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The transposition into German law of the 10th Directive¹ on cross-border mergers of companies with share capital

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1. How the German law came into being

In Germany, as in the transposition process for the **SE**, **two separate drafts (from two different ministries) were drawn up and issued in spring 2006:**

- A draft, from the Ministry of Justice, for a Second law to amend **The law on changing the corporate form** (Zweites Gesetz zur Änderung des Umwandlungsgesetzes)
- A draft law, from the Ministry of Labour, on **transposing the rules of participation in the case of cross-border mergers of limited liability companies from different member states** (by the Ministry of Labour) (Gesetz zur Umsetzung der Regelungen über die Mitbestimmung der Arbeitnehmer bei einer Verschmelzung von Kapitalgesellschaften aus verschiedenen Mitgliedsstaaten).

Up to the moment of adoption by Parliament, the two drafts followed different paths. In the case of the proposal for the rules of participation, for example, there was only a hearing at which the “old arguments” of the SE debate were heard once again.

The most curious – and also lucky² – fact was that the bill about the participation rules reached Parliament earlier than the law on changing the corporate form. **The law on participation rights** was thus adopted on 9 November 2006 and published in the Federal Law Gazette (*Bundesgesetzblatt*) on 21 December 2006. It then **came into force on 22 December**. The bill to **amend the existing law on changing the corporate form**, on the other hand, had to go through our second chamber (*Bundesrat*) after having been adopted by Parliament on 1 February 2007 and was not published until 24 April 2007, coming **into force on 25 April 2007**.

2. A few words about the company law

Apart from some other incidental changes to the law, resulting from developments in recent years (the law itself dates back to 1994), the paragraphs directly relating to the 10th directive were inserted as a separate chapter entitled “cross-border merger of limited liability companies” in §§ 122 a- 122 l.

¹ Official Journal of the European Union 25.11.2005 L 310/ 1ff.

² Lucky because the failure of the Biedenkopf-Kommission II (Governmental Commission on “Modernisation of Participation rights”) was made public on 13 November (the report was given to chancellor Merkel on 20 December).

The rules are very much inspired by the national rules governing company mergers and the rules contained in the SE law. What is new for German companies from now on is that they can merge with companies located across the border and that there are secure rules for these companies to merge into a German one. The first point was previously in doubt, even though we had the ECJ decision in the Sevic case³, whereas, in relation to the second point, the principle had been decided by the Sevic case.

Generally speaking, the method of merger is:

- One or more companies **transfer all their assets and liabilities to another existing company, the acquiring company** or
- Two or more companies **transfer all their assets and liabilities to a company that they form, the new company.**

An important point in relation to the new **company law** is that it **relates only to companies with share capital, not to cooperatives⁴ and especially not to partnerships** (here the idea of the German ministry of Justice is that the European Commission should adopt its own regulation). And the other point of importance is that, in the case of such a merger, creditors may demand securities or payment of their claims if the acquiring or new company is not subject to German law.

The merger plan must contain **information about the likely repercussions of the merger on employment** (§ 122 para 2 Ziff.4) and the merger report, which is to be sent to the works council (or, in the absence of such a body, to the employees) at the latest one month before the assembly of shareowners held to decide the merger, has to contain **explanations concerning the repercussions on employees** (§122 e).

The **court where the merger is registered is required to ascertain** (§ 122 I para 2) that the merging companies have approved the common draft terms of the cross-border merger in identical terms and that, **where appropriate, an agreement about employee participation has been signed.**

3. The rules for employee participation in case of a cross-border merger

a) Overview

The new provisions are orientated very much to the law that transposed the SE directive into German law:

- There are **general provisions** (§§1.-5), relating to **definitions** (§ 2 para 7 defines participation, in the same way as the SE directive, as the right to elect, appoint, recommend or oppose members of the supervisory body or board of directors) and the **scope** of the law.
- There is one section (§§ 6-21) about the **Special Negotiating Body** (composition, election and negotiating process).
- Next comes a section (§§ 22-30) on **employee participation** (whether by **agreement or by law** - fall back position).
- Last come the rules governing **protection and criminal proceedings** (§§ 31-35).

b) Employee participation law applicable in case of merger

The **general principle** is stated in § 4 :

The participation rules of the state where the company resulting from the cross-border merger has its headquarters will apply (that is, if there are any).

³

13.12.2005.

⁴

They can merge via the SCE.

But the **exception to that is stated in § 5:**

The rules on participation – whether by agreement or by law – are applicable, if:

aa) In the six months before publication of the merger plan **at least one of the companies involved employs on average more than 500 workers and in this company a system of participation exists** as defined in § 2 para 7.

This means that all German companies with employee board membership (threshold) are included.

bb) The **relevant national law governing the company emerging from the cross-border merger does not require the same amount of participation as was found in the companies involved** in the merger.

Allocation, in such cases, follows the proportion of worker, and other, representatives on the supervisory board or board of directors (see Art. 16 para 2 a of the directive: the phrase “the management group which covers the profit units of the company” (a Finnish phenomenon) is simply translated into German and incorporated into the law).

Or

cc) The **national law** for the emerging company **does not provide for the same right of participation for the employees located in other member states.**

Nowhere in Europe is this currently the case and so it is an exception that will not apply.

c) The negotiating process

These rules are well known from the SE rules:

aa) Information by management

When managements are planning a cross-border merger, they are required to inform the employee representatives (in Germany: the works councils, etc.) and the “committee of managerial staff” in the affected companies, etc. of the plan to merge (§ 6). Details of the information to be supplied are given in § 6 para 3.

bb) Composition of the SNB and election

For every proportion of the employees in a member state **of ten percent** or a portion thereof, a member is to be elected or delegated to the SNB (§ 7 para1). Extra members are to be elected to guarantee representation of every company that will cease to exist as a result of the merger. The number of extra members shall not exceed 20 % of the number according to para 1.

If, during the negotiations for the SNB, **changes take place in the structure or in the number of employees**, such as to require a change in the composition of the SNB, the **managements must supply the requisite information immediately.**

The rules governing worker representatives are those of the member states (§ 8 para1). Among German members those eligible for election are **employees of the companies** and plants as well as **union officials**. If the Germans have more than two seats, every third seat is reserved for an official of a union that has members in that company or plant (while every seventh seat is allocated to a member of the managerial staff).

Election proposals (rights of unions and managerial staff to “their” seats § 10 para 1) are made to the election body which is simply defined as the **highest works council in the national group.**

An assembly of up to 40 members is held to elect the German delegates to the SNB (§12).

cc) The negotiating process itself

Apart from one special feature of the mergers directive, according to which the relevant bodies of the merging companies have the right to choose, without any prior negotiation, to be directly subject to the standard rules (Art. 16 para 4 a directive and now § 23 para 1 Nr. 3 German law, see below d) bb)), the negotiation process is comparable with that of founding a SE:

The election of the SNB must take place within 10 weeks. Immediately after the members of the SNB have been appointed, they are to be invited by the managements to a **constituent meeting** (§§ 13,14).

The SNB can use **experts** in the negotiations, including representatives of appropriate Community-level trade union organisations, and the SNB may decide to issue information concerning the beginning of the negotiations to representatives of appropriate external organisations.

The **decisions of the SNB** (§17) are normally taken by a majority of its members who at the same time represent the majority of the employees. A majority of two thirds is necessary if the result of the negotiations would cause a reduction of participation rights. This refers to a situation where the proportion on the board or supervisory board (or the other bodies according to the Finnish institutions) would be less than the highest level of representation in the existing companies, or where the right to elect members to the boards or supervisory boards would be abolished or reduced.

Finally, there is the **possibility for the SNB not to negotiate** or to break off negotiations that have started (§18), a decision also requiring a majority of two thirds. In such a case the national law on employee participation of the country where the company has its seat will be applicable (if such a law exists).

The necessary costs of the negotiations are covered by the company.

The time allowed for negotiations is 6 months or, if agreed by both sides, up to one year.

As was already the case in the SE law, there is **no opt-out clause** in the German law concerning the fallback rules (once again allowed by Art. 16 para III e of the directive).

d) The possible results: Agreement or Participation according to legislative provisions

aa) Agreement

§ 22 is very similar to the provisions on participation contained in the SE Law (§21) and covers:

- The **scope** of the agreement, including the companies and plants lying outside the sovereign territory of the member states.
- The **date** when the agreement comes into force, its **duration**, the **cases in which** the agreement **shall be subject to renegotiation** and the requisite procedure.
- The **number of members of the supervisory board or the board** of the emerging company that can be elected by the employees (and other groups).
- The **election procedure** for those members
- And the **rights of those members**.
-

The agreement must also state that negotiations are to be held before any structural changes are made to the emerging company.

The agreement may also provide that the legislative provisions governing participation (§§ 23-27) shall be applicable (in full or in part).

bb) Participation according to the legislative provisions (the standard rules)

The standard rules are applicable if:

- 1. the parties so **agree**,
- 2. by the end of the negotiation period **no agreement has been reached** and the SNB has not decided to stop the negotiations,
- 3. or the **managements of the involved companies decide, at the time of registering the company, to use these rules from the outset.**

In cases 2 and 3, further conditions are necessary:

One or more form of **participation** must have existed in one or more of the **companies** involved in the merger either

- covering at least a third of the total number of the employees of all companies and subsidiaries or
- covering less than a third, but where a decision to this effect was taken by the SNB.

If more than one form of participation was in existence (see definition above 3.a.), the SNB has to decide which of these forms will be applicable to the newly resulting company. If no such decision is taken and a domestic company whose employees have participation rights is involved, then participation takes place by election or appointment of members to the supervisory board or the board of directors. If no domestic company is involved, the form of participation introduced shall be that which formerly covered the highest number of employees in the companies involved in the merger.

Given that these decisions have to be taken by the SNB, it is apparent that, even if the managements of the companies take a direct decision to use the participation law without negotiations, **a sort of SNB is nonetheless required**. In such a case the body will have no mandate for negotiations, making the process much shorter than in the founding of an SE (where six months are required), but the above decisions, and especially the allocation of the seats (§ 25), have to be performed by a delegation of the companies involved. One might still speak of an SNB, or alternatively name it a **Special Delegating Body**, but its existence is required. There are no special additional rules in the German law for this purpose; it is simply a case of right use of the law in such a case.

The amount of participation is defined in § 24:

The employees have the right to elect members to the supervisory board or the board of directors. The number is defined by the **highest proportion in the bodies of the companies affected**. (There is even a rule covering the case where the new company headquartered in Germany is a private limited liability company: then the company has to set up a supervisory board and certain rules of the stock corporations act apply to that company).

The process for allocation of seats is well known from the SE. The SNB (or the delegating body) distributes the seats according to the proportion of the employees in the member states. Insofar as the member states have no rules of their own governing the seats to be allocated to them, it is up to the SNB (or delegating body) to decide how the seats are to be allocated.

The seats for the German employees in such a body are determined in accordance with the same rules as in the SNB.

The **legal position** of the employee members is the **same as that of the representatives of the owners**. The number of managers has to be at least two, one of whom is responsible for work and social affairs.

For companies defined as **”Tendenzunternehmen”** (a phenomenon rarely encountered outside Germany), the **only** possibility is to obtain participation **by agreement**. There are no fall back rules for such companies (as under domestic German law they are exempt from worker representative on the supervisory board).

Art. 16 IV c of the directive, according to which the member states could **limit the number of employee seats on the board of directors to one third** was not transposed into German law.

e) The continuation of national structures and the event of subsequent mergers

As in the SE, here too there is a paragraph (§30) stating that the rules and structures of domestic state employee representation shall continue in operation if the national legal company ceases to exist as a result of the merger. So not only is there a works council in the German part of the company (as is legally required in every plant), but also a company works council, even though there is no longer a German legal entity.

Art. 16 para VII of the directive requires protection of the employee participation system in the company resulting from the cross-border merger, if **subsequent domestic mergers** take place **within a period of three years after** the cross-border merger has taken effect. The German transposition includes specific provision for this protection (which is possible given the wording of the directive):

If domestic mergers take place following the cross-border merger then the national rules for participation apply. But if these rules are less favourable to worker participation than those in § 5 Nr. 2 (see above 3. b), the existing company rules are applicable for three years in the company emerging from the domestic merger. No new negotiations take place in such a case; a practical solution, especially considering that the results of the negotiations would be valid for only three years.

f) Protection rules

The same rules are found here as in the case of the SE: duty of confidentiality, protection against dismissal, attendance at meetings and continuation of remuneration. There is accordingly no need to go into further detail on these matters here.