

# **CORPORATE EFFECTS OF THE DANOSA CASE: IS THE TERMINATION OF MEMBERSHIP OF THE BOARD OF DIRECTORS ALLOWED IN THE CASE OF A PREGNANT BOARD MEMBER?**

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*Summary: The Court of Justice of the European Union (Second Chamber) on 11 November 2010 pronounced a judgment in the proceedings between Ms Dita Danosa and LKB Lizings SIA, a limited liability company, concerning the decision of the LKB general meeting of shareholders to remove Ms Danosa from her post as a member of the company's board of directors during her pregnancy. The Court's ruling could have significant repercussions on the appointment to and termination of the membership of boards of directors of capital companies in Europe. The authors analyse the corporate effects of the judgment in various countries from the point of view of the principles of company law and emphasise the difference in the contractual and corporate relationships which exist between a company and members of the board of directors. When analysing the ruling of the Court, the authors also point out the differences between public limited companies (both dual and single-board systems) and limited liability companies in terms of the position of members of the board of directors with regard to the termination of membership of the board.*

## **1 Introduction**

The Court of Justice of the European Union has a significant role in the interpretation and application of European Union directives. Although judgments of the Court are not considered as an immediate source of law for Member States, besides cases before the Court, they also have an influence on national legislation and the judgments of national courts. This is the reason why the Court, when rendering a judgment in a particular case, needs to evaluate not only the facts of the case before it combined with the applicable EU directives, but also the wider implications of its rulings.

The Republic of Croatia, soon to be a Member State of the EU, has a company law system based on the German and Austrian systems. Thus, alongside the provisions of Croatian company law in the area of termina-

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tion of membership of the board of directors, German and Austrian rules and, more importantly, legal practice will be analysed.

It will be shown that there are great differences in the positions of members of the board of directors in public limited companies (joint-stock companies) and limited liability companies in the above-mentioned legal systems. The Court did not consider these differences in its ruling. It is an omission of the Court, from the author's point of view, not to take into account company law rules and principles when rendering a judgment in the present case. It will be demonstrated that there is a way to protect the social and material rights of pregnant members of boards of directors without interfering in the widely accepted corporate rules on the termination of membership of the board of directors which protect the best interests of the company, but also the interests of the board members.

## **2 The Danosa case**

### ***2.1 The facts of the case***

On 21 December 2006, Ms Dita Danosa was appointed as a member of the board of directors of LKB Lizings SIA (hereinafter LKB), a limited liability company.<sup>1</sup> By a decision of 11 January 2007, LKB's supervisory board set the remuneration of the members of the company's board of directors and entrusted the chairman of the board with concluding all the necessary agreements for the implementation of the decision.<sup>2</sup>

The general meeting of shareholders removed Ms Danosa from her post as a member of the board of directors on 23 July 2007.<sup>3</sup> Ms Danosa considered she had been unlawfully dismissed from her position as a member of the board and brought an action against LKB before Riga Central District Court.<sup>4</sup> Given the fact that she was 11 weeks pregnant at that time, her dismissal was in breach of Article 109 of the Latvian Labour Code which prohibits the dismissal of pregnant workers.<sup>5</sup> On the other hand, Article 224 paragraph 4 of the Latvian Commercial Code authorises the general meeting of shareholders to dismiss a member of the board at any time, which according to Ms Danosa is in conflict with Article 109 of the Latvian Labour Code.<sup>6</sup>

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<sup>1</sup> Case C-232/09 *Dita Danosa v LKB Lizings SIA* [2010] ECR I-11405, para 20.

<sup>2</sup> *Danosa* (n 1) para 21. The nature of the contract concluded between Ms Danosa and LKB was not clear. According to the order for reference, no civil contract between Ms Danosa and LKB was concluded, although LKB asserts that a contract of agency had been concluded.

<sup>3</sup> *Danosa* (n 1) para 23.

<sup>4</sup> *Danosa* (n 1) para 24.

<sup>5</sup> *Danosa* (n 1) para 25.

<sup>6</sup> *Danosa* (n 1) para 25.

Ms Danosa's action was dismissed both in the first instance and on appeal. She lodged an appeal before the Latvian Supreme Court.<sup>7</sup> She claimed that even though she was a member of the board of directors of a capital company, she should be treated as a worker in the sense of EU law, namely Council Directive 92/85/EEC<sup>8</sup> of 19 October 1992 on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or breastfeeding (hereinafter Council Directive 92/85/EEC).<sup>9</sup> On the other hand, LKB argued that members of a capital company's board of directors do not perform their tasks and duties under the direction of another person, and thus cannot be treated as workers.<sup>10</sup>

The Latvian Supreme Court decided to stay the proceedings and to refer two questions to the Court of Justice for a preliminary ruling:

- a) are the members of the directorial body of a capital company to be regarded as covered by the concept of 'worker' within the meaning of Community law?
- b) is Article 224(4) of the Latvian Commercial Code, under which a member of the board of directors of a capital company may be dismissed without restriction, with no account being taken specifically of the fact that she is pregnant, incompatible with Article 10 of Council Directive 92/85/EEC and the case law of the Court of Justice?<sup>11</sup>

## **2.2 The Advocate General's opinion**

When considering the first question, Advocate General Bot pointed out the criteria for the concept of 'worker' under Council Directive 92/85/EEC. A person is regarded as a worker when three conditions are met: the performance of services, in return for remuneration, for and under the direction of another person.<sup>12</sup>

The question of performing duties under the direction of another was in fact a matter of dispute between Ms Danosa and LKB. The Advocate General concluded that a member of a capital company's board of directors can be regarded as carrying out his/her duties in the context of a

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<sup>7</sup> Danosa (n 1) para 26.

<sup>8</sup> Danosa (n 1) para 27.

<sup>9</sup> Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or breastfeeding OJ L348/1, 1-7.

<sup>10</sup> Danosa (n 1) para 28.

<sup>11</sup> Danosa (n 1) para 30.

<sup>12</sup> Danosa (n 1) Opinion of AG Bot, para 3.

relationship of subordination and, accordingly, can be treated as a worker within the meaning of Council Directive 92/85/EEC.<sup>13</sup> The fact that the parties did not conclude a contract of employment and concluded a contract of agency cannot determine the categorisation of their working relationship and whether the applicant was employed or self-employed for the purposes of Council Directive 92/85/EEC.<sup>14</sup>

The Advocate General concluded, after analysing the relationship between the applicant and LKB, that Ms Danosa was in fact a 'worker' because all three necessary conditions had been met:

- a) by virtue of the conditions in accordance with which she was appointed, she formed an integral part of the company;
- b) she performed her duties under the control of bodies such as the shareholders' meeting or the supervisory board, which she did not control or over which she was unable to exercise a decisive influence;
- c) she could be removed from her post by one or other of those bodies on the sole ground that they had lost confidence in her.<sup>15</sup>

When considering the second question, the Advocate General pointed out that the national court was in fact asking whether Article 10 of Council Directive 92/85/EEC must be interpreted as precluding national legislation under which a member of a capital company's board of directors can be removed from that position without any restriction, especially regarding her pregnancy.<sup>16</sup> In the Advocate General's opinion, Article 10 of Council Directive 92/85/EEC requires Member States to adopt the necessary provisions to prohibit the dismissal of a worker on grounds

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<sup>13</sup> Opinion of AG Bot (n 12) para 64. The Advocate General, among other things, points out that in order to assess whether a director is in a relationship of subordination, it is necessary to take into account all the elements which characterise that person's working relationship with the company and to have regard, in the course of that assessment, to the nature of his duties, Opinion of AG Bot (n 12) para 75.

<sup>14</sup> Opinion of AG Bot (n 12) para 67.

<sup>15</sup> Opinion of AG Bot (n 12) para 99. However, the Advocate General in his final conclusion in paragraph 131 of the Judgement, when writing about the conditions for considering a board member as a 'worker', points out she was performing her duties 'under the supervision of company bodies'. Although the Advocate General probably uses the words 'supervision' and 'control' as synonyms, we believe it is important to emphasise the possible differences between these two terms. The term 'supervision' is used in a dual-board system of public limited companies where supervisory boards have the authority to supervise the board of directors, but not the authority to give mandatory business instructions to the board. The term 'control', unlike the term 'direction' does not have a specific legal meaning in company law legislation and its use is merely explanatory. For further analysis, see n 23.

<sup>16</sup> Opinion of AG Bot (n 12) para 102.

**relating to her pregnancy.**<sup>17</sup> It does not prohibit dismissal **during** the period of protection laid down in Article 10 for workers if the termination is based on **other grounds** provided for under national legal systems.<sup>18</sup>

The Advocate General concluded that Article 10 of Council Directive 92/85 EEC precludes national legislation (eg Article 224(4) of the Latvian Commercial Code) under which a member of a capital company's board of directors may be removed from that position without restriction if the national legislation permits dismissal on grounds relating to pregnancy.<sup>19</sup> It is for the national courts to verify that the grounds for dismissing the board member are not related to pregnancy.<sup>20</sup>

### 2.3 The judgment<sup>21</sup>

When considering the first question, the Court, among other things, pointed out that the answer to the question of whether a relationship of

<sup>17</sup> Opinion of AG Bot (n 12) para 104.

<sup>18</sup> Opinion of AG Bot (n 12) para 104. Article 224(4) of the Latvian Commercial Code provides a lower level of protection than the national rules applicable to other workers, which is, in the Advocate General's opinion, not contrary to Article 10(1) of Council Directive 92/85/EEC under the condition that it applies to women workers who are in different situations, which could fall within the scope of the margin of discretion that Article 10(1) of the Directive expressly leaves to Member States, Opinion of AG Bot (n 12) para 107.

<sup>19</sup> Opinion of AG Bot (n 12) para 108.

<sup>20</sup> Opinion of AG Bot (n 12) para 109. If, however, the national court finds that the grounds for dismissal are related to pregnancy, Article 224(4) of the Latvian Commercial Code, for example, would not provide a lawful basis for that dismissal, Opinion of AG Bot (n 12) para 109.

<sup>21</sup> The second Chamber of the Court ruled as follows:

a) A member of a capital company's board of directors who provides services to that company and is an integral part of it must be regarded as having the status of worker for the purposes of Council Directive 92/85/EEC of 19 October 1992 on the introduction of measures to encourage improvements in the safety and health at work of pregnant workers and workers who have recently given birth or are breastfeeding (tenth individual Directive within the meaning of Article 16(1) of Directive 89/391/EEC), if that activity is carried out, for some time, under the direction or supervision of another body of that company and if, in return for those activities, the board member receives remuneration. It is for the national court to undertake the assessments of fact necessary to determine whether that is so in the case pending before it.

b) Article 10 of Directive 92/85 is to be interpreted as precluding national legislation, such as that at issue in the main proceedings, which permits a member of a capital company's board of directors to be removed from that post without restriction, where the person concerned is a 'pregnant worker' within the meaning of that directive and the decision to remove her was taken essentially on account of her pregnancy. Even if the board member concerned is not a 'pregnant worker' within the meaning of Directive 92/85, the fact remains that the removal, on account of pregnancy or essentially on account of pregnancy, of a member of a board of directors who performs duties such as those described in the main proceedings can affect only women and therefore constitutes direct discrimination on grounds of sex, contrary to Article 2(1) and (7) and Article 3(1)(c) of Council Directive 76/207/EEC of 9 February 1976 on the implementation of the principle of equal treatment for men and women as regards access to employment, vocational training and promotion, and working conditions, as amended by Directive 2002/73/EC of the European Parliament and of the Council of 23 September 2002.

subordination, which was one of the crucial questions of the dispute, exists within the meaning of the definition of the concept of 'worker' must, in each particular case, be arrived at on the basis of all the factors and circumstances characterising the relationship between the parties.<sup>22</sup>

In paragraph 39, the Court sets out the objective criteria for defining the concept of 'worker' for the purposes of Directive 92/85 according to the relevant EU case law. A person is considered to be a worker if she/he performs services for and under the direction of another person for a certain period of time, in return for which she/he receives remuneration. But, how do these objective criteria apply in cases such as the case at hand, when the person considered is a member of a directorial body of a company? The Court in paragraph 51 further interprets these objective criteria taking into consideration the specific duties entrusted to the board members, as well as the context in which these duties are performed and the manner in which they are performed. The Court provides additional criteria and remarks for deciding when a member of a board is to be considered a 'worker'. Board members who, in return for remuneration, provide services to the company which has appointed them and of which they are an integral part, who carry out their activities under the direction or control of another body of that company and who can, **at any time, be removed from their duties without such removal being subject to any restriction**, satisfy *prima facie* the criteria for being treated as workers within the meaning of the case law of the Court. However, when the Court summarised the criteria and considerations for a member of a capital company's board of directors to be a 'worker' for the purposes of Directive 92/85 in paragraph 56 of the judgment and, more importantly, in point 1 of the ruling, it surprisingly left out one of the remarks made in paragraph 51: removal from duties without any restriction. This is an omission of the Court which could have serious consequences for the understanding of the concept of a member of a board of directors as a worker in certain national legal systems.<sup>23</sup> The question of whether a

<sup>22</sup> Danosa (n 1) para 46. In this particular case, the fact that Ms Danosa was a member of the board of directors of a capital company is not enough in itself to rule out the possibility that she was in a relationship of subordination to that company. It is necessary to consider the circumstances in which the board member was recruited; the nature of the duties entrusted to that person; the context in which those duties were performed; the scope of the person's powers and the extent to which he or she was supervised within the company; and the circumstances under which the person could be removed, Danosa (n 1) para 47.

<sup>23</sup> For example, German law and national company law legislation which is based on German legislative solutions, eg that of Austria, Croatia, and Slovenia. Furthermore, the Court in paragraph 51 uses the term 'direction or control' of another body, but in paragraph 56, and more importantly in the first point of the ruling, uses the term 'direction or supervision'. This just goes to show that the Court is not aware of the different meanings of the words 'supervision' and 'control' combined with the term 'direction' in company law. Supervision is the duty of the supervisory board of a public limited company. Direction, on the other

director can scrutinise the removal according to the applicable company law rules is one of the key elements for establishing the relationship of subordination. It will be shown that the concept of a board member as a worker depends on the type of capital company.

When considering the second question, the Court followed the opinion of the Advocate General and went a step further in providing protection for Ms Danosa under Directive 76/207, which ensures equal treatment for men and women regarding access to employment, vocational training and promotion, and working conditions. Furthermore, the Court pointed out that whichever directive applies, it is important to ensure for the person concerned the protection granted under EU law to pregnant women in cases where the legal relationship linking her to another person has been severed on account of her pregnancy.<sup>24</sup>

The problem appears when the wording of point 2 of the ruling is read closely. The words ‘who performs duties such as those described in the main proceedings’ are not precise enough because of the differences in the criteria in paragraphs 51 and 56 of the judgment. The duties described in the main proceedings surely include carrying out activities under direction or supervision, **but what about removal from their duties without any restriction?** This is a question which asks for a precise answer because of the rules regulating the appointment and termination of membership of a board of directors in capital companies in certain European countries.

### **3 Termination of membership of the board of directors of a public limited company**

Capital companies are the most important types of legal entities for doing business in the Republic of Croatia and Europe in general. The duties and responsibilities of persons responsible for conducting the company’s business vary depending on the type of company.

The differences between the two-tier system (dual-board system) of a public limited company, the one-tier system (single-board system) of a public limited company, and corporate governance in limited liability companies need to be analysed and addressed taking into account the ruling in the Danosa case. Differences in the corporate position of mem-

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hand, is the duty of a board of directors of a single-board public limited company towards the executive officers of the company and the shareholders’ meeting of a limited liability company towards the board of directors. ‘Direction’ combined with ‘control’ thus refers only to a single-board public limited company and a limited liability company (paragraph 51), and ‘direction’ combined with ‘supervision’ refers to all types of capital companies.

<sup>24</sup> Danosa (n 1) para 70.

bers of boards of directors in these companies are greatly influenced by the appointment procedure and the reasons, possibilities and procedures for recall of the appointment of board members.

Various countries have different models and rules of corporate governance in public limited companies. In general, it may be stated that national laws either prescribe a one-tier system (single-board system)<sup>25</sup> or a two-tier system (dual-board system),<sup>26</sup> while some countries allow both systems.<sup>27</sup> This means it is up to every single company to choose which system it will have and to apply it in practice.<sup>28</sup> However, this should not be understood as the possibility of combining the systems, ie to pick and choose the rules which the company likes from either system. The right of choice should consequently also be viewed as an obligation to fully apply and follow the rules applicable to the chosen system<sup>29</sup> and equally to use the proper terminology.<sup>30</sup>

### **3.1 The dual-board system**

The dual-board system (two-tier system) of a public limited company is the usual system for the incorporation of public limited companies in Croatia. The reason for this is the fact that the possibility of choosing the organisation of a public limited company's boards has existed in the Croatian Companies Act since 2007. Until the Companies Act amendments in 2007, a dual board was the only option for the internal organisation of a public limited company. The influence of the German and Austrian legal systems on the Croatian legal system in the area of company law is thus more than evident.

Members of the board of directors in a dual-board system are appointed by the supervisory board for a maximum period of five years,

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<sup>25</sup> For example, Belgium, Denmark, Greece, Ireland, Spain and Switzerland.

<sup>26</sup> For example, Austria, Germany and Poland.

<sup>27</sup> For example, Croatia, France, Italy and Slovenia.

<sup>28</sup> Very few companies have, for example, chosen the one-tier system of corporate governance in Croatia since this possibility was introduced into the Croatian legal system in 2007.

<sup>29</sup> For example, the corporate structure of INA, the Croatian national oil company, is a typical case of picking and choosing rules from both systems. Even though INA is a dual-board company, the board of directors appointed a group of so-called executives in an Executive Committee, which is not allowed according to the dual-board rules of corporate governance. This practice may lead to problems of misrepresentation, legal uncertainty and to confusion for third parties.

<sup>30</sup> For example, in Croatian practice, companies managed by the two-tier system sometimes use an expression such as 'president and chief executive officer', although the person is president of the board of directors. Similarly, a person who is a member of the board of directors may be called 'senior vice president'.

with the possibility of re-election.<sup>31</sup> The appointment is the exclusive right and duty of the supervisory board and cannot be delegated to another body, commission, etc.<sup>32</sup> For the appointment to be valid, the decision of the supervisory board needs to be declared to the future board members and accepted by the members of the board. Recall of appointment of a member of the board of directors is also the responsibility and right of the supervisory board. A member of a board of directors can be recalled only when an **important reason** for his/her recall exists.<sup>33</sup> The existence of an important reason as grounds for recall of a board member is the expression of a rule by which a board of directors manages company business independently without the interference of other company bodies. This rule ensures the much needed autonomy of the board of directors by preventing arbitrary and frivolous recalls by the supervisory board.<sup>34</sup> The rule is vital for encouraging members of the board of directors to be creative and to take reasonable business risks.<sup>35</sup> Members of the board of directors need to be in a position of not conducting the company's business according to the instructions and desires of a supervisory board, taking into account first and foremost the criteria of a reasonable businessman.<sup>36</sup>

The existence of an important reason for the recall of an appointment must be determined individually in each particular case.<sup>37</sup> An important reason is thus a legal standard which gains its substance with each decision of a supervisory board. The supervisory board needs to determine facts which are important and grave enough to constitute an important reason. If the decision of the supervisory board is based on a reason which in the opinion of the member of the board is not important, the recalled board member has the right to determine the validity or invalidity of his/her recall in a court of law.<sup>38</sup> Thus, the courts have the final word in deciding whether the termination of membership of a board of directors has been conducted lawfully.

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<sup>31</sup> Article 244(1) of the Croatian Companies Act, Official Gazette of the Republic of Croatia, No 111/93, 34/99, 52/00, 118/03, 107/07, 146/08, 137/09; Article 84(1) of the German *Aktiengesetz*; Article 75 (1) of the Austrian *Aktiengesetz*.

<sup>32</sup> J Barbić, *Pravo društava - društva kapitala*, vol 1 (Organizator 2010) 688.

<sup>33</sup> Croatian Companies Act (n 31) Article 244(2); Article 84(3) of the German *Aktiengesetz*; Article 75(4) of the Austrian *Aktiengesetz*.

<sup>34</sup> Barbić (n 32) 763.

<sup>35</sup> Barbić (n 32) 763.

<sup>36</sup> J. Barbić, 'Board of Directors in Capital Companies' (1997) *Hrvatska gospodarska revija* 1327.

<sup>37</sup> Barbić (n 32) 764.

<sup>38</sup> Croatian Companies Act (n 31) Article 244(2); Article 84(3) of the German *Aktiengesetz*; Article 75(4) of the Austrian *Aktiengesetz*.

Important reasons for the recall of a board member include gross breaches of duty by the board member, inability to conduct the company's business in an orderly way, and withdrawal of confidence by the general meeting.<sup>39</sup>

### 3.1.1 *Gross breaches of duty*

For the existence of gross breaches of duty it is not important to prove the guilt or gross negligence of the board member.<sup>40</sup> When deciding on the existence of such a reason for recall, the supervisory board needs to take into account the best interests of the company. Insignificant and minor breaches of duty (eg minor offences) cannot usually constitute an important reason for recall of a board member. Examples of many different gross breaches of duty can be found in the extremely rich and diverse German judicial practice.<sup>41</sup>

### 3.1.2 *Inability to conduct the company's business in an orderly way*

This reason exists when a board member is not capable of carrying out all usual, standard activities as a board member, and also when a board member no longer has certain characteristics and qualities which made him/her the best candidate for membership of the board of directors.<sup>42</sup> Guilt or gross negligence is not a requirement for recall for this particular reason.<sup>43</sup> German judicial practice is once again the main source of examples of inability to conduct a company's business in an orderly manner.<sup>44</sup>

<sup>39</sup> Croatian Companies Act (n 31) Article 244(2); Article 84(3) of the German *Aktiengesetz*; Article 75(4) of the Austrian *Aktiengesetz*.

<sup>40</sup> Barbić (n 32) 764.

<sup>41</sup> U Hüffer, *Aktiengesetzkommentar* (Verlag CH Beck 2010) Rn 28 § 84 *Aktiengesetz*; G Spindler in W Goette, M Habersack and S Kalss (eds), *Münchener Kommentar zum Aktiengesetz*, vol 2 (Verlag CH Beck, Verlag Franz Vahlen 2008) Rn 120 § 84 *Aktiengesetz*; M Weber in W Höllers (ed), *Aktiengesetz Kommentar* (Verlag CH Beck 2011) Rn 74 § 84 *Aktiengesetz*. On Austrian law, see S Kalss, C Nowotny and M Schauer, *Oestereichisches Gesellschaftrecht* (ManzVerlag 2008) 655. For example, concluding speculative contracts; criminal offences of board members, even in the private domain; taking and giving bribes; usurping company assets; extraordinarily high company indebtedness; inappropriately high indebtedness of board members; inappropriate conduct by a board member that is damaging to the reputation of the company; using the position as board member mainly for personal profit; manipulating financial reports of the company; manipulating stored goods of the company; verbal and physical attacks on shareholders; acting against Corporate Governance Codes. These cases can also be applied in Croatian law, Barbić (n 32) 764 and 768.

<sup>42</sup> J Pichler and E Weninger, *Der Vorstand der AG*, (LexisNexis Verlag 2004) 37.

<sup>43</sup> Pichler and E Weninger (n 42) 38.

<sup>44</sup> Hüffer (n 41) Rn 28 § 84; Spindler (n 41) Rn 120 § 84 *Aktiengesetz*; Weber (n 41) Rn 74 § 84 *Aktiengesetz*. For example, lack of necessary skills and knowledge of the board mem-

### 3.1.3 Withdrawal of confidence by the general meeting

The general meeting of the shareholders does not have a direct influence on the appointment and recall of board members. This is the exclusive authority of the supervisory board. There is no hierarchy between the bodies of a public limited company. The general meeting, on the other hand, has the authority to exonerate members of the board of directors for their conduct of the company's business. If the general meeting refuses to exonerate a member of the board, this constitutes one of the important reasons for the recall of a board member. In such a case, the supervisory board can decide to recall a member of the board of directors, but will not do so if the vote to refuse to exonerate a member of the board was reached on an evidently unjustifiable basis.<sup>45</sup>

## 3.2 The single-board system

The board of directors and general meeting are the mandatory bodies of a public limited company with a single-board organisation system. The board of directors must appoint at least one executive officer. The single-board system of organisation concentrates the duties of conducting the company's business and the supervision of the conduct of the company's business in a single body: the board of directors.<sup>46</sup> The board of directors has the authority to decide on all significant business decisions, the strategic management of the company, and the way of conducting the company's business. Executive officers, on the other hand, are authorised to conduct the company's business on a day-to-day basis.

Even though they conduct the company's business, their position is quite different from the position of a board of directors in a dual-board system. Executive officers need to conduct the company's business subject to the direction, control and mandatory instructions of the board of directors. They can be recalled at any time, without any particular, important reason, and without the possibility of scrutinising the justification for the decision of the board of directors in a court of law.<sup>47</sup> The decision

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ber, unreliability of the board member, animosity towards other members of the board, etc. Long-lasting sickness and health problems are also considered as reasons for termination of membership of a board of directors. Although pregnancy and long-lasting sickness cannot be compared in any way, this reason for recalling a director could be relevant in the context of the *Danosa* case. Certain health problems are not gender neutral and can affect only women or men. Could Council Directive 76/207/EEC also be applied analogously in these cases? Our position is that it cannot, because corporate rules are a *lex specialis* for such hypothetical situations.

<sup>45</sup> Croatian Companies Act (n 31) Article 244 (2); Article 84 (3) of the German *Aktiengesetz*; Article 75 (4) of the Austrian *Aktiengesetz*.

<sup>46</sup> Barbić (n 32) 1006.

<sup>47</sup> Barbić.(n 32) 1006.

of the board of directors of the company does not need to be adopted in any particular form. Therefore, we can conclude that a hierarchy of relations exists between the board of directors and the executive officers in single-board public limited companies. This conclusion basically means that the existence of control and supervision of the board of directors over executive officers makes executives suitable candidates to be considered as 'workers' within the meaning of Council Directive 92/85/EEC.

#### **4 Termination of membership of the board of directors of a limited liability company**

Limited liability companies are the most common legal entity in the Republic of Croatia.<sup>48</sup> The board of directors and shareholders' meeting are the mandatory bodies of a limited liability company. The supervisory board is an optional body, mandatory only in several cases required by law.<sup>49</sup> When comparing the duties and responsibilities of bodies in a limited liability company with those of public limited company bodies, we can conclude that the relationship between the bodies in a limited liability company is similar to the structure of a single-board public limited company.<sup>50</sup> Directors of a limited liability company have essentially the same corporate position as executive officers in a single-board public limited company.

The board of directors of a limited liability company needs to conduct the company's business in accordance with the articles of association of the company, decisions of the company's shareholders and mandatory instructions of the shareholders' meeting and supervisory board, if the company has one. The shareholders' meeting is a body which has a prior duty and responsibility to appoint and recall the directors of the company.<sup>51</sup> This authority can be transferred to the supervisory board, some or just one of the shareholders or to certain other bodies of the company.<sup>52</sup> Members of the board of directors can be recalled at any time<sup>53</sup> by the shareholders' meeting or supervisory board, without any particular or important reason, and without the opportunity to scrutinise the justification for the decision in court proceedings. The decision of the shareholders' meeting or supervisory board of the company does not need to be explained or elaborated on in any particular form. Shareholders may

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<sup>48</sup> As they are in other European countries.

<sup>49</sup> Croatian Companies Act (n 31) Article 434(1, 2).

<sup>50</sup> J Barbić, *Pravo društava - Društva kapitala*, vol 2 (5<sup>th</sup> edn 2010) 320.

<sup>51</sup> Croatian Companies Act (n 31) Article 441(1).

<sup>52</sup> Barbić (n 50) 335.

<sup>53</sup> Croatian Companies Act (n 31) Article 424(1); Article 38(1) of the German *GmbHGesetz*; Article 16(1) of the Austrian *GmbHGesetz*.

prescribe the possibility of recalling a board member in the articles of association only where there is an important reason, but this possibility is rarely used and is not recommended.

In limited liability companies, the directors of the company are often shareholders of the same company.<sup>54</sup> If we take into consideration the criteria of the Court for the concept of a 'worker', in a case where the major shareholder is also a member of the board of directors, the criterion of performing duties under 'direction and supervision' is not met. At the same time, the majority shareholder is not likely to dismiss her/himself.

## 5 Implications of the judgment of the Court

### 5.1 Substantive issues

First of all, it is to be stressed that the relationship between the director of the company and the company itself is twofold. On the one hand, it is purely contractual (eg a work contract, agency contract, management contract), and on the other is based on the provisions of corporate law.<sup>55</sup> The latter means that the position of the director is based on the provisions of the corporate laws (corporate governance) providing for his/her competences and rights and obligations *vis-a-vis* the company. Probably, the basic feature of this relationship is the trust of the company<sup>56</sup> towards its director. A company is and should in principle always have the opportunity to appoint and remove from office a director who does not satisfy the managerial requirements imposed upon him/her, as defined by the company's policy, objectives and business plans.<sup>57</sup>

Of course, the issue of appointment, and even more so removal from office, is regulated by law and it is at the company's discretion only within

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<sup>54</sup> This is not a surprise because limited liability companies are a legal form much more suitable for small and medium businesses. The case where the same person is at the same time a sole director of the company and the only shareholder is quite common.

<sup>55</sup> This is clearly stated in Article 244(2) of the Croatian Companies Act and Article 84(3) of the German *Aktiengesetz* for public limited companies and in Article 424(1) of the Croatian Companies Act and Article 38(1) of the German *GmbHGesetz* for limited liability companies. The provision basically states that the recall of the director from the position of member of the board does not in any way influence rights arising out of a contract between the company and a board member.

<sup>56</sup> This primarily means the company shareholders and, depending on the legal form of the company, other corporate bodies, eg in the case of a public limited company governed by a dual-board system, the supervisory board.

<sup>57</sup> Lack of trust by the company in the director's skills and dissatisfaction with his/her performance should be sufficient grounds for his/her removal from office. In this respect, it should be borne in mind that the director is the company's legal representative and its proxy, and his actions are considered as the actions of the company. Thus, anything that the director does has a direct effect on the company's well-being, its position on the market and ultimately its destiny and future.

the framework set out by the law. This means that the articles of association of a company may regulate the issue of appointment and removal from office only to the extent that the law allows and may not go beyond this. The level of the company's autonomy in this respect depends, as shown in the prior sections of this note, on the legal form of the company. In general terms, it may be stated that the highest level of autonomy exists in a limited liability company while, by way of contrast, provisions are mostly mandatory in a public limited company with a dual-board system.

Even if we take as the starting point the fact that different internal organisations of various companies, depending on their legal form and corporate governance systems, provide for different rules regarding the recall of directors, it should ultimately always be remembered that, as pointed out, the director needs to enjoy the trust of the company, since otherwise the whole system of corporate governance is in vain.

Taking that trust as the focal point, from the corporate law point of view, it is actually of no relevance what the reason is for the lack of trust.<sup>58</sup> This is notably so in the case of directors in **a limited liability company** and in **a single-board public limited company**. Thus, if a director may be recalled without any particular reason and without the legal obligation of the company to justify the recall,<sup>59</sup> it makes no difference whether this was done due to long-term illness, managerial incompetence or the company's general dissatisfaction with the director. Consequently, if a company<sup>60</sup> believes that its director no longer enjoys its trust, he/she may be recalled. Even more so, if the company concludes that the director is not capable of performing his/her tasks, he/she may be removed. In an objective factual situation that a director is in a position that he/she may not come to work or not work sufficiently to satisfy the needs of the company, the company should have every right to recall the director. There should be no doubt about this, irrespective of the reasons for this situation, whether it is due to the director's health, laziness, taking up

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<sup>58</sup> In spite of this, it naturally depends on legal provisions as to whether the recall of a director may only be due to an important reason (as is the case in a dual-board public limited company) or whether he/she may be removed from office without any particular reason (executive directors in a single-board public limited company and directors in a limited liability company).

<sup>59</sup> This results in the logical consequence that the recall may in principle not be scrutinised, even by a court. Nevertheless, if the recall is carried out contrary to the provisions of the contract (of whatever type) between the company and director, this might lead to the company's obligation to compensate the director. At the same time, however, recall is considered valid from the point of view of corporate law and the recalled person is no longer considered to be a director of the company.

<sup>60</sup> I.e., the corporate body responsible for making the decision on the director's removal from office.

additional work or starting a private business. Bearing in mind the need to take care of the well-being of the company, this should apply even in the case of the pregnancy of a female director of the company. Company law, especially in a limited liability company does not deal with the reasons for a lack of trust. Therefore, protection with regard to pregnancy or protection of any other kind should not interfere with the shareholders' rights to remove a director from his/her corporate position at any time. One of the main features of a limited liability company is the shareholders' key influence on conducting company business. If legislation and jurisprudence start to limit this influence, which is mainly based on the shareholders' right to remove directors from their position at any time (for example, if members of the board refuse to follow through the business decisions of shareholders), this could diminish the attractiveness of limited liability companies for future investors.

In this respect, it must be stressed that recall is actually not carried out because of pregnancy (which would definitely be contrary to anti-discrimination laws), but because of the fact that the director is not in a position to perform her duties. To emphasise, removal from office is not a consequence of pregnancy, but a consequence of the inability of the person concerned to perform her duties as a director, whatever the reason for this.

It could be stated that any employee who is dismissed because of pregnancy is being dismissed because they are unable to work rather than because of pregnancy. These are, however, two different situations. When an employee is dismissed, the company terminates all relations between the employee and the company by terminating the employee's employment contract or any other similar contract. Recall of a female director does not necessarily mean the termination of a labour, agency or any other similar contract between the director and the company. Only the corporate relationship between the director and the company is being severed, while the contractual relationship is resolved according to the applicable contractual rules (primarily the contract) and not corporate rules. This actually means that the director's salary and other material rights can be protected according to national and international pro-maternity regulations. In other words, pregnant directors will be paid according to their contract during their pregnancy and maternity leave, but they will not perform the director's duties. Furthermore, the duties and responsibilities of a director and any other employee, regardless of the employee's position and importance, are quite different. The will of the director is the will of the company, even though the director in a limited liability company needs to perform under the directions of the shareholders if the shareholders wish to exercise their right to give mandatory instructions. Board members are legal representatives of the company, and

their right to represent the company cannot be limited. The position of a board member is thus much more similar to the position of an employer rather than that of an employee.

As noted in the paragraph above, a completely different issue is that of respect for a female director's right as a pregnant woman. Her financial and social rights arising from the contract with the company should be respected and fully honoured. It should be noted once again that according to the rules and principles of company law, the relationship between the director of the company and the company itself is twofold. One is purely contractual and the other is based on the provisions of corporate law. When accepting an appointment, a director negotiates the terms of the employment/management/agency contract between her/him and the company (e.g. salary, stock/share options, bonuses, termination of contract). Premature termination of a corporate relationship does not necessarily mean the termination of a contractual relationship. Managers usually negotiate financial compensation for recalls of appointment such as lump sum monetary payments or a couple of months' salary after the termination of their appointment. This means that a pregnant director's rights arising from the contract should be protected via pro-maternity legislation in the same way in which the rights of pregnant workers are protected. Extending such protection to the corporate law sphere could be detrimental to the well-being of the company.<sup>61</sup>

The situation is different in the case of a **dual-board public limited company**, whose director may be removed from office only for an important reason and with the necessity of stating the reason in a decision which is subject to supervision by the courts. Such important reasons might be gross negligence in the performing of the director's duties (gross breaches of duty), inability to perform those duties or a lack of trust towards the director by the shareholders. Thus, the difference in comparison with limited liability and single-board public limited companies is in the obligation of the company to state the reason for the recall of the director. However, in the case at hand there is actually no crucial substantive difference. In principle, in a dual-board public limited company, if a director is incapable of performing his/her duties due to sickness, there is an important reason for his/her recall. Any reason leading to the impossibility of performing his/her duties provides sufficient grounds

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<sup>61</sup> We might imagine a situation where the articles of association provide for only one director. If the current director may not be recalled, the company's actual existence is jeopardised. A similar situation is where two or more directors exercise joint representation of the company. This cannot be remedied by a simple change in the articles of association, because the procedure for changes in the articles of association is much more complex than the procedure for the recall of the appointment of a director, especially in single-board public limited companies.

for recall. This should also apply to pregnancy. However, as previously stressed, the reason for recall is not the pregnancy itself, but rather the fact that the pregnant director cannot perform her duties, if that is the case.<sup>62</sup>

## **5.2 Procedural issues**

If we compare limited liability and single-board public limited companies on the one hand, and dual-board public limited companies on the other with regard to the recall of a director, there are differences with respect to procedural issues as well as with respect to substantive ones. This is the consequence of the legal requirements that are the precondition for the recall of a director and the obligation to justify and state the reasons for such recall in a dual-board public limited company.

The reasoning of the Court in the present case opens the door to problems, especially in the case of the recall of a director in limited liability and single-board public limited companies. As already stated, in these companies a director may be removed from office without the need to justify the removal and without the necessity to state the reasons for it. That being so, one may wonder how the court could be in a position to scrutinise the recall at all from the substantive point of view. If there is only a decision on recall, a recalled director cannot actually claim that the removal was not justified, since the law does not oblige the company to justify the removal. So, in the situation at hand, how could a pregnant director prove that the recall was due to pregnancy if the decision to remove her does not state any reason at all? Taking into account the ruling of the Court, German legal theory is already advising shareholders' meetings of German limited liability companies to justify their decisions to recall pregnant members of the board with certain other reasons and facts which are not connected to pregnancy, even though there is no such obligation under German law.<sup>63</sup> Should the burden of proof then lie on the director or on the company? In a lawsuit against a company for the illegal recall of an appointment, the burden of proof lies on the plaintiff, the recalled director. However, in the case of a lawsuit of a pregnant director, the grounds for the lawsuit are in fact anti-discrimination laws. This basically means that the burden of proof is on the company. If it lies on the company, it would be its obligation to prove that the removal was not due to pregnancy, since there would be a logical natural presumption that this was precisely the reason for recall. It would almost be impos-

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<sup>62</sup> It should at the same time be stressed that there should be no important reason for recall if a pregnant director performs her duties.

<sup>63</sup> U Baeck and T Winzer, 'Mitglied des Vertretungsorgans einer Gesellschaft als Arbeitnehmer' (NZG 2011) 101 <<http://beck-online.beck.de>> accessed 30 August 2012.

sible to prove this. The final consequence would be that anti-discrimination laws, with all the best intentions, would lead to a practical change in the corporate law provisions regarding the recall of directors of certain types of companies.

An additional problem might arise if the director was recalled not only because she could no longer perform her duties, but also due to the internal reorganisation of the company. Should the company then be stuck with the current but ineffective organisation which does not match its business needs?

## **6 Conclusion**

When ruling in the case at hand, the Court took into consideration the pro-maternity and anti-discriminatory provisions of EU directives, namely Council Directive 92/85/EEC, referred to in the first point of the judgment and Council Directive 76/207/EEC, referred to in the second point of the judgment. An analysis of the Court's reasoning, combined with the rules of company law and the doctrine of certain European countries, indicated the following conclusions for the first and second points of the judgment:

1) Pregnant members of the board of directors in dual-board public limited companies cannot be considered as 'workers' within the meaning of Council Directive 92/85/EEC, because their activity is not conducted under the direction and control of another body. On the other hand, pregnant members of the board of directors in limited liability companies and executive officers in single-board public limited companies can be considered as 'workers' within the meaning of Council Directive 92/85/EEC. The problem in these cases is the fact that under company law rules these board members and executives can be recalled from office at any time without the reason for their recall being stated. These board members do not have the opportunity, unlike board members of public limited companies, to scrutinise the decision in court proceedings which could result in their reinstatement to the position of board member or executive.

2) Council Directive 76/207/EEC basically prohibits the recall of board members essentially on account of their pregnancy. It would be much easier to apply these rules in the case of a public limited company's board of directors, because the decision of the supervisory board needs to be substantiated with reasons for the recall, usually in written form. However, if a pregnant member of the board cannot perform her duties in an orderly way, according to company law rules, this is reason enough to remove the board member from her post. A commercial court judge ruling in a hypothetical case such as the case at hand (but in a public lim-

ited company) would probably rule in favour of the company if national company law rules remain the same as they are now. On the other hand, members of boards of directors in limited liability companies and executive officers in single-board public limited companies do not even have to be informed of the reasons for their removal from the post, because of the corporate governance rules for these types of companies. Commercial court judges would probably have trouble with the implementation of anti-discrimination laws in pure and simple corporate proceedings. This would especially be the case in new EU Member States, including the soon-to-be member Croatia. For example, Ms Danosa's action was dismissed both in the first instance and on appeal prior to the appeal on a point of law before the Latvian Supreme Court. This basically means that commercial court judges should keep themselves informed of the existence of such EU and national legislation and the need to apply not only corporate but also anti-discrimination rules. This, however, does not mean that widely accepted corporate rules should be undermined by anti-discrimination ones. Thus, the termination of a purely corporate relationship between a pregnant director and a company should be governed mainly by company law rules and legislation. The termination of a purely contractual relationship between the director and the company which is the basis for all welfare and material rights of the pregnant director is a separate issue, and this contractual relationship (which includes all material rights) should be protected under relevant anti-discrimination rules. It is important to stress once more that members of the board of directors are in fact legal representatives of companies and their position is basically similar to the position of employers and not employees. Therefore, directors are usually excluded from the protection provided for by national labour legislation.<sup>64</sup>

It once again needs to be stated that **the Court does not take into account the existence of two different and essentially independent relationships (corporate and contractual) between the company and the members of the board.** The right approach of the Court should be, in the authors' opinion, the protection of the contractual relationship between the pregnant member of the board and the company according to the applicable EU legislation, leaving at the same time the corporate relationship to the widely accepted rules of company law. According to this approach, all the material, financial and social rights of the pregnant member of the board would be protected, as well as the rights and well-being of the company as an independent legal entity.

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<sup>64</sup> For example, the Croatian Labour Act, *Official Gazette of the Republic of Croatia*, No 149/2009, Article 2(4) states that if a member of the board of directors has entered into a labour contract with the company, the provisions of the Labour Act governing the termination of labour contracts are not applied.

It should be noted that the extension of the judgment to the corporate relationship, and analogous possible amendments in national company law legislation could be counter-productive. It could result in the reduction or stagnation of the number of female members of boards of directors because companies cannot exercise their corporate rights under national legislation towards men and women equally, or it could result in a decrease in the mandate period for female members of the board.

One should not doubt that such effects were definitely not intended by the Court's judgment. On the contrary, the Court was no doubt motivated simply by the desire to respect and uphold existing anti-discrimination legislation. Equally, the aim of the authors of this note is not to undermine the importance of or to criticise anti-discrimination law, rather to emphasise the need to take into account their co-existence with company law. It seems we are now facing the undesired situation that one of them has to be given preference at the expense of the other. In order to avoid this, it might be necessary to adopt special provisions which would explicitly provide for the preservation of the social rights of a pregnant female director, while maintaining the effects of general corporate law.