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Labor Participation in German Companies and Its European Context

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One of the most important items of post-war legislation affecting German industry and the social and political environment came into effect on July 1, 1976. This is the Law on the Co-determination of Employees, in short, Co-determination Act 1976[1] (according to some scholars the correct name should have been Law on the Co-determination of Employees and Trade Unions).[2] It provides for an equal number of shareholders' representatives on the one hand, and employees' and union representatives on the other hand, on the supervisory boards of German corporations with more than 2,000 employees. With such a far-reaching law, Germany—perhaps together with the Netherlands and Sweden—has become the most progressive country in Western Europe as far as labor participation is concerned. This may be some justification for the fact that in spite of the rather ambitious title most of the limited space in this contribution will be dedicated to the German scene.[3]

To evaluate the new law on German co-determination some background information may be in order.

If one defines co-determination in the broader sense as a legal provision for employees to participate in management decisions other than by simply negotiating an individual employment contract, or by accepting or rejecting a job under given conditions, then such collective employee co-determination can be channelled through four different devices conceivably achieving similar re-

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[1]Gesetze uber die Mitbestimmung der Arbeitnehmer (MitbestG) of May 4, 1976, BGBl. I p. 1153.

[2]Meilicke/Meilicke, Kommentar zum MitbestG 1976, Introduction, note 28.

[3]A rather concise English language survey of the Common Market countries has been issued by the Commission in Supplement 8/85 of the Bulletin of the European Committees.

sults: collective bargaining, works council, employee shareholders and board participation.

I. Collective Bargaining

The classical device of co-determination is that of collective bargaining. Depending on national traditions and the structure and political power of the unions, the object of such collective bargaining may be restrained to wages and other working conditions—as in Germany—or extend to any other subjects of management decisions directly or indirectly affecting employees—as in the United Kingdom and Italy—or even to political issues.

In *Italy*, for instance, collective bargaining agreements have in fact become the vehicle for co-determination. They are negotiated on two levels: national (or provincial) and local (company). The 1976 nationwide labor contracts[4] in the most important industries include provisions under which: (i) the trade associations and unions will regularly exchange and discuss information concerning global production, investment plans and programs relating to industrial relocation, including closing, enlarging or transfer of plants, and (ii) similar exchange information and discussion will be held on the local level where the company exceeds a certain size (e.g., 300 textile or 500 metal employees). The new *Swedish* law combines co-determination through works councils with that through collective bargaining agreements (see below under II).

In Germany, there are virtually no competing unions, the unions being organized on an industry-by-industry basis, all united together in the powerful German Federation of Trade Unions (DGB).[5] Almost without exception collective bargaining agreements are negotiated on a regional rather than a company level and are normally binding only on companies which are members of the employers' association.

II. Works Council

The second means, now in effect with many variations in most European countries, is that of the works council (or enterprise committee), i.e., a board

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[4]Not yet published.

[5]In this connnection, when comparing the German trade unions and their tradition and philosophy with that of other West European countries, it is often pointed out that the German unions accept at least the principle of a free market economy to a considerably more significant extent, and fight for the employees as part of such a system rather than as its enemies. Although there is certainly some truth in such a comparative statement, its importance should not be overemphasized: it is certainly not because of the attitude of the German unions alone that their objectives in the past have realistically been limited to the wages and welfare of employees and excluded political issues and management policy from their present work. Any significant change in the political and/or economic environment may bring back to light tendencies similar to those prevailing in most European countries.

formed by the employees working within a plant on the basis rather of labor than of company law. Such a body representing the employees can be constituted rather informally—as in Italy and the United Kingdom—or based on sophisticated statutory law as in Austria, Germany and the Netherlands. Depending on the country, the representatives may either come exclusively from within the plant, or consist of local union leaders, or both.[6] The powers of such a works council can be confined to mere information rights or extended to consultation on certain matters affecting the situation of the employees in the plant, or even provide for definite co-determination with the management on matters such as hiring and firing, as is the case in Germany.

In *Italy* local agreements worked out between the company and the works council in conjunction with the unions relate to all manner of managerial decisions (how, where and what to produce). A similar development has been experienced by companies located in the *United Kingdom,* where so-called joint regulations with increasing frequency include status-quo clauses under which the management agrees not to make decisions affecting the employees until agreement has been reached or negotiating procedures exhausted.

The *Swedish* Law on Co-determination at Work of June 2, 1976 (coming into effect on January 1, 1977), provides for far-reaching rights for the local union organization with respect to companies which are party to collective bargaining agreements (in some cases even other companies). The management has a duty continuously to inform the union of the economic development and operations as well as the personnel policy, and the union is entitled to inspect the accounts and other records. Before deciding on any major changes in operation or other matters determined by the union, the company must negotiate with the union and postpone its decision during the course of the negotiations. However, in the case of disputes concerning the duty of work or the contents of an agreement on specific co-determination, the interpretation of the union, and in the case of a dispute regarding wages or salaries, the interpretation of the employer, shall prevail until settlement on a national level or by the labor court. In cases such as the award of subcontracts the union has a veto power.

III. Employee Shareholders

The most natural way, within the framework of company law, for employees to obtain some kind of influence on management similar to that of the share-

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[6]Even in Germany with its sophisticated Work Shop Constitution Law (Betriebsverfassungsgesetz of January 15, 1972 BGB1. I p. 13) it has recently been held legal in a labor court decision for the unions to demand as part of a collective bargaining agreement that the company grant paid free time to union representatives within the company and restrict its right to terminate their employment contract (AG Kassel DB 76, 16795). It is still open whether such practice, which would be in competition with the works council, will be upheld by the higher courts.

holders, would be for the employees to become shareholders themselves. However, this is nowhere practiced on a large scale and where it is practiced at all, as in Germany and France, it is done under incentive or savings aspects rather than under co-determination aspects.[7] There are plans, however, in Denmark, Sweden and Germany to force companies to distribute part of their profits in the form of their own stock to employee- or union-controlled funds, which could thereby gain control over such companies. The most highly developed plan was the so-called Meidner Paper in *Sweden,* which played a major role in the recent election campaign (and according to most journalists was one of the reasons for the Social Democrats' defeat). According to the Meidner Paper, all companies with more than fifty employees should annually distribute one-fifth of their pre-tax earnings in the form of stock to union-controlled funds. The result would have been that over the years the unions would have indirectly gained control over private companies and their management.

IV. Board Participation

The most important instrument of labor co-determination is that of forcing the companies to open their boards to employee and/ or union representatives, either as consulting or as normal members. Obviously this is the most effective instrument of co-determination, since in this way the employee representatives do not act—which usually means re-act—as the counterpart of the company, but within the company's decision-making board. The least that is normally brought about in this way is a continuous and up-to-date flow of information on the affairs of the company. Depending on the details, however, the possibilities offered by co-determination in this narrow sense may far exceed simple information.

A. *Company Structure*

In order to understand better the mechanics and significance of labor participation on the boards of European companies, a short review on the structure of European companies appears necessary.

The company law of probably all Western countries has had, and still has, to cope with the problem of how, in the case of big companies with many shareholders, to provide for effective control over management. The early solution adopted in many countries, namely to make the board of directors directly answerable to the shareholders' general meeting, has turned out to be

[7] It should be noted in this connection that, e.g., in Germany the unions themselves have established companies which over the years have obtained significant positions in banking, housing, retail stores and other sectors of industry.

increasingly unsuitable the bigger operations have become. This system has been improved by more or less informally increasing the board and providing for passive or controlling directors in addition to the executive or managing directors. The shortcomings even of this improved system do not need to be elaborated further to an American auditorium or reader.

As early as 1870, Germany adopted the form of a dualist, or two-tier, system providing for a strict separation between the board of directors or *management* board and the *supervisory* board (the functions of both being strictly segregated and the members of one not being permitted to act on the other). This system is mandatory for stock corporations and optional for limited liability companies. In the case of stock corporations the members of the supervisory board are elected and removed by the shareholders' meeting, and the supervisory board in turn appoints the management board. The management board has continuously to keep the supervisory board informed on the company's affairs and, in particular, on the management policy envisaged. The supervisory board in turn has the right at any time to investigate the company's affairs. In addition, if the statutes so provide, certain types of business operations require supervisory board approval.

A similar system has in recent years been adopted by the Netherlands and, on an optional basis, by France and other European countries.[8] It may be noted that this may be the path which the company law of the European countries will take. At any rate the draft Common Market legislation points in this direction, last but not least, because the two-tier system appears to be particularly suitable for labor participation.[9]

B. *Historical Development of Co-determination in Germany*

Co-determination of labor as some kind of counterpart to political democracy has a fairly old tradition.

First attempts in Germany to provide for factory councils (within the scope of the general trade law—"Gewerbeordnung") were made as early as 1848. They were unsuccessful until 1890, but mandatorily prescribed for mining and for war supply companies in 1916. The first general works council law was adopted in 1920.[10]

Co-determination on the company rather than the plant level first came into existence for coal and steel companies under the British Military Government

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[8]For details see FROMMEL & THOMPSON, COMPANY LAW IN EUROPE (London: Kluwer-Harrap Handbooks, 1975).

[9]Statute for the European Stock Corporation 1970 and Fifth Directive on the Structure of European Companies 1972.

[10]Works councils and some kind of co-determination were even provided for in the constitution (Art. 165 and Art. 156 WRV).

for the British occupation zone of Germany. The owners or chief executives of the big German heavy industry enterprises had encountered particular suspicion on the part of the occupation forces because of their political attitude before and during the war. The only way for them to retain some control over their companies and to avoid some kind of nationalization was to turn to the unions. The unions made their assistance dependent on the introduction of permanent and responsible labor representation on the boards of such companies. Subsequently, in view of a resolution by all works councils then in office to answer the abolition of their board representation with a general strike, the Federal Legislature sanctioned the system by the Coal and Steel Co-determination Act of 1951.[11] This law provides for supervisory boards with equal numbers of shareholders' and employees' representatives (the majority of the latter had to be nominated by the union; the union, in addition, could even object to the minority elected by the employees directly). The shareholders' and the employees' union representatives together had to elect a so-called neutral member in order to avoid a constant pat (stalemate) situation. In addition, the management board must have one member in charge of personnel matters ("Director of Labor") who cannot be appointed or removed without the approval of the majority of the employees', i.e., union, representatives.[12]

After this achievement the German unions pressed hard for an expansion of the co-determination concept into other sectors of industry. However, with the strength of the Christian Democrats under Chancellor Adenauer in the Federal Government, they were unsuccessful. Instead, in 1952 the Workshop Constitution Law[13] was adopted, providing for shop councils in workshops or plants with five or more employees. The unions were not granted any statutory right to delegate or propose members for election to works councils.

The Shop Constitution Law also provides that corporations (excluding partnerships) with more than 500 employees must have one-third of the members of the supervisory boards elected by the employees, and such limited liability companies which did not have a supervisory board for this reason had to form one. The board may consist of three or more members; if (in case of a three-member board) one is to be elected by the employees, he must be an employee of the company himself, otherwise at least two labor representatives must be from within the company. They have the same rights as the representatives of capital, who of course can always outvote them.

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[11]Montan-MitbestG of May 21, 1951, BGBl. I p. 347.

[12]The Montan-MitbestErgG of August 7, 1956 provided for co-determination of holding companies where the majority of the consolidated sales are from coal and steel business except that the new law did not repeat the union's right to participate in the appointment of the Director of Labor (this different wording in the new law, however, turned out to be of little practical effect).

[13]*See* note 6 *supra.*

Such has been the situation for more than twenty years, and the issue of equal labor representation on the board had almost vanished from public discussion. In 1972, the Shop Constitution Law was revised[14] to expand the rights of the works councils, providing, inter alia, that in a plant with more than twenty employees the employer must seek the consent of the shop council before hiring any new labor; and, in the absence of such consent, must apply to the labor court. Also, any firing requires prior information of the shop council and in the case of objection the employee must be retained in his job until the labor court decides the issue. In the case of mass firings, a so-called social plan providing for severance pay or other compensation must be negotiated and, if necessary, settled in court. The shop councils must give their consent to other social and personnel matters (excluding salaries and wages, which are left to collective bargaining), and be informed on significant business matters.

When the Social Democrats joined the Federal Government in 1968, the unions again pressed hard for co-determination on equal terms, and the government appointed an expert commission (the Biedenkopf Commission) to prepare a report and make recommendations, having due regard for past experience with co-determination.[15] In 1974 the government introduced a draft law,[16] which, although it did not encounter much interest among the workers (who according to polls were much more concerned about job security and wage levels), immediately became a major topic for lawyers and economists. The former discussed the constitutionality of the draft, the latter the efficiency of the proposed company structure. After some significant amendments in view of the more than doubtful constitutionality of the original draft, the law was virtually unanimously adopted in 1976, but still met with heavy criticism from both the unions and the employers' association.

C. *German Co-Determination Act 1976*

First, it should be noted that the Coal and Steel Co-determination Act 1951 is still in effect and that the co-determination provided for under the Workshop Constitution Law continues to apply to corporations with more than 500 but less than 2,000 employees.

Under the Co-determination Act 1976[17] the supervisory board of all German

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[14]Betriebsverfassungsgesetz of January 15, 1976, BGBl. I p. 13.

[15]After two years of research and hearings an impressive and profound report was issued (Bundestagdrucksache VI/334 of February 4, 1970).

[16]Bundesratdrucksache 200/74 of February 22, 1974. Four public hearings were held between October and December 1974 and a number of opinions by law school professors were attached to the Bundestagprotokoll (Anlage 2-7 Protokoll Nr. 62 der 7. Wahlperiode).

[17]May 4, 1976, BGBl. I p. 1153. For an English translation plus introductions see D. HOFFMAN, THE GERMAN CO-DETERMINATION ACT 1976, Kluwer (Deventer, The Netherlands) and M. PELTZER, CO-DETERMINATION ACT 1976, Otto Schmidt KG (Köln).

stock corporations and limited liability companies with more than 2,000 employees will in the future consist of an equal number of shareholders' and labor representatives. This does not apply to companies of other legal forms such as partnerships or (branches of) foreign corporations. However, the law expressly includes limited partnerships where the general partner is a German corporation[18] and groups of affiliated companies where the parent is a German corporation.

During the discussion of the government bill a compromise had to be reached. The Social Democrats supported the union's insistence on a strict parity principle with strong union representation as being the only system of co-determination where the owners' side was actually forced to reach agreement with the labor side. In addition, they insisted on a labor representative as the member of the board of management who should be in charge of personnel matters. The Liberals, the junior partner within the ruling party coalition, preferred to reduce direct union influence to the benefit of the employees of the company. In addition, they favored direct representation of the group of managerial employees. The position of the opposition Christian Democrats was more complex. Their left wing tended to support the union demand. More conservative party members used arguments of the employers association that the system demanded by the unions would replace market considerations as the main decision-making factors with politics and unduly increase the power of the unions rather than that of the employees. A motion of the Christian Democrats not to provide for any mandatory right of the unions to be represented on the boards was rejected by the other two parties and not pursued further. The main point in bringing about the final compromise was that most legal experts felt that the strict parity system would risk being held as unconstitutional by the Federal Constitutional Court and/or even as violating bilateral treaties.[19]

Similar political discussions in the *Netherlands* with particular emphasis on the question of how to avoid continuous political confrontation within the supervisory board brought about the Law of 1971 on the Structure of Public and Closed Companies (in effect since July 1, 1973). New members of the supervisory board, which has similar functions to its German counterpart (including appointment of the management board), are appointed on a "co-option" basis: proposals may come from the owners (shareholders' meeting), the employees (enterprise council) and also the management board, except that no person

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[18]Provided that the holders of the majority of the shares in the limited partnership and the general partner are identical.

[19]*E.g.*, German American Treaty of Friendship, Trade and Navigation of October 29, 1954, Article VII/1c of which gives German and American investors the right to manage and control companies that they have acquired or established in their respective host countries.

qualifies who is employed by the company or any subsidiary or by the relevant trade unions. The final choice lies with the supervisory board itself. However, both the enterprise council(s) and the shareholders' meeting may object to an appointment on the grounds either that the candidate is not qualified or that after the appointment the composition of the board would not be "appropriate." The final decision in the case of an objection lies with the Social-Economic Council of the Netherlands.

Under the German Co-determination Act of 1976 one-half of the members of the supervisory board must be labor representatives.[20] They are elected by the employees, i.e., (unless the employees resolve differently) directly in the case of companies with less than 8,000 employees or otherwise through electors. The elections are particularly complicated. They are either made jointly or in two groups, the blue collar employees (wage earners) and the white collar employees (salary earners). The total size of the board depends on the number of employees. Two of the six or eight, or three of the ten labor representatives must be elected from proposals made by the union, the so-called union representatives. At least one of the white collar employees must be from the managerial staff (managing employees).

The management board continues to be appointed by the supervisory board (in the case of limited liability companies this right passes, by virtue of the new law, from the shareholders' meeting to the supervisory board). One member, the Director of Labor, must be in charge of personnel and social matters. Unlike the Coal and Steel Co-Determination Law, the new law does not prescribe that his appointment must not take place against labor or union objection. However, this is the position taken by the unions.

The crucial issue, also under the heading of constitutionality, was that of how to deal with a pat (stalemate) situation. The law now provides that a chairman be elected who, after exhaustion of a complicated procedure in the absence of agreement between the two benches, will come from the shareholders' side and the deputy from the labor side. In the case of a continuing stalemate the chairman (not the deputy) has the casting vote. It is believed, because of this possibility that the shareholders' side may have the majority, that the new law will

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[20]Obviously secrecy rules are of particular practical significance in the case of labor participation. The law provides that any board member must "keep secret the confidential statements and secrets of the company, especially trade and operational secrets" (§ 93(1) German Stock Corporation Law). The German Federal Court recently outlawed the attempt to extend this provision to all information, in particular the discussions and resolutions of the board on the basis of the articles or by-laws. BGHZ 64, 325. It is still open whether the articles may prescribe that a board member who intends to advise a third person, such as a union, of board discussions which do not concern genuine secrets, shall make such intention known to the full board beforehand.

be just short of being unconstitutional.[21] To be sure, this majority right will function only if proper safeguards are taken, among others, against the absence of shareholder representatives.[22]

The law also prescribes the above co-determination principles with respect to subsidiaries and parent companies, provided the 2,000 employees test is met.

Under the new law companies have, at the latest, until June 30, 1978 to comply with the above principles.

V. Criticism and Outlook

About 600 companies are affected by the new German Co-Determination Act, including approximately fifty subsidiaries of United States firms. It is certainly difficult at this stage to make any precise forecast of how the German Co-determination Law will work in practice.

The situation in the coal and steel industry where, generally speaking, heated confrontations probably have been as much the exception as drastic or courageous management decisions, has been too specialized to serve as a safe basis for comparison.[23] Certainly the fear expressed by the employers' association that the new law will add much bureaucracy and considerably reduce flexibility is rather moderately phrased.[24] A negative aspect of the German law is that it neither provides for strict parity nor grants the shareholders a clear majority as an accepted fact, but only indirectly allows the shareholders' side to attain such a position if it is prepared to accept continuous confrontation with the labor side.[25] In any case, the power of the German unions has considerably increased, and any young man interested in a business career will be well advised not only to develop traditional managerial qualifications but also to be fully cognizant of

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[21]This is still an open issue. *See* Meilicke/Meilicke *op. cit.* note (2): Introd., notes 31 *et. seq.*

[22]At least one corporation has changed its legal form to a KGaA (partnership limited by stock) because in this case the management board (more precisely, the general partner) is not appointed by the supervisory board but by the shareholders, and a KGaA does not need to have a Labor Director. For the difference between AG, GmbH and KGaA see COMPANY LAW IN EUROPE (*op. cit.* note 8), p. 246 *et seq.*

[23]As a rule the so-called neutral man on the board does not feel qualified to take a position against either the owners or the labor bench, and decisions normally come about on the basis of a quid pro quo or horse trade. For details see report of Biedenkopf Commission, *op. cit.*, note 15.

[24]E.g., President of the Rhineland-Palatine Entrepreneurs Association, Mainz, FAZ, July 6, 1976. Bankers are afraid that in the long run the new Co-determination Law may more than outbalance the advantages to the investor resulting from the German Corporate Income Tax Reform of 1976 which will terminate the traditional double taxation of dividends. *See* Johann Philipp Freiherr von Bethmann, FAZ, August 21, 1976.

[25]Since it is probably true that the constitutionality of the new law depends in part on the owners' final right to control, the responsibility for preserving the constitutional property right and free collective bargaining system has in a way passed from the Bundestag to the shareholders' representatives in the big companies (Hanns Martin Schleyer, President of the German Federation of Employers' Associations, FAZ, August 28, 1976).

union power. On the other hand, companies these days suffer not only from reduced flexibility and growing bureaucracy but probably even more so from serious labor unrest; and there is some hope that the new law may work as an instrument to keep German industry in a relatively peaceful social atmosphere.

Whether comparable legislation in other European countries will help to create a similar atmosphere in such countries is in this writer's view even more speculative.

In *France* the President had installed a commission (the Sudreau Commission) to examine the problem of the reform of the business enterprise as a whole. In its report of 1975 it recommended that one-third labor representatives be provided on the supervisory boards of companies with more than 2,000 employees. However, even this moderate recommendation was strongly rejected by the employers and even more strongly by the unions who still see their role more as opponent than as partner of the employers. Other recommendations which encountered fewer objections included a reinforcement of the position of the shop councils with improved information, inspection and consultation rights. The present political scene, however, does not appear to be one favoring implementation of either recommendation.

The *United Kingdom* debate on industrial democracy has been taking place among the parties, employers' association and unions for several years. The present labor government has appointed an inquiry committee (the Bullock Committee) to advise it on how best to provide for workers' participation on the boards of private-sector companies (the nationalized industries to be reviewed at a later stage). The committee has particularly investigated the German and Swedish systems. The British Trade Union Congress (TUC) is insisting on a strict parital system between capital and union representatives, although its position is somewhat complex, in that a significant number of radical unions are against any mandatory co-determination and prefer reinforced consultation rights for the unions on the shop level, leaving everything else to the individual collective bargaining agreements. It is expected that the report will be issued before the end of this year and that it will recommend that companies with over 2,000 employees (about 600) should have boards with members drawn from three sources, the shareholders, the unions and a third group jointly nominated by the first two.[26]

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[26]The Financial Times, July 30, and September 20, 1976.

In *Italy* no general plan to introduce co-determination at the board level has become known. However, the Christian Democrats have recently re-introduced a bill according to which newspapers, an industry suffering from heavy losses and high price increases, should in the future be published only by corporations where labor representatives have seats on the board.