A German success story

The European Company (SE): an alternative legal form with compelling options for employee codetermination on the board level

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In 2004, the European Company, Societas Europaea (SE), was added to the canon of legal forms available to companies in Germany. After several years in hibernation, the SE was then discovered by a number of companies such as Allianz, Porsche and BASF. The SE not only served as a solution for very specific situations such as the merger of RAS Italia and Allianz, but also as a chance to optimize employee codetermination on the board level. If the SE today is widely regarded as a success story in Germany – and in Germany only – it’s because the SE has been chosen by a large and still growing number of medium-sized and family-owned companies. The main driver for establishing an SE for these companies is often the aspect of employee codetermination on the board level.

Codetermination in Germany

Stated in a very simplified manner, companies in Germany, among other entities, organized in the legal form of a stock corporation or limited liability company face the issue of corporate codetermination if they regularly have more than 500 or 2,000 employees, respectively. A stock corporation or limited liability company with more than 500 employees in Germany has to establish a supervisory board that consists of one-third employee representatives (Section 1 of the One-Third Participation Act [Drittelbeteiligungsgesetz]). In a company with more than 2,000 employees (groupwide) in Germany, a supervisory board needs to be constituted that consists of an equal number of employee and employer representatives (Section 1 of the Codetermination Act [Mitbestimmungsgesetz, MitbG]).

It is disputed whether or not workers employed abroad have to be considered when determining the threshold for corporate codetermination. According to the majority view, only employees employed in Germany are considered. In contrast, the Frankfurt District Court (February 16, 2015; reference No. 3/16 O 1/14) ruled that workers employed abroad have to be considered. This judgement is not, however, legally binding. A submission proceeding (C-566/15) at the European Court of Justice (ECJ) is pending on the question of whether or not European fundamental rights require including employees of EU foreign companies in determining the codetermination threshold.
To summarize, corporate codetermination has significant consequences for companies: Codetermination provides for rights to extended information and control as well as sets out mandatory formal provisions. In practice, breaches of confidentiality are not uncommon. Moreover, should a supervisory board have an equal number of employee and employer representatives, management is determined by the supervisory board – that is, employees have a say on the appointment and compensation of management. Lastly, two members of the supervisory board have to be external union representatives.

**Codetermination in an SE**

For an SE, however, the German rules mentioned above do not generally apply to codetermination on the board level. The SE does not have any original system of corporate codetermination. Instead, employee participation in an SE is primarily negotiated between the management of the company planning to become an SE and employee representatives. The outcome of these negotiations may have an impact on the composition of the supervisory board, especially in terms of the number of employee representatives as well as on the board’s internal rules and on the decision not to establish any employee codetermination on the board level. The parties to the negotiations are generally free to decrease the level of employee codetermination or even to forego such codetermination. Should no corporate codetermination have existed in one of the companies establishing the SE, employees have no means to enforce codetermination on the board level. As a consequence, an SE here may be established free of company codetermination without the employee agreement – and this may also last into the future.

Should no agreement be reached, corporate codetermination will, to put it in a nutshell, only exist insofar and to the extent that such codetermination was in place in one of the companies establishing the SE before the incorporation of the SE. Depending on the approach selected for establishing the SE, a certain quorum on the number of employees covered by the codetermination system must be established.

**Options to design employee codetermination on the board level**

One notable advantage of the SE is that once it has been established, there is generally no obligation to create a codetermined supervisory board should the regular number of employees increase above the threshold of more than 500 or 2,000 employees, respectively. The SE becomes “immune” to employee codetermination, therefore this legal form is especially attractive for companies with fewer than 500 employees.

For companies already subject to codetermination in terms of having one-third employee representation on the supervisory board, the SE is also an interesting option should such companies plan further growth – either organically or through acquisitions – and risk reaching the threshold of regularly having more than 2,000 employees. Those companies still have the chance to avoid the obligation to establish a supervisory board with an equal number of employee and employer representatives.

But even if equal codetermination applies, the SE form may be highly attractive: Depending on the specifics of the company, companies unable to “escape” equal codetermination still have the chance work with their employees to find tailor-made solutions for corporate codetermination:

One aspect of significant relevance is the option to reduce the number of supervisory board members, for example from 20 to 12 members. Administrative optimization might also be of interest: For instance, alternative procedures for the election process concerning employee representatives for the supervisory board may be agreed on to simplify this complex and very costly exercise. In addition, it is possible to agree on having foreign employee representatives on the supervisory board instead of trade union representatives.

**Further reasons for setting up an SE**

Corporate codetermination is not the only trigger for establishing an SE. Companies need to handle increasing globalization and the SE may be a good solution. As a legal form, the SE highlights the company’s image as an international, modern enterprise and thereby shapes public perception of the company. Furthermore, the SE makes acquisitions in other EU countries easier because the acquirer is not a German company but a European company or European group. The SE offers the possibility of transferring its seat to other EU countries while preserving its legal identity. No other legal form in Germany grants such an opportunity.

In addition, the SE creates financing possibilities for German stock corporations that do not entail any loss of power for the entrepreneur. This is because an
SE may be constituted according to the monistic model instead of a dualistic model consisting of a supervisory board and a management board. As chairperson of the board of directors, the entrepreneur may then combine the management and supervisory functions within his or her own person.

**Procedure for establishing an SE**

Establishment of an SE may be accomplished by various means. The law provides for the cross-border merger of at least two stock corporations, establishment of a holding SE by companies from at least two different EU Member States, the establishment of a subsidiary SE by companies of two different EU Member States, the transformation of a stock corporation existing in one of the EU Member States if such a stock corporation has had a subsidiary for at least two years under the laws of a different EU Member State.

A further way to establish an SE that is quite frequently used in practice is establishing an SE as a shelf company. In this approach, an SE is also available for the merger of a company that does not fulfill the prerequisites for a transformation into an SE. It has to be noted, however, that not all questions concerning codetermination matters have been answered yet when it comes to shelf companies.

Whatever approach is taken to establish an SE, a negotiation process with the company’s employees needs to be conducted in the course of establishing the SE. In this process, employees are temporarily represented by a special negotiating body (SNB) established solely for the purpose of these negotiations. The negotiating partner is the management of the company or companies establishing the SE.

The negotiating parties are supposed to negotiate employee participation in the SE, a process addressing two main topics: corporate codetermination and the employees’ right to information and consultation in cross-border matters. The right to information and consultation is usually accomplished by an SE works council, which is similar to a European works council. It does not have the power to block decisions made by the employer, and, in fact, it solely has rights to information and consultation.

The SNB is free to decide not to commence negotiations or to terminate commenced negotiations. The company management is not allowed to make such decisions. It is also sufficient if the time period for the negotiations, generally limited to six months, elapses without any outcome.

Members of the SNB are determined for employees of the companies participating in the establishment of the SE or employees of subsidiaries and establishments affected by the incorporation of the SE who are employed in any of the EU Member States. The German members of the SNB are elected by the existing works councils; if no works council exists, a primary election is held. As a general rule regarding German members of the SNB, the relevant trade union has to be involved in the process.