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Participation in the meetings of supervisory and management board

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von
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A. Introduction

The scope of this paper is the formal participation in the meetings of Supervisory and Management Board. Content of the participation, that is the duties and responsibilities, are only dealt with, as they pertain to question of selection of members or the laws of procedure which govern the two organs.

B. Supervisory Board

I. Size

1. Specifications of the German Joint-Stock Corporation Act

The minimum number of board members of the supervisory board (SB) is three. The articles of incorporation however can determine any number of members as long as it can divided by 3. The maximum number of members is determined by the amount of registered capital: Up to € 1,5 Million the maximum number is 9, beyond € 10 Million it is 21 members. Any corporation within these limits has a maximum number of 15 members.[1]

2. Modifications by the Laws of Co-Determination

There are three laws of Co-Determination which modify the number possible or mandatory within the supervisory board:

- The Co-Determination Act (Mitbestimmungsgesetz – MitbestG)

  Imposing rules for companies with a number of more than 2000 employees. An important division is to be made between the legal entity of corporation and the definition of *Betrieb* (~plant, company) as is used in the MitbestG. They are independent, e.g. two companies working at one factory (joint venture) could form one *Betrieb*.

  The number of members of the SB is determined by the number of employees of the *Betrieb*: Up to 10.000 the size is 12, up to 20.000 the size is 16 and with more than 20.000 employees the size is 20

[1] § 95 I AktG (Public Corporations Act 1965).

members. Half of the members are employers or delegates from the unions.

- The One Third Participation Act (Drittelbeteiligungsgesetz – DrittelbG)

  Imposing rules for companies with a number of employees more than 500 but less 2000. As the name suggests: one third of the members of the SB are to be delegated from the work-force.

- The Montan Co-Determination Acts (Montanmitbestimmungsgesetz – MontanMitbestG, Montan-Mitbestimmungs-Ergänzungsgesez - MonMitbestErgG)

  Regulating the composition of the supervisory board within corporations of the Montan-Industry, that is the mining, steel- und iron-producing companies. If the company employs more than 1000 workers the supervisory board consists of 11 members.

  The owners and the workers each are represented with 5 members. The 11th member, the so called neutral member, is elected by a process of proposition and approval of the general assembly. It is possible to augment the size to 15 and 21, if the amount of registered capital is more than 10 or 25 Million respectively.

II. Election process

In principal the members of the supervisory board are being elected by the general assembly with the (simple) majority of the votes.[2] The bye-laws however can make adjustments to the specific needs of the corporation. It can provide for a larger number of votes.

The election by list (or en bloc) is possible, when the chairman of the assembly points out the shareholders to vote against the list and thus force the single election of each member.[3] If only one of the shareholders objects

[2] § 101 I 1 AktG.

[3] Roth/Wörle "Die Unabhängigkeit des Aufsichtsrats - Recht und Wirklichkeit," *ZGR* 2004, 576; Hüffer § 101, Rn. 6; Henze, Hartwig, "Neuere Rechtsprechung zu Rechtsstellung und Aufgaben des Aufsichtsrats" *BB* 2005, p. 170.

to the list election, the single election has to follow as well.[4] In practice the list election, however, still prevails. It is also possible to adjunct the right to name a member of the board to a specific stock ("privilege of delegation").[5] In this case there is no election at all.

If Co-Determination rules apply the general principals only apply to the owner side of the board members. The worker's members of the board are being elected by a ballot-vote or, at large corporations, a two-tier election process of delegates electing the members.[6]

III. Selection of Members

1. Legal Requirements

a. Statutory

A member of the supervisory board may not be a company itself but need to be a natural person, which has no restriction of making legal transactions.[7]

Most evident restriction, considering the separation of management- and control-function, is that any member of the management board or with similar authorities equipped person may not be part of the supervisory board.[8]

Furthermore the member is restricted to holding 10 positions on supervisory boards of commercial companies with a mandatory supervisory board.[9] Within an affiliated group, however, 5 positions are not counted.[10]

Another disqualification cause which is caused by the construction of an affiliated group is that the legal representative of a dependent company may

[4] LG München I ZIP 2004, 853.
[5] § 101 II AktG ("Entsendungsrecht").
[6] § 9, §§ 15 ff MitbestG.
[7] § 100 AktG.
[8] § 105 AktG.
[9] § 100 II Nr. 1 AktG.
[10] § 100 II 2 AktG.

not serve as a member of the supervisory board.[11] Even if two companies are independent there is restriction on an informal, personal level, if there are cross-over mandates (also called interlocking directorate). In cross-over mandates a member of a management board (MB) of one company is member of the supervisory board of the second and vice versa. These cross-over mandates are also prohibited.[12]

b. Self-Regulation

Apart from these statutory rules there is a supplementing regime of non-statutory rules for corporations, which are listed at a stock-exchange. Via reference to the Corporate Governance Code (DCGK) the self-regulatory comply-or-explain approach has been adopted.[13] Companies are obliged by law to publish a statement of their compliance with the code on their homepage or in another similar way. The average compliance to the recommendations of the DCGK is 82,9%; to the "shall"-recommendations 61,2%.[14] Hence the companies need to explain any deviation of the following specifications of the DCGK:

The maximum number of possible positions on supervisory boards is reduced to 5.[15] There shall not be more than 2 members of the supervisory board who have been members of the management board.[16] There should also not be the custom changing from the management directly to the supervisory board.[17] This is especially relevant in the person of the chairman of the board of management. Comparable to regulations in the USA a cooling-off period has been proposed.[18]

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[11] § 100 II Nr. 2 AktG.
[12] § 100 II Nr. 3 AktG.
[13] § 161 AktG.
[14] For comprehensive and recent collection of statistics: v. Werder, Axel und Talaulicar, Till, "Kodex Report 2007: Die Akzeptanz der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex" *DB* 2007, 869-875.
[15] 5.4.5. DCGK.
[16] 5.4.2. DCGK.
[17] 5.4.4. DCGK.
[18] With further references: Rode, Oliver, "Der Wechsel eines Vorstandsmitglieds in den Aufsichtsrat - eine gute Corporate Governance? - Neuregelung in Ziff. 5.4.4. Deutscher Corporate Governance Kodex" *BB* 2006, p. 343.

There are a couple of DCGK specifications which are still too vague to be effective. One of them is the task of taking special care electing *able* officials with *sufficient competencies*.[19] More disputed is the postulation of independence of the members.[20] The current Code stipulates that there need to be (only) an adequate number of independent members.[21] The SB therefore has the leeway of tolerating several even obviously not independent members. A SB-member is considered independent if he/she has no business or personal relations with the company or its management board which cause a conflict of interests.[22] The definition of conflict of interests gives here also more room for interpretations.

c. Further Developments

The recommendations of the EU regarding corporate governance provide for a much stricter definition of independence.[23] Managers active in other companies are generally not considered independent and even workers of the company itself are considered stakeholders with special interests which are not compatible with the service on the board. Next to the specific criticism that inside knowledge, which is vital for assessing and controlling a company, will be lost[24], the recommendations spark a clash of different philosophies about the nature of the board: The Anglo-Saxon shareholder driven approach of high-paid external auditors, which satisfy the needs of private-equity and other institutional investors, versus the German approach of internal reconciliation of different stakeholders.[25]

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[19] 5.4.1. DCGK.

[20] For a complete introduction: Hoffmann-Becking, Michael "Organe: Strukturen und Verantwortlichkeiten, insbesondere im monistischen System" *ZGR* 2004, 355-382.

[21] 5.4.2. sent. 1 DCGK.

[22] 5.4.2. sent. 2 DCGK.

[23] Recommendation of the commission of 15. 2. 2005 regarding the duties of non executive directors/members of SB of stock-listed companies (2005/162/EG), ABlEG v. 25. 2. 2005 Nr. L 52, p. 51.

[24] See Schäfer, Albrecht, "Der Prüfungsausschuss - Arbeitsteilung im Aufsichtsrat" *ZGR* 2004, 416-431, who argues that it is impossible for an outsider to set the audit priorities with 50.000 products in 192 countries.

[25] Nagel, Bernhard, "Unabhängigkeit der Kontrolle im Aufsichtsrat und Verwaltungsrat: Der Konflikt zwischen der deutschen und der angelsächsischen Konzeption" *NZG* 2007, p. 167; Wirth, Gerhard, "Anforderungsprofil und Inkompatibilitäten für Aufsichtsratsmitglieder" *ZGR* 2005, p. 338.

2. Business Practice

When considering the actual selection process one needs to discriminate between the different size and age of the company. Depending on the needs of the company different criteria have to be met. Before scrutinizing individual needs it is helpful to keep the bottom line in mind, that the company is to make reasonable profit. At any given point in development of a company these may vary.

a. Large public Corporation

aa. Who decides on the Selection?

Abstract regulations of independence and incompatibilities neglect the important aspect of who really is the one selecting the members.[26] The SB is proposing the members to be (re-)elected to the SB. Though shareholders are allowed to nominate other candidates those seldom get voted and most of the time the proposition of the SB gets approval rates of 99%. Therefore de facto the SB selects the candidates to be elected.

But it is not even the complete SB that decides – (ideally) after careful discussion and preparation of the proper profile of qualification – but a select few. If the company does not have a major shareholder there are two "secret" ways of exerting influence on the election:[27]

- The chairman of the SB has talked to two or three leading persons in the SB as well as the chairman of the MB ("Kooptation")
- The chairman of the MB has talked to the chairman of the SB, who in turn has assured the votes of two or three leading person.

With this practice the intention of the law that the chairman of the MB has no influence on the election of his controllers is being perverted.

This is supported by empirical data: The majority of shareholder representative in the SB are (former) members of MB of other companies. Within the DAX-Corporations the percentage is 58%.[28] This means that on

[26] Wackerbarth, Ulrich, "Investorvertrauen und Corporate Governance," *ZGR* 2005, p. 715.
[27] Roth/Wörle p. 578.
[28] Roth/Wörle p. 584 with data from 2003.

average 5 ½ members of the supervisory boards are representatives of other companies. Representatives of financial institutions are found in 65% of all SB. A recent ranking of the DSW (an association to protect private shareholders) supports this view in a drastic way and gives insightful numbers to the different multi-members of SB in Germany.[29] Though these numbers are high, interesting enough most of the DCGK recommendations are being complied by.[30] Summing up it could be argued that rather than being controlled it is more likely that management is using the composition of the SB as a strategic instrument.

bb. What are the Criteria?

Since large part of the design of the Companies Act is catered towards the protection of creditors of the companies, it is not surprising that with large public corporations the control function becomes most prominent. One of the most recent cases, the dismissal of the chairman of the supervisory board of the Siemens AG Heinrich von Pierer, was driven by the allegation of corruption within numerous divisions of the company while he was chairman of the management board. Special care was taken by the representatives of the capital that an outsider will overview the investigation process. To insure further independence the investigation was assigned to a US-law firm, which reports to the supervisory board.[31]

Empirically it is possible to divide the large public corporations into one group of fragmented shareholders and another one with one or few shareholders, who by themselves or together have dominating influence. The function of the SB varies accordingly. SB in the first group have to protect the company from management, in the second they have to protect the small investors. [32] These become or at least should be the criteria of selection.

However, within companies of fragmented shareholder groups it is not uncommon that the management board de facto picks the supervisory

[29] http://www.dsw-info.de/uploads/media/DSW-Aufsichtsratsstudie_Ranking.pdf.
[30] Roth/Wörle p. 592 with further sources.
[31] Business News 10.05.2007, Debevoise & Plimpton Law Firm.
[32] Wirth (2005), p. 329.

board.[33] It is evident that effective control is inhibited, when the member of SB is indebted with gratitude and the hope to keep his job another 5 years.[34]

b. Start-Up, Web 2.0

One of the most critical aspect of a new company is raising capital and gaining a reputation as a serious business partner. Therefore the fundamental function of the supervisory board to control is superposed by strategic needs. Contacts within the financial community and the ability to network along with a solid reputation are vital. As it is custom with the management board it can be observed that the supervisory board of young companies have a combination of different abilities and function. Next to a "door-opener" a position of scientific advisor is often necessary in the biotech or technology industries.[35]

Within a small community of a highly specialized industry, to get hold of a prominent manager signals that the company has attained the accolade of being among the first in the field.

c. Family Corporations

Family corporations deserve special attention for numerous reasons. Family corporation with a number of employees of less than 500 are exempt from the Co-Determination. The supervisory board is then also used to introduce family members, who are designated to lead operative positions, to the strategic considerations of the company.

d. Affiliated Groups[36]

After mergers or spin-offs the supervisory board may be divided into groups suspicious of each. Great care then has to taken to find a chairman and other members who are able to reconcile the position and mediate between the

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[33] Hopt, Klaus J. and Leyens, Patrick C, "Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy" *ECFR* 2004, p. 141.

[34] Roth, Günter and Wörle, Ulrike, "Die Unabhängigkeit des Aufsichtsrats - Recht und Wirklichkeit" *ZGR* 2004, p. 575 et seq.

[35] Mattauch, Christine, "Aufsicht, Weitsicht, Übersicht" *brand eins* 2000, www.brandeins.de visited 4.3.2007.

[36] For an overview of the SB in an affiliated group: Lutter, Marcus, "Der Aufsichtsrat im Konzern" *AG* 2006, 517-521.

groups. In the case of spin-offs the SB can serve as a positive link between the affiliates. The members, both on the controlling and controlled side, however have to expect additional tasks.[37]

IV. The End of the Membership

The only legal provision to end the membership is the revocation. This can be done by a ¾ majority of the general assembly[38], or, following a proposition on grounds of significant reason with a ½ majority of the supervisory board, by a court ruling[39]. A delegate member of the board (see above B.II.) can be revoked at all times by the respective stock owner.[40]

Since these are the only provisions, the articles of incorporation of the company need to provide and specify other forms of termination of membership. Most importantly it regulates the resignation of a member. Other ways of ending the position are: expiring of the membership period, the occurrence of estoppels as described above in B.III.1., the successful legal challenge of the appointment of a member, the end of the supervisory board itself through liquidation or reorganisation/commutation of the company and – at length – the death of a member.

The appointment of members of the work-force, who are elected by the laws of Co-Determination can be revoked by a ¾ majority of the body, who elected the member.[41]

V. The Laws of Procedure for the Supervisory board

There are three specifications of how the work of the supervisory board is to be done: The Companies Act[42], the articles of incorporation and the bye-laws of the SB itself (laws of procedure). Since the SB benefits from the

[37] Semler, Johannes, *Leitung und Überwachung der Aktiengesellschaft,* Köln: 1996, p. 233 et seq.
[38] § 103 I 1 AktG.
[39] § 103 III AktG.
[40] § 103 II AktG.
[41] § 23 MitbestG.
[42] §§ 107-110 AktG.

fundamental principle of self-government[43] the Companies Act only statues essential proceedings and the articles of incorporation may contain regulations, but are limited by the right of autonomous organization. The decision on the bye-laws of SB lays therefore in the hands of the SB itself and is made with a simply majority.[44]

1. The Chairman of the Supervisory Board

a. Selection

Statutory onset is that one of the supervisory board members will be elected by his peers as their chairman.[45] Another member is being elected as his deputy. In a recent ruling the BGH stated that if the shareholders decide on a strategy to elect the chairman, the left out stockholder does not have the right to claim charges based on "acting in concert" regulations of financial market laws.[46]

In principal the majority of the votes is sufficient. If the rules of Co-Determination apply[47] however, the chairman needs to obtain two thirds of the votes of the board. With the number of members evenly divided between the owners and the work force, possible impasses are being solved by a second election in which the owners determine the chairman and the work force decide on the deputy.

b. Powers

The chairman is charge of summoning the meetings as he deems necessary or by request of one of the other members.[48] Depending on the bye-laws he is leading the communication with the management board or is even generally empowered to represent the SB and execute the resolutions

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[43] Rellermeyer, Klaus, *Aufsichtsratsausschüsse,* Köln: 1986, p. 14.
[44] § 108 I AktG, § 77 II 3 AktG is not applicable by analogy, for details: Hüffer § 107, n 23.
[45] § 107 I AktG.
[46] BGH 18.09.2006 II ZR 137/05; Diekmann, T.F. "Acting in Concert: Absprachen zur Besetzung des Aufsichtsrats - Besprechung des BGH-Urteils vom 18. 9. 2006" *DStR* 2007, 445; Goette, Wulf, "Acting in Concert: Absprachen zur Besetzung des Aufsichtsrats - Besprechung des BGH-Urteils vom 18.9.2006" *DStR* 2007, 445-448.
[47] § 27 I MitbestG.
[48] § 109 AktG.

adopted. He will be authorized individually by the SB e.g. to contract managers of the MB or press legal charges in the name of the SB.

The chairman is – in his original function – chairing the meetings, deciding on the order of the items on the agenda, necessity of outside expertise or the method of resolutions.

2. Resolutions

Decision of the supervisory board have to be adopted in the form of resolutions.[49]

To achieve a valid resolution a necessary number of members need to be present (quorum). The legal default is at least half of the members.[50] Unless the laws of Co-Determination apply, which turn this default regulation mandatory[51], the articles of association can deviate and provide for a different standard. The qualified majority is therefore an option for small corporations[52], which, following the law for small corporations and deregulation, has become a serious alternative to the private limited company (GmbH).

It is possible to provide in the rules of procedures that votes shall be cast secretly upon motion of at least two members.[53] Highly disputed are the legal ramifications of votes cast based on false information or erroneous resolutions.[54]

3. Meetings

Resolutions of the Supervisory Board are usually made at meetings. Meetings and adopting resolutions in writing, by telephone, or with the aid

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[49] § 108 I AktG.
[50] § 108 II AktG.
[51] § 28 MitbestG, § 10 MontanMitbestG, § 11 MontanMitbestErgG.
[52] In detail: Jürgenmeyer, Michael, "Satzungsklauseln über qualifizierte Beschlussmehrheiten im Aufsichtsrat der Aktiengesellschaft" *ZGR* 2007, 112-143.
[53] E.g. § 6 I 2 Rules of Procedure of the Supervisory Board of Symrise AG, www.symrise.com, visited 17.4.2007.
[54] Schmidt (2002) § 15 II 1 et seq.

of other means of telecommunication are acceptable[55], and usually left to the discretion of the chairman.[56] The number of annual mandatory meetings is 4 or 2 depending whether the corporation is listed at a stock exchange.

With all the caveats of the above remarks the meetings then are the place where numerous tasks are accomplished. If well prepared the control and information rights can be discussed and coordinated. The committee can report to contribute to a comprehensive image of the corporation. This in turn can spark ideally strategic discussions. The meeting then is a place of reconciliation of interests.[57] A capable chairman will have supplied the members with the necessary information and functions as a mediator between the different groups and leader of the organ.

Leaving the meeting the member needs to take not give away confidential information. Especially union members are sometimes stuck between a rock and a hard place if difficult decisions regarding the workforce have been discussed[58], but also acquisition partners, who already hold a seat on the board have a difficult time balancing their interests and loyalties.[59] A breach of confidentiality is a criminal offense.[60]

4. Committees[61]

With the increasing work-load of a growing company the tasks of the supervisory board become too vast to be handled completely and in detail by a large SB. Therefore the SB is empowered to install committees to prepare the resolutions and negotiations.[62] It is even possible to install a

[55] Wagner, Jens, "Aufsichtsratssitzung in Form der Videokonferenz - Gegenwärtiger Stand und mögliche Änderungen durch das Transparenz- und Publizitätsgesetz" *NZG* 2002, 57-64.
[56] E.g. Articles of Association Linde AG, 14.03.2007, www.linde.de, visited 15.4.2007; § 6 III Rules of Procedure of the Supervisory Board of Symrise AG, www.symrise.com, visited 17.4.2007 and Adidas AG, www.adidas-group.de, visited 15.4.2007.
[57] Nagel (2007), p. 167.
[58] Schmidt (2002) § 28 III c, p. 824.
[59] Möllers, Thomas M.J, "Interessenkonflikte von Vertretern des Bieters bei Übernahme eines Aufsichtsratsmandats der Zielgesellschaft" *ZIP* 2006, p. 1621.
[60] § 404 AktG.
[61] In depth Rellermeyer (1986).
[62] § 107 III 1 AktG.

committee with resolution power as long as it is has the minimum number of 3 members.[63]

As regards the content of the delegation the SB is inhibited in assigning core tasks to the committees.[64] With regard to the scope of this paper the most relevant restriction are: Election of the chairman, the preparation of the laws of procedure for the management board, the appointment of the members and chairman of the MB.

a. Conciliation Committee

If the laws of Co-Determination are applicable the installation of the conciliation committee is mandatory.[65] Sole function is the participation in personnel decisions, if a resolution of the SB cannot be adopted.[66] This committee is necessary because of the parity within the SB. The Co-Determination law provides for a procedure to resolve an impasse.[67]

b. Presidential Committee

Personnel decisions as well as long term succession planning are usually prepared by a presidential/personnel committee. Next to the appointment and the removal of member of the executive board the presidential committee can resolve upon the following matters in lieu of the supervisory board:

- Entering into, the amendment and the termination of service and pension agreements with members of the executive board.[68]
- The legal representation of the Company to members of the management board pursuant to sec. 112 of the Joint-Stock Corporation Act.
- The approval of transactions exceeding a certain value between the company or an affiliate on the one hand and a member of the management board on the other.

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[63] BGHZ 65, 190.
[64] § 107 III 2 AktG.
[65] § 27 III MitbestG.
[66] § 31 III 1, V MitbestG.
[67] § 31 II 1 MitbestG.
[68] For this reason the decision to award payment to members of the Mannesmann Management board was made by the presidential committee and only these faced criminal charges, BGHSt 50, 331 – 346 ("Mannesmann").

- The approval of a MB member holding offices at business outside the group or similar activities.[69]
- The granting of loans to members of the boards and similar persons.[70]

The presidential committee often serves also as a self-controlling body. It then reviews the efficiency of the SB.

The presidential committee usually consists of 3 or 4 members: The chairman and one of members elected by the shareholders and one delegated by the staff. Optionally the vice chairman is part of the committee.

c. The Audit Committee

The size of the audit committee is usually anywhere between 3 and 6. As opposed to the presidential committee more restrictions apply: The chairman has to be elected by the shareholders, but shall not be a former member of the management board or the current chairman of the SB.

The audit committee prepares the resolution of the SB on the approval of the financial statements and the consolidated financial statements. For such purpose the audit committee shall review the financial statements, the consolidated financial statements, the management reports and the proposal for the appropriation of profits. One of the most important duties is the selection and engagement of the auditor. Also the definition of areas of audit emphasis and the fee are prepared.

The audit committee is recommended by the DCGK[71] and should be installed to insure an effective and efficient internal controlling of the company.[72]

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[69] Pursuant to § 88 AktG.
[70] §§ 89, 115 AktG.
[71] 5.3.2. DCGK.
[72] The scope of the tasks concerning affiliates is described in Böcking, Hans-Joachim und Stein, Thomas, "Prüfung des Konzernlageberichts durch Abschlussprüfer, Aufsichtsräte und Deutsche Prüfstelle für Rechnungslegung," *Der Konzern* 2007, 43-54.

The audit committee assists the SB in the supervision of the MB and concerns itself with risk management. For that purpose it may be empowered with the information rights of the Corporations Act[73].

German Corporations with listings in the USA

German corporations which are listed on stock-Exchanges in the USA need to comply with the Sarbanes-Oaxley-Act (SOX)[74]. One of the ramifications is that for the participation in the audit committee the SOX stipulates at least one member to be a financial expert.[75] As opposed to the status quo of German corporate law specific requirements are set. Since these might point to future developments even for companies not listed in the USA, they are of special interest. A financial expert needs to have at least 5 skills: understanding of accounting principles and the use of this understanding for estimates, accruals and reserves; experience with the analysis and auditing of annual reports, which are comparable to the company; understanding of financial controlling instruments and understanding of the function of the audit Committee itself.[76]

d. "Squeeze-out" of Work-Force Delegates

Since there are no clear statutory regulations on the composition of the committee, the participation of the members delegated by the work-force has been contended.[77] If no such member is part of a committee the information deficit of these members would increase. This in turn could be used as a tool to thwart their interests. Meanwhile the notion seems to prevail that only the discriminatory exclusion of a group is illegitimate.[78]

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[73] § 111 II AktG.

[74] H. R. 3763, 107th Cong. 2d Sess. (Pub. L. 107-204, 116 Stat. 745 [2002]). See also *http://news.findlaw.com/hdocs/docs/gwbush/sarbanesoxley072302.pdf*; and *www.sarbanes-oxley.com.*

[75] See Schäfer (2004) for a complete outline of ramifications for a large German corporation.

[76] Supra n. 43 and Altmeppen, Holger, "Der Prüfungsausschuss - Arbeitsteilung im Aufsichtsrat" *ZGR* 2004, 390 - 415.

[77] Overview of the discussion: Schmidt, Karsten, *Gesellschaftsrecht,* Köln: 2002, § 28 III d.

[78] BGHZ 122, 342, 358ff („Hamburg-Mannheimer").

VI. Individual Benefits and Drawbacks of Participation

1. Benefits

As much as it is important to state the function of the member in the organ of the SB it helps to recapitulate the benefits of a manager to participate in the work and meetings of the board. Especially if the manager is of excellent quality the work on the board competes with higher paying opportunities in management or consulting. Following an interview of an executive of an IPO-Consulting company working on the SB of several young corporations one of the reasons is surely prestige that comes with it. Being a mentor and being able to help foster exciting ideas and young people is another reason. Of course the gathering of new contacts and information is an incentive which entails real business advantages and in the long run money.[79]

How much money the network of the currently most prominent chairman of a supervisory board, Gerhard Cromme, made can only be estimated, but largely due to his connections he was contracted by a leading private equity company. After leading successfully the merger of Krupp and Thyssen he now serves as member of the following SB: ThyssenKrupp AG, Allianz AG, Lufthansa, E.ON, Hochtief, BNP Paribas, Suez S.A. and lately Siemens, after allegations of corruption shook the corporation and left the chairman seat vacant. His membership in these organs make him one of the most powerful managers in Germany. Adding to the business network is his position as the chairman of the government commission on the German Corporate Governance Codex.

2. Drawbacks

A detailed discussion of the rights and duties of the SB needs to be left to another paper. However, a few notes on the negative effects of participation in the meetings shall be given and provide the interface to that discussion.

[79] Supra (n 35).

a. Incompatibilities and Non-Competition

The increasing number of incompatibility requirements and non-competition clauses have a limiting effect on the field of operative activity of the member. Especially if lucrative consulting services are restricted[80] the cost-benefit assessment of some members might be reversed.

b. Liabilities

Institutional investors are pressing more and more charges also against members of the SB.[81] Violation of insider information non-disclosure rules might be costly.[82] On the other hand the capital market laws might force a member to publish a dissenting opinion following an offer of acquisition.[83] It is no surprise that the number of consultants contracted by the SB has increased in the last years, especially after the Mannesmann trial.[84]

VII. Current Problems and Discussions

1. Ongoing Criticism of the German SB culture

For years and with more intensity every time that corporate governance failed the criticism of the German system is voiced. Generally the criticism can be divided into structural weakness of the organ itself and the weakness of the member itself.[85] The most prominent arguments are[86]:

- With the Co-Determination the size is too big to have efficient results. With 20 members proper discussions are seldom profound. Since the number of meetings is also limited there is an even greater stress and demand on making good decisions in a timely manner. As a result there is no leadership or efficient control.

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[80] Bosse, Christian, "Rechtliche Anforderungen an Verträge mit Aufsichtsratsmitgliedern und die Zustimmung des Aufsichtsrats nach § 114" *NZG* 2007, 172-175; Möllers (2006) p. 1619.
[81] Wirth (2005) p. 338.
[82] Möllers (2006) p. 1616.
[83] Fleischer, Holger and Schmolke, Klaus Ulrich, "Zum Sondervotum einzelner Vorstands- oder Aufsichtsratsmitglieder bei Stellungnahmen nach § 27 WpÜG" *DB* 2007, p. 97.
[84] BGHSt 50, 331 – 346.
[85] Roth, Günter und Wörle, Ulrike "Die Unabhängigkeit des Aufsichtsrats - Recht und Wirklichkeit" *ZGR* 2004, p. 570.
[86] E.g. “Ende der Altherrenclubs”, Jörg Eigendorff, Die Welt vom 10.5.2006, www.welt.de, visited 4.3.2007.

- The members are considered incompetent. These consideration are not limited to the staff delegates who often do not have the proper skills to exercise the control necessary, but also members voted by shareholders, who, after retirement, do not want to fall into oblivion.[87]
- Even though the number of cross-over mandates (see above B.III.1.a.) have become less since the days of the "Deutschland AG" there are still tight personal networks. The Deutschland AG is derived from the time of a tight knit network of business leaders across virtually all mayor industries during the 50ies until recently; e.g. a couple of years ago the Deutsche Bank decided to discard virtually all strategic holdings of corporations which were not related to their core competencies. With bonds between the relevant players that tight, it becomes improbably that the Chairman of the SB is taking on a tough stand with management.
- The so called structural deficit of the two-tier model: the SB is not sufficiently involved in strategic decisions, has an information deficit and with 4 meetings a year is confined to an ex-post analysis and control.[88]
- The Co-Determination results in a chronically over-staffed company and [89]a loss of company-value of more than 30%. Even the One Third Participation Act should only be applicable to companies with more than 5000 instead of 500 employees.

2. Initiative Prohibiting the Direct Change to the SB

There has been the notion to pass a bill that prohibits the direct change of a member of the management board to the SB. The idea seems persuasive that this is a clear violation of the rule that controller and controlled cannot be the same person.[90] This notion to regulate however is also part of the German tradition of statutory regulation. There is strong opposition that this

[87] Following anecdote seems fitting: Supposedly one 70 year old chairman of a large German affiliate, who wanted to retire on grounds of age, was asked to stay by his peers, because by his reasoning, they all would have to resign.
[88] Jungmann, Carsten, „One-Tier and Two-Tier Board System" ECFR 2006, p. 452.
[89] Adam, Michael, "Das Ende der Mitbestimmung" *ZIP* 2006, p. 1563.
[90] In favor: Karl-Heinz Büschemann, „Schlechte Praxis", Süddeutsche Zeitung 19.12.2006.

responsibility can not be discarded to the law-maker, but it is the shareholders who need to end the serving time of a weak member of the SB. If they are too powerless as individual shareholders they should sell the share.[91]

3. The Biedenkopf-Commission

In 2005 a commission with the chairman, former President of the Saxony, Kurt Biedenkopf was installed to examine the necessity of reforms in the current system of Co-Determination. Composed of 3 members each of the unions and employer associations as well as 2 experts the conference collapsed in the end of 2006. Therefore an opportunity to make the work in the SB more efficient was wasted. With the economic upturn within the last year it seems the chances of changes will lessen with the economic strain for change.[92]

4. Additional Approaches and Theories

Following the rule that anytime the specific regulation is too complex to handle for the law-maker it serves well to specify a procedure which has a high probability of leading to a desired goal[93], there is a tendency to define certain rules of nomination for the members.[94] One of the rules assuring the necessary identification of competencies. Another approach is the postulation of a liability of the SB in the proposal and selection of members to be appointed.[95]

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[91] As argued by Prof. Thomas Straubhaar in Die Welt 27.12.2006, “Angriff auf das Unternehmertum”, www.welt.de, Article704811, visited 4.03.2007.

[92] A commentary on the Co-Determination in the SB and recommendations: Arbeitskreis Externe und Interne Überwachung der Unternehmung der Schmalenbach-Gesellschaft für Betriebswirtschaft e.V. (AKEIÜ), "Best Practice der Mitbestimmung im Aufsichtsrat der Aktiengesellschaft" *DB* 2007, 177-180.

[93] Sometimes called “regulated self-regulation”.

[94] A series of statements and recommendations is presented by v. Werder, Axel und Wieczorek, Bernd J, "Anforderungen an Aufsichtsratsmitglieder und ihre Nominierung" *DB* 2007, 297-303.

[95] Lutter, Marcus, "Auswahlpflichten und Auswahlverschulden bei der Wahl von Aufsichtsratsmitgliedern" *ZIP* 2003, 417-419..

A think tank has developed an evaluation sheet[96] along with several proposals for improvement. The most important being mirroring the divisions and committees of the MB. Also a profile of qualifications for every position on the SB should be drafted and an externally mediated self-evaluation executed.[97]

Another approach to the "network of gratitude", the peer pressure[98] and a fraternizing atmosphere has been proposed on a sociological level. In order to leave learned roles a different image and professionalism are necessary, which view the work in the SB as a separate, engaging profession. Highly trained members could serve solely on no more than 5 SB. The membership is not a medal of merit for achievements in the past.[99]

[96] Arbeitskreis Externe und Interne Überwachung der Unternehmung der Schmalenbach-Gesellschaft für Betriebswirtschaft e.V. (AKEIÜ), "Best Practice des Aufsichtsrats der AG" *DB* 2006, p. 1633-1636.

[97] Arbeitskreis Externe und Interne Überwachung der Unternehmung der Schmalenbach-Gesellschaft für Betriebswirtschaft e.V. (AKEIÜ) (2006) a.a.O. , p. 1627, 1632.

[98] On consultant contracts BGH v. 20.11.2006 – II ZR 279/05; Peltzer, Martin, "Beratungsverträge der Gesellschaft mit Aufsichtsratsmitgliedern: Ist das gute Corporate Governance? Zugleich Besprechung BGH v. 20.11.2006 - II ZR 279/05, ZIP 2007, 22" *ZIP* 2007, p. 309 with a reference of an actual account of a chairman of a SB on psychological mechanisms within; Benecke, Martina, "Beratungsvereinbarungen mit Aufsichtsratsmitgliedern - neue Akzente der Rechtsprechung und ungeklärte Fragen" *WM* 2007, 717-722.

[99] Roth/Wörle p. 629.

C. Management Board

I. Size

The number of members on the Management Board (MB) has to be defined in the articles of incorporations (AoI).[100] It is also possible that the AoI lay out specific rules of how the number is to be determined. One of the option is to leave the definition to the discretion of the supervisory board (SB).[101]

In theory therefore the board can consist of only one manager. Only if the registered capital exceeds € 3 million, the minimum number shall be 2. But the articles of incorporation can define otherwise.[102] The deputy member of the MB[103] is a fully valid member, whose restrictions are only internally and defined by the laws of procedure of the MB.[104]

If the company is subject to the laws of Co-Determination(see B.I.2) the number of members is at least two, because a Chief personnel director ("Arbeitsdirektor") is mandatory.

Some empirical facts. Size of the MB of selected DAX-Members: Deutsche Bank (5), Adidas (4). E.on (6), Münchener Rück (8). Size of the MB of the smallest[105] SDAX[106]-Members: Grammer (4), Curanum (2), Elexis (2), Loewe (3).

II. Appointment

The member is appointed by a resolution of the SB[107] and the consent of the manager[108]. The executive can only be appointed to a maximum number of 5 years at one time. Next to the appointment an employment contract is

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[100] § 23 III Nr. 6 AktG.
[101] See court approval and further details: LG Köln DB 1998, 1855.
[102] § 76 II AktG.
[103] § 94 AktG.
[104] Hüffer § 94, Rn. 2.
[105] Market Capitalization about € 240 Million.
[106] Small-Cap Index of the Deutsche Börse AG, Frankfurt.
[107] § 84 AktG.
[108] Gach, Bernt, Hefermehl, Wolfgang, Kalss, Susanne et al, *Münchener Kommentar zum Aktiengesetz,* München: 2004.-*Hefermehl/Spindler* § 84, Rn. 17; Hüffer AktG Rn 3 f.

drafted which contains duties in excess of the legal ramifications of the appointment and the remuneration.[109] The 5 years limit applies for this adjacent contract as well.[110] The entry in the commercial register is required but doesn't affect the appointment as such.

III. Selection

The qualification of the management board is much more homogeneous than the supervisory board. Especially for large corporations any human resource responsible would be able to name the essential qualities necessary to succeed on the board: Leadership, political mindset, decisiveness, business savvy and honed social skills have been developed in the years climbing the corporate ladder. In contrast the SB is a motley crew of highly qualified, less qualified, young and retired, workers and academics, motivated people and delegates with an outside union agenda.

In theory the presidential committee of the SB (see B.V.4.b) has identified high potential managers that could serve on the MB. In addition the currently serving members of the MB have advanced the careers of candidates they find suitable. Given the above phenomenon of an adhesive group bound by interests, aptitude, gratitude, dependability and dependencies (see B.III.2.a), a candidate enters the inner circle through mentorship until he or she himself has enough power to claim the appointment himself.

IV. End of the Membership

The appointment ends automatically with the end of the (usually 5 year) period. Extraordinary reasons of termination are the revocation of the appointment, the resignation of the member or an amicable severance agreement.

[109] Hoffmann, Dietrich und Preu, Peter, *Der Aufsichtsrat,* München: 2003, p. 44 sec.
[110] § 84 I sent. 5 AktG.

If the corporation wants to get rid of the manager, it needs to take care to terminate *both* the employment contract and the corporate appointment. To execute a revocation successfully an important reason, that is a major fault, needs to be given. Some of these are explicitly named in the Public Corporation Act:[111]

- Severe negligence of duty, e.g. highly speculative transactions, breach of confidence with the SB.
- Incompetence. Given the high responsibilities, fast paced developments and tough business practice, more frequently than might be expected, managers are revoked because of incompetence/illness.[112]
- Loss of confidence with the shareholder assembly. This however, is not a tool to undermine the general leeway of the MB and his business judgement freedom as guaranteed by law. To revoke the appointment for reasons of confidence an objectively comprehensible reason needs to be presented.

To insure the operative manageability the law provides for an assumption that the revocation is justified until the respective member of the MB proves otherwise. Practical consequence of this assumption is that, after the months of quarrel have passed, a return to the position on the board is highly improbable. What is left to argue is the *price* of the severance payment.

Once the revocation has been issued the employment contract needs to be terminated as well. Usually both contracts have a conjunction clause: The employment contract then terminates after a regular severance period. If this clause is missing, care needs to be taken to issue the dismissal letter declaration within the appropriate time limit. In the case of severe reasons this needs to be done within two weeks of notice.[113] It is disputed when these two weeks start, whether it is sufficient that any member of the SB knows or the chairman or even the complete board.[114]

[111] § 84 III 2 AktG.
[112] Hüffer § 84, Rn. 28.
[113] § 626 II BGB (Civil Code).
[114] Hüffer § 84, Rn. 41.

V. Laws of Procedure for the Management Board

1. Chairman of the Management Board/Chief Executive Officer[115]

The supervisory board is entitled to name one of the board members to be the chairman; this right cannot be delegated to one of the committees.[116] The MB itself can only determine that one of its members is leading the meetings.

2. Laws of Procedure

The SB is also entitled to give the MB the laws of procedure in as far as the articles of incorporation have not specified limitations.[117] Only if the SB and the AoI do not make use of their rights it is possible for the MB to give itself laws of procedure itself.

The participation in the meetings of the MB thus needs to obey these procedures, which usually contain a number of special reporting duties as well as a list of transactions which need prior consent of the SB.[118] The reporting duties might include specifications of the legal information rights[119] or an increase in the frequency of reporting. The recommendation of the DCGK to install an information regime[120] is (logically) in itself a natural part of laws of procedure.

The laws of procedure should provide that transactions of a certain volume or risk entailing dealings as defined by the bye-laws are to be decided on by the complete MB or at least a special committee of the MB. Also the standardized process and documentation needs to be observed.[121] The result is that ambitious members or members with insufficient distance to business partners are disciplined through the participation of the meetings and

[115] Hoffmann-Becking, Michal, „Vorstandsvorsitzender oder CEO?“ NZG 2003, 745-750.
[116] § 84 II, § 107 III 2 AktG.
[117] § 77 II AktG.
[118] Examples are given in Happ, Wilhelm and Groß, Wolfgang, *Aktienrecht,* Köln: 2004.
[119] § 90 AktG.
[120] 5.3.1. DCGK.
[121] Hüffer, Uwe, "Die leitungsbezogene Verantwortung des Aufsichtsrats" *NZG* 2007, p. 51.

compliance to the rules. Participation in the meeting then leads to better and safer decisions for the corporation.

a. Resolutions and Meetings

Resolutions follow generally the same rules as the laws of procedure for the SB. Equally organized is the convocation of the meetings, the discretion of the chairman on how the agenda is to be handled, etc. Through the formalization of business decisions participation in the meetings is a vital process of making management decisions[122], and making them documented and structured.

b. Committee

The management board can likewise as the SB organize their work through committees. The Deutsche Bank has installed operational, functional and regional committees totalling 10 sub-committees.[123] Other corporation have no committees, but find a division and distribution between the members based on the issue sufficient.[124]

[122] §§ 77, 83, 90-92 AktG.
[123] Geschäftsordnung für den Vorstand der Deutsche Bank AG.
[124] Examples: Henn, Günter, *Handbuch des Aktienrechts,* Heidelberg: 2002, p. 305.