

# DIRECTOR'S DUTY TO EMPLOYEES: CO-RELATION BETWEEN CORPORATE AND LABOUR LAWS

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## *Abstract*

*Labour law does not always provide a satisfactory answer to the issue on the protection of workers' or employees' interests. Modern corporate law gives an alternative way in promoting the interests of employees; whereby it obliges directors to take into account not only shareholders' but also employees' interests in decision-making process.*

## *Abstrak*

*Hukum perburuhan tidak selalu memuaskan dalam melindungi kepentingan buruh atau pegawai perusahaan. Hukum perusahaan yang modern memberikan alternatif untuk memajukan kepentingan para pegawai perusahaan, di mana ia menentukan agar direktur dalam mengemban tugasnya pada perusahaan, tidak hanya memperhatikan kepentingan pemegang saham tetapi juga harus memperhatikan kepentingan pegawai dalam proses pengambilan keputusan.*

**Keywords:** *employee, labour, director, ESOP, co-determination.*

## **A. Introduction**

Directors of corporations play a significant role in the area of corporate governance. This is because all managerial powers in corporations are vested to the directors. It can be understood, therefore, if director's duty to the corporation becomes an important issue in the discussion of corporate governance, in which it has been discussed by many authors in many countries.<sup>1</sup> Managerial powers exercised by directors, however, are not their own. For who are those powers exercised? This issue

had been an academic and applied debate in the United States since eighty years ago.

In the early 1930s, a series of three articles published in the Harvard Law Review by Professors Berle and Dodd set out two models of corporations: the shareholder-focused model and the stakeholder-focused model. Although the debate between Professors Berle and Dodd was about American corporations and took place eighty years ago, "it remains highly pertinent for application in other countries and in other corporate contexts due to the

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<sup>1</sup> Klaus J. Hopt, "Director's Duties to Shareholders, Employees, and Other Creditors: A View from the Continent", in McKendrick (ed.), 1992, *Commercial Aspects of Trusts and Fiduciary Obligations*, Oxford University Press, New York, p. 115.

ubiquitous nature of the choice of the two models.”<sup>2</sup>

Professor Berle’s article appeared first. He argued that “all powers granted to a corporation or to the management of a corporation, or to any group within the corporation, whether derived from statute or charter or both, are necessarily and at all times exercisable only for the rateable benefit of all the shareholders as their interests appear.”<sup>3</sup> Berle stated that his proposition could be supported by analysing five absolute corporate powers, such as the power to issue stock and the power to declare or withhold dividends, in which the result of it was these powers were exercised only for the interests of shareholders.

A year after the publication of Professor Berle’s article, Professor Dodd wrote in response. Dodd disagreed with Berle’s thesis and claimed that managers ‘should concern themselves with the interests of employees, consumers, and the general public, as well as of the stockholders’.<sup>4</sup> Dodd asserted that it was common at that time to use corporate funds to suggest ‘a social responsibility rather than an exclusively profit making viewpoint’. He acknowledged that such charity was not the duty of

the board, but by referring to the judgment of *Hutton v. West Cork Ry*,<sup>5</sup> he stated that so long as the charity was required for the benefit of the company, it was acceptable. He believed that by considering the welfare of employees and consumers, the profits of stockholders would increase in the long run.<sup>6</sup>

In his reaction, Berle declared that social responsibility, although it was justified, was theory, not practice.<sup>7</sup> He contended that there was no mechanism for enforcing social responsibility, and that stockholders’ interests should not be weakened except for “a clear and reasonably enforceable scheme of responsibilities to someone else”.<sup>8</sup> Twenty years later, Berle acknowledged that the debate had “been settled (at least for the time being) squarely in favour of Professor Dodd’s contention,” but, in spite of that fact, he rejected the assumption that Dodd was right all along.<sup>9</sup>

The effect of this famous debate has changed corporate doctrine from the traditional view as Berle’s proposition to Dodd’s that corporation is not merely an aggregate of its shareholders but it includes a range of other interests, which are the

<sup>2</sup> Andrew Clarke, “The Models of the Corporation and the Development of Corporate Governance”, *Corporate Governance eJournal*, September, 2005. J. Parkinson, 1993, *Corporate Power and Responsibility: Issues in the Theory of Company Law*, Oxford University Press, Oxford.

<sup>3</sup> Adolf A. Berle, “Corporate Powers as Powers in Trust”, *Harvard Law Review*, Vol. 44, 1931, p. 1049.

<sup>4</sup> E. Merrick Dodd, “For Whom Are Corporate Managers Trustees?”, *Harvard Law Review*, Vol. 45, 1932, p. 1156.

<sup>5</sup> *Hutton v. West Cork Ry* (1883) 23 Ch. D. 654 at 673: “The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as is required for the benefit of the company.”

<sup>6</sup> E. Merrick Dodd, 1932, *Loc.cit.*

<sup>7</sup> Adolf A. Berle, “For Whom Corporate Managers Are Trustees: A Note”, *Harvard Law Review*, Vol. 45, 1932, p. 1367.

<sup>8</sup> *Ibid.*

<sup>9</sup> Joseph L. Weiner, “The Berle-Dodd Dialogue on the Concept of the Corporation”, *Columbia Law Review*, Vol. 64, 1964, p. 1464.

interests of employees, customers and creditors.<sup>10</sup> Furthermore, the development of the concept of corporation gives a substantial effect to define director's duties, which is directors owe duty not only to shareholders, but they have a duty to consider the interests of employees, customers and creditors in certain circumstances as well.<sup>11</sup>

This article will focus on the discussion of directors' duty to take into account the interest of employees in their business decisions. In this regard, employees should include white collar employees and workers (labours) as well. Promoting the employees' interest is a problematic issue since this interest is usually placed in the opposite position from that of the corporation interest. It is not unusual if directors set aside the interest of employees in order to pursue the interest of the corporation. Labour law is not always successful in protecting the interest of employees. Accordingly, approaching this issue with corporate law suggests a solution in promoting the interest of employees.

The problem which will be dealt with in this article is that Indonesian corporate law does not recognise director's duty to employees. It is questionable therefore, whether directors should be imposed a duty to employees under Indonesian corporate law. Since similar situation is also faced by Australian corporate law, this article will compare the legal development in attributing the employees' interest into the interests of the company as a whole under

Indonesian and Australian corporate laws and practical approaches taken by Indonesian and Australian companies in dealing with this issue. This article will also explore the role of employees in German corporate governance, the possibility of incorporating the formal recognition of employees into Indonesian corporate governance and some controversial issues when applying this rule, such as conflict of interests between shareholder's interest and employee's interest.

## **B. Analysis**

### **1. Legal Development**

#### **a) Indonesian Law**

The current law that governs corporations is Act Number 40 of 2007 concerning Limited Liability Companies (*Undang-Undang tentang Perseroan Terbatas* or UUPT). The UUPT does not provide for an express duty of directors to take into account the interest of employees in their business decisions. Pursuant to Article 97 (2) of the UUPT, the board of directors has to exercise its powers and discharge its duties in good faith and with full responsibility in the interests and business of the company. There is no explanation in this act on the meaning of the interests of the company. It is doubtful that the interest of employees is within the meaning of the interests of the company under this provision.

Article 126 (1) of the UUPT requires mergers, consolidations, acquisitions and

<sup>10</sup> Jennifer G. Hill, "Corporate Governance and the Role of the Employee", in Patmore and Golan (eds.), 2003, *Partnership at Work: The Challenge of Employee Democracy: Labor Law Essays*, Pluto Press, Sydney, p. 7.

<sup>11</sup> Klaus J. Hopt, 1992, *Loc.cit.*

spin offs to take into account the interests of company, minority shareholders, employees, creditors, trading partners, as well as the interests of public and fair competition. The persons upon whom this obligation falls are not identified. Thus, they could include directors, commissioners and shareholders of the respective companies. It is interesting to note, that this provision separates the interest of company from the interest of employees. Consequently, under this provision the interests of the company do not include the interest of employees.

The UUPT also seems reluctant to accommodate the interest of employees as it is shown in Article 43 (3). This provision mentions about the issuance of shares for employees or Employee Stock Ownership Plans (ESOPs). Nevertheless, it does not require the company in certain circumstances to issue shares for its employees. Thus, it is under the discretion of the board of directors, as the embodiment of the company, whether or not the company may offer its shares to its employees.

Attributing the interest of employees into the interests of the company as a whole also seems difficult considering the nature of the corporate structure in Indonesia. Based on Article 1 (2) of the UUPT, the corporate structure consists of 3 elements: the general meeting of shareholders (GMS), the board of directors and the board of commissioners. As a civil law country, Indonesia adopts a two-tier board structure, which are the management board (the board of directors or *Direksi*) and the supervisory

board (the board of commissioners or *Dewan Komisaris*). The GMS has all authority and powers not granted to the *Direksi* or *Dewan Komisaris* within the limits of the UUPT or the Articles of Association.<sup>12</sup> The GMS appoints to the *Direksi* and *Dewan Komisaris*. The *Direksi* shall carry out the management of the company.<sup>13</sup> *Dewan Komisaris* has duties to supervise the *Direksi* in the operation of the company and to provide advices for the *Direksi*.

From these provisions it can be seen that the UUPT still adopts the traditional view of the corporation as an aggregate of its shareholders. Through the mechanism of the GMS, the shareholders appoint members of the *Direksi* and of *Dewan Komisaris*. The UUPT does not give any chance for employees to be represented in the corporate structure. At this point, corporate law is parallel with labour law, which puts employees as outsiders to the corporate structure. The nature of the corporate structure can reflect to what extent corporate law can protect the interest of employees.

Even though the UUPT does not impose the duty on directors to take into consideration the interest of employees in their business decisions, directors are under obligation to protect the interest of employees based on labour law. Two major pieces of Indonesia's labour legislations are Act Number 13 of 2003 concerning Manpower (Manpower Act) and Act Number 2 of 2004 concerning the Industrial Relations Dispute Settlement (IRDS Act). Indonesia

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<sup>12</sup> Article 75 (1) of the UUPT.

<sup>13</sup> Article 92 (1) of the UUPT.

has also ratified numerous ILO conventions including all eight of the ILO's core labour conventions, which are:

1. Convention concerning Forced or Compulsory Labor;
2. Convention concerning the Abolition of Forced Labor;<sup>14</sup>
3. Convention concerning Freedom of Association and Protection of the Right to Organize;<sup>15</sup>
4. Convention concerning Discrimination in Respect of Employment and Occupation;<sup>16</sup>
5. Convention concerning the Application of the Principles of the Right to Organize and to Bargain Collectively;<sup>17</sup>
6. Convention concerning Equal Remuneration for Men and Women Workers for Work of Equal Value;<sup>18</sup>
7. Convention concerning Minimum Age for Admission to Employment;<sup>19</sup> and
8. Convention concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labor.<sup>20</sup>

On paper, labour law in Indonesia has provided several protections on employees' interests. The fundamental rights already granted to employees include the right to organise into trade unions, the right to bargain and strike, and the provision of certain minimum standards, such as wages, work hours, sick leave, maternity leave, holiday pay, overtime, and severance pay. Article 86 of the Manpower Act stipulates that

employees are entitled to have protections in respect of safety, health and morality, the promotion of labour morale and treatment in accordance with the dignity of mankind and religious morals. Pursuant to Article 151 of the Manpower Act, employers, as well as employees and trade unions, must make all efforts to prevent the termination of employment. The employer must consult his/her intention to terminate with the trade union or with the non-unionized worker directly. If no agreement is reached, then the employer must receive permission to terminate the employment contract of the employee from the institution for the settlement of industrial relation disputes (ISIRD). If the employee is unwilling to accept the dismissal for grave wrongdoings, he/she may file a suit to the ISIRD.

The IRDS Act provides five dispute settlement procedures: bipartite settlement, mediation, conciliation, arbitration and an Industrial Relations Court. Article 3 of the IRDS Act stipulates the procedures to be taken in the event of a dispute over termination of employment. This provision requires that industrial disputes first be resolved through bipartite bargaining within 30 days of commencement of negotiations. If the negotiations fail, at least one or both of the parties can file the dispute to the local manpower office, which will offer both parties the opportunity to settle the dispute

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<sup>14</sup> Act Number 19 of 1999.

<sup>15</sup> Presidential Decree Number 83 of 1998.

<sup>16</sup> Act Number 21 of 1999.

<sup>17</sup> Act Number 1 of 1956.

<sup>18</sup> Act Number 80 of 1957.

<sup>19</sup> Act Number 20 of 1999.

<sup>20</sup> Act Number 1 of 2000.

through conciliation. Article 5 of the IRDS Act states that, should conciliation not yield a result, one of the parties can file a legal petition to the Industrial Relations Court. If the employee wishes to appeal the decision of the Industrial Relations Court, he/she must file an appeal within seven working days to the Supreme Court.<sup>21</sup>

The text of labour laws is meaningless if there is no successful enforcement. Despite industrial relations reforms, the Indonesian labour law system remains to benefit employees only on an occasional and arbitrary basis. The reforms reserve discretion in the hands of employers and the state.<sup>22</sup> Although trade unions enjoy significant freedoms since the collapse of the New Order, they face new and difficult challenges. The 1997 economic crisis prompted the flight of foreign investors and mass unemployment.<sup>23</sup> This results an extremely vulnerable labour force able to be mobilised to keep labour costs low and capable of instant replacement in the case of a strike or other such disruption.<sup>24</sup> Similarly, an export-oriented industrialisation strategy needs low labour costs in order to compete with other Asian states. This produces a labour law framework designed to control unions and wage demands.<sup>25</sup>

Furthermore, under labour law employees are equal partners of employers. This means, labour law deems employees are outsiders to corporations.<sup>26</sup> As the outsiders, however, employees are directed to feel as insiders in order to maintain and defend the business perpetuity. Even though labour law tries to protect the interests of employees, a complicated and unfair situation is quite often faced by employees. In fact, the position of corporations is clearly stronger than that of employees.

Perhaps, that is an impact of the definition of employers given by the Manpower Act, which assumes individual, entrepreneur, legal entities or other entity as the same creatures.<sup>27</sup> Although the Manpower Act does not define employers as corporations only, it can be found in the commercial reality that employers tend overwhelmingly to be corporations. The Manpower Act fails to take into account special features and the internal system of a corporation, in which employees are an internal part of a corporation. It seems, the Manpower Act ignores the relevance of corporate law for labour law. To be sure, corporate law is always relevant for the discussion of promoting employees' interests.

<sup>21</sup> Article 110 of the 2004 Act.

<sup>22</sup> Alexandra Owens, "Testing the Ratcheting Labor Standards Proposal: Indonesia and the Shangri-La Workers", *Melbourne Journal International Law*, Vol. 7, 2004.

<sup>23</sup> Aloysius Uwiyono, "Employer's Perspective of the Present Industrial Relations", *The International Labour Organization*, Vol. 3, 2000.

<sup>24</sup> Tim Lindsey and Teten Masduki, "Labour Law in Indonesia after Suharto: Reformasi or Replay?", in Sean Cooney (ed.), *Law and Labour Market Regulation in East Asia*, 2002, London and New York.

<sup>25</sup> Sean Cooney, "Labour Law and Labour Market Regulation in East Asian States: Problems and Issues for Comparative Inquiry", in Sean Cooney (ed.), 2002, *Law and Labour Market Regulation in East Asia*, London and New York.

<sup>26</sup> Jennifer G. Hill, 2003, *Op.cit.*, pp. 2-5.

<sup>27</sup> Article 1 (4) of the 2003 Act: employers are individual, entrepreneur, legal entities or other entity that employ manpower.

### b) Australian Law

Australia adopts common law system; accordingly the sources of law in Australia are case law and statute. Court decisions are binding on lower courts in subsequent cases and on the same courts as well. Regarding director's duty to the company, the court has declared that one of fiduciary duties owed by directors is to act *bona fide* (in good faith) for the benefit of the company as a whole. The meaning of 'the benefit of the company as a whole' however, is far from clear. In the early of the 20th century, the court declared that the director owed a duty to his company alone and owed no duty to anyone else.<sup>28</sup> Several years later, the court took a different approach by declaring that the interest of the company as a whole simply meant the interest of the company's shareholders,<sup>29</sup> both present shareholders and future shareholders.<sup>30</sup> A significant change of this rule had been developed when the court held that the interests of creditors were paramount over those of shareholders if the solvency of the company was in state of doubtful.<sup>31</sup> Nevertheless the interest of employees is still set aside.

In the case of *Parke v. Daily News Ltd*,<sup>32</sup> where a shareholder challenged the

company's policy to give the whole purchase price of its newspaper for the redundant employee's benefit, the court rejected a proposition that the board of directors must take into consideration its duties to employees as a proposition of law.<sup>33</sup> The court upheld the rule in *Greenhalgh v. Arderne Cinemas Ltd*.<sup>34</sup> that the benefit of the company meant the benefit of shareholders as a general body.

In the United Kingdom, this rule has been overruled by the Companies Act 1985 which mandates that company directors shall include the interest of employees in their decision making.<sup>35</sup> Similarly, in New Zealand, the Companies Act 1993 has adopted the approach that the interest of employees may be taken into account by directors in administering the company.<sup>36</sup> Under Australian law, however, there is no case law or corporation legislation which obliges directors to take into account the interest of employees in their decisions for the company.<sup>37</sup> Despite that, a company is bound by laws on conditions of labour which provide several protections to the interests of employees.<sup>38</sup> Directors, therefore will be in breach of their fiduciary duty to the company if they fail to consider the employees' interest as regulated by those

<sup>28</sup> *Percival v. Wright* (1902) 2 Ch 421.

<sup>29</sup> *Greenhalgh v. Arderne Cinemas Ltd.* (1951) Ch.286; *Ngurli Ltd. v. McCann* (1953) 90 CLR 425.

<sup>30</sup> *Gaiman v. National Association for Mental Health* (1971) Ch. 317.

<sup>31</sup> *Walker v. Wimbrone* (1976) 137 CLR 1; *Kinsela v. Russell Kinsela Pty Ltd. (in liq)* (1986) 4 ACLC 215.

<sup>32</sup> *Parke v. Daily News Ltd* (1962) Ch. 927.

<sup>33</sup> *Ibid.*

<sup>34</sup> *Greenhalgh v. Arderne Cinemas Ltd* (1951) Ch. 286.

<sup>35</sup> Andrea Corfield, "The Stakeholder Theory and its Future in Australian Corporate Governance: A Preliminary Analysis", *Bond Law Review*, Vol. 10, 2, 1998, p. 213.

<sup>36</sup> H. A. J. Ford and R. P. Austin, 2010, *Ford and Austin's Principles of Corporations Law*, 14 ed., Butterworths, Sydney, p. 265.

<sup>37</sup> *Ibid.*

<sup>38</sup> *Ibid.*



laws. Accordingly, in discussing directors' duty to the company's employees, it is necessary to analyse how far labour law requires an employer, in this case a company via its directors, considers the interest of its employees in its business decisions.

The Workplace Relations Act 1996, as amended by the Workplace Relations Amendment Act 2005 provides several protections to the interests of employees, as the act adopts international labour standards. For example, the Act requires that employers provide employees with five minimum entitlements, which covered maximum ordinary working hours, annual leave, parental leave, personal/carer's leave and minimum pay scales. These five minimum entitlements were referred to as the Australian Fair Pay and Conditions Standard.<sup>39</sup> However, in response to widespread criticism, the government introduced a Fairness Test to replace the Australian Fair Pay and Conditions Standard which came into effect on 7 May 2007.

When an employer decides to terminate an employee's employment because of the company's genuine operational reasons, it must give an appropriate notice of termination to that employee.<sup>40</sup> Compensation instead of notice may be given. When termination is taking place on account of the employee's conduct or performance, the employee must be given an opportunity to defend himself against the allegations.

An employee's employment cannot be terminated by an employer unless there is a valid reason or reasons, connected with either the employee's conduct or capacity, or the operational requirements of the undertaking, establishment or service. A reason is not valid if the termination is harsh, unjust or unreasonable.<sup>41</sup> An employer is prohibited to terminate employment on the grounds:<sup>42</sup>

- a. discriminatory reasons such as age, race, national extraction, political opinion, sex, sexual preference, religion, marital status, disability, pregnancy and family responsibilities;
- b. refusal to sign an Australian Workplace Agreement (AWA);
- c. being involved in proceedings against an employer for alleged breach of the law;
- d. membership or non-membership of a union or participation in union activities; and
- e. absence from work due to illness or injury, parental leave or emergency management activities.

Whenever an employer terminates 15 or more employees because of economic, technological, structural or similar reasons, the employer must notify a body prescribed by the Workplace Relations Regulations 2006<sup>43</sup> (currently the said body is Centrelink<sup>44</sup>) in writing of the intended termination explaining the reasons of termination, the numbers and categories of employees likely to be affected, and the time over which the employer intends to carry out

<sup>39</sup> Colin Fenwick, "How Low Can You Go? Minimum Working Conditions Under Australia's New Labour Laws", *The Economic and Labour Relation Review*, Vol. 16, 2, 2006.

<sup>40</sup> Section 661.

<sup>41</sup> Section 652 (1)b.

<sup>42</sup> Section 659.

<sup>43</sup> Section 660.

<sup>44</sup> Regulation 12.9, Workplace Relations Regulations 2006.



the termination.<sup>45</sup> The Australian Industrial Relations Court can impose a penalty to an employer of no more than \$1000 for contravention of this provision and order the employer not to terminate the employment of employees pursuant to the decision, except as permitted by the order.<sup>46</sup> The employer must also notify a union of the proposed termination and to consult with the union as to whether the impact of the redundancies could be mitigated.<sup>47</sup>

Despite these employee's interest protections, it is apparent that these provisions do not impose the company via its directors to consider the interest of employees in its business decision as a part of the interest of the company as a whole. In other words, employees are treated as the outsider of the company. When the company decides to terminate 15 or more employees because of economic, technological, structural or similar reasons, the company is under obligation to notify the Centrelink and the union as well. However, it should be noted that the obligation comes along after the company made the decision, and both the Centrelink and the union cannot change that decision. The Act does not regulate that in making a business decision, the company must consider the interest of employees. It ignores any consideration applied behind the decision. Although the company must mention the reasons of

termination when it notifies the Centrelink, there is no power given to the Centrelink to reject the reasons. For these circumstances, it can be understood that labour law does not deal with corporate governance, even less any business judgments. One of its aims is to protect employees who are in the vulnerable position against the employer. Corporate governance is a matter of corporate law, so that corporate law is always relevant to promote the interest of employees.

## 2. Practical Approach

Although corporate laws in Indonesia and Australia are still uncertain in dealing with this issue, in reality, every successful company accepts, either explicitly or implicitly, that it has an obligation to pay due regard to the interest of its employees.<sup>48</sup> However, in the absence of statutory obligation, it is doubted whether employees can demand their interests to be considered in directors' decision. By supposing the reversed fact in the American case of *Dodge v. Ford Motor Co*,<sup>49</sup> where Ford declared that it would not give its employees any pay rise or bonus because it preferred to pay extravagant dividends to its shareholders, the enforcement of the duty owed by directors to pay due regard to the employees' interest is doubtful, since there is no mechanism for doing so

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<sup>45</sup> Section 660.

<sup>46</sup> *Ibid.*

<sup>47</sup> *Ibid.*

<sup>48</sup> Allan Lowrie Mackenzie, "The Employee and the Company Director", *New Law Journal*, July, 1982, p. 689.

<sup>49</sup> *Dodge v. Ford Motor Co* (1919) 170 NW 668. In this case, Ford sought to end special dividends for shareholders in favor of massive investments in new plants that would enable Ford to dramatically grow the output of production, and numbers of people employed at his plants, while continuing to cut the costs and prices of his cars.

provided by corporate law or any branch of the law.<sup>50</sup>

For the above circumstances, some people suggest that employees or trade unions should be given a few shares so that they become qualified to take an action, 'either *qua* member to have the company observe their rules of company law and the terms of the corporate constitution, or in derivative form as representing the company'.<sup>51</sup> Nevertheless, taking an action *qua* member is inconsistent with the rule that a personal action can be exercised to enforce rights enjoyed in the capacity as a member, not rights enjoyed in any other capacity.<sup>52</sup> When employees become members, therefore, they are entitled to take an action *qua* members to enforce their member rights only, not their employee rights. Thus, an employee share ownership is not an effective mechanism for an employee to demand her or his rights to be considered.

In spite of this ineffectiveness, an employee share ownership plan (ESOP) is acknowledged as a way to have regards the interest of employees, and has been popular in Australia's largest companies.<sup>53</sup> An ESOP is a scheme whereby shares are offered for subscription or purchase only to any or all full or part-time employees of the issuing corporation. The main types of

ESOPs currently in operation in Australia are Fully Paid Share Plan with Company Loans, Partly Paid Share Plan, Option Plan, Employee Share Acquisition Plan (ESAP), Executive Share Unit Trust (ESUT), and Share Replicator Plan.<sup>54</sup>

In Indonesia, since 1990s some companies have exercised ESOPs in order to adjust the new phase in Indonesia and to get more commitment from their employees.<sup>55</sup> As there is no regulation on ESOPs, the arrangement and the number of shares purported differ from one company to others.<sup>56</sup> In the absence of law on this issue, no one can impose companies in Indonesia to exercise ESOP as a mechanism for promoting the interests of employees.

ESOPs are essential to bridge the gap between capital and labour in modern society. Generally speaking, their objectives are to establish a foundation for the creation of a true partnership between owners and employees, to enhance employee performance and motivation to increase productivity, to overcome a fairly common cynical attitude of employees towards workplace organisation initiatives designed to facilitate participation, and to establish a remuneration structure which will complement and reinforce the company's strategic business plans.<sup>57</sup>

<sup>50</sup> L.S. Sealy, "Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural", *Monash Law Review*, Vol. 13, 1997, p. 164.

<sup>51</sup> *Ibid.*, p. 184.

<sup>52</sup> *Hickman v. Kent or Romney Marsh Sheep-Breeders' Association*, (1915) 1 Ch. 881

<sup>53</sup> Ann O'connell, "Employee Share Ownership Plans in Australia: the Taxation Law Framework", *Journal of the Australasian Tax Teachers Association*, Vol. 3, 1, 2008, p. 36.

<sup>54</sup> Gary Fitton and Geoff Price, 1990, *Employee Share Planning in Australia*, Information Australia, Melbourne, p. 12.

<sup>55</sup> Ishak Rafick, "Membangun Komitmen Karyawan", *SWADigital*, p. 4.

<sup>56</sup> *Ibid.*

<sup>57</sup> *Ibid.*, pp. 3-6.

For employees, the plans give several advantages. They deliver the full value of dividends when declared and offer the opportunity to make periodic sales of shares to realise capital gain.<sup>58</sup> Nevertheless, they also have a risk of large losses when the share price falls. Because of the risk, some people suggest that an employee should not 'put all his eggs in one basket', he 'should not be investing in the firm where he works'.<sup>59</sup> For this objection, it can be argued that 'the way to make money is to put all your eggs in one basket and watch the basket', and that, the plans are 'the icing on the cake, not the whole cake'.<sup>60</sup>

Another reason to reject the plans is that when an employee wants to own shares, he can save up and buy them in the stock market. For this reason, it can be argued that a stock market is not 'a share shop for small first-time buyers', but it is a place where people who have built up a business spread their risks by exchanging some of their shares for other securities. Besides that, there is a psychological barrier to buy shares on a stock market for any first-time investors, especially an unsophisticated employee, in which, this barrier can be crossed by introducing shareholding via an employee share ownership plan.<sup>61</sup>

### 3. The Formal Recognition of Employees

Indonesian and Australian corporate

laws are examples of the shareholder-focused model of corporate governance. As pointed out by Professor Berle, this model requires profit maximisation for shareholders to be the guiding principle for directors. This means, shareholders are the one and only shareholder group that directors should take into account when making a decision. Under this model, the role of employees in the corporate governance framework may not be formally recognised in statute and in other formal sources of law.

In contrast, the stakeholder-focused model of corporate governance asserted by Professor Dodd requires company directors to be guardians of all the interests whom the corporation affects – such as employees, creditors and consumers – and not merely to be servants of its shareholders. This model stresses the importance of employee participation in the corporate governance and employees may be formally recognised and accepted as integral players in the corporate governance arrangement.<sup>62</sup>

The stakeholder-focused model is best recognised in German corporate law.<sup>63</sup> As a civil law country, Germany adopts a two-tier board structure, which are the management board (*Vorstand*) and the supervisory board (*Aufsichtsrat*).<sup>64</sup> The *Vorstand* holds all managerial

<sup>58</sup> *Ibid.*, p. 21.

<sup>59</sup> G.R. Cyriax, 1981, *Planning Employee Share Schemes*, Gower Publishing Co. Ltd., Aldershot, Hants, England, p. 3.

<sup>60</sup> *Ibid.*

<sup>61</sup> *Ibid.*

<sup>62</sup> Andrew Clarke, 2005, *Op.cit.*, p. 3.

<sup>63</sup> Katharine V. Jackson, "Towards A Stakeholder-Shareholder Theory of Corporate Governance: A Comparative Analysis", *Hastings Business Law Journal*, Vol. 7, 2001, p. 353.

<sup>64</sup> Patrick C. Leyens, "German Company Law: Recent Developments and Future Challenges", *German Law Journal*, Vol. 6, 10, 2005, p. 1411.

powers<sup>65</sup> whilst the *Aufsichtsrat* performs the ‘watch-dog function’.<sup>66</sup> The German corporate law requires employee representation on the *Aufsichtsrat*. Thus, the *Aufsichtsrat* consists of shareholders and employee representatives.<sup>67</sup> The *Aufsichtsrat* has power to appoint to the *Vorstand*.<sup>68</sup> Likewise, the *Vorstand* is required to have one employee representative (*Arbeitsdirektor*).<sup>69</sup> The employee representatives in the *Aufsichtsrat* and the *Vorstand* is called co-determination (*Mitbestimmung*), that is the right to participate in decision making.<sup>70</sup>

The employee representatives in the *Aufsichtsrat* and the *Vorstand* are fed a wealth of information by the Works Council (*Betriebsrat*) in order to be able to become informed participants in company discussions. The Works Council comprises members elected from the workforce. Its size depends on the size of the company to which it is attached. It deals with any matter relating to the conditions of employment of employees of the company including hours, overtime and remuneration. Employee issues that are within the domain of the trade unions are left to the unions. The role of the Works Council and trade unions are different. The ideology of the Works Council is the belief that employees are interested in the long-term view of

business and are, to a large extent, unconcerned by dividends to shareholders.<sup>71</sup>

#### **4. Incorporating the Formal Recognition of Employees into Indonesian Corporate Governance**

The non-recognition of employees’ roles in the corporate governance as adopted by Indonesian corporate law represents a traditional view of the corporate doctrine. Modern corporate governance recognises the roles played by employees and accounts for the interest of employees. It also requires directors to pay attention to the needs and collective welfare of the employee group. As noted by Professor Dodd, that “there is a widespread and growing feeling that industry owes to its employees not merely the negative duties of refraining from overworking or injuring them, but the affirmative duty of providing them so far as possible with economic security.”<sup>72</sup>

Some scholars strongly suggest that “no corporation can sustain itself without appropriate attention to all those who hold a stake in its performance - customers certainly, but also suppliers, creditors, neighbours, society in general and, of course, those most directly affected – employees [...] There is a growing sense that rank and file employee, as well as middle-level

<sup>65</sup> Article 76 of the Stock Corporations Act (*Aktiengesetz*).

<sup>66</sup> Article 111 of the Stock Corporations Act.

<sup>67</sup> Article 96 of the Stock Corporations Act.

<sup>68</sup> Article 84 of the Stock Corporations Act.

<sup>69</sup> Article 76 (2) of the Stock Corporations Act.

<sup>70</sup> Katharine V. Jackson, 2001, *Op.cit.*, p. 368. Tom C. Hodge, “The Treatment of Employees As Stakeholders In The European Union: Current And Future Trends”, *Syracuse Journal of International Law and Commerce*, Vol. 38, 2010, pp. 116-117.

<sup>71</sup> Patrick C. Leyens, 2005, *Loc.cit.*

<sup>72</sup> E. Merrick Dodd, 1932, *Op.cit.*, p. 1151.

management, disproportionately share the risk, but not the gains of corporate success.<sup>73</sup>

In recent times promoting the interest of employees is not merely the concern of labour law but the concern of corporate law as well. The American, English and New Zealand corporate laws provide that directors, in considering the best interests of the corporation in discharging their duties, are permitted to consider the interests of shareholders, employees, suppliers, customers, creditors and communities. German corporate law obliges large corporations to accommodate employee representatives in the supervisory board (*Aufsichtsrat*). Thus it is the time for Indonesian corporate law to shift its traditional concept of a corporation to the modern one by recognising the role of employees in the corporate governance formally.

There are three mechanisms can be employed by the UUPT in incorporating employee's role in the corporate governance. First, imposing a duty on directors to take into consideration the interest of employees in their business decisions, as have been done by American, English and New Zealand corporate laws. Second, requiring employee representatives to participate in the decision making on the boards of commissioners and of directors as has been done by German corporate law. Third, mandating large corporations in certain circumstances to purport share for their employees (ESOPs). Through these

mechanisms the interest of employees will be better protected and in the long run the company will benefit from this system as well, since this system will decrease disputes and strikes, and consequently will increase productivity.

## 5. Controversial Issues

Some controversial issues arise when the interest of employees is incorporated within the meaning of the benefit of the company as a whole. It is argued that requiring directors to take into account the interest of shareholders and the interest of employees altogether will lead to potential conflicts since often, the objectives of the two groups are in opposition, or do not coincide.<sup>74</sup> For example, where a company is in financial difficulties, the directors will have to choose between protecting shareholders by making some employees redundant, or protecting the employees at the expense of shareholders, which is by reducing the amount of dividends paid to shareholders.

It is stated that such a situation will put directors in an impossible situation since one interest will inevitably be paramount,<sup>75</sup> while if directors consider the interests of one and disregard those of the other, they will be in breach of their duties. However, it can be argued that directors' function is to balance a number of different interests in reaching the decisions which they are obliged to make to be in the company's best overall interests. In this case,

<sup>73</sup> R. J. Mahoney, "Business Should Act for All Its Stakeholders – Before 'The Feds' Do".

<sup>74</sup> Allan Lowrie Mackenzie, 1982, *Op.cit.*, p. 689.

<sup>75</sup> *Ibid.*

directors can compromise those different interests, for example by paying sizable premiums to older and to foreign employees if they agree to retire before their time or to return to their home countries.<sup>76</sup>

Another issue is that every director's decision will potentially be a subject for judicial review whenever there is one group who feels its interests are disregarded. Such a situation has been pointed out by Berle when he commented Dodd's proposition that company law should regard the trusteeship of corporate managers as extending to embrace the interests of employees, customers and others.<sup>77</sup> Berle asserted that this proposition would create legal difficulties and would make the proposal unpractical.<sup>78</sup> "The only thing that can come out of it, in any long view, is the massing of group after group to assert their private claims by force or threat [...]. This is an invitation not to law or orderly government, but to a process of economic civil war."<sup>79</sup>

Such a fear, however, cannot be justified since corporate law does not allow shareholders, by majority vote or unanimous consent to overrule or interfere with directors' decisions made in lawful in exercising managerial powers. There is a clear separation between ownership and management in the corporation. Corporate law also does not give any power to shareholders to pass advisory resolutions.

Besides that, there is a business judgment rule, whereby the courts are reluctant 'to review business judgments of directors and to give their own judgments on the merits unless specifically required by statute'.<sup>80</sup> This rule is an American rule but it is widely recognised by corporate laws in other jurisdictions.

On the other hand, many obstacles exist to discourage and impede actions brought by employees against directors. Primarily, labour law encourages the employer, in this case the company, and the employees to settle their dispute in an agreement at the workplace or enterprise level. The Industrial Relations Court is to prevent and settle industrial disputes by mediation or arbitration and to encourage the parties to fulfil the agreed procedures for preventing and settling industrial disputes.

Moreover, there are difficulties in obtaining legal aid. If a trade union is to pursue the case on behalf of its members, its lawyers will have to be assured that there are good reasons for going to law.<sup>81</sup> Trade union lawyers surely will be averse towards having costs awarded against their union and will surely prefer to spend their time advising on ways of avoiding litigation.<sup>82</sup> Then, in the case that the company decides some of its employees to be made redundant because of its financial difficulties, their union will not take any action

<sup>76</sup> Friedrich K. Kübler, "Dual Loyalty of Labour Representatives", in Hopt and Teubner (eds.), 1985, *Corporate Governance and Directors' Liabilities*, Walter de Gruyter, Berlin, p. 432.

<sup>77</sup> E. Merrick Dodd, 1932, *Loc.cit.*

<sup>78</sup> Adolf A. Berle, 1932, *Loc.cit.*

<sup>79</sup> *Ibid.*

<sup>80</sup> H. A. J. Ford and R. P. Austin, 2010, *Op.cit.*, p. 257.

<sup>81</sup> Allan Lowrie Mackenzie, 1982, *Loc.cit.*

<sup>82</sup> *Ibid.*

against that decision when they realise that the decision made in order to preserve the remaining jobs and hope for revitalisation as a result.<sup>83</sup> This is preferable than avoiding redundancy which can lead the company into liquidation, which means, all employees will lose their jobs. Thus, it is unlikely that employees bring actions against directors whenever their interests are set aside.

### C. Conclusion

To sum up, the legal rule which has been developed and applied in Indonesia is that company directors owe a duty to exercise their powers and discharge their duties in good faith and with full responsibility in the interests and business of the company, in which the meaning of the interest of the company is merely the interest of shareholders. The interest of employees is not within the meaning of the interest of the company. This rule represents a traditional and narrow conception of the corporation; accordingly, it needs to be

reformed. Although Indonesia has ratified numerous ILO conventions, these reforms have not translated into concrete protections in practice. Indonesian directors, therefore, should be imposed a duty to the company to take into account the interest of employees in their business decisions, as have been done by other countries.

The absence of positive law gives rise difficulties in enforcing the duty since there is no mechanism available to do so. It is true that labour law has provided mechanisms to protect the interests of employees, but it is less severe to impose directors to consider the interest of employees in their decision making. Accordingly, it is necessary for Indonesian company law or UUPT to declare that directors in considering the best interest of the corporation in discharging their duties are obliged to consider the effect of any decision upon all groups affected by such decision, including shareholders, employees, creditors, customers and communities where its office is located.

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<sup>83</sup> *Ibid.*



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