

## The future of German codetermination

### Supervisory boards in Germany: Are they facing a paradigm shift?

By Dr. Lutz Englisch and Dr. Mark Zimmer

July 1 this year marked the 40th anniversary of the German Codetermination Act (*Mitbestimmungsgesetz*). The act implements the rule of parity (that is, equal representation of shareholders and employees on a supervisory board), especially for German stock corporations (*Aktiengesellschaften – AG*), German private limited liability companies (*Gesellschaften mit beschränkter Haftung – GmbH*) and German limited liability partnerships (*GmbH & Co. KG*) with more than 2,000 employees.

The German One-Third Participation Act (*Drittelbeteiligungsgesetz*) allocates just one-third of a supervisory board's seats to employee representatives and especially applies to German stock corporations and private limited liability companies with between 500 and 2,000 employees.

#### German codetermination legislation: the starting point

The German Codetermination Act was originally highly disputed, but has become an accepted part of corporate Ger-



Supervisory boards in Germany include employee representatives.

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many in past decades due to attempts to balance the interests of shareholders and employees.

Nevertheless, the factual landscape in Germany has slowly but continuously experienced quite noticeable changes over of the last 10 years. As a result of the freedom of establishment (*Niederlassungsfreiheit*) as laid down by the Treaty on the Functioning of the European

Union (TFEU) and formed by European Court of Justice case law, the number of German companies regulated by the Codetermination Act dropped from roughly 770 in 2002 to 635 in 2015. German companies have been evading the Act by adopting other legal forms: either the *Societas Europaea* (SE), which is more flexible in this respect than traditional German legal forms, or founding a company under English law but domiciling it

in Germany. These entities have become more and more visible in Germany.

In light of the developing jurisdiction of the European Court of Justice in terms of the freedom of establishment for companies within the European Union, there has been increasing discussion in the German legal literature whether moving the administrative seat of a German company out of Germany and into another EU Member State could affect the applicability of German codetermination laws on such a company.

#### The current controversy ...

A recent legal development holds the potential to have a huge effect not only on German codetermination laws, but also far-reaching and practically important consequences on other EU Member States:

Previously, it was widely undisputed that only employees of companies domiciled in Germany that have the German legal form conclusively set out by German

codetermination legislation would fall under these acts. The previously undisputed tenet was that employees of foreign subsidiaries of the German parent company did not count for purposes of determining the respective (2,000 or 500) thresholds under German codetermination laws or the size of the supervisory board. Correspondingly, it has always been self-evident that foreign staff members of EU subsidiaries outside Germany were not entitled to vote or be elected for a supervisory board seat.

These principles, perceived to be iron-clad laws, have now been tested in German courts in four different cases – and it looks as if the question about the territorial and personal reach of German codetermination laws will have to be decided by the European Court of Justice. Of the four cases recently brought before German courts, three are still pending, just one has been finally decided. The competent lower courts as well as the courts of appeals reached conflicting decisions and based them on different arguments:

Just a few months ago, on June 17, 2016, the Higher Regional Court of Frankfurt am Main decided by court order (No. 21W91/15) to stay proceedings in the matter of the composition of the supervisory board of Deutsche Börse AG until the

European Court of Justice has decided on a different case, the TUI case, and to wait for the subsequent preliminary ruling from the European Court of Justice. In the first instance, the Frankfurt District Court (No. 3-16 O 1/14) had taken a different position and decided the Codetermination Act also calls for factoring in the workforce employed by subsidiaries of the German parent company in other EU Member States – for determination of both the relevant applicable threshold and the way to organize the respective supervisory board.

As mentioned above, the Higher Regional Court of Berlin (No. 14 W 89/15 – TUI) had deferred their decision to the European Court of Justice in a matter regarding the composition of the supervisory board of TUI AG. They did this to obtain a preliminary ruling, and presented their questions to the European Court of Justice as to whether the limitation on active and passive participation to workers employed in Germany would conflict with Article 18 and/or Article 45 of the TFEU. It is expected that the court's ruling will not be completed earlier than 2017.

In another case, the Higher Regional Court of Zweibrücken (No. 3 W 150/13 – Hornbach) drew from the specific facts of the case to leave open whether workers

employed by a foreign subsidiary of a German codetermined company would need to be considered for purposes of the determination of the lawful size and structure of the company's supervisory board.

And in the fourth case, the Munich District Court (No. 5 HK O 20285/4 – BayWa) took the position that the German Codetermination Act does not violate EU law and that it, in particular, does not conflict with Article 18 and Article 45 of the TFEU, and so foreign EU employees of subsidiaries of German parent companies would not be entitled to vote for the supervisory board seats on the employee representatives' side at the level of the German parent company. This case is now pending at the Higher Regional Court of Munich. As recently communicated by the Court, the procedural status of this case is not yet clear.

### ... and its consequences

What are the legal and practical consequences of these contradictory decisions and the current uncertainties resulting from this situation? The obvious and preeminent question is, of course, whether the German codetermination system is, in the eyes of the European Court of Justice, perceived to restrict

freedom of movement and discriminate against employees from other EU states. If so, the follow-up question would be whether domestic codetermination systems of other EU Member States are also affected by such a ruling – and whether this could lead to a point when the EU Commission might consider taking action as part of its company-law agenda. At present, companies potentially affected are well-advised to carefully analyze their respective factual situations and their exposure in terms of the structure and size of their supervisory boards. This analysis might also include considering established structural measures to avoid the current legal uncertainties described above. ←



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