup>139</sup> that the exclusive focus on the interests of executive managers and short-term market value-oriented shareholders and the externalisation of risks introduced by a theoretical view of the status and architecture of the modern corporation that has been described as “aspirational rather than grounded in corporate law”<sup>140</sup> presents significant costs and risks to all other actors, interests, and time-frames involved in the theory and practice of corporate governance. The entity view and co-determination both allow to conceive of corporate status, architecture and purpose in a way that allows directors to consider risks and interests relevant to broader actors and time-frames. Beyond the entity view and co-determination, an open approach to corporate governance allows to challenge stylistic depictions of status, architecture and purpose and develop more empirical and creative ways to conceive of organizational architectures and institutions. In this paper, I have shown how such an open approach to corporate governance provides means by which boards may develop, embed, and safeguard a positive conception of corporate status, architecture, and purpose that support an engagement with sustainability and long-termism.

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<sup>137</sup> Jeroen Veldman, Paige Morrow and Filip Gregor, *Corporate Governance for a Changing World: Final Report of a Global Roundtable Series* (London and Brussels: Frank Bold and Cass Business School, 2016).

<sup>138</sup> Aguilera and Jackson (2010) above at 534-535.

<sup>139</sup> Frank J De Graaf and Cynthia A Williams, *The Intellectual Foundations of the Global Financial Crisis: Analysis and Proposals for Reform* in CA Williams and P Zumbansen (eds.), *The Embedded Firm: Corporate Governance, Labor, and Finance Capitalism* (Cambridge: Cambridge University Press, 2011); Aguilera and Jackson (2010) above at 521.

<sup>140</sup> David Millon, *Radical Shareholder Primacy* 10 University of St. Thomas Law Journal 33 (2014).