# STRENGTHENING THE POSITION OF MEMBERS OF A SUPERVISORY BOARD ELECTED BY EMPLOYEES – CO-DETERMINATION IN THE LIGHT OF LEGAL AND EXTRA-LEGAL REALITY

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***Abstract:*** *One of the most frequently discussed issues of corporate governance is co-determination – mandatory employee representation on supervisory boards. The voices of employees are often strengthened through further legislation. Companies may thus be required to record all dissenting opinions of employee representatives and communicate them at general meetings.*

*However well-intentioned, it is debateable whether such involvement really strengthens the voice and involvement of employees.*

*On joining the board, an employee representative may find themselves receiving a remuneration far in excess of their regular salary. There is a perverse – but human – incentive in some cases that they want to hold onto this new role as long as possible. To do so they ensure that their views and votes do not deviate from those of the majority. The value of such 'constructive' approach is then frequently emphasised by management, increasing the chances of the representative's re-election.*

*However, the described rules initially designed to protect dissenting opinions conflict with this reality. Recording opinions and further communicating them can have a dampening effect. Rather than feeling safe to express strong opinions, there is the potential to tone-down comment, resulting in a passive, non-committal approach. As well as suppressing personal opinions, it ultimately reduces the motivation to defend employee interests.*

*So how to act? It seems more appropriate to record a dissenting opinion only if the representative deems it appropriate; for example, to be able to demonstrate in the future that they acted in the best interest of the company, regardless of how this is perceived by different jurisdictions.*

***Keywords:*** *co-determination, supervisory board, joint-stock company, stock coporation, public limited company, employee, dissenting opinion, Czech Republic, Czechia, Slovakia, Germany*

## I. INTRODUCTION

Corporate law provides almost an unlimited number of areas suitable for both theoretical and practical research. This is due to the wide substance of the branch of corporate law, and also to the extensive dynamics of business relations. As a result, legislative bodies have to react almost continuously not only to the requirements of corporate practice, but also to risks relating to newly established and so far unknown procedures. Good practice in such cases suggests that the passage of respective legislative provisions should be preceded by an analysis of the recent situation and assessment of whether an alteration of the respective legislation is or is not necessary. Nevertheless, even after many years, it can be quite difficult to identify the reasons for inclusion of some statutory provisions into the legal order.

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Some rules the meaning of which remains unclear apply to the specific strengthening of the position of members of a supervisory board elected by the employees of a joint-stock company (stock corporation in the USA and public limited company in the UK).[1] The main purpose of this paper[2] is to introduce those rules, to substantiate their reasoning, or the lack thereof, in the literature, and to confront them with the author's own extra-legal experience and knowledge acquired during his personal contacts with members of supervisory boards of various companies (Chapter 4). Chapter 2 introduces basic features and characteristics of corporate governance, as the author of this paper does not intend to carry out an extensive analysis of issues relating to it. The same approach applies to the role of supervisory boards in the functioning of companies (Chapter 3). Both chapters are intended to complement the perspective of a reader regarding the main topic of this paper.

## II. ENGAGEMENT OF EMPLOYEES IN CORPORATE GOVERNANCE OF COMPANIES

### II.1 Forms of employees' participation

Doctrine and individual legal systems utilise more possibilities of engaging employees in corporate governance of companies.

The employment law relates to relevant fields such as collective bargaining, establishing works councils and strengthening information duties on the part of the employer towards employees and their representatives. Corporate law, on the other hand, governs the establishment of non-mandatory employees' bodies having various advisory and consultative functions,[3] and, in particular, so-called co-determination, i.e. entrusting the employees of a company with the election of part of the membership of the supervisory board of the company.

Germany has been traditionally designated as a 'cradle' of co-determination.[4] However, various forms of co-determination are present in other countries, such as Austria, France, Sweden, Denmark, and also in Slovakia and the Czech Republic.[5] On the contrary, the institution of co-determination is not inherent to the Anglo-Saxon legal environment. Although Great Britain saw some attempts to foster the position of employees in big public

[1] It should be noted that since the 1990s *joint-stock company* has been a traditional translational equivalent of the Czech *akciová společnost*, although the substance of the Czech entity corresponds to what is in common law jurisdictions termed *(stock) corporation* (USA) or *public limited company* (UK). In order to simplify terminology, the general term *company* is used in this paper to include a joint-stock company in the Czech, Slovak (*akciová spoločnosť*) and German (*die Aktiengesellschaft*) law.

[2] This paper is a follow-up to the author's contribution at the Edinburgh Postgraduate Law Conference 2021 on the topic "Great Expectations: When Law Meets Reality".

[3] Regarding a possibility in Czech law to constitute bodies other than those foreseeable by the respective legislation see the judgment of the Supreme Court of the Czech Republic of 24 November 2008, file No. 29 Cdo 4563/2008.

[4] Regarding German regulation see, for example, HIRTE, H. *Kapitalgesellschaftsrecht. 8. Auflage.* Köln: RWS Verlag, 2016, pp. 203 and following; WIRTH, G., ARNOLD, M., MORHÄUSER, R., CARL, S., GREENE, M. *Corporate Law in Germany.* 3rd ed. Munich: C. H. Beck, 2017, pp. 114–115.

[5] Some countries, such as Poland, Hungary and Estonia, introduced co-determination in the past, but have gradually been removing that possibility. See HURYCHOVÁ, K., TOMÁŠEK, P. Zastoupení zaměstnanců ve volených orgánech akciové společnosti ve Velké Británii a České republice. In: J. Pichrt – J. Tomšej (eds.). *Zaměstnanecké participativní modely.* Praha: Wolters Kluwer, 2019, chap. 4.1.

limited companies, the right to have an influence upon the composition of a board of directors was not eventually granted to the employees.[6]

### II.2 Positives and negatives factors of co-determination

Opinions regarding obligatory inclusion of employees in corporate governance of a company vary. Its positives as well as negatives are seen primarily in the economic area, but also in the legal and social field.

The main positive impacts include the strengthening of an interest in the sustainable development of a company in the long-term.[7] While shareholders in bigger companies often fluctuate,[8] employees of the company usually represent a more stable set of persons.[9] Fostering their influence can bring in a more intense sense of belonging to the company, which may potentially result in increased loyalty of employees to the company. Members of boards of directors can expand their own perspective in regular discussions with employees elected to supervisory boards; as a result, directors become familiar with a wider range of views regarding the activities of a respective company particularly because employees can provide a more detailed view of the functioning of the company in its depth and breadth as such perspective is not necessarily easily attainable by the top management of the company.[10]

On the other hand, legal and social negatives of co-determination are often presumed to be represented particularly by an immanent conflict of interests where employees, in their capacity as supervisory board members, tend to prefer exclusively the interests of employees (i.e. of their colleagues) although their statutory duty is usually to observe and protect the interests of their company as a whole.[11]

At a macroeconomic level, opinions can be found that countries with a higher degree of employee participation reach better results with respect to the employment rate, decreasing poverty, and increasing investments in science and research.[12] Negative impacts of co-determination, on the other hand, include the decline of the value of a company as the obligatory representation of employees in supervisory boards leads to reducing the extent of control to be possessed by its shareholders.[13]

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[6] Ibid., chap. 4.2.

[7] GELTER, M. Employee Participation in Corporate Governance and Corporate Social Responsibility. Working Paper N° 322/2016, p. 3. In: *Research Gate, ECGI Working Paper Series in Law* [online]. July 2016 [2022-07-19]. Available at: <https://www.researchgate.net/publication/310952532_Employee_Participation_in_Corporate_Governance_and_Corporate_Social_Responsibility>.

[8] Thus the opinion of a general meeting with respect to the future direction of a company could be varying and changing more quickly.

[9] Such stability is usually supported by limited possibilities on the part of an employer (company) to unilaterally terminate employment of a worker.

[10] See also KRAAKMAN, R. et al. *The Anatomy of Corporate Law. A comparative and Functional Approach. 3rd ed.* Oxford: Oxford University Press, 2017, p. 74, pp. 105 and following.

[11] HURYCHOVÁ, K., TOMÁŠEK, P. *Zastoupení zaměstnanců ve volených orgánech akciové společnosti ve Velké Británii a České republice.* chap. 3.

[12] WILLIAMSON, J. Workers on Board: The case for workers' voice in corporate governance. In: *Trades Union Congress* [online]. September 2013 [2022-07-19]. Available at: <https://www.tuc.org.uk/sites/default/files/Workers_on_board_0.pdf>, pp. 16 and following.

[13] DAVIES, P. *Introduction to Company Law.* 2nd ed. Oxford: Oxford University Press, 2010, p. 282; GORTON, G., SCHMID, F. A. Capital, Labor, and the Firm: A Study of German Codetermination. *Journal of the European Economic Association.* 2004, Vol. 2, No. 5, p. 895.

However, the real extent of employees' participation should not be considered only through the dual optics of whether a respective legal system includes co-determination in its regulation or not and, if so, what advantages and disadvantages can be resulting therefrom. It is necessary to consider the overall position of a respective supervisory body, its role within a company and individual powers with which the members of supervisory boards are entrusted by the law.

## III. THE ROLE AND COMPETENCE OF A SUPERVISORY BOARD OF A COMPANY

The dualist system of companies which is typical of the Czech, Slovak and German legal environments assigns to a supervisory board the role and function of a controlling body. In addition to many detailed rules, such position is usually formulated in initial provisions of relevant legislation entrusting the supervisory board with general supervision over the activities of a company.[14]

Under Czech law, a supervisory board possesses a wide range of powers to supervise *"the execution of powers of the board of directors, and activities of the company."*[15] The supervisory board holds the right to supervise any matter relating to the activities of the company. As the doctrine has correctly suggested, the controlling role of a supervisory board is not limited just to checking legality, but also to expediency and economic effectiveness of the company's activities.[16]

At the same time, the general principle of proportionality implies that the requirements for due supervision would also be determined by concrete specifics of a respective company, for example its size, complexity of its functioning, etc. It would not be correct to conclude that the mode and scope of supervisory activities would be identical in a small company with several employees and smaller turnover and in a bid company with thousands of employees and turnover in the billions.[17]

The law entrusts a supervisory board, or directly its individual members, with certain rights (competences) in order to help them fulfil their controlling functions. The most important is the right *"to inspect all documents and records relating to the activities of a company*".[18] Members of the supervisory board of a Czech joint-stock company may exercise that right only upon the decision of the supervisory board unless the supervisory board is unable to execute its functions.[19] It means in practice that a single member of the super-

[14] Section 111 (1) Aktiengesetz vom 6. September 1965 ("AktG") in German law; section 197 of Act N. 513/1991 Zb., the Commercial Code, as amended ("ObchZ") in Slovak law.

[15] Section 446 (1) of Act N. 90/2012 Sb., regulating business companies and cooperatives (the Business Companies and Cooperatives Act), as amended ("ZOK").

[16] As for German law see WIRTH, G., ARNOLD, M., MORHÄUSER, R., CARL, S., GREENE, M. *Corporate Law in Germany.* 3rd edition. Munich: C. H. Beck, 2017, pp. 119–120; as for Czech law not so explicitly ŠTENGLOVÁ, I., HAVEL, B., CILEČEK, F., KUHN, P., ŠUK, P. *Zákon o obchodních korporacích. Komentář. 3rd ed.* Praha: C. H. Beck, 2020, p. 947.

[17] See arguments relating to the defining of the concept of business management contained in the judgment of the Supreme Court of the Czech Republic of 27 February 2007, file No. 29 Odo 1108/2005.

[18] Section 447 (1) ZOK; similarly in Slovak law in section 197 (2) ObchZ, and in German law section 111 (2) AktG.

[19] Section 447 (2) ZOK. Slovak law does not regulate the respective collective principle (section 197 (2) ObchZ). Therefore, each member of the supervisory board may exercise the right to inspect all documents and records; see OVEČKOVÁ, O. et al. *Obchodný zákonník. Veľký komentár.* Bratislava: Wolters Kluwer, 2017, p. 1286.

visory board may not request that he or she should inspect the documents of the company (e.g. contracts), but may do so only upon prior decision of the supervisory board as a collective body.[20] Such decisions can be in the form of a so-called schedule of controlling activities determining individual to control particular segments of a company's activities.

However, (not only) the Czech legislation relinquishes the collective principle in other situations. For example, a petition to court applying for declaring invalidity (nullity) of resolutions of a general meeting may be lodged by any supervisory board member;[21] similarly, each supervisory board member should be given the floor at a general meeting any time he or she so requests.[22, 23]

It should be added that, depending on the internal situation of a company, the role of a supervisory board need not be just to control, but also is of an "enforcing" nature to a certain extent. This may happen if by-laws provide the supervisory board with the right to express its prior approval of legal transactions of the board of directors[24] or even to elect directors.[25] Under German law (in the latter case), this is a competence of a supervisory board determined directly by statute.[26]

On the other hand, German law assigns the right to inspect documents of the joint-stock company to the supervisory board as a whole (section 111 (2) AktG), although this right may be committed to one of its members; see WIRTH, G., ARNOLD, M., MORHÄUSER, R., CARL, S., GREENE, M. *Corporate Law in Germany.* 3rd edition. Munich: C. H. Beck, 2017, p. 119.

[20] I tend to argue that the by-laws of a joint-stock company can deviate from the wording of the statute and the respective right can be thereby assigned to individual members of the supervisory board.

[21] Section 428 (1) ZOK. A member of the supervisory board is obliged to attend the general meeting (section 449 (1) ZOK), unless prevented due to serious reasons (judgment of the Supreme Court of the Czech Republic of 30 January 2020, file No. 27 Cdo 481/2019); absence of the supervisory board members at the general meeting is not, by itself, a reason for declaring an invalidity of a resolution of the general meeting (see also judgment of the Supreme Court of the Czech Republic of 27 January 2009, file n. 29 Cdo 3009/2007). Under Slovak law, the duty to attend the general meeting of a company is stipulated by section 201 (1) ObchZ, and every supervisory board member may file a motion to declare invalidity of a resolution of the general meeting (sections 183 and 131 (1) ObchZ). Under German law, supervisory board members are obliged to attend general meetings (section 118 (3) AktG), but the right of an individual member to submit a motion to declare adopted resolutions invalid is tied to the fulfilment of other conditions (see section 245 AktG).

[22] Section 449 (2) ZOK. It is necessary in this context to reject an opinion sometimes emerging in practice, namely that a general meeting is a platform only for debates between directors and shareholders of the company.

[23] Slovak law expressly provides the right to speak at a general meeting only to members of the supervisory board of a limited liability company (section 140 (1) ObchZ). However, the issue may be whether such right should be inferred from other provisions of the Act, such as from section 188 (2) f) ObchZ, providing for the right of a supervisory board member to request that his or her protest against adopted resolutions be included in the minutes of the general meeting.

[24] Section 47 ZOK.

[25] Section 438 (1) ZOK, or section 194 (1) ObchZ in Slovak law.

[26] Section 84 (1) AktG. On the position of a supervisory board in a German joint-stock company see also The German Supervisory Board: A Practical Introduction for US Public Company Directors. In: *Deloitte* [online]. 2021 [2022-07-19]. Available at: <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Risk/gx-german-supervisory-board-publication.pdf>.

## IV. SPECIAL POSITION OF SUPERVISORY BOARD MEMBERS ELECTED BY EMPLOYEES OF A COMPANY

As already indicated, co-determination has been part of both the Czech[27] and Slovak legal systems. There are several common issues as well as differences between the two jurisdictions. Both systems (with certain exceptions) link the right of employees to elect part of the supervisory board membership exclusively to a joint-stock company with the number of members elected by employees of the respective company essentially being one third of all supervisory board members.[28] What differs is the scope of companies subject to co-determination. Whilst the Czech legislation stipulates that obligatory representation applies to companies with more than 500 workers engaged upon their contracts of employment, the Slovak regulation applies to companies with more than 50 regular employees.[29]

In some cases, the legislature feels unsatisfied with just the obligatory representation of employees on supervisory boards of companies, and it seeks to foster the position of employees through other rules (beyond the framework of general provisions applicable to all supervisory board members).

Both the Czech and Slovak systems stipulate that supervisory boards are obliged to inform the general meeting of the results of their controlling activities.[30] In addition, Slovak law requires that the general meeting should be notified of any dissenting opinions of board members elected by employees and that such dissent should be obligatorily included in the minutes of a respective supervisory board meeting.[31] The same regulation used to be applicable under Czech law but was removed.

Expert commentaries regarding the purpose of earlier Czech legal regulation have been rather limited. They usually state that members of a supervisory board elected by employees may have a different opinion regarding the issues on the agenda[32] and that it is appropriate to notify the general meeting of such dissent should those members be outvoted.[33]

Commentaries in Slovakia add more or less no other reasons leading to current Slovak regulation.[34] Although, the duty to inform a general meeting of a different opinion of supervisory board members elected by employees has apparently been restricted, beyond the scope of the law, to issues of a serious nature.[35]

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[27] On the recent situation and legislative development in Czech law see DĚDIČ, J., ŠUK, P. Nad novelou zákona o obchodních korporacích (aneb sporné otázky nové úpravy zaměstnanecké participace). *Obchodněprávní revue*. 2017, Vol. 9, No. 4; DVOŘÁK, T. Participace zaměstnanců některých dualistických akciových společností po 1. 1. 2021. *Obchodní právo*. 2020, Vol. 29, No. 9; HAVEL, B., PIHERA, V. Česká úprava kodeterminace v evropském kontextu corporate governance. *Obchodněprávní revue*. 2021, Vol. 13, No. 1; TOMÁŠEK, P. Obnovení povinné kodeterminace – návrat nejistoty. *Obchodně právní revue*. 2017, Vol. 9, No. 2.

[28] See section 448 (1) and (2) ZOK, or section 200 (1) ObchZ.

[29] Ibid.

[30] Section 449 (1) ZOK, or section 201 (1) ObchZ.

[31] Section 201 (2) and (3) ObchZ.

[32] POKORNÁ, J., KOVAŘÍK, Z., ČÁP, Z. et al. *Obchodní zákoník. Komentář*. 1st ed. Praha: Wolters Kluwer, 2009, p. 30.

[33] ŠTENGLOVÁ, I., PLÍVA, S., TOMSA, M. et al. *Obchodní zákoník. Komentář*. 13th ed. Praha: C. H. Beck, 2010, p. 742.

[34] For example see OVEČKOVÁ, O. et al. *Obchodný zákonník. Veľký komentár*. p. 1298. And for the narrow interpretation of the regulation see also MAMOJKA, M. *Obchodný zákonník. Veľký komentár. 1. zväzok (§ 1 – § 260)*. Bratislava: Eurokódex, 2016, p. 788.

[35] PATAKYOVÁ, M., et al. *Obchodný zákonník. Komentár*. 3rd ed. Praha: C. H. Beck, 2010, p. 594.

The rules were obviously formulated with the honourable motive to increase the power of employees. However, due to the absence of legislative reasoning of the rules as well as their doctrinal limitation just to issues of a serious nature, a question arises as to whether such rules can reach that aim in practice.

In this context, it should be kept in mind that upon membership in a supervisory board the member usually becomes entitled to compensation for the performance of the new position.[36] The amount of money would depend upon the situation in a respective company, but it may represent a significant economic bonus for the employee and, in some cases, may even exceed the amount of wages the employee regularly obtains from the employment in the company. Therefore, it is hardly surprising that employees elected to the supervisory board try to keep their membership for as long as possible.

In order to attain their aim they may tend to express opinions not different from those of other supervisory board members and from opinions of the board of directors. Such "helpful" attitude may be "appreciated" by directors in various ways. For example, activities of supervisory board members elected by employees can be regularly praised at various meetings, or such members can be provided with certain space for presenting their activities in company media, etc. Those tolls help create a strong personal picture of a respective supervisory board member and increase his or her chances in the next supervisory board elections.

In addition, other motivational tools can be seen in practice. In exchange for a constructive approach the board of directors can offer to hold communication between shareholders and supervisory board members aimed at increasing renumeration of supervisory board members,[37] or, in the extreme, to offer better working conditions for the performance of their employment.[38]

It is obvious that members of the board of directors have several tools at their disposal to pursue influence upon employees elected to the supervisory board. Such supervisory board members could be motivated to maintain unsubstantial and non-conflicting discussion rather than to express their real opinions.

Needless to say, the rules that dissenting opinions must be recorded and communicated to a general meeting unfortunately foster an undesirable situation. If a board member elected by employees of the company intends to express his or her different position the member must always consider the fact that it might be not only an oral opinion articulated at a closed supervisory board meeting, but it may also be recorded in writing and subsequently presented at the general meeting before shareholders and members of the board of directors.[39] This may eventually lead to concealing one's own

[36] Although neither Czech nor Slovak law expressly prohibit performing supervisory board membership without any renumeration (or even an compensation for expenses that relates to the membership), the practical experience of the author of this paper clearly indicates that determining the amount of a monthly fee is more than common.

[37] Under both Czech and Slovak law, renumeration of the supervisory board members are determined by the general meeting through the approval of a contract to perform the position (section 59 (2) and section 60 ZOK, and section 66 (6) and section 187 (1) i) ObchZ).

[38] In practice, there may be assignment to more interesting working tasks, more frequent business trips abroad or even less strict control over a respective board member's performance at work.

[39] Naturally, this is applicable only if the company sticks to the quoted provisions of the law.

opinion and to declining one's willingness to defend interests of employees at supervisory board meetings, i.e. the interests of those who have elected the respective member of the supervisory board.[40]

## V. CONCLUSION

Obligatory recording of dissenting opinions of supervisory board members elected by employees proves to be ineffective and can even be counterproductive. It would suffice, as both the Czech and Slovak systems apply to all supervisory board members, that it would depend upon a respective board member whether he or she requests their opinion to yet it recorded in the minutes of the supervisory board meeting.[41] It seems also sufficient that a respective supervisory board member decides whether he or she exercises the right to speak at the general meeting and to communicate their different position. If a supervisory board member is expected to observe the duty to act with due professional care and diligence he or she would be competent enough to consider whether the oral presentation of different opinion at the supervisory board meeting is sufficient, or alternatively, whether it is desirable to record it in writing (in its substantial parts) and to present it subsequently at the general meeting. The opposite approach merely challenges the very expertness of the supervisory board members.

As for the remuneration of supervisory board members, it should be determined whether the amount of a fee can be set with a certain degree of independence, such as upon consideration by a third person (a professional) who would recommend the amount of a usual fee reflecting the specificity of a particular company and relating requirements for the performance of the position of a supervisory board member.[42] In this context, it is possible to look to German law, which does not expressly regulate obligatory remuneration of supervisory board members, yet it provides that the renumeration should correspond with the nature of the tasks of a supervisory board member and the economic status of a respective company.[43] We can see even in the Czech Republic an attempt to prevent the remuneration of supervisory board members to be fully incidental, namely in the case of companies with state assets.[44]

[40] It should be noted in this context that, under Czech law, the statutory duty to act with due professional care and diligence means to act in compliance with the interests of the company as a whole, i.e. to consider all significant circumstances including the interests of employees, but not only their interests. In British law, for example, there is an express statutory duty to promote the interests of the company employees (section 172 (1) b) of the Companies Act 2006).

[41] Section 450 (3) ZOK, and section 201 (3) ObchZ. A supervisory board member can apply for recording his or her dissenting opinion so that such member would be able to prove in the future, if needed, that he or she in their capacity as a supervisory board member acted with due care and diligence.

[42] If it is an competence of the general meeting to approve the renumeration, it may as well impose upon the board of directors a duty to arrange for a respective professional analysis of the issue.

[43] Section 113 (1) AktG.

[44] *The principles of remuneration of managers and members of bodies of controlled business companies with state assets and managers of state enterprises and other state organizations established by the law or a ministry*, as approved by Resolution of the Government of the Czech Republic of 12 December 2018, No. 835.