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A New Constitution for German Big Business:

The Co-Determination Act of 1976

This is the text of a speech given by Professor Rittner to the Dickinson Society of International Law, Hastings College of the Law, University of California in October of 1976.

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I. THE CENTRAL THEME OF THE STATUTE AND ITS SCOPE OF APPLICATION

THE FEDERAL REPUBLIC of Germany enacted a new co-determination statute on May 4, 1976.[1] This Act changes the legal structure of German corporations so dramatically that there is doubt whether these entities can still be considered as "corporations" in the traditional sense of the term. Certainly the idea of corporations being associations of persons managed by boards required to act in the interest of the shareholders has been eliminated. A new concept has been introduced—that of a "constitution for enterprises" *(Unternehmensver fassung)*. At present, this concept only applies to big business; that is, according to the statutory definition, those enterprises which regularly employ 2,000 or more persons. The new law[2] requires that one half of the members of the supervisory board of those enterprises be "representatives of the employees." The supervisory board is a German invention which has also found favor in other countries. It is a body which functions as an intermediary between the shareholders and the management. The German Stock Corporation Act.[3] defines the board's functions and responsibilities, including the appointment and dismissal

1. Gesetz über die Mitbestimmung der Arbeitnehmer (1976 BGBl I S. 1153) of 4 Mai 1976.

2. For discussion reflecting the state of the law prior to the new Act *see* VAGTS, *Reforming the "Modern" Corporation, Perspectives from the German*, 80 HARV. L. REV. 23, 64-75 (1966).

3. Aktiengesetz of 6 Sept. 1965 (1965 BGBl I S. 1089).

of the members of the managing board, as well as the approval of certain types of transactions.

In the Federal Republic of Germany there are 2,200 stock corporations. These include virtually all major companies, such as Volkswagen, Daimler-Benz, Mannesmann, Thyssen, Bayer, Deutsche Bank, Allianz-Versicherung, *etc.* The stock corporation is the corporate form designed for large enterprises and is required for all companies that offer their shares to the public. Smaller companies tend to incorporate as limited liability companies (*Gesellschaft mit beschraenkter Haftung*, GmbH), a form designed for closely held corporations and subject to less stringent supervision and disclosure requirements.[4]

The new Co-Determination Act does not apply exclusively to stock corporations. Other corporate forms,[5] including the limited liability company (GmbH), cooperatives (*Erwerbs-und Wirtschaftsgenossenschaft*) and mining companies (*Bergrechtliche Gewerschaften*), as well as partnerships limited by shares (KGaA) are subject to its provisions. However, there are very few enterprises using these legal forms which meet the threshold requirement of employing 2,000 or more persons. Thus, of the some 650 companies to which the statute will actually apply, only about 40 are not stock corporations or limited liability companies. Accordingly, the following discussion will not consider these other types of companies.

It should be noted that the central provision of the new statute, namely the principle of fifty percent workers' representation on the supervisory board, operates somewhat differently in enterprises organized as, for example, limited liability companies, than in stock corporations. The difference is rooted in the fact that the supervisory board of a GmbH does not have the same function as that of a stock corporation. This permits the shareholders of a GmbH to control management directly rather than through an intermediary supervisory board. Thus the notion of a single "constitution for enterprises" is somewhat illusory because the statute does respect, in various provisions, the differences between the various types of corporate forms. The question may arise as to why the draftsmen of the Act did not attempt to avoid this differential treatment since, from a legislative standpoint, it is inconsistent to have the principle of equal control by "capital" and "labor" function differently for different types of com-

4. Gesetz betreffend die Gesellschaften mit beschränkter Haftung of 20 April 1892 (RGBl S. 477).

5. Concerning German corporate forms, *see generally* F. JUENGER & L. SCHMIDT, GERMAN STOCK CORPORATION ACT 2-4 (1967).

panies. The answer is that the legislature was primarily concerned with changing the power relationships within large corporations. The fact that in Germany, unlike other European countries, smaller enterprises are not usually organized in this form allowed the legislature to address the enactment primarily to stock corporations and thereby exclude altogether certain other types of business organizations, such as partnerships (OHG) and limited partnerships (KG). For the politicians these small enterprises were not worthy targets in the fight for parity between capital and labor.

II. THE BASIC CONTENT OF THE STATUTE

A. The Voting Process

The details of the co-determination statute primarily affect the supervisory board of the designated enterprises. The supervisory board will consist of twelve, sixteen or twenty persons, depending on the number of regular employees in the enterprise. Only one half of the members of the supervisory board will be elected by the shareholders. The other members of the board are to be labor representatives, partly selected by the employees and partly appointed by the unions whose members are employed in the enterprise.

The selection of the labor representatives is fairly complicated. For example, a twelve or sixteen person supervisory board must include two union representatives. A twenty person supervisory board requires three union representatives. Moreover, the statute contains detailed provisions regarding the number of representatives to be elected by blue collar workers, salaried personnel and executive personnel. The statute thus establishes a three class society among employees of an enterprise and ordains that each of the three classes is to be represented according to its numerical strength.

The voting procedure might be the most complex in the world. The election provisions comprise more than 600 sections and the sheer bulk of the statutory scheme is likely to cause serious difficulties in interpretation and implementation. Elections are required to be held approximately every four years. It is anticipated that there will be a great deal of controversy in this area.

B. The Chairperson of the Supervisory Board

Electing the chairperson for a board comprised of two antagonistic groups is a difficult task. This problem is compounded by the chair-

person's status of *primus inter pares*. In practice, he is in constant liaison with the manager or managing board. This function is particularly important where the supervisory board is large, as mandated by the new Act. The chairperson also conducts the shareholders meetings in addition to several other important functions. Most importantly, the chairperson can cast a tie-breaking vote. Thus, there are only two conceivable ways to achieve full parity between capital and labor: either have representatives of the two factions alternate regularly, or have someone selected who belongs to neither of the two social groups, for example, a professor, a housewife or a priest. The German legislature opted for the latter alternative with respect to co-determination in the coal and steel industry pursuant to an act of 1951.[6] Experience has shown, however, that there are very few truly neutral persons. For instance, in the coal and steel industry, capital and labor have made arrangements somewhat along the following lines: the neutral person in one company may be slightly sympathetic towards labor whereas in another company the neutral person might lean towards a capitalistic philosophy. However, this solution is only appropriate in an oligopolistic industry, if at all.

An initial proposal, endorsed by the government, envisaged an annual change of chairpersons. This solution proved unacceptable for two reasons. First the annual rotation endangers the continuity of office, causing instability. A second and probably more important reason was that during the consultation concerning the Co-Determination Act, serious doubts were raised as to the constitutionality of the draft. The argument was that full parity violates the property guarantee of Article 14 of the West German Constitution. The argument was sufficient to sway the legislature, which gave the shareholders a small but significant advantage.

According to Section 27 of the Act, the members of the supervisory board must first attempt to designate a chairperson jointly. If this attempt proves unsuccessful, the members of the supervisory board representing the investors select the chairperson, while the vice-chairperson is designated by the supervisory board members representing the employees. Thus the shareholders have a clear advantage, though it may be lost at times by chance. For example, if the chairperson cannot officiate at a meeting because of sickness or a traffic jam, the vice-chairperson would preside.

6. Gesetz über die Mitbestimmung der Arbeitnehmer in den Aufsichtsräten und Vorständen der Unternehmen des Bergbaus und der Eisen und Stahl erzeugenden Industrie of 21 Mai 1951 (1951 BGBl I S. 347).

C. The Appointment and Dismissal of Members of the Managing Board

The most important task of the supervisory board is the appointment and dismissal of members of the managing board. Each member's term, according to Section 24 of the Stock Corporation Act, cannot exceed five years. One of the principle objectives of the Co-Determination Act is to provide parity in the selection process. Again, the rules governing this process are extremely complicated. The Act provides for essentially three stages:

> STEP 1: The supervisory board, by a two-thirds majority, appoints a member of the managing board. Here the process ends if both factions agree on the choice.
> STEP 2: A committee of the supervisory board, designated on the basis of parity, agrees on a candidate who is then accepted by the supervisory board as a whole by simple majority vote. Once again the two groups must reach agreement. In practice, this step merely provides pressure for consensus.
> STEP 3: Should the first two steps fail to yield a positive result, the chairperson of the supervisory board may cast a second vote to break the stalemate. The tie vote procedure was considered necessary to avoid the constitutional problem.

The practicality of this procedure is questionable. Although it has never been tried, two typical situations may be anticipated. The first involves corporations with only one or a few shareholders where the trend will be to bypass the two initial steps of decision-making. In other words, the shareholders, relying on the second vote of the chairperson, will attempt to appoint all members of the managing board. This would be the case, for example, in wholly owned subsidiaries of foreign enterprises such as Ford AG, Opel AG, Esso AG, Deutsche Shell AG and so on. However, this path may not always be open. It is endangered both by political considerations and various random factors. Unions and employees may not be prepared to accept a continual denial of the right to have an effective voice in the appointment of members of the managing board. Also, the third stage of the selection process requires presence of the chairperson at the supervisory board meeting, since he alone can cast a second vote. Moreover, at any given meeting the number of shareholders' representatives must be at least equal to the number of labor members to enable the use of the second vote. The shareholders, therefore, will not only have to consider whether their representatives have the necessary experience and competence, but they will also have to make sure that their representatives are in excellent health and stamina. Shareholder representatives must

always be punctual, transportation strikes and automobile accidents notwithstanding.

The second situation involves corporations which are not controlled by one shareholder or a group of shareholders. Where the chairperson of the supervisory board lacks the backing of a sole or major shareholder, it is unlikely that the third phase of the decision-making process will even be reached. The contending factions within the supervisory board, as well as the candidates for appointment to the managing board, will make an all-out effort to achieve results at the first stage. The ultimate outcome will depend primarily on private negotiations with the candidates, in which supervisory board members from both groups will participate on an equal basis.

As a practical matter, labor representatives will increasingly present their candidates for management positions. In part, these candidates will be "climbers" trained in union schools who have sufficient experience to earn consideration for membership on managing boards. In part, they will be either opportunists who have discovered an easy access to a promising career or old-time union members who believe that it is their turn to land a "cushy" job. Some members of the latter group may in fact be fit for management positions. Still, it is disturbing to watch the emergence of standards wholly unrelated to the objectives and requirements of the enterprise. Until now, members of managing boards had common goals and could share confidences. The new Act divides management into "red" and "blue" members. Experiences derived from the Austrian political system during the so-called *proporzes*[7] suggest that the polarization so created is likely to trickle down to all levels of corporate activities, so as to produce not only "red" and "blue" management, but "red" and "blue" clerks and warehousemen as well.

D. Other Functions of the Supervisory Board

The supervisory board is also responsible for the management of the enterprise. Most importantly, it must approve major corporate transactions, as specified in the corporate charter or in the by-laws adopted by the supervisory board.[8] The charters of most German stock corporations contain a long catalog of transactions that require supervisory board approval. These customarily include real estate transactions, guarantees for loans, the appointment of executives, the appointment of classes of corporate agents and the establishment and

7. That is to say, the practice of altering offices in the executive branch depending on party affiliation.

8. *See* Section III (4) of the Stock Corporation Act.

dissolution of branches. To the extent that such a catalog is insufficient, the supervisory board can specify additional catagories of transactions that require its approval. Thus, in practice, the supervisory board is directly involved in all important business, financial and personnel decisions. Section 29(1) of the Co-Determination Act again provides for parity in these decisions by requiring a majority vote. This forces the two factions within the supervisory board to agree, and consequently negotiation is made to play an important role. If, for example, the managing board wants to close a plant, the labor group may well condition its consent on special benefits for the displaced workers.

As in the case of managerial appointments, Section 29(2) of the Act accords the chairperson of the supervisory board a second vote under certain conditions. The chances are, however, that he will be less inclined to cast a tie-breaking vote in situations that are not as crucial as the appointment of the managing board. Thus the bargaining process between the managing board and the two groups within the supervisory board, as an operational rule of the supervisory board assumes a decisive role.

III. THE PROBABLE EFFECTS OF THE STATUTE

A. The Temporary Character of the Statute

Changes that are likely to occur as a result of the new Act are difficult to predict. The Act must be viewed as a temporary measure since it constitutes an important step along an uncertain path.

Even the most vociferous supporters of the Act have divergent opinions as to the goals of co-determination. Some view it as the next to last step toward a socialist-type constitution for enterprises, similar to the Yugoslavian or other socialist models. Others believe that the Act is necessary to maintain the capitalist system, because worker participation could forestall worse alternatives. It is difficult to determine at this point which school of thought will ultimately triumph.

The temporary character of the statute has been conceded by the government. Three years ago a committee was appointed to develop a new concept for the "enterprise system." The committee is still pondering the problems and publication of its recommendations cannot be expected in the near future. These recommendations will certainly affect the total revision of the Co-Determination Act of 1976. Eventually the Act is expected to be discarded in favor of a new statute on the "enterprise system." One reason for appointing such a committee

is the strange phenomenon that Germany has four different co-determination statutes,[9] with widely divergent provisions as to their scope of application as well as their substantive co-determination rules. This legislative arbitrariness and the resulting confusion was caused by expedience to accommodate the demands of a changing political setting.

B. The Two Other Levels of Labor Co-Determination

The uncertainties of the statute are enhanced by the fact that in Germany, apart from the Co-Determination Acts, there are two other levels of labor participation which also have an impact on corporate decision-making. The first of these levels is the so-called works councils. The Works Councils Act of 1972,[10] successor to the Works Councils Act of 1952,[11] gave employees of German enterprises far-reaching rights against management. Under Section 87 of the Act of 1972 the works councils have a voice equal to that of management regarding the following matters: questions of order within the enterprise and the conduct of employees in the enterprise; the beginning and end of the work day, including breaks, as well as the distribution of work time over the work week; and questions of wage policy within the enterprise. These are some of the many situations in which the works councils make decisions jointly with management. If management does not agree with the works council on such issues, the decision is made by a joint committee, composed of equal numbers of management and labor representatives. Accordingly the managing board must frequently negotiate twice, first with the works council and subsequently with the labor representatives on the supervisory board.

The second level of worker participation involves the negotiation of collective bargaining agreements. In Germany it is customary to conclude industry-wide agreements between a union and an industrial association representing all the enterprises involved. The main topics of these agreements are minimum wages, minimum vacation time and other employee benefits. The collective-bargaining mechanism, by its very nature, presupposes equality of weaponry among the participants as well as the capacity of each to make independent decisions. The Co-Determination Act of 1976 upsets this scheme by having labor share management functions with the subsequent result of having

9. *See* authorities cited in notes 1 and 5 *supra;* Sections 76-77 of the Betriebsverfassungsgesetz of 11 Oct. 1952 (1952 BGBl I S. 681) and Mitbestimmungergänzungsgesetz of 7 Aug. 1956 (1956 BGBl I S. 707).

10. Betriebsverfassungsgesetz of 15 Jan. 1972 (1972 BGBl I S. 13).

11. Betriebsverfassungsgesetz of 11 Oct. 1952 (1952 BGBl I S. 681).

labor bargain with itself. Section 33 of the Act extends this idea even further by providing for a "labor director" on the managing board. One member of the managing board must be given responsibilities for labor and related matters, including the negotiation of collective bargaining agreements. After the Act was promulgated the unions announced their claim, and now operate on the assumption that labor will determine the appointment and dismissal of that director. Hence, in many bargaining situations union representatives will be sitting across from union representatives. This condition has been called "over-parity," a term as illogical as it is cogent.

C. The Effects on Enterprises

The presumable effects of the Co-Determination Act on the approximately 650 corporations directly affected are numerous.

All observers, including the most fervent supporters of the statute, expect that corporate decision-making will become more time-consuming and more complicated. Conceivably, the loss in efficiency will diminish the competitiveness of these companies. Moreover, now that employees have a voice in management, the emphasis will be on protection of jobs, rather than on efficiency. This clearly will be a drawback in international competition.

On the other hand, the Act is likely to promote the "integration" of labor in society, a factor which has produced many favorable experiences. Under the Act there are fewer strikes than in most European countries and the social climate is quite harmonious and pleasant. Yet the actual necessity for the Act is subject to serious doubt. It appeared, until recently, that Germany was well on the way toward establishing a decent social order that envisaged economic freedom and also provided substantial protection for the weak without insulting their dignity. At present, Germany may have been diverted from this path to head for the point at which there is simply a "change of elites." Apparently a certain segment of union leadership views that as a goal. Whether workers will permit them to be bosses in the long run, could be a central question to the German future.

D. The Constitutional Question

The Co-Determination Act is designed to change the economic and social life of Germany — a change of such magnitude that it arguably calls for constitutional ratification. Article 15 of the Basic Law of 1949 concerns nationalization. Since co-determination is at least as much

of an encroachment on private right as nationalization, it is doubtful such a major change should be effectuated simply by a statute. The Swiss considered a similar constitutional amendment authorizing co-determination, but the amendment was defeated in a referendum.

Even if the Act does violate the German constitution, it would be difficult to obtain a decision to that effect from the Constitutional Court. In the lower house of the German Parliament almost all representatives voted in favor of the Act, the government coalition as well as the opposition. The Act was therefore adopted by a majority sufficient to amend the Basic Law. Given this legislative history, the Constitutional Court can be expected to disfavor becoming embroiled in this controversy and escape the criticism it would otherwise draw by declaring the Act unconstitutional. It would seem the Act will thus remain on the books, improved perhaps by the interpretations of the Constitutional Court and by the practical utilization of the Act by the workers, management and unions.