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Potential issues surrounding recall of managers in a two-tier system – how to effectively avoid problems in advance?

In a two tier-system in joint-stock companies in Slovenia, competences are divided between general meeting, supervisory board and management board. The division of competences under Slovenian Companies Act (ZGD-1) reflects to a high degree the one accepted in the German *Aktiengesetz*. Division of competences is mandatorily prescribed and cannot be changed by the provisions of a company's statute (Par. 2 Art. 183 ZGD-1).

The main characteristic of a two-tier system in Slovenia (like in Germany) is that the management board enjoys a greater autonomy than managers in a one-tier system. Pursuant to ZGD-1, the management board manages the business of a company independently and at its own responsibility (Par. 1 Art. 265 ZGD-1), whereas the supervisory board only supervises managing of a company by the management board (Par. 1 Art. 281 ZGD-1). In line with this, the management of a company cannot be transferred (delegated) to the supervisory board (Par. 5 Art. 281 ZGD-1).

ZGD-1 primarily ensures the autonomy of the management board through the provision of Par. 2 Art. 268, which provides that a member (or the president) of the management board can be recalled only:

- if a member/president seriously breaches his/her obligations;
- if a member/president is incapable of running business;
- if the general meeting passes a vote of no confidence, except where the vote of no confidence is passed for clearly unsubstantiated reasons; or
- if other economic and business reasons exist (significant changes in the shareholders' structure, reorganisation, etc.).

The above reasons are similar to causes (Ger. *wichtiger Grund*) in German law, which justify the recall of members of the management board by the supervisory board.

Looking at the described regulation, one can imagine that in case of a recall of member(s) of the management board disputes between the recalled managers and supervisory board (i.e. the company) are common, if the recalled manager thinks that he/she was recalled without cause and, in particular, where the company refuses to pay him/her a compensation.

Corporate law aspects of the recall

In accordance with settled case law supervisory boards' resolutions can either be null (Ger. *nichtig*) or challengeable (Ger. *anfechtbar*) according to the *mutatis mutandis* application of the provisions of the Obligations Code governing the invalidity of contracts.[1] With regard to the supervisory boards' resolutions on the recall of the members of the management board, the Slovenian Supreme court[2] has already adopted a position that such resolutions are null (Ger. *nichtig*), if a member of the management board was recalled without the existence of a cause referred to above.[3] The nullity of such resolutions must be enforced in a commercial civil procedure before the competent civil district courts,[4] whereas the claim must be directed against a company (and not e.g. against supervisory board). Unlike German courts, Slovenian courts in case of a recall without cause do not recognize and accept a so-called reintegration claim (i.e. claim that a recalled manager should be returned to a position of the member of the management board), which means that the recalled manager cannot be returned to the

[1] This position deviates from the position accepted in Germany, where supervisory boards' resolution in the absence of explicit regulation can be only null (Ger. *nichtig*).
[2] See e.g. judgement III Ips 56/2016 and judgement III Ips 23/2016.
[3] Such resolution is null in accordance with the *mutatis mutandis* application of Par. 1 Art. 86 of the Obligations Code, which provides that a contract that contravenes the constitution, compulsory regulations or moral principles shall be null and void if the purpose of the contravened rule does not assign any other sanction or if the law does not prescribe otherwise for the case in question.
[4] See e.g. principle legal opinion of the Supreme Court dated 12 June 2008.

function of the member of the management board.[5] Slovenian courts also limit the *ex tunc* effect of the nullity in the way that the recall is valid until the nullity of the resolution on the recall is declared with the final judgement.[6] This means that a new member of the management board is validly appointed and that there will be no problems related to "parallel directorship" or questions on "who is validly appointed director".[7]

On the basis of the above, it can be concluded that corporate aspects of the recall of the members of the management board are in principle clear. Having said that it must be pointed out that the courts have not yet addressed the question what happens if the resolution on the recall is adopted with "procedural breaches", e.g. if a resolution is not adopted with the prescribed majority, if the quorum is lacking or a member of the supervisory board was not afforded the right to participate at the meeting of the supervisory board etc. In these cases two questions arise. Firstly, depending on the nature of the breach, it is questionable, whether the resolution is null (Ger. *nichtig*) or challengeable (Ger. *anfechtbar*). An experienced lawyer will assert both possibilities in a lawsuit, otherwise there might be a risk that the court would reject the lawsuit. And secondly, it is questionable, whether courts would limit the *ex tunc* effect in the same manner as in the case of substantive breaches (i.e. in case, where neither the statutory cause for the recall existed at the time of the recall), or there might come to "parallel directorship" or to a conclusion that only unlawfully recalled manager are validly appointed.[8] This is yet to be seen, therefore in a potential dispute strong argumentation of either party might make a difference.

Resolution on the recall must be sufficiently reasoned

According to settled case law, a resolution on the recall must be sufficiently reasoned. In case that the resolution on the recall only states the statutory prescribed cause for the recall (or does not even state any cause), without sufficiently describing the circumstances and substantive causes/reasons for the recall, the recall is automatically unfounded (i.e. the resolution on the recall is null).[9] In addition, the courts only assess the existence of the cause for the recall within assertions contained in the resolution on the recall.

[5] This is not a huge difference in comparison to the German system, since it is not common in Germany that a recalled manager would be in fact returned to its position.
[6] See e.g. judgement III Ips 56/2016 and judgement III Ips 23/2016.
[7] See e.g. judgement III Ips 56/2016 and judgement III Ips 23/2016.
[8] Also German theory differentiates between substantive and procedural breaches.
[9] See e.g. judgement of the Supreme court VIII Ips 159/2016 and judgement VIII Ips 41/2018.

Therefore, in order to ensure that the resolution on the recall will be sufficiently reasoned and thus valid, an experienced lawyer should be involved to advise the client on how best to structure the reasoning and how detailed the reasoning should be.

Double legal position of the members of the management board

The most common issue surrounding the recall of the members of the management board are associated with a so-called "double legal position" of the members of the management board. On the one hand, members of the management board are in a so-called corporate relationship with a company, which was described above. On the other hand, members of the management board are also in certain kind of a "contractual" relationship with the company, which regulates e.g. remuneration of the members of the management board, their benefits, severance payments etc. Such a contract can be either civil law service contract or, pursuant to the Slovenian Employment Relationships Act (ZDR-1), also an employment contract, which means that in the latter case the member of the management board is also in an employment relationship with the company.

Similar to German law, Slovenian law completely separates the corporate legal position of the members of the management board and their contractual or employment relationships with the company related to these functions. Therefore, if a corporate function of the member of the management board terminates due to recall, this does not mean that such manager's contractual relationship or employment relationship with the company would automatically terminate as well. Contractual and employment relationships terminate according to their own rules.

Civil law service contract or employment contract?

The decision which contract should be concluded between a member of the management board and the company is, as always, the result of the negotiations between the parties. However, when negotiating, the parties should be aware of the differences between the two.

If a member of the management board has a civil law service contract concluded with the company for such a function, the member will not be in an employment relationship. This means that civil courts will be competent to decide disputes relating to such contracts (e.g. termination of the contract, payment of compensation in case of unlawful recall etc.). This is

very important in cases where courts decide on payment of compensation in case of an unlawful recall, since jurisdiction will be concentrated in one court (unlike in cases of employment contracts, see below). The civil court will first decide, whether the decision on the recall is valid[10] (as a preliminary question or as a main claim, which will become final) and then decide also on compensation due to unlawful recall. In addition to that, for the assessment of a contractual relationship (termination, remuneration etc.) only provisions of the contract and provisions of the Obligations Code will be considered by the court.[11]

On the other hand, if a member of the management board has an employment contract with the company for such a function, the member will be in an employment relationship, which means that provisions of employment law will apply and that labour and social courts will be competent to decide disputes relating to employment relationship. Here, a few points have to be emphasized.

Firstly, the employment relationship will not terminate automatically with the resolution on the recall, unless this would be explicitly specified in the employment contract. Please note that the provisions of the employment contract must be interpreted in favour of an employee, so the language of the employment contract has to be very clear in order to ensure that the employment relationship terminates at the same time as the corporate relationship. That both relationships terminate at the same time is strongly suggested, since this prevents complicated questions on how to lawfully terminate the employment relationship (e.g. who is responsible to give notice of termination, what is the lawful reason etc.). It is worth mentioning that a great number of disputes relate precisely to the issue, when the employment relationship terminated, which is caused by unclear or insufficient wording of the employment contract.

Secondly, in cases where the severance pay of the manager due to unlawful recall is agreed with the employment contract, labour and social courts will decide on the lawfulness of the decision on the recall as a preliminary question (i.e. whether the decision on the recall is valid),[12] unless this question has already been decided in a commercial civil procedure before the competent civil district courts (Art. 21 of the Labour and Social Courts Act) or they would optionally decide to stay the proceedings if the proceedings regarding nullity of the decision on the recall already run before the competent civil district court.[13] This means that there might be concurrent proceedings with regard to the question of lawfulness of the recall in place. Please note that due to their specific expertise, civil courts are in principle more competent to

[10] Or decision is null due to non-existence of statutory cause justifying recall.
[11] And potential other laws regulating civil law matters.
[12] Whether decision is null due to non-existence of statutory cause justifying recall.
[13] See e.g. judgement of the Supreme Court VIII Ips 41/2018.

decide on the lawfulness of the recall; however, considering that proceedings before the labour and social courts are usually shorter than proceedings before the civil courts, it will be often the case that the labour and social courts will in fact decide on the lawfulness of the recall irrespective of the fact that civil courts are more competent to decide on this matter.

And thirdly, in many cases employment contracts contain unclear provisions also with regard to the severance payment, so that it is unclear whether severance payment is agreed due to recall itself or "only" when at the same time also employment relationship terminates. In the former case, courts might adopt a position that the recalled manager (if the recall was unlawful) shall be entitled to the severance payment, whereas at the same time the recalled manager further stays in an employment relationship (and might be e.g. entitled to certain severance payment also when the employment relationship is terminated). In such cases it can be also unclear, which courts are competent to decide on "severance payment due to recall itself" (civil courts or labour and social courts).[14]

Considering all the above, companies are advised to seek counsel that would (i) advise on which type of the contract is most suitable to enter into considering expectations of the parties and potential problems that can arise, and (ii), in particular in cases of employment contracts (but also in case of civil law service contracts), carefully draft terms of the contract in order to avoid potential problems indicated above as much as possible.

Author:
Timotej Kozar, junior associate

[14] Case-law in this regard is rather unclear, since in certain cases courts regard severance payment due to recall as a corporate right, even though it is determined in the employment contract, see e.g. judgement of the Higher labour and social court Pdp 302/2018 and judgement of the Supreme Court VIII Ips 41/2018. In such case one might assert that civil courts are competent to decide in such a dispute.