Your World First

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German codetermination under scrutiny

Status of court proceedings concerning the compatibility of German corporate codetermination with EU law

Rulings Rendered by the Frankfurt Regional Court (LG Frankfurt) on 16 February 2015 and the Berlin Higher Regional Court (KG Berlin) on 16 October 2015

We have already reported on the **ruling rendered by the Frankfurt Regional Court on 16 February 2015 (Case 3-16 O 1/14)**, which, in particular, concerns businesses with employees and subsidiaries within Europe but outside Germany. It is common knowledge that the Frankfurt Regional Court decided in status proceedings initiated by Deutsche Börse AG regarding the composition of the supervisory board that, contrary to the prevailing opinion, the claimant's motion for alternative relief was to be allowed, because both the Deutsche Börse AG employees employed abroad and employees of its foreign subsidiaries must be included in the thresholds for corporate codetermination. The Frankfurt Regional Court had gathered this from an interpretation of the wording of the German One-Third Participation Act (*DrittelBG*) and the German Codetermination Act (*MitbestG*): These acts were not limited to employees employed in Germany. According to the Frankfurt Regional Court ruling, the composition of the supervisory board of Deutsche Börse AG was incorrect, because due to the number of employees in Germany (1,624) only one-third of the board consists of employee representatives pursuant to the German One-Third Participation Act. Instead, owing to the total number of 3,811 employees employed in Europe, the supervisory board would have to be equally composed of six representatives of the shareholders and six representatives of the employees pursuant to § 7 (1) sentence 1 No. 1 of the German Codetermination Act.

The Frankfurt Regional Court rejected the claimant's principal motion. This motion focused on the decision not to apply the One-Third Participation Act at all, because this act restricted the active and passive voting right to German employees and thus constituted a violation of EU law. For this reason, the claimant's wish was that no employee representatives were supposed to be members of the supervisory board. The Frankfurt Regional Court did not regard the question concerning the legitimacy of the One-Third Participation Act's election regulations in the European Union as material to the decision, because such a question could be asked only in a procedure to contest the election and not in status proceedings.

Also in 2015, in status proceedings concerning TUI AG, the **Berlin Higher Regional Court**, on the other hand, presented the procedure by **order dated 16 October 2015 (Case 14 W 89/15)** to the European Court of Justice (EuGH), asking whether the exclusion of the active and passive voting right for employees of European members of the group outside of Germany constituted a violation of Article 18 of the Treaty on the Functioning of the European Union (AEUV, prohibition of discrimination) and of Article 45 of the Treaty on the Functioning of the European Union (AEUV, freedom of movement for workers).

In its capacity as the appeals court (*Beschwerdegericht*) in the Frankfurt proceedings, the Frankfurt/Main Higher Regional Court (OLG Frankfurt) has meanwhile reached an interim decision: On 17 June 2016 (Case 21 W 91/15), it decided to suspend the proceedings until the European Court of Justice ruled on the question referred by the Berlin Higher Regional Court. The European Court of Justice reports that the Advocate-General's expert opinion is to be expected in winter 2016/2017 and the European Court of Justice decision in the course of 2017.

In the following, we will provide a brief overview of the most important questions and answers:

1. What is at issue?

The question whether German corporate codetermination is compatible with EU law is under scrutiny. Similar status proceedings are currently being conducted in a number of cases. These primarily involve two different issues:

- First, it has to be determined whether group employees employed outside of Germany are to be counted when determining whether the threshold for the participation of employees (more than 2,000 employees pursuant to the Codetermination Act and more than 500 employees pursuant to the One-Third Participation Act) is reached.

- Second, the question arises whether the exclusion of the active and passive voting right for group employees employed outside of Germany regarding the election of the employee representatives for the supervisory board of the German company is incompatible with EU law.

These two questions do not necessarily have to be answered in the same way. It is indeed possible to count employees outside of Germany when determining whether the threshold has been reached without simultaneously granting them an active and passive voting right in Germany. However, the active and passive voting right is at issue in the case referred to the Berlin Higher Regional Court.

The Frankfurt/Main Higher Regional Court links both questions in its order dated 17 June 2016 in the status proceedings against Deutsche Börse AG. This court is of the opinion that German codetermination rights could be considered incompatible with EU law due to the non-consideration of employees employed outside of Germany only if a passive voting right for employees outside of Germany was assumed. Therefore, the proceedings must be suspended until the European Court of Justice has reached a decision on the question referred by the Berlin Higher Regional Court with regard to the TUI case.

2. What significance do these questions have for German companies?

The result of these proceedings is of great significance for German companies. If it turns out that restricting German codetermination to Germany was incompatible with EU law, the codetermination scene in Germany would change considerably:

- If employees from outside of Germany also had to be counted when determining whether the **threshold** for one-third participation or equal codetermination was reached, the rules regarding one-third participation or parity codetermination would, in the future, apply to many German companies to which they have not applied so far. The number of companies with codetermination, particularly parity (equally represented) codetermination, would increase significantly.

- If foreign employees also had an **active and passive voting right**, the composition of the supervisory board would change. Whereas now it is possible to elect only German employee representatives to the supervisory board it would then lead to the "Europeanisation" of the supervisory board, with employee representatives from Germany and other countries on the supervisory board.

3. What decisions can the European Court of Justice make, and what would the consequences be?

It cannot be predicted how the European Court of Justice will assess German codetermination and its compatibility with EU law.

If the European Court of Justice follows the **(so far) prevailing opinion in Germany** and limits codetermi-

nation to the respective country, nothing would change. In the specific status proceedings before the Frankfurt Regional Court and the Berlin Higher Regional Court, the composition of the supervisory boards would be correct.

If, however, the European Court of Justice comes to the conclusion that the German codetermination law is inconsistent with EU law, it would remain unclear what will apply in this case.

It is conceivable that the codetermination rules regarding the supervisory boards would then not be applicable, and the supervisory boards would have to remain without employee representatives. This would result in the general decline of codetermination in Germany. However, since codetermination leads to more employee rights and the European social welfare policy is designed to improve living and working conditions by way of a "bottom-up" adjustment (Article 151 of the Treaty on the Functioning of the European Union), such a result is not to be expected.

Instead, **it is most likely** that also foreign employees must be counted in some way or other. This could mean that foreign employees are only to be counted when determining whether the threshold is reached. The consequence would be a significantly increased number of companies that are now subject to codetermination laws. With regard to foreign subsidiaries with a great number of employees, it is also possible that the supervisory boards of German companies subject to codetermination will become larger. If employees of foreign subsidiaries were additionally to receive active and passive voting rights (like employees of German subsidiaries), this would lead to foreign employees joining the supervisory boards of the codetermined companies, meaning the "Europeanisation" of the supervisory boards. It is not clear how the "Europeanisation" of the supervisory board would have to be carried out in detail. It would be conceivable to apply the principles of a European regulation, for example, § 36 of the SE Employee Involvement Act on the composition and election of the supervisory board in European stock corporations (SE).

First and foremost, the **German legislature** would have to decide on the consequences of any incompatibility with EU law. How the legislature would handle any potential incompatibility with EU law is entirely open. Based on the trend, discernible for years, not to govern disputed issues under labour law, it is most likely to be expected that the German legislature will not react at all and will leave it to the courts to find a solution.

4. What will German companies now have to do?

If the German codetermination law turns out to be incompatible with EU law, employees employed in any manner abroad will probably have to be taken into account with regard to codetermination.

If and what kind of statutory regulations will be introduced is entirely unclear. It may take years to achieve clarity.

Against this background, companies should review whether it is possible to implement one of the strategies available in practice to avoid codetermination, particularly by using an European stock corporation.

Yours sincerely,

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