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LABOR'S PARTICIPATORY RIGHTS IN MANAGEMENT

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Executive Summary

In German corporations and limited liability companies with more than 2,000 workers, the employees elect half of the members of the supervisory board. Management decides, however, when a vote of the board is tied. (In the German two-tier corporate structure, the supervisory board sets the policy of the enterprise and oversees the day-to-day management of the board of directors.)

An even fuller parity of participatory rights is granted to workers in companies with more than 1,000 workers in the coal and steel industries. In these companies, shareholders and employees have an equal number of supervisory board members, and when their votes on the board are tied, a neutral board member casts the decisive vote.

In corporations and limited liability companies with more than 500 but fewer than 2,000 employees, the employees are entitled to appoint one-third of the members of the supervisory board.

In addition to these rights at the corporate level, participation rights exist at the plant level: in all enterprises with more than five employees, the employees may appoint a workers council at the plant level to exercise participatory rights on issues relating to working conditions.

I. Overview

In Germany, workers have genuine rights of participation in managerial decision-making, yet the extent of these rights differs according to industry, as well as the size and structure of each company.¹ A genuine equality of rights between the shareholder and the workforce exists only in companies engaged in coal mining or in the iron or steel industries (hereafter coal and steel companies).² A status that comes close to parity in decision-making exists for other

¹ An overview is provided in HANS BÖCKLER STIFTUNG, REPRESENTING WORKER'S INTERESTS IN THE GERMAN INDUSTRY, http://www.boeckler.de/pdf/mb_2004_12_folien_english.pdf (last visited Mar. 11, 2011). Included as an *Attachment* is Dieter Sadowski, Joachim Junkes & Sabine Lindenthal, *The German Model of Corporate and Labor Governance*, 22 COMP. LAB. L. & POL'Y J. 33 (2000). Aside from some minor changes, this article is still relevant.

² Montan-Mitbestimmungsgesetz [Montan-MitbestG], May 21, 1951, BUNDESGESETZBLATT [BGBl.] I at 347, as amended.

corporations and similar companies that have at least 2,000 workers. In these companies, the workers elect half the members of the supervisory board of the company, yet management has tie-breaking rights.³ Companies with more than 500 but fewer than 2,000 workers, on the other hand, get to elect only one-third of the members of the supervisory board.⁴

In addition to these codetermination rights at the corporate level, worker representation exists at the plant level. Any plant, office, or shop (*Betrieb*) with more than five workers may elect to constitute a works council to exercise participatory rights on issues affecting working conditions.⁵

The participatory rights of labor at the corporate and plant levels are exercised by the entire workforce. According to the law, the involvement of the unions in these structures is limited, although in practice they exercise considerable influence.⁶ German unions are mostly engaged in the bargaining of industry-wide collective agreements,⁷ yet they have always been strong supporters of codetermination.⁸

The patchwork nature of the current codetermination provision stems from the complexity of the historic development. Participatory rights of workers were discussed in Germany as early as 1815, and some form of participation has been practiced since the middle of the nineteenth century.⁹ At the same time, codetermination has always been a hotly contested issue and opinions have always differed strongly as to its desirability and effects.¹⁰

The current system of participatory rights began to evolve in 1951, with the passage of the Coal and Steel Codetermination Act.¹¹ In 1952, a Works Constitution Act¹² granted workers of companies with more than 500 employees the right to appoint one-third of the members of the supervisory board, and today these rights are expressed in the One Third Participation Act of 2004.¹³ In 1976, after a long and bitter struggle, Germany enacted the Codetermination Act¹⁴ for companies with more than 2,000 employees.

³ Mitbestimmungsgesetz [MitbestG], May 4, 1976, BGBL. I at 1153, *as amended*.

⁴ Gesetz über die Drittelbeteiligung der Arbeitnehmer, May 18, 2004, BGBL. I at 974, *as amended*.

⁵ Betriebsverfassungsgesetz, repromulgated Sept. 25, 2001, BGBL. I at 2518, *as amended*.

⁶ Klaus J. Hopt, *European Community: New Ways in Corporate Governance: European Experiments with Labor Representation*, MICH. L. REV. 1338, 1355 (1984).

⁷ Michael Kaplan, *Comment: Is Labor a Widget: A Comparative Study*, 59 TUL. L. REV. 1517, 1539 (1985).

⁸ HEINER MICHEL, CO-DETERMINATION IN GERMANY: THE RECENT DEBATE 29 (March 2007), <http://www.uclouvain.be/cps/ucl/doc/etes/documents/WDW004.pdf>.

⁹ WILLIAM SÓLYOM-FEKETE, CO-DETERMINATION RIGHTS OF EMPLOYEES IN THE FEDERAL REPUBLIC OF GERMANY 17 (Law Library of Congress, 1976).

¹⁰ *Id.* at 65–72, for the period before the enactment of the 1976 Codetermination Act; for recent disagreements, see MICHEL, *supra* note 8.

¹¹ Montan-Mitbestimmungsgesetz [Montan-MitbestG], May 21, 1951, BGBL. I at 347, *as amended*.

¹² Betriebsverfassungsgesetz 1952, BGBL. III 801-1, *as amended*.

¹³ Gesetz über die Drittelbeteiligung der Arbeitnehmer, May 18, 2004, BGBL. I at 974, *as amended*.

The effectiveness of these laws seemed endangered with the applicability of Regulation 2157/2001 of the European Union,¹⁵ which allows companies in the member states to organize or reorganize themselves under the rules for a European company (*Societas Europaea*) and this corporate structure does not call for the granting of participation rights according to the German models. To salvage German participation rights, Germany enacted a *Societas Europaea* Implementation Act in 2004 that encourages negotiations between labor and management in reorganized companies with the goal of preserving worker participation rights.¹⁶

II. German Company Structures

Participatory management rights of the workforce exist in corporations (*Aktiengesellschaft*),¹⁷ partnerships limited by shares (*Kommanditgesellschaft*),¹⁸ limited liability companies (*Gesellschaft mit beschränkter Haftung*),¹⁹ and cooperatives (*Genossenschaft*).²⁰ Among these, the codetermination rules for the corporation serve as a prototype to which the rules for the other companies are adapted.

A German corporation (*Aktiengesellschaft*) is governed by two boards, the board of directors²¹ and the supervisory board.²² Of these, the board of directors is responsible for the day-to-day operations of the corporation. The supervisory board appoints the board of directors, oversees its operations, and determines the overall policy of the corporation. The supervisory board is elected by the shareholders and, to the extent foreseen by law, by the workforce of the corporation.

The partnership limited by shares has several partners one of which is fully liable for the debts of the company whereas the other partners are shareholders in a corporation that is part of the company.²³ The codetermination rights for the company focus on the corporation that is part of the company and expand the number of members of the supervisory board so as to reflect the influence of the unlimited associate.

¹⁴ 5 Mitbestimmungsgesetz [MitbestG], May 4, 1976, BGBL. I at 1153, *as amended*,

¹⁵ Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European Company, OFFICIAL JOURNAL OF THE EUROPEAN UNION (L 294) 1.

¹⁶ SE Ausführungsgesetz., Dec. 22, 2004, BGBL. I at 3686.

¹⁷ Aktiengesetz [AktienG], Sept. 6, 1965, BGBL. I at 1089, *as amended*.

¹⁸ *Id.* § 278.

¹⁹ Gesetz betreffend die Gesellschaften mit beschränkter Haftung, repromulgated May 20, 1898, REICHSGESETZBLATT 369, *as amended*.

²⁰ Genossenschaftsgesetz, repromulgated Oct. 16, 2006, BGBL. I at 2230.

²¹ AktienG. §§ 76-94.

²² *Id.* §§ 95-116.

²³ *Id.* § 278.

The limited liability company consists of several share-owning associates who carry out a business through one or several managers. This company form allows the owners of participation great flexibility in their relations among each other and with management. Although a supervisory board is generally not required for a limited liability company, such a board must be formed in companies of a size that requires codetermination rights.²⁴

Cooperatives of any significant size are required by law to have a board of directors and a supervisory board. Consequently, the implementation of codetermination laws does not pose organizational problems for cooperatives, although some adjustments of the rules governing corporations are provided by law.²⁵

III. Co-determination in the Coal and Steel Industries

The Coal and Steel Codetermination Act applies to corporations and limited liability companies that are engaged in coal or iron ore mining or in the iron and steel industries and that employ at least 1,000 workers.²⁶ These companies must have a supervisory board that consists of an uneven number of members.²⁷ Half the members are elected by the shareholders and the other half by the workforce. One additional member of the board is elected jointly by all members of the board. This board member must be neutral, that is, he or she may not be a shareholder or employee or closely affiliated with either group.²⁸ It is expected that this member will have the confidence of both labor and shareholders²⁹ and thereby be able to resolve impasses.³⁰

In addition to parity on the board of supervisors, the workforce is also represented by a labor director on the board of directors who is to be in charge of matters relating to working conditions.³¹ The supervisory board elects the labor director, but he cannot be elected if a majority of the board members representing labor reject him. If no decision can be reached, a conciliation committee must be appointed and it must negotiate until the position is filled.³²

The special codetermination of the coal and steel enterprises has historic roots. It developed in the British zone of occupation after World War II when codetermination was encouraged to promote the reconstruction of these German industries in a peaceful manner that avoided the danger of the formation of new trusts in German industry.³³

²⁴ MitbestG, § 6.

²⁵ *Id.*

²⁶ Montan-MitbestG § 1.

²⁷ *Id.* §§ 4, 9.

²⁸ *Id.* §§ 4, 8.

²⁹ RUDI MÜLLER-GLÖGE ET AL., *ERFURTER KOMMENTAR ZUM ARBEITSRECHT* 2331 (10th ed. 2010).

³⁰ SÓLYOM-FEKETE, *supra* note 9, at 55.

³¹ MÜLLER-GLÖGE ET AL., *supra* note 29, at 2335.

³² Montan-MitbestG § 13.

³³ SÓLYOM FEKETE, *supra* note 9, at 38.

The constitutionality of the Coal and Steel Codetermination Act was challenged in 1979 and an amending act dealing with the expansion of coal and steel codetermination to holding groups³⁴ was challenged in 1999, on the grounds that the principle of equality was violated by granting lesser codetermination rights to the workers in other industries and that the guarantee of property of the shareholders was violated by making labor coequal in corporate decision-making.³⁵ In the decision of 1999,³⁶ however, the Federal Constitutional Court upheld the constitutionality of the amending act³⁷ by stating that the legislature had a justifiable interest in protecting the special form of codetermination in the coal and steel industries.

IV. Codetermination in Large Companies

The Codetermination Act of 1976 applies to corporations and other qualifying companies (see above, Chapter II, “Corporate Structures”) with more than 2,000 employees. Exempted from this regime, however, are the coal and steel companies that are governed by the Coal and Steel Codetermination Act and various companies of a nonindustrial nature, such as those operating press or media enterprises, or scholarly, charitable, religious, or artistic institutions.³⁸

The Codetermination Act of 1976 requires the supervisory board of a company to have a specified even number of members, depending on the size of the company in terms of the number of workers employed. Half of these members represent the shareholders and the other half represent the workforce. For the latter, the law requires about one-third of them to be union representatives and the remainder to be company employees. Thus, for companies with more than 20,000 employees, ten supervisory board members represent the shareholders and ten represent the workforce. Among the latter, seven must be employees of the company and three must be union representatives.³⁹ Depending on the size of the company, the labor members of the supervisory board are either elected by delegates or, in smaller companies, through direct elections.⁴⁰

After each new election of the supervisory board, the newly constituted board elects a chairman and his deputy from among the board members. A two-thirds majority is required for this vote, and if it cannot be achieved, the shareholder board members elect the chairman and the workforce board members elect the deputy.⁴¹ If decisions of the board are tied by an equal number of votes, then the chairman has a second vote in the next polling of the same

³⁴ Gesetz, Dec. 20, 1988, BGBL. I at 2312.

³⁵ MÜLLER-GLÖGE ET AL., *supra* note 29, at 2322.

³⁶ Bundesverfassungsgericht, Mar. 2, 1999, ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS 99, 367.

³⁷ Mitbestimmungsergänzungsgesetz, Aug. 7, 1956, BGBL. I at 707, *as amended by* Gesetz, Dec. 20, 1988, BGBL. I at 2312, art. 3.

³⁸ MitbestG § 1.

³⁹ *Id.* § 7.

⁴⁰ *Id.* §§ 10–24.

⁴¹ *Id.* § 27.

resolution.⁴² This second vote, combined with the right of the shareholder members to elect the chairman of the board, gives the shareholder an advantage in decision-making.⁴³

The appointment of the members of the board of directors is one of the functions of the supervisory board. The directors are to be elected with a two-thirds majority of the supervisory board, and if this requirement cannot be met, a simple majority, augmented by the second vote of the chairman, elects the directors.⁴⁴ A labor director must be among the directors thus elected.⁴⁵ The law does not specify the duties of the labor director, yet it is generally assumed that he should be responsible for employee relations, compensation, and working conditions.⁴⁶

V. Effects of Codetermination

Codetermination continues to be favored by labor and disliked by shareholder interests. In recent years, in particular, German industry has exerted pressure on the labor unions to accept cutbacks in codetermination rights, on the grounds that economic recovery requires such a sacrifice.⁴⁷

Some economists also cast doubt on the beneficial effects of codetermination. In 2004, Gary Gorton of the Wharton School and Frank Schmid of the Federal Reserve Bank of St. Louis concluded that German firms with parity codetermination traded at lower share prices than firms falling under less stringent codetermination requirement.⁴⁸ The German unions, on the other hand, stress the importance of social peace in German enterprises, as evidenced by the low number of strikes that according to them results from codetermination.⁴⁹

According to Klaus Hopt, a renowned scholar of German corporation law, the empirical verdict on the impact of codetermination is still out.⁵⁰ Hopt stresses the potentially beneficial effects of codetermination on corporate governance, and also on the strengthening of the company against hostile takeovers that results from the joining of labor and shareholder interests to preserve the company.⁵¹ On the other hand, Hopt is doubtful whether codetermination prevents the excessive compensation of managers or major fraud or scandals. According to

⁴² *Id.* § 29.

⁴³ MÜLLER-GLÖGE ET AL., *supra* note 29, at 2308.

⁴⁴ MitbestG § 31.

⁴⁵ *Id.* § 33.

⁴⁶ MÜLLER-GLÖGE ET AL., *supra* note 29, at 2313.

⁴⁷ Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725, 1754 (2006).

⁴⁸ GARY GORTON & FRANK A. SCHMID, CAPITAL, LABOR AND THE FIRM: A STUDY OF GERMAN CODETERMINATION (Jan. 19, 2004), <http://www.som.yale.edu/faculty/gbg24/papers/published/Capital%20Labor-G%20Gorton.pdf>.

⁴⁹ MICHEL, *supra* note 8, at 29.

⁵⁰ Klaus J. Hopt, *Comparative Corporate Governance: The State of the Art and International Regulation*, 59 AM. J. COMP. L. 1, 55 (2011).

⁵¹ *Id.* at 54.

Hopt, an evaluation of the benefits or detriments of codetermination depends on the philosophical premise of whether the company should only represent the ownership interests of the shareholders or whether the employees should be considered as stakeholders who also have a legitimate interest in the welfare of the company. Yet Hopt realizes that any potential benefits of codetermination come at the price of diluting shareholder governance.⁵²

According to Sadowski, Junkes, and Lindenthal, three experts on European labor relations, the retention of qualified workers may be a benefit of codetermination, in that workers have an opportunity to voice discontent instead of choosing to leave.⁵³ Yet these experts also think that it is difficult to quantify the economic effects of codetermination.⁵⁴

In any event, it appears that codetermination is here to stay in Germany. This becomes apparent with the choices made by German corporations when they transform themselves into European corporations. Although this new corporate form gives the corporation flexibility to choose a one-tier board structure that would prevent the existence of a German-style codetermination system, German companies that become *Societates Europaeae* appear to retain co-determination voluntarily. This at least has happened when the German insurance company Allianz became a *Societas Europaea*.⁵⁵ According to Hopt, it would be very difficult for a German company to abolish codetermination, even if this were legally possible, because it would reflect very poorly on the image of the company.⁵⁶

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⁵² *Id.*

⁵³ Sadowski et al., *supra* note 1, at 41.

⁵⁴ *Id.* at 61.

⁵⁵ Hopt, *supra* note 50, at 53.

⁵⁶ *Id.* at 53 n.325.