



Universität Hamburg

Seminar für Handels-, Schiffs- und
Wirtschaftsrecht

Geschäftsführender Direktor

Prof. Dr. Heribert Hirte, LL.M. (Berkeley)

**Seminar on
Comparative Corporate Law:
The Two-Tier System in Italy and Germany**

Prof. Dr. Heribert Hirte, LL.M.

Sommersemester 2007

*Two-Tier System and Best Practices
(German Corporate Governance Code)*

by
Christine Ede

Table of contents	II
List of Literature	IV
A. INTRODUCTION.....	1
B. CONFLICTS OF INTERESTS AND INDEPENDENCY	3
I. INDEPENDENCY AND THE GERMAN TWO-TIER SYSTEM.....	3
II. GENERAL INDEPENDENCE REQUIREMENTS UNDER AKTG AND DCGK.....	4
1. <i>Independency under the AktG</i>	5
a) Incompatibility under the AktG.....	5
b) Contracts Subject to Agreement.....	5
c) Nomination and Duty to Disclose.....	6
2. <i>Introduction to the DCGK</i>	7
3. <i>Independency under the DCGK</i>	8
a) Addressed Board Members	8
b) Adequate Number of Independent Members.....	9
(1) Possible Approaches.....	9
(2) Personal Statement	10
c) Self-assessment of the Supervisory Board.....	11
d) Report to the General Meeting	11
III. CONFLICT OF INTEREST.....	12
1. <i>Development of Conflict of Interests</i>	13
2. <i>Regulation under the AktG</i>	13
3. <i>Regulation under the DCGK</i>	15
a) Attempt of the DCGK	15
b) Disclosure and Treatment of Conflicts.....	15
c) Criticism of the DCGK Recommendation's.....	16
d) Terms of Reference	17
C. ISSUES AFFECTING INDEPENDENCY.....	17
I. PERSONAL OR BUSINESS RELATIONS TO THE COMPANY	18
1. <i>Effects of Business Relations</i>	18
2. <i>Relevant Business Relations</i>	18
3. <i>Personal Relation</i>	19
4. <i>Measures to Handle Personal and Business Relations to the Company</i>	20
II. TRANSFER FROM MANAGEMENT TO SUPERVISORY BOARD.....	21
1. <i>Advantages and Disadvantages</i>	21
a) Advantages of a Transfer.....	21
b) Disadvantages of the Transfer	22
c) Personal Statement	23
2. <i>Regulation under the AktG</i>	24
3. <i>Regulation under the DCGK</i>	25
a) Recommendation of the DCGK	25
b) Purpose of the DCGK Recommendations	26
c) Criticism of the DCGK Recommendation's.....	26

4. “Cooling-Off Period”	27
a) “Cooling-Off Period” by Law	27
b) “Cooling Off Period” under the DCGK	28
c) Personal Statement	29
5. <i>Further Measures to Handle a Transfer</i>	30
III. SEATS IN COMPETITORS BOARDS’	30
1. <i>Regulations under the AktG</i>	31
2. <i>Regulations under the DCGK</i>	32
a) Representatives of Important Competitors	32
b) Representatives and Conflict of Interest.....	33
c) Independency	34
3. <i>Conclusion</i>	34
4. <i>Personal Statement</i>	35
D. PERSONAL STATEMENT	36

List of Literature

- Arbeitskreis Externe und Interne
Überwachung der Unternehmung der
Schmalenbach-Gesellschaft für
Betriebswirtschaft e.V. (AKEIÜ) Best Practice des Aufsichtsrates der AG –
Empfehlungen zur Verbesserung der Effektivität und
Effizienz der Aufsichtsratsstätigkeit
DB 2006, 1625 – 1636
- Bender, Christian/
Vater, Hendrik Lückenhaft und unverbindlich –
Der Deutsche Corporate Governance Kodex lässt
auch nach der Überarbeitung wichtige
Kernprobleme der Unternehmensüberwachung
ungelöst
DStR 2003, 1807 – 1812
- Du Plessis, Jean The German Two-Tier Board and the German
Corporate Governance Code
European Business Law Review 2004, Vol. 15 Issue
5, 1139- 1164
Quoted: *Du Plessis*, EBLR 2004, 1139 (...).
- Fischer, Roderich Entsprechenserklärung und
Entsprechensentscheidung 2005/ 2006 – Vorschläge
zur Haftungsminimierung der erklärungspflichtigen
Unternehmen
BB 2006, 337 – 341
- Götz, Heinrich Rechte und Pflichten des Aufsichtsrates nach dem
Transparenz- und Publizitätsgesetz
NZG 2002, 599 – 604
- Goulding; Simon/
Miles, Lilian/
Schall, Alexander Judicial Enforcement of Extra-Legal Codes in UK
and German Company Law – Including
Observations on OLG Schleswig Holstein, NZG
2004, 669 (Mobilcom II) and LG München I, NZG
2004, 626 (Hypovereinsbank)
ECFR 2005, 20 – 62
- Hirte, Heribert (Hrsg.) Das Transparenz- und Publizitätsgesetz
München 2003
Quoted: *Hirte/ Bearbeiter*, Das Transparenz- und
Publizitätsgesetz, Kap. ... Rn. ...
- Hommelhoff, Peter/
Mattheus, Daniela Corporate Governance nach dem KonTraG
AG 1998, 249 - 259
- Hopt, Klaus J. ECLR - Interessenwahrung und Interessenkonflikte
im Aktien-, Bank- und Berufsrecht
ZGR 2004, 1 – 52

- Hopt, Klaus J./
Leyens, Patrick C. Board Models in Europe –
Recent Development of Internal Corporate
Governance Structures in Germany, the United
Kingdom, France, and Italy
ECFR 2004, 135 – 168
- Hüffer, Uwe Aktiengesetz
7. Auflage, München 2006
Quoted: *Hüffer*, § ... Rn. ...
- Hüffer, Uwe Die Unabhängigkeit von Aufsichtsratsmitgliedern
nach Ziffer 5.4.2 DCGK
ZIP 2006, 637 – 644
- Ihrig, Hans-Christoph/
Wagner, Jens Die Reform geht weiter: Das Transparenz- und
Publizitätsgesetz kommt
BB 2002, 789 – 797
- Jungmann, Carsten The Effectiveness of Corporate Governance in One-
Tier and Two-Tier Board Systems
- Evidence from the UK and Germany -
ECFR 2006, 426 – 474
- Krebs, Karsten Interessenkonflikte bei Aufsichtsratsmandaten in der
Aktiengesellschaft,
Dissertation
In: Abhandlungen zum deutschen und europäischen
Handels- und Wirtschaftsrecht
Bd. 133, Köln 2002
Quoted: *Krebs*, S. ...
- Kropff, Bruno/
Semler, Johannes Münchener Kommentar zum Aktiengesetz

Bd. 3, §§ 76 – 117 AktG, MitbestG, § 76 BetrVG
1952
2. Auflage, München 2004

Bd. 5/1, §§ 148 – 151, 161 – 178 AktG §§ 238 –
264 c, 342, 342 a HGB
2. Auflage, München 2003

Quoted: *MüKo(-Bearbeiter)* AktG, § ... Rn. ...
- Lange, Oliver Der Wechsel aus dem Vorstand in den Aufsichtsrat
NZG 2004, 265 – 270
- Lieder, Jan Das unabhängige Aufsichtsratsmitglied – Zu den
Änderungen des Deutschen Corporate Governance
Kodex
NZG 2005, 569 – 574

- Lutter, Marcus
Auswahlpflichten und Auswahlverschulden bei der
Wahl von Aufsichtsratsmitgliedern
ZIP 2003, 417 – 419
- Lutter, Marcus
Kodex guter Unternehmensführung und
Vertrauenshaftung
In: Festschrift für Jean Nicolas Druey zum 65.
Geburtstag, Zürich 2002
S. 463 – 478
Quoted: *Lutter* in: FS Druey, 463 (...).
- Lutter, Marcus/
Krieger, Gerd
Rechte und Pflichten des Aufsichtsrats
4. Auflage, Köln 2002
Quoted: *Lutter/ Krieger*, Rn. ...
- Möllers, Thomas M. J.
Treuepflichten und Interessenkonflikte bei
Vorstands- und Aufsichtsratsmitgliedern
In: Handbuch Corporate Governance -
Leitung und Überwachung börsennotierter
Unternehmen in der Rechts- und Wirtschaftspraxis
Köln 2003
Hrsg.: Peter Hommelhoff/ Klaus J. Hopt/ Axel von
Werder
S. 405 – 428
- Müller, Welf/
Röder, Thomas
Beck'sches Handbuch der AG
mit KGaA, Gesellschaftsrecht, Steuerrecht,
Börsengang
München 2004
Quoted: Beck AG-HB/*Bearbeiter*, § ... Rn. ...
- Nagel, Bernhard
Unabhängigkeit der Kontrolle im Aufsichtsrat und
Verwaltungsrat:
Der Konflikt zwischen der deutschen und der
angelsächsischen Konzeption
NZG 2007, 166 – 169
- Nowak, Eric/
Rott, Roland/
Mahr, Till G.
Wer den Kodex nicht einhält, den bestraft der
Kapitalmarkt? Eine empirische Analyse der
Selbstregulierung und Kapitalmarktrelevanz des
Deutschen Corporate Governance Kodex
ZGR 2005, 252 – 279

- Oechsler, Walter A. Qualifikation und Personelle Besetzung des
Vorstands und Aufsichtsrats
In: Handbuch Corporate Governance
Leitung und Überwachung börsennotierter
Unternehmen in der Rechts- und Wirtschaftspraxis
Köln 2003
Hrsg.: Peter Hommelhoff/ Klaus J. Hopt/ Axel von
Werder
S. 305 - 322
- Oetker, Hartmut Aufsichtsrat/ Board: Aufgaben, Besetzung,
Organisation, Entscheidungsfindung und
Willensbildung – Rechtlicher Rahmen
In: Handbuch Corporate Governance
Leitung und Überwachung börsennotierter
Unternehmen in der Rechts- und Wirtschaftspraxis
Köln 2003
Hrsg.: Peter Hommelhoff/ Klaus J. Hopt/ Axel von
Werder
S. 261 - 284
- Peltzer, Martin Handlungsbedarf in Sachen Corporate Governance
NZG 2002, 593 – 599
- Peltzer; Martin Beratungsverträge der Gesellschaft mit
Aufsichtsratsmitgliedern:
Ist das gute Corporate Governance?
ZIP 2007, 305 – 309
- Peltzer, Martin Corporate Governance als zusätzliche
Pflichtenbestimmung für den Aufsichtsrat
NZG 2002, 10 – 16
- Peltzer, Martin/
Werder, Axel von Der “German Code of Corporate Governance
(GCCG)” des Berliner Initiativkreises
AG 2001, 1 – 15
- Ringleb, Henrik-Michael/
Kremer, Thomas/
Lutter, Marcus/
Werder, Axel von Kommentar zum Deutschen Corporate Governance
Kodex
2. Auflage, München 2005
Quoted: DCGK-(*Bearbeiter*), Rn....
- Rode, Oliver Der Wechsel eines Vorstandsmitgliedes in den
Aufsichtsrat – eine gute Corporate Governance?
BB 2006, 341 – 344
- Roth, Günther/
Wörle, Ulrike Die Unabhängigkeit des Aufsichtsrats - Recht und
Wirklichkeit
ZGR 2004, 565 – 630

Schiessel, Maximilian	Deutsche Corporate Governance post Enron AG 2002, 593 – 604
Seibt, Christoph	Deutscher Corporate Governance Kodex und Entsprechens-Erklärung (§161 AktG-E) AG 2002, 249 - 259
Semler, Johannes/ Schenck, Kersten v.	Arbeitshandbuch für Aufsichtsratsmitglieder 2. Auflage, München 2004 Quoted: Semler/ v. Schenck (<i>-Bearbeiter</i>), § ... Rn. ...
Ulmer, Peter	Der Deutsche Corporate Governance Kodex – ein neues Regulierungsinstrument für börsennotierte Aktiengesellschaften ZHR 166 (2002) 150 - 181
Werder, Axel von	Der Deutsche Corporate Governance Kodex – Grundlagen und Einzelbestimmungen DB 2002, 801 – 810
Werder, Axel von/ Wieczorek, Bernd J.	Anforderungen an Aufsichtsratsmitglieder und ihre Nominierung DB 2007, 297 – 303
Werder, Axel von/ Taulaicer, Till	Kodex Report 2005: Die Akzeptanz der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex DB 2005, 841 – 846
Werder, Axel von/ Taulaicer, Till	Kodex Report 2006: Die Akzeptanz der Empfehlungen und Anregungen des Deutschen Corporate Governance Kodex DB 2006, 849 – 855
Wirth, Gerhard	Anforderungsprofil und Inkompatibilitäten für Aufsichtsratsmitglieder ZGR 2005, 327 – 347

A. Introduction

This paper is concerned with the “Two-Tier System and Best Practices” in Germany focused on the regulations concerning the independence of supervisory board members under the German Stock Corporation Act of 1965 (AktG) and the German Corporate Governance Code of 2002 (DCGK).¹

The German corporate governance system, especially the role and function of the supervisory board has since the 1990’s increasingly been subject to national and international objection. In summary, the supervisory board system has been objected for the size of the boards, the organization of their workflows, their role understanding, lacks of discreetness, large total numbers of mandates in different boards, lacks of interest and motivation as well as lacks in qualification and independence of the members. An intensive discussion started which lead to widespread legislative changes² and to the introduction of the DCGK in 2002. The DCGK approaches most of those issues by recommending certain ways of behaviour and procedure to achieve best practice.

One key feature for an effective control through the supervisory board is the selection of the supervisory board members in terms of independency because only an independent board can monitor objectively in the company’s best interest. This paper will therefore focus on the requirements concerning the independency of the supervisory board and its members which need to be fulfilled in terms of best practice. It will be evaluated how the DCGK attempts to enhance the general independency of the board. Further, it will be estimated whether the standards set up by the DCGK are satisfying and which further requirements might need to be set up.

¹ The DCGK was adopted on February 26, 2002 and was announced in the official section of the electronic Federal Gazette by the Federal Ministry of Justice on August 20, 2002, cp. MüKo(-Semler) AktG, § 161 AktG Rn.25.

It has been amended several times since then and has found its latest version with the amendments of June 12, 2006 which were published in the official section of the electronic Federal Gazette on July 24, 2006. All Versions of the DCGK can be downloaded from www.corporate-governance-code.de as accessed on March 8, 2007. The latest version of the Corporate Governance Code can also be downloaded from www.ebundesanzeiger.de as accessed on March 8, 2007.

² The AktG was amended by the “Control and Transparency in the Corporate Sector Act of 1998” (KonTraG), BGBl. I 1998, 786ff. and the “Transparency and Publicity Act of 2002” (TransPuG), BGBl. I 2002, 2681 (2682).

The DCGK does not address the issue of co-determination and the problems in the composition of the supervisory board resulting from it.³ Therefore they will be excluded from this paper, too.

³ See e.g. *Florian Schilling* “Mitbestimmung und Unternehmensaufsicht”, article published in the F.A.Z. on April 16, 2007. See also: *Jungmann*, ECFR 2006, 426 (455ff.).

B. Conflicts of Interests and Independency

The independency of the supervisory board (members) has increasingly been at the centre of attention because it is assumed that only a board which is sufficiently independent can effectively monitor the management board.⁴

I. Independency and the German Two-Tier System

The request for (more) independency developed through the influence of the Anglo-Saxon countries and it has its roots in the single-board system.⁵ In the single board system it is crucial that the non-executive directors are independent and free of any conflict of interest to be able to effectively control the executive directors.

In the two tier system the supervisory board has the duty to advice and control the management board.⁶ This control must be exercised in the company's best interest.⁷ This does not follow directly from the AktG but is the prevailing opinion in jurisdiction and juridical literature.⁸ In contrast to the one-tier system, the prevailing opinion used to be that through the personal division of the boards' independency was sufficiently secured.

Moreover, the German supervisory board is composed with representatives of the different groups of stakeholders.⁹ Thereafter, it was originally not even aimed at composing the supervisory board with independent controllers but instead every group of stakeholders was supposed to have its representatives.¹⁰ Actually, the legislator accepted that conflicts of interest would develop. He assumed that arising conflicts were going to be settled within the supervisory board.¹¹ Therefore not only the division of the board but also the approach to

⁴ Cp. *Oechsler* in: *Hommelhoff/ Hopt/ v. Werder*, Hdb. Corporate Governance, 305 (313, Fn.60).

⁵ See e.g. DCGK(-*Kremer*), Rn.1028.

⁶ Cp. § 111 Abs.1 AktG.

⁷ Cp. No. 5.5.1 Satz 1 DCGK.

⁸ Cp. *BGH* v. 21.01.1962, NJW 1962, 864 (866); *OLG Schleswig* v. 26.04.2004, NZG 2004, 669 (670); *Hüffer*, § 116 AktG Rn.4, 5; *Lutter/ Krieger*, Rn.765; MüKo (-*Semler*) AktG, § 161 AktG Rn.452.

⁹ Cp. *Du Plessis*, EBLR 2004, 1139 (1148); *Krebs*, S.12; *Nagel*, NZG 2007, 166 (167); MüKo(-*Semler*) AktG, § 96 AktG Rn.2 as well as § 100 Rn.120, 124; *Semler/ v. Schenk (-Marsch-Barner)*, AR Hdb., § 12 Rn.82ff.

¹⁰ Cp. *Nagel*, NZG 2007, 166 (167).

¹¹ Cp. *Nagel*, NZG 2007, 166 (167); MüKo(-*Semler*) AktG, § 96 AktG Rn.2.

effective control is different in the German system in comparison to the US-American or British corporation laws.

But still, additional issues developed in the German supervisory board system. The position of a supervisory board member is formed under the AktG to be an additional task.¹² As a matter of fact, being a member of a supervisory board was considered to be a merely honorary position.¹³ Moreover, it has been and still is common practice for former management board members to become members of the supervisory board. Finally, supervisory boards were used as platforms to cultivate business relations between suppliers, clients, and creditors.¹⁴ As a result, the division between the two boards blurred and the supervisory boards were affected by a numerous amounts of interests.¹⁵

Those issues have been subject to national and international objection and due to the increasing pressure of the international capital market the composition of the supervisory board is changing. There is a development towards a more independent supervisory board, hence an adaptation of the US-American and British ideas of corporate control.¹⁶

II. General Independence Requirements under AktG and DCGK

The AktG sets up some basic independence requirements while the DCGK recommends additional business procedures to assure the independency of the supervisory board. Those independency requirements apply before a board member is elected to secure that the particular member can independently decide and a conflict of interest is avoided. In addition, an adequate number of independent members shall balance the representatives of the different stakeholders and secure that the decision-making is carried out in the best interest of the company.

¹² Cp. § 100 Abs.2 Satz 1 Nr.1 AktG. See *Krebs*, S.2; *Semler/ v. Schenk (-Marsch-Barner)*, AR Hdb., § 12 Rn.82ff.

¹³ *Jungmann*, ECFR 2006, 426 (463).

¹⁴ Cp. *Jungmann*, ECFR 2006, 426 (458) (on the influence of the banks); *Krebs*, S.13f.

¹⁵ See for the composition of German supervisory boards: *Roth/ Wörle*, ZGR 2004, 565 (584ff.).

¹⁶ Cp. *Hopt/Leyens*, ECFR 2004, 135(164); *Nagel*, NZG 2007, 166 (167).

1. Independency under the AktG

Under the AktG a few independency requirements are set up which only set up a basic standard.

a) Incompatibility under the AktG

§ 105 Abs.1 AktG prohibits supervisory board members to be simultaneously member of the management board, proxy holder or registered manager under §§ 48, 54 HGB. Members of the supervisory board are also not allowed to be simultaneously members of the management board of a depending company, § 100 Abs.2 Satz 1 Nr.2 AktG. This is supported by the prohibition of cross integration under § 100 Abs.2 Satz 1 Nr.3 AktG.

Further, the AktG restricts the total number of supervisory board seats which can be held simultaneously. As a principal rule ten seats in supervisory boards are allowed, § 100 Abs.2 Satz 1 Nr.1 AktG. A chair position must be counted twice, § 100 Abs.2 Satz 3, while up to five seats hold by a manager of a holding company in the supervisory board of a group company do not count into the total of ten seats, § 100 Abs.2 Satz 2 AktG. Those restrictions are primarily supposed to ensure that the board members have sufficient time to fulfil their duties.¹⁷ But still, if the number of seats a supervisory board member holds is reduced, the risk of potential conflicts of interests is reduced, too.¹⁸

§ 100 Abs.4 AktG allows the company to define further criteria concerning the qualification and independency of the supervisory board members in the company's constitution.¹⁹ But until now hardly any company has used this opportunity.²⁰

b) Contracts Subject to Agreement

Under §§ 114, 115 AktG a member of the supervisory board needs the approval of the board if he or she wants to conclude a contract with the

¹⁷ Cp. Begr. d. RegE KonTraG zu § 100 AktG, BT-Drs. 13/9712, S.16. See also Semler/ v. Schenk (-Marsch-Barner), AR Hdb., § 12 Rn.90.

¹⁸ Cp. Oechsler in: Hommelhoff/ Hopt/ v. Werder, Hdb. Corporate Governance, 305 (312).

¹⁹ Cp. DCGK(-Kremer), Rn.1032; MüKo(-Semler) AktG, § 100 AktG Rn.58. This possibility is not given concerning the representatives of the employees.

²⁰ Hüffer, ZIP 2006, 637 (638); Peltzer/ v. Werder, AG 2001, 1 (4); Wirth, ZGR 2005, 327 (332).

company. By this, the AktG tries to ensure that the member does not become dependent on the management board without the knowledge of the board as a whole.²¹ Subject of contracts under § 114 AktG usually are consultancy agreements.²²

The legitimacy of contracts like this is discussed and evaluated very critical.²³ The consultancy of the company is an original task of every supervisory board member, cp. § 111 Abs.1 AktG. Hence, if the contract contains subjects, which already are part of the duties of the supervisory board member, it is void from the beginning.²⁴

Even more critical is that by contracts like this the board member can be influenced by the management board. It is not necessary that the management tries to corrupt the supervisory board member but an unconscious impact can already occur with the conclusion of the contract.²⁵ Moreover, the need for an approval of the contract through the supervisory board to hinder dependence cuts short because the board will often be tempted to approve the contract because of collegueship and peer pressure.²⁶ Consequently, the legislator should prohibit consultancy contracts between supervisory board members and the company.²⁷

c) Nomination and Duty to Disclose

The supervisory board is under § 124 Abs. 3 Satz 1 AktG and the shareholders are under § 127 AktG in charge of the nomination for supervisory board election. The members are elected by the general meeting unless they are delegated due to co-determination statutes, § 119 Abs.1 Nr.1 AktG. The supervisory board is obliged to only nominate candidates that are capable to fulfil the duties of a board member. Therefore the candidate must at least fulfil

²¹ Oetker in: *Hommelhoff/ Hopt/ v. Werder*, Hdb. Corporate Governance, 261 (273).

²² Peltzer, ZIP 2007, 305.

²³ Cp. *BGH* v. 25.03.1991 in: BGHZ 114, 127ff. = NJW 1991, 1830ff.; *ders.* v. 04.07.1994 in: BGHZ 126, 340 (344) = NJW 1994, 2484 (2485); *ders.* v. 03.07.2006 in: BGHZ 168, 188ff. = NZG 2006, 712ff.; *ders.* 20.11.2006 in: BGHZ 170, 60ff. = NJW 2007, 298ff.; Peltzer, ZIP 2007, 305.

²⁴ *BGH* v. 25.03.1991 in: BGHZ 114, 127 (129f.) = NJW 1991, 1830 (1831); Peltzer, ZIP 2007, 305.

²⁵ Peltzer, ZIP 2007, 305 (308).

²⁶ Peltzer, ZIP 2007, 305.

²⁷ Peltzer, ZIP 2007, 305 (309).

a minimum standard of qualification and have the necessary time to attend his or her duties.²⁸

The nomination must be supplied by a declaration over name, residence and the currently exercised profession as well as the membership in other supervisory boards or similar control organs.²⁹ The disclosure must not only be made to the general meeting but also has to occur in the appendix of the final audit.³⁰ Those duties to disclose shall enable the shareholders to evaluate the individual work load of a candidate as well as expose potential conflicts of interest that might affect his or her independency.³¹ The legislator decided that it should be left to the discretion of the company respectively the shareholders to evaluate independency and potential conflicts of interest instead of creating a special catalogue of incompatibilities.³²

2. Introduction to the DCGK

The DCGK is annually issued by a Standing Corporate Governance Committee. For this reason, the DCGK itself has no parliamentary legitimacy, hence it has no direct legal force.³³

The DCGK is anchored into the German law by § 161 AktG. It contains the legal obligation for the management and the supervisory board of listed companies to “comply or explain”, i.e. to declare and publish annually whether they have complied with the recommendations of the DCGK and whether they intend to do so in the future (so called “declaration of compliance”).³⁴ Subject to § 161 AktG are only the recommendations of the Code, i.e. the provisions marked by the use of the word “shall”, No. 1 Abs.6 Satz 1-3 DCGK. Those

²⁸ Cp. MüKo(-Semler) AktG, § 100 Rn.71 as well as § 116 AktG Rn.126.

²⁹ § 124 Abs.3 Satz 3 and § 125 Abs.1 Satz 3 AktG. Those regulations were amended respectively introduced through the KonTraG., BGBl. I 1998, 786 (787). See Hüffer, § 124 AktG Rn.16.

³⁰ § 285 Nr.10 HGB. It has been amended through the KonTraG, BGBl. I 1998, 786 (789).

³¹ Cp. Begr. d. RegE KonTraG zu §§ 124 Abs.3, 125 Abs.1, BT-Drs. 13/9712, S.17.

³² Cp. Begr. d. RegE KonTraG zu §§ 124 Abs.3, 125 Abs.1, BT-Drs. 13/9712, S.17. In this sense also: *Hopt/ Leyens*, ECFR 2004, 135(164); *Semler/v. Schenk (-Marsch-Barner)*, AR-Hdb, § 12 Rn.79.

³³ Cp. MüKo(-Semler) AktG, § 161 AktG Rn.29; *Lutter*, FS Druey 2002, 463 (468); *Peltzer*, NZG 2002, 593; *Seibt* AG 2002, 249 (250); *Ulmer*, ZHR 166 (2002), 150, 159. For the discussion concerning the legal nature and the legitimacy of the GCGC see: *DCGK(-Ringleb)*, Rn.51ff.; *Ulmer*, ZHR 166 (2002), 150, 158ff.

³⁴ To the declaration of compliance see e.g. *Fischer*, BB 2006, 337ff.

contain business behaviors which are assumed to be nationally and internationally recognized as best practice.³⁵

3. Independency under the DCGK

No. 5.4.2 DCGK contains a recommendation under which the supervisory board shall include what it considers an adequate number of independent members. In compliance with this, No. 5.4.1 Satz 1 DCGK recommends concerning the nomination of candidates that care shall be taken that the board as a whole is composed of members who are sufficiently independent. Those recommendations are subject to the declaration of compliance under § 161 AktG. It has been introduced with the amendments of February 2, 2005 on the background of a recommendation of the European Commission of February 15, 2005.³⁶

a) Addressed Board Members

If a board is composed under co-determination laws, it is composed with representatives of the employees as well as of the shareholders. The first issue arising is, whether the recommended adequate number of independent members must be determined related to the board as whole or only to the representatives of the shareholders.

This issue is a relevant one because the representatives of the employees can generally not be considered independent because of their relations to the company.³⁷ The inclusion of the employee representative's would therefore lead to the situation that possibly all of the representatives of the shareholders would have to be independent to comply with the Code. If this would be true, almost no German corporation would currently fulfill the recommendation.

Hence, it is assumed for the most parts that the number of independent members must only be considered in relation to the representatives of the shareholders.³⁸ It is argued that the provisions of the DCGK following the

³⁵ Cp. No.1 Abs.1 Satz 1 DCGK. MüKo(-Semler) AktG, § 161 AktG Rn.26.

³⁶ Recommendation of the *European Commission* "on the Role of Non-Executive Directors or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board" (2005/162/EC) ABl. EG L 52, 51ff. v. 25.02.2005. See: *Hüffer*, ZIP 2006, 637 (638).

³⁷ *Hüffer*, ZIP 2006, 637 (639); critical: *Lieder*, NZG 2005, 569 (571).

³⁸ Cp. *Hüffer*, § 100 AktG Rn.2b; *ders.* ZIP 2006, 637 (639); v. *Werder/ Wiczorek*, DB 2007, 297 (302) (These 3.12).

independence requirement can only apply to the representatives of the shareholders because only those are elected by the general meeting.³⁹ Moreover, the recommendation of the European Commission excludes representatives of the employees from the independence requirements, too.⁴⁰ Finally, the DCGK segregates the issue of co-determination completely. It is unlikely that in this special case the issue was supposed to be considered. Thus, there are better arguments for a consideration of only the representatives of the shareholders for determining the adequate number of independent members.

b) Adequate Number of Independent Members

The DCGK recommends an adequate number of independent members. At question is what number can be considered an “adequate” one. The DCGK does not allege a certain number, but obviously there should be at least one independent member.⁴¹ The Code does not recommend a certain number because it is hardly possible to allege any number if the different sizes and compositions as well as the different needs of the particular companies are considered.⁴²

The DCGK rather puts the questions of the adequate number of independent members into the judgment of the supervisory board respectively of the shareholders to enable it respectively those, to choose how many independent members are needed. By this, freedom of scope is left to choose members that might not be independent but have crucial knowledge and experience that might be more important to the company.⁴³

(1) Possible Approaches

It is suggested that outside from incorporated companies at least half the number of the representatives of the shareholders should be independent.⁴⁴ A large supervisory board that is composed under co-determination laws has ten

³⁹ Hüffer, ZIP 2006, 637 (639).

⁴⁰ Cp. Recommendation of the *European Commission* (Fn.36), Annex II, lit. b, 2. Hs., (2005/162/EC) ABl. EG L 52, 63 v. 25.02.2005.

⁴¹ Hüffer, § 100 AktG Rn.2b; ders., ZIP 2006, 637 (641); Lieder, NZG 2005, 569 (572). Cp. to the matters of a factual enterprise: *OLG Hamm v. 3.11.1986*, NJW 1987, 1030.

⁴² Cp. §§ 95, 96 AktG.

⁴³ Lieder, NZG 2005, 569 (574). Still it must be declared under § 161 AktG if the number of independent members is not adequate.

⁴⁴ v. *Werder/ Wiczorek*, DB 2007, 297 (302) (These 3.12). They argue that in case of an incorporated companies the minority shareholders are protected under the law.

shareholder representatives. According to that proposal at least five of them should be independent. Other numbers given for the large supervisory board vary between two and five independent members.⁴⁵ However, it is commonly accepted that a number can only serve as a guideline and needs to be determined in the concrete case.⁴⁶ Hence, it is at the discretion of the company.⁴⁷ Some authors even demand general independence of all the supervisory board members.⁴⁸

A different approach is taken by the *European Commission*.⁴⁹ It demands a sufficient number of independent members and therefore differentiates between companies with dispersed ownership and companies with a controlling shareholder.⁵⁰ In the first case the number is supposed to be sufficient if the manager can be made accountable to the shareholders. In companies with a controlling shareholder the number is assumed to be sufficient if the interests of the minority shareholders are represented.⁵¹

(2) Personal Statement

The approach of the *European Commission* is preferable because it considers the diverse needs of the different types of companies. A stare number related to the size of the particular board that could apply to all (listed) companies can not be established because of the different needs. Especially, the DCGK puts it into the discretion of the shareholders and the supervisory board to determine the sufficient number. That enables them not only to consider the structure of the company but also to take into account the particular needs at the present time. Nevertheless, as a rule of thumb a number between two and five independent members in case of the large supervisory board can be considered adequate.

⁴⁵ Hüffer, § 100 AktG Rn.2b; ders., ZIP 2006, 637 (641).

⁴⁶ Cp. Hüffer, § 100 AktG Rn.2b; ders., ZIP 2006, 637 (641); v. Werder/ Wiczorek, DB 2007, 297 (302) (These 3.12).

⁴⁷ Hopt/ Leyens, ECFR 2004, 153 (164).

⁴⁸ AKEIÜ, DB 2006, 1625 (1632).

⁴⁹ Recommendation of the *European Commission* (Fn.36), (2005/162/EC) ABl. EG L 52, 52 v. 25.02.2005.

⁵⁰ Recommendation of the *European Commission* (Fn.36), (2005/162/EC) ABl. EG L 52, 52 v. 25.02.2005.

⁵¹ Recommendation of the *European Commission* (Fn.36), (2005/162/EC) ABl. EG L 52, 52 v. 25.02.2005.

As long as no accepted rule or number exists to define the adequate number of independent members the board should declare under § 161 AktG as soon as less than half of the shareholder representatives are independent to avoid claims. In case of the large supervisory board non-compliance must therefore be declared if the board has less than five independent members.

c) Self-assessment of the Supervisory Board

The supervisory board must declare under § 161 AktG whether it contains an adequate number of independent members.⁵² This is carried out by self-assessment of the board.⁵³ The DCGK does not require a certain form for the self-assessment. But since the decision is the regular form to decide, this form of determination should be used.⁵⁴

According to the wording of the DCGK the board as a whole is required to make the decision. But as pointed out above only the independency of the shareholder representatives is to be taken into account, hence only those evaluate the independency and decide.⁵⁵ This interpretation is supported by the right of the shareholder representatives under § 124 Abs. 3 Satz 4 AktG to exclusively decide on the nomination of the candidates who are elected by the general meeting.

d) Report to the General Meeting

The DCGK does not contain a recommendation under which the board would be obliged to give reasons why it considers itself independent. Under No. 3.1 Satz 1, 2 DCGK in combination with No. 5.4.2 Satz 1 DCGK it shall be explained why the board does not contain an adequate number of independent members. Since the adequacy of the number of independent members is set into the judgment of the board they are obliged to explain under the Code only if they feel that the number of independent members is inadequate. This has been criticized because shareholders cannot control

⁵² See to the issue who is obliged to declare under § 161 AktG e.g. Hirte/ ders. Das Transparenz- und Publizitätsgesetz, Chapter 1, Rn.22ff.

⁵³ Cp. Hüffer, ZIP 2006, 637 (640); Lieder, NZG 2005, 569 (574).

⁵⁴ § 108 Abs.1 AktG. Hüffer, ZIP 2006, 637 (640). Cp. also Hirte/ ders. Das Transparenz- und Publizitätsgesetz, Chapter 1, Rn.23.

⁵⁵ Hüffer, ZIP 2006, 637 (640).

independency if the supervisory board believes itself to be independent and as a result does not give a report on it nor explains its judgment.⁵⁶

The DCGK aims in wide parts at enhancing transparency. For example, conflicts of interests and their treatment must be reported to the general meeting.⁵⁷ As well as the direct transfer from the chair position of the management board to the chair position of the supervisory board must be justified at the general meeting, too.⁵⁸ It would only be consequent if the supervisory board respectively the representatives of the shareholders would be obliged to explain their self-assessment and give reasons for it to the general assembly. This approach also complies with the legislative duties to disclose certain information about the candidates under §§ 124 Abs.3 Satz 3, Abs.1 Satz 3 AktG.

Therefore, the Standing Corporate Governance Commission should introduce a recommendation to report on the independency of the members as well as the independency of nominated candidates to the general assembly.⁵⁹ This can be combined with a justification of a nomination concerning matters of qualification.⁶⁰ By this, the board would be forced to deal with the question of independency more closely. Concerning the nomination of supervisory board members, the evaluation could be combined with the information that need to be given under §§ 124 Abs.3 Satz 3, 125 Abs.1 Satz 3 AktG.

III. Conflict of Interest

Even if the company complies with the independence requirements a conflict of interest can occur, which might affect the decision-making process and the ability to objective and independent monitoring. The regulations and recommendations concerning independency try to avoid a possible conflict of interest by composing the board with members who are not bound by interests, which possibly conflict with the company's interest. The regulations and

⁵⁶ *Lieder*, NZG 2005, 569 (574).

⁵⁷ No. 5.5.3 Satz 1 DCGK.

⁵⁸ No. 5.4.4. Satz 2 DCGK.

⁵⁹ Same request: Recommendation of the *European Commission*, (2005/162/EC) ABl. EG L 52, 57 v. 25.02.2005; *Hüffer*, ZIP 2006, 637 (640); *Lieder*, NZG 2005, 569 (574). Further v. *Werder/Wieczorek*, DB 2007, 297 (302) (These 4.2), who request such a report for election and re-election of supervisory board members.

⁶⁰ Cp. *Lieder*, NZG 2005, 569 (573f.); *Lutter*, ZIP 2003, 417 (419); *Roth/Wörle*, ZGR 2004, 565 (576).

recommendations concerning a conflict of interest try to solve accrued conflicts to the company's best interest and in terms of best practice.

1. Development of Conflict of Interests

Conflicts of interests can occur because of personal or business interests of the members. They can also arise if the member is a representative of stakeholders or of a rival business. The likelihood is magnified because being a supervisory board member is still only an additional office. As a result the members often are members of the management or the supervisory board of other companies.⁶¹ Even if the board has an "adequate" number of independent members still "dependent" members remain who might get caught in a conflict of interest.

2. Regulation under the AktG

The AktG does not contain explicit regulations concerning the handling of an occurred conflict of interest. But it contains some general duties to disclose certain information concerning supervisory board members and candidates. It is generally accepted that in case of a conflict of interest the AktG requires in the exercise of the mandate strict loyalty to the company's best interest.⁶² Especially an occurring conflict of interest cannot justify putting other interests first while exercising the mandate.⁶³ This follows from the fiduciary duty under corporate law every member is bound to.⁶⁴

In case of a non-detachable conflict the member has to find a solution. He might be obliged to disclose the conflict and may not be allowed to participate in the particular decision or, as the case may be, must also stay away from the debate concerning the particular issue.⁶⁵ This, too, follows basically from the

⁶¹ For an exemplarily list of persons having more than one mandate in the 100 largest German corporations see *Krebs*, S. 17ff.

⁶² Cp. *BGH v. 21.12.1979* in: NJW 1980, 1629 (1630); Beck AG-HB/*Schiedermair/ Kolb*, § 7 Rn.244, 245; DCGK(-*Kremer*), Rn.1094; *Hüffer*, § 116 AktG Rn.5; *Krebs*, S.69; *Lutter/ Krieger*, Rn.765, 769; *Möllers* in: *Hommelhoff/ Hopt/ v. Werder*, Hdb. Corporate Governance, 405 (416).

⁶³ Cp. *BGH v. 21.12.1979* in: NJW 1980, 1629 (1630). Critical *Krebs*, S. 70f. referring to the duty of discretion to be observed in relation to another company.

⁶⁴ *BGH v. 29.01.1962* in: BGHZ 36, 296 (306, 310); *Krebs*, S. 69; *Möllers* in: *Hommelhoff/ Hopt/ v. Werder*, Hdb. Corporate Governance, 405 (416).

⁶⁵ Cp. *OLG Schleswig v. 26.04.2004* in: NZG 2004, 669 (670); DCGK(-*Kremer*), Rn.1121; *Lutter/ Krieger*, Rn.773; Critical: *Semler/ v. Schenk (-Marsch-Barner)*, Arb. Hdb., § 12 Rn.102.

fiduciary duty.⁶⁶ It is debated controversially whether an exclusion of the voting right can be enforced under the law in corresponding application of e.g. § 34 of the German Civil Code (BGB).⁶⁷ However, to deal with this discussion would exceed the limits of this paper. Focused on the issue of best practice it is sufficient to know that the exclusion of the voting right can be one measure to handle an occurred conflict of interest.

However, the exclusion from the voting right or even the exclusion from the meeting affects the membership right. Furthermore, it must be considered that in the large supervisory board under co-determination the chairman has in favor of the shareholder representatives a casting vote. If one shareholder representative is excluded from the voting-right the majority might tick over. Hence, it must be evaluated according to the particular conflict if an exclusion of the voting right is a proportionate measure and it must be decided in consultation with the affected member.⁶⁸ That shows that no superior way exists to handle an occurred conflict of interest, thus it might be advisable to avoid those.

In case of a permanent important conflict, the member can be obliged to resign from office.⁶⁹ Is the candidate a representative of a direct competitor in an important field and does that result into a permanent conflict right from the beginning, it can exceptionally be undue and challengeable to elect such a candidate, because he or she would not be able to exercise his or her mandate.⁷⁰

If the member conducts a breach of duty in case of a conflict of interest he or she might be held liable under §§ 116, 93 AktG. Finally, he or she can be recalled from office by court if the conflict has become an important reason in the sense of § 103 Abs.3 Satz 1 AktG.

⁶⁶ DCGK(-*Kremer*), Rn.1121; *Krebs*, S. 77; *Lutter/ Krieger*, Rn.771.

⁶⁷ Cp. *Hopt*, ZGR 2004, 1 (32); *Lutter/ Krieger*, Rn.771; The legal foundation of the exclusion of the voting right is debated controversially. See for detailed representation: *Krebs*, S. 113ff. Disapproving of an analogy to § 34 BGB: *Semler/ v. Schenck (-Marsch-Barner)*, Arb.Hdb., § 12 Rn.119.

⁶⁸ Cp. Beck AG-HB/*Schiedermair/ Kolb*, § 7 Rn.246.

⁶⁹ DCGK(-*Kremer*), Rn.1121; *Lutter/ Krieger*, Rn.772; *Möllers* in: *Hommelhoff/ Hopt/ v. Werder*, Hdb. Corporate Governance, 405 (416); *Wirth*, ZGR 2005, 327 (346).

⁷⁰ Cp. *OLG Schleswig v. 26.04.2004* in: NZG 2004, 669 (670).

3. Regulation under the DCGK

The DCGK addresses conflicts of interests under No. 5.5 DCGK. It contains three recommendations which are subject to the declaration of compliance under § 161 Satz 1 AktG. It also clarifies that the members are bound by the company's best interest.⁷¹

a) Attempt of the DCGK

The DCGK tries to solve conflicts of interests by increasing transparency. This enables the company and the shareholders to decide in the particular case how to handle a certain conflict.

Under No. 5.5.2 DCGK every member is obliged to inform the board of any conflict of interest which may result from a consultant or directorship function with clients, suppliers, lenders, or other business partners. Through the disclosure the conflict can be considered within the decision-making process. If further measures are necessary, e.g. not to participate in the particular decision, those can be taken by the board. The publication of a potential conflict may even hinder the conflict to come into existence. The conflicts and their treatment must also be disclosed to the general meeting.⁷² Consequently, the necessary transparency is achieved.

b) Disclosure and Treatment of Conflicts

Under No. 5.5.2 DCGK any conflict shall be disclosed. The disclosure must occur at the latest when the conflict affects the issues debated by the supervisory board.⁷³ To disclose conflicts is at the duty of every single member. Whether a conflict exists and whether it has impact on the work of the board must be decided in the particular case.

It has to be disclosed to the board as a whole but it is sufficient if the conflict is reported to the chairman who then informs the board. The chairman is obliged to examine under the principals of law and best practice what measures need to

⁷¹ No. 5.5.1 Satz 1 DCGK. See to the definition of the „company's best interest“ and the difficulties between shareholder and stakeholder approach: v. *Werder*, DB 2002, 801 (804).

⁷² No. 5.5.3 Satz 1 DCGK.

⁷³ Cp. DCGK(-*Kremer*), Rn.1106.

be taken.⁷⁴ If it is a material conflict or not just a temporary one, it is recommended under No. 5.5.3 Satz 2 DCGK to terminate the mandate.

In most cases, it will be sufficient to abstain from the particular decision. However, in case of non-participation in the decision respectively the exclusion of the voting right, it must be carefully evaluated what impact this has on the division of the votes. For this reason the DCGK does not recommend a certain procedure but only the disclosure of a conflict. That enables the board to decide according to the particular case.

Under No. 5.5.3 Satz 1 DCGK the supervisory board shall inform the general meeting of any occurred conflict of interest and their treatment. By this, the shareholders obtain information for the decision of exoneration under § 119 Abs.1 Nr.3 AktG and future re-election of board members.⁷⁵

c) Criticism of the DCGK Recommendation's

It has been criticized that the member of the board who is subject to a conflict of interest may often not realize the conflict or will feel that he or she is still able to an independent decision-making.⁷⁶

This criticism is true indeed, but the board members are obliged to act with the due diligence and therefore must evaluate the situation carefully. It is a matter of fact that in the end every member is self responsible and an external control is only possible in limited terms.

Even if a catalogue of relations or situations, that are assumed to be a conflict of interest, are issued, be it by law or by the DCGK, it can never be barred that a member will not truly disclose. The assumption that members in general will carelessly not disclose cannot be made. In contrary, most members will carefully check for any conflicts and draw the necessary consequences to avoid getting under suspicion and being held responsible. Nevertheless, it would not be harmful to publish a list of typical conflicts of interest and possible ways to handle those to help the board and its members to evaluate situations and

⁷⁴ DCGK(-*Kremer*), Rn.1106.

⁷⁵ DCGK(-*Kremer*), Rn.1117.

⁷⁶ *Bender/ Vater*, DStR 2003, 1807.

possible treatments. To keep the clarity of the DCGK it could be published in an annex.

d) Terms of Reference

§§ 107 to 110 AktG list basic regulations concerning the organization of the supervisory board. To achieve an efficient and transparent inner organization the supervisory board should issue terms of reference. It is enabled by law to do so⁷⁷ and it is recommended under No.5.1.3 DCGK.

The terms of reference can help to enhance transparency of the inner organization in particular the way decisions are reached.⁷⁸ Moreover, it can be used to define the way the conversion of the DCGK shall be achieved. Within the terms of reference the procedure to disclose and handle a conflict of interest can be set.⁷⁹

C. Issues affecting Independency

First issue coming up is how independency is defined or in other words, when can a member of the supervisory board be considered independent? According to No. 5.4.2 Satz 2 DCGK a “member is considered independent if he or she has no business or personal relations with the company or its management board which cause a conflict of interests.”⁸⁰ Therefore, No. 5.4.2 Satz 3 DCGK recommends that no more than two former members of the management board shall be members of the supervisory board and, in addition to that, that members shall not exercise directorships or similar positions or advisory tasks for important competitors of the enterprise.

The DCGK did not set up a list of criteria to define independence even though the European Commission recommended this.⁸¹ It only sets up a broad formula whereby personal and business relations to the company (and its management

⁷⁷ § 82 Abs.2 AktG assumes that the supervisory board issues terms of reference. Cp. *BGH v. 05.06.1975* in: BGHZ 64, 325 (328); Beck AG-HB/ *Schiedermair/ Kolb*, § 7 Rn.126.

⁷⁸ Cp. DCGK(-*Kremer*), Rn.954; *Hommelhoff/ Mattheus*, AG 1998, 249 (254).

⁷⁹ Cp. DCGK(-*Kremer*), Rn.954.

⁸⁰ This is principally in accordance with the Recommendation of the *European Commission*, (2005/162/EC) ABl. EG L 52, 56 v. 25.02.2005, but it excludes relations to the controlling shareholder.

⁸¹ Recommendation of the *European Commission*, Annex II, No.1 (e), (2005/162/EG), ABl. EG Nr. L 52, S.63 v. 25.02.2005.

board) hinder independency. But still, the criteria set up by the European Commission can be used to define independency under the German Code.⁸²

I. Personal or Business Relations to the Company

It is obvious that personal or business relations of the supervisory board member to the company and especially to the management board can affect his or hers independency, hence his or hers ability to objectively monitor the management board.

1. Effects of Business Relations

A business relation in the sense of No. 5.4.2. Satz 2 DCGK exists if there is a substantial volume of business between the member and the company respectively the management board.⁸³ If the member has business relations to the company he or she must deal with the management board. That leads to the threat that the member might not correctly control the management board for not endangering his or hers business relation. Or it might be that he or she is tempted to monitor not too closely because he or she would harm his or her business interests. Out of this reasons, it is assumed that a business relation with the company respectively the management board will influence the monitoring of the management as soon as the business volume exceeds certain limits.

2. Relevant Business Relations

The business relation can be “direct” or “indirect”. A direct business relation is existent if the member itself is business partner of the company, e.g. if they have a contract for an external consultancy.⁸⁴ An indirect business relation exists if the member is at the same time member of the management of a client, lender, or a supplier.

At question is whether the definition of independency in No. 5.4.2 Satz 2 refers only to the direct relations or to the indirect relations as well. The Standing German Corporate Governance Commission did not further define the

⁸² *Lieder*, NZG 2005, 569 (570).

⁸³ Cp. *Lieder*, NZG 2005, 569 (570).

⁸⁴ *Lieder*, NZG 2005, 569 (571). See on consultancy contracts of supervisory board members with the company: *BGH* v. 20.11.2006 in: ZIP 2007, 22ff.; *Peltzer*, ZIP 2007, 305ff.

independence criteria.⁸⁵ But it refers to the Recommendation of the *European Commission* and they again assume that “indirect” relations to the company will make the member dependent, too.⁸⁶ Hence, a member is dependent under the DCGK if he or she has a business relation to the company respectively the management board no matter if the relation is direct or indirect.

It is suggested that independency should be defined according to §§ 319, 319 a of the German Commercial Code (HGB).⁸⁷ Those contains strict criteria under which the independence of the auditor is determined. Those basically exclude an auditor if he or she had or has any business relations to the company as long as they are not insignificant. Hence, those correspond with the criteria set up by the *European Commission* to determine the independency of supervisory board members.⁸⁸ Therefore they can be consulted as a guideline to define (personal and) business relations. Nevertheless, it must be kept in mind while using the criteria of §§ 319, 319 a HGB that the demands on the auditor regarding independence are higher compared to the supervisory board (member) because of its different role and function. Thus, the direct application of the criteria of §§ 319, 319 a HGB would be too strict.

3. Personal Relation

A personal relation that puts independency at a risk exists if the member has a close familiar and/or emotional relation to one of the management board members or the company which is able to affect his or hers judgment.⁸⁹ In case of a company hold by a family, family members are placed in the supervisory board to control the company. This does not necessarily contradict best practice but the member cannot be considered independent.

Emotional relations can also occur if the member used to be a member of the management board and thus still has a personal relation to his former

⁸⁵ Cp. Speech of the chairman of the Standing Corporate Governance Commission Dr. Gerhard Cromme, S.7f. The speech can be downloaded from http://www.corporate-governance-code.de/ger/download/CGC_Konferenz_Berlin_2005_Dr_Cromme_de.pdf as accessed on May 8, 2007.

⁸⁶ Recommendation of the *European Commission* (Fn.36), Annex II 1. (e), (2005/162/EC) ABl. EG L 52, 63 v. 25.02.2005.

⁸⁷ Cp. *AKEIÜ*, DB 2006, 1625 (1626).

⁸⁸ Cp. Recommendation of the *European Commission* (Fn.36), Annex II 1., (2005/162/EC) ABl. EG L 52, 63 v. 25.02.2005.

⁸⁹ Cp. *Lieder*, NZG 2005, 569 (571).

colleagues. The same problem can occur if the person has been an auditor of the company.⁹⁰ However, in the case of the former auditor it has to be considered that the auditor is bound to strict independence. A personal relation can therefore only be assumed if additional relations exist.

In the evaluation of the personal relations, it must be taken into account that a respect- and trustful cooperation between the management and the supervisory board is essential for the success of the company, cp. No. 3.1 DCGK. Consequently, emotional relations must be evaluated in the particular case.

4. Measures to Handle Personal and Business Relations to the Company

A member who has a business or a personal relation to the company or the management board cannot be considered independent. As long as an adequate number of the remaining board members are independent, the company complies with the Code and a declaration must not be given.⁹¹ The DCGK does not contain the obligation to disclose such relations as long as no conflict of interest has arisen.⁹² If a conflict of interest is caused, the member is bound to the company's best interest and he or she must disclose the conflict to the board and subsequently to the general meeting.⁹³

Beyond this the board should disclose all relevant business relations between the board members respectively candidates and the company respectively the management board. A recommendation with such a content should be introduced into the DCGK. By this transparency is enhanced and the shareholders are enabled to truly evaluate the composition of the board. Such a justification complies with the duties to disclose under §§ 124 Abs.3 Satz 3, 125 Abs.1 Satz 3 AktG and the overall idea of the DCGK to enhance transparency.

⁹⁰ Cp. *Bender/ Vater*, DStR 2003, 1807 (1808f.).

⁹¹ Cp. No. 5.4.2 Satz 1 DCGK.

⁹² Cp. No. 5.5.2 DCGK.

⁹³ No. 5.5.2 and 5.5.3 DCGK.

II. Transfer from Management to Supervisory Board

Independency can further be threatened if former management board members become members of the supervisory board. The issue is a current one because it is existing practice in German companies.⁹⁴ In January 2004 half of the chairmen of the supervisory boards of the Dax-30-companies were former chairmen of the management board of the respective company.⁹⁵ Even the chairman of the Standing Corporate Governance Commission, Dr. Gerhard Cromme, transferred directly from the chair position of the management board to the chair position of the supervisory board of the “ThyssenKrupp AG”.⁹⁶

In the past the transfer from management to supervisory board was not at issue because the prevailing idea was that due to the personal division of the boards independency was guaranteed.⁹⁷ This idea has been questioned and it must be evaluated whether it still can be considered good corporate governance if former management board members become members of the supervisory board.

1. Advantages and Disadvantages

A transfer from the management to the supervisory board can have advantages and disadvantages. The issue arises with every transfer from management to supervisory board and even bears more importance if the chairman of the management board directly transfers to the position of the chairman of the supervisory board.

a) Advantages of a Transfer

The transfer (of the chairman) of the management board to (the chair position of) the supervisory board has certain advantages. First of all, this person has an advanced knowledge of the company's matters as well as an expertise qualification in terms of business relations and all similar matters concerned

⁹⁴ DCGK(-*Kremer*), Rn.961; *Wirth*, ZGR 2005, 327 (339f.).

⁹⁵ *Bender/ Vater*, DStR 2003, 1807 (1808); *Rode*, BB 2006, 341.

⁹⁶ See the homepage of ThyssenKrupp AG under <http://www.thyssenkrupp.com/en/konzern/cromme.html&device=printer> as accessed on May 8, 2007.

⁹⁷ *Bender/ Vater*, DStR 2003, 1807.

with the company.⁹⁸ As a result, the quality of the advice and the monitoring through the supervisory board can be enhanced. In addition, it serves continuity in the business policy of the company.⁹⁹

Moreover, it is assumed that the former chairman of the management board has the ability to become a strong chairman of the supervisory board and thus has better abilities to control the management board.¹⁰⁰ Finally, the company does not need to find someone else suited to fill this position.¹⁰¹

b) Disadvantages of the Transfer

The direct transfer from management to supervisory board and especially the transfer from the position of the chairman of the management to the position of the chairman of the supervisory board has been subject to objection.

One argument set up is that the new supervisory board member/chairman will control his or her former business management and he or she will not be critical enough to control it adequately.¹⁰² If there have been cases of mismanagement it might even be that those will be kept secret while he or she is in charge in the supervisory board.¹⁰³ An independent judgment might also be endangered because of personal solidarity to his former colleagues.¹⁰⁴ Conflicts can furthermore arise if the former management board member influences his successor and undermines its authority.¹⁰⁵

Another issue can arise if a change in business strategy is necessary. If the former chairman of the management board developed the strategy it is likely that he will not be open minded to a change but instead will try to prevent it.¹⁰⁶ As a result a (necessary) further development is blocked, especially if the

⁹⁸ Cp. DCGK(-Kremer), Rn.961, 1036; *Hopt/ Leyens*, ECFR 2004, 135 (164); *Jungmann*, ECFR 2006, 426 (466); *Lange*, NZG 2004, 265 (266); *Nagel*, NZG 2007, 166 (168); *Rode*, BB 2006, 341f.; *Schiessl*, AG 2002, 593 (598); *Wirth*, ZGR 2005, 327 (340).

⁹⁹ *Lange*, NZG 2004, 265 (266); *Rode*, BB 2006, 341 (342).

¹⁰⁰ Cp. *Schiessl*, AG 2002, 593 (598).

¹⁰¹ *Lieder*, NZG 2005, 569 (574).

¹⁰² *Bender/ Vater*, DStR 2003, 1807 (1808); *Lange*, NZG 2004, 265; *Lieder*, NZG 2005, 569 (572f.); *Rode*, BB 2006, 341 (342); *Roth/ Wörle*, ZGR 2004, 565 (586).

¹⁰³ *Lieder*, NZG 2005, 569 (572f.); *Rode*, BB 2006, 341 (342); *Schiessl*, AG 2002, 593 (598).

¹⁰⁴ *Bender/ Vater*, DStR 2003, 1807 (1808); *Hüffer*, ZIP 2006, 637 (642); *Rode*, BB 2006, 341 (342).

¹⁰⁵ *Schiessl*, AG 2002, 593 (598).

¹⁰⁶ Cp. *Bender/ Vater*, DStR 2003, 1807 (1808); DCGK(-Kremer), Rn.961, 1036; *Lange*, NZG 2004, 265 (267); *Lieder*, NZG 2005, 569 (572f.); *Rode*, BB 2006, 341 (342); *Roth/ Wörle*, ZGR 2004, 565 (586).

required change is subject to approval under § 111 Abs.4 Satz 2 DCGK. The advantage of continuity in business politics through the transfer turns backwards in such a case.¹⁰⁷

c) Personal Statement

A direct transfer from management to supervisory board endangers on the one hand the independency of the supervisory board but on the other hand might bring in useful expert knowledge. Those two aspects are heightened if the former chairman of the management board becomes the chairman of the supervisory board. For the evaluation of the issue, it must be differentiated between the number of independent members recommended under the DCGK and the question whether a transfer can be considered best practice at all.

It is evident that a former manager is not independent, especially not if he used to be the chairman of the management board. Hence, the person cannot be counted as an independent board member under No. 5.4.2 Satz 1 DCGK. If the board has otherwise enough independent members they still can comply with No. 5.4.2 DCGK as long as no more than two former management board members are on the supervisory board, No. 5.4.2 Satz 3 DCGK.

To answer the other question, whether a transfer can be considered best practice at all, it must be differentiated: A transfer is afflicted by the risk that the former manager will not be able to adequately control his former management and will often have problems not to block or influence his successor. Therefore, a transfer should be avoided. Even though it is still common practice in Germany it cannot be considered best practice. Notwithstanding, cases might occur in which the advice of the former manager is crucial to the company, e.g. if the company is in a phase of reorganization that has not been completed. In such a constellation the transfer serves the welfare of the company and thus it might actually be best practice. Nevertheless, a transfer requires the personal ability of the person to understand and adapt to its changed role.¹⁰⁸ As a result, it can be established that a direct transfer cannot be considered best practice in general but in single particular cases an exception might be necessary.

¹⁰⁷ *Rode*, BB 2006, 341 (342).

¹⁰⁸ *Cp. DCGK(-Kremer)*, Rn.962.

Nevertheless, a transfer is still common practice in Germany. In that context the question arises which regulations exist under the AktG and under the DCGK and what further measures could be taken.

2. Regulation under the AktG

§ 105 Abs.1 AktG forbids according to its wording only simultaneous membership in both boards. Therefore, a change is not directly prohibited under the regulation of the AktG.

In the juridical literature it has been discussed, if § 105 Abs.1 AktG could be applied by analogy. It was argued that § 105 AktG should be understood related to its purpose and not related to the person.¹⁰⁹ Purpose of § 105 AktG is to secure the division of power.¹¹⁰ Hence, it was interpreted in the way that the management cannot be controlled by former managers even if they have retired.

An analogy requires that an unintended loophole exists and that the rule that shall be applied regulates comparable circumstances. The legislator knew that it was common practice for management board members to transfer to the supervisory board.¹¹¹ However, he did not regulate the issue even though he could have done so within the KonTraG or even the TransPuG. As a result there is no unintended loophole. The split of function is indeed not directly endangered if the membership in the supervisory board follows after the termination of the membership in the management board.¹¹² Accordingly, there is no necessity for an analogy.

For the same reasons an also suggested analogy to § 319 II, III Satz 1 Nr.2 HGB must be rejected.¹¹³ According to § 319 II, III Satz 1 Nr.2 HGB an auditor is excluded if he or she is a member of the supervisory board of the company or of a related company. There is still no loophole that would allow an analogy and the function of the auditor cannot be compared with the function of the supervisory board. Consequently,

¹⁰⁹ *Lange*, ZGR 2004, 265 (268).

¹¹⁰ MüKo(-Semler), AktG, § 105 AktG, Rn.2.

¹¹¹ *Wirth*, ZGR 2005, 327 (342).

¹¹² *LG München I* v. 15.04.2004 in: NZG 2004, 626 (627f.).

¹¹³ *Lange*, ZGR 2004, 265 (268).

§ 319 II, III Satz 1 Nr.2 HGB does not regulate comparable circumstances.¹¹⁴ This leads to the conclusion that the necessary requirements for an analogy do not exist.

As a result, it can be noted that the AktG does neither direct nor indirect prohibits the transfer from management to supervisory board.¹¹⁵ Actually, the prohibition of a transfer would restrict the company significantly in its business judgment and would therefore probably be disproportionate anyway.¹¹⁶

3. Regulation under the DCGK

Next question is whether a transfer can be considered best practice under the DCGK respectively how a transfer can be wound up in terms of best practice.

a) Recommendation of the DCGK

The Code does not directly prohibit a transfer from management to supervisory board, either. It only restricts a transfer by recommending that no more than two former management board members shall be members of the supervisory board as well as it should not be the rule for the former chairman of the management board to become the chairman of the supervisory board or a supervisory board committee.¹¹⁷ In case of an intended transfer from one chair position to the other, “special reasons shall be presented to the annual general meeting.”¹¹⁸ Both provisions are subject to the declaration of compliance under § 161 AktG, hence a non-compliance must be declared. Finally, No. 5.3.2 Satz 3 DCGK suggests that a former member of the management board should not become the chairman of the audit committee. This suggestion is not considered to be best practice yet, thus it is not subject to the declaration of compliance under § 161 AktG.

Besides this, a former management board member cannot be considered independent because of the personal relations that exist to his former colleagues and the company. The company still complies with

¹¹⁴ *LG München I v.* 15.04.2004 in: NZG 2004, 626 (628).

¹¹⁵ Cp. *Goulding/ Miles/ Schall*, ECFR 2004, 58f.; *Hüffer*, ZIP 2006, 637 (638, 640); *Wirth*, ZGR 2005, 327 (341f.).

¹¹⁶ See *Rode*, BB 2006, 341 (343).

¹¹⁷ Cp. No. 5.4.2 Satz 3, 1. Hs. and No. 5.4.4 Satz 1 DCGK.

¹¹⁸ No. 5.4.4. Satz 2 DCGK.

No. 5.4.2 Satz 1, 2 DCGK if an adequate number of independent board members remain.

b) Purpose of the DCGK Recommendations

Even though the issue of a direct transfer from the (position of the chairman of the) management board to the (position of the chairman of the) supervisory board had been known for a longer period, No. 5.4.4. DCGK was only introduced into the DCGK in June 2005.¹¹⁹

The DCGK acknowledges that transfers from management to supervisory board are common practice and therefore it chose a moderate solution instead of a prohibition. The number of former managers in the supervisory board shall be restricted to two and the direct transfer from one chair to the other chair position shall only take place if it is indicated by special reasons. Hence, the Code aims to force the company to carefully evaluate a transfer and prevent an automatic transfer.¹²⁰ The conclusion of this is that the DCGK generally considers a transfer not to be best practice, but there might be cases in which a transfer still is in accordance with best practice.¹²¹

It needs to be pointed out that in almost no German stock corporation more than two former members of the management board are members of the supervisory board.¹²² In most cases it is only one former manager member of the supervisory board.¹²³ Therefore, the recommendation, that no more than two former managers shall be members of the supervisory board, represents the overall established practice and does not contain a new measure to enhance independency.

c) Criticism of the DCGK Recommendation's

One point criticized about No. 5.4.4 DCGK is the chosen wording.¹²⁴ The Code states that “it shall not be the rule”. That leads to the question at what point a

¹¹⁹ No. 5.4.4. of the DCGK was amended on June 2, 2005. An overview over the amendmends of the DCGK can be downloaded under <http://www.corporate-governance-code.de/> as accessed on May 8, 2007.

¹²⁰ Cp. *Lieder*, NZG 2005, 569 (573).

¹²¹ Cp. *Hüffer*, ZIP 2006, 637 (642).

¹²² *Roth/ Wörle*, ZGR 2004, 565 (586).

¹²³ *Roth/ Wörle*, ZGR 2004, 565 (586).

¹²⁴ *Rode*, BB 2006, 341 (342).

transfer must be considered “the rule”. Can it be considered “the rule” if it occurs regularly or in general or is it enough if it occurs at all? The company has to declare under § 161 Satz 1 AktG solely if it considers the current transfer as “the rule”. Thus, if No. 5.4.4 DCGK is interpreted strict to the wording, it does not bear too much pressure.

This criticism is legitimate because the Standing Corporate Governance Commission intended to generally consider a transfer not as best practice and it should take place only in special cases. But since the attempt is quiet apparent it would probably be an undue avoidance of a declaration of non-compliance under § 161 AktG if a transfer is not declared because the company does not consider it “the rule”. Nevertheless, the wording of the Code should be changed.

4. “Cooling-Off Period”

One measure suggested to conduct a transfer in terms of best practice is to introduce a “cooling off period”.¹²⁵ Members of the management board willing to change to supervisory board should transfer only after a certain amount of time has passed. The time periods recommended vary between at least two years up to three or even five years.¹²⁶ Neither the AktG nor the DCGK contains a regulation or recommendation for a “cooling-off period” yet.

a) “Cooling-Off Period” by Law

One suggestion is to introduce a “cooling-off period” by law.¹²⁷ One argument for such a solution is that a transfer in the described manner is in Germany still understood as good corporate governance and the companies are very reluctant to change this attitude.¹²⁸ For this, the voluntary approach of the DCGK is considered not to be successful.¹²⁹

¹²⁵ Recommendation of the *European Commission* (Fn.36), Annex II 1. (a) (2005/162/EC) AB1. EG L 52, 63 v. 25.02.2005; *Nagel*, NZG 2007, 166 (166, 168); *Rode*, BB 2006, 341 (343).

¹²⁶ Cp. Recommendation of the *European Commission* (Fn.36), Annex II No. 1. (a), (2005/162/EG), AB1. EG Nr. L 52, S.63 v. 25.02.2005; DCGK(-*Kremer*), Rn.961; *Nagel*, NZG 2007, 166 (166, 168).

¹²⁷ Approving: *Rode*, BB 2006, 341 (344).

¹²⁸ *Rode*, BB 2006, 341 (344).

¹²⁹ *Rode*, BB 2006, 341 (344).

This demand must be rejected. The approach through self-regulation under the DCGK is satisfactory because the company would be forced to give reason for a direct transfer and the shareholders would be free in their choice.¹³⁰ Moreover, a regulation under compelling law would lead to a lack of flexibility.¹³¹ Especially for companies held by a family or companies with similar owner structures the control first through the management and afterwards through the supervisory board is crucial and part of the business policy. For this a prohibition under the law would be probably be even disproportionate. If a “cooling-off-period” is introduced at all it should be as a recommendation or suggestion under the DCGK.

b) “Cooling Off Period” under the DCGK

The demand to introduce a “cooling-off period” under the DCGK has been criticized by the juridical literats and the Standing Corporate Governance Commission.

The German Standing Corporate Governance Committee that issues the DCGK wanted it to be possible that a transfer from management to supervisory board is possible without waiting for a certain period of time.¹³² They argued that such a period is neither necessary nor useful because there is no evidence that it enlarges independency. Such a period would first of all result in a loss of knowledge and expertise the company might need.¹³³ Secondly, it would often lead to a disqualification of the person due terms of his or her age because in most cases former managers will be in their sixties at the time they retire from the management board.¹³⁴ Moreover, it is difficult to decide at what point a former management board member has regained neutrality.¹³⁵ Therefore, it is not felt that a “cooling-off period” would help to solve the issues connected with a transfer and was not introduced into the DCGK.

¹³⁰ Cp. the argumentation of *Bender/ Vater*, DStR 2003, 1807 (1808).

¹³¹ Cp. *Bender/ Vater*, DStR 2003, 1807 (1809).

¹³² See page 10 of the speech of *Gerhard Cromme* on the occasion of the 4th Conference on the German Corporate Governance Code on June 24, 2005, (Fn.85).

¹³³ See page 10 of the speech of *Gerhard Cromme* on the occasion of the 4th Conference on the German Corporate Governance Code on June 24, 2005, (Fn.85). Similar: *Hüffer*, ZIP 2006, 637 (643); *Rode*, BB 2006, 341 (343); *Wirth*, ZGR 2005, 327 (342).

¹³⁴ See page 10 of the speech of *Gerhard Cromme* on the occasion of the 4th Conference on the German Corporate Governance Code on June 24, 2005, (Fn.85). Similar: *Hüffer*, ZIP 2006, 637 (642).

¹³⁵ DCGK(-*Kremer*), Rn.961, 1037.

c) Personal Statement

In my opinion a “cooling-off period” serves independency quiet well because it would create a certain distance between the former manager and his colleagues and the company. It also avoids that he or she will control his or her own business management and enables the new chairman respectively the new management board member(s) to undertake necessary changes. The election of a former manager after a period of three to five years can consequently be considered best practice by all means. The member can also be considered independent under No. 5.4.2 Satz 1, 2 DCGK if five years have passed since the retirement from the management board.¹³⁶

Nevertheless, it can generally not be considered best practice if a direct transfer occurs even though it still is common practice in Germany. Even though the critics of a “cooling-off period” point out correctly that such a period may lead to a loss of knowledge and that the member might not be at the company’s disposal anymore after having taken the “cooling-off period”. Hence, a direct transfer is supposed to be justified by the advantages the company might gain. Still, the disadvantages overweigh the advantages. The risks resulting from an ineffective control through the supervisory board are even greater than the possible achievement of knowledge. Concerning this frightened loss of knowledge, it needs to be clarified that even after a “cooling-off period” of five years the former manager will not have forgotten all of its knowledge concerning the company’s business and structure. Hence, even after five years he or she can give valuable advice.

One further measure could be to introduce a “cooling-off period” into the DCGK by suggestion, i.e. a declaration under § 161 AktG would not be necessary. That solution would on the one hand recognize that it has not really been accepted as best practice but on the other hand would articulate that a direct transfer must be evaluated with the necessary care and will in future times not be accepted as easily.

¹³⁶ Cp. Recommendation of the *European Commission* (Fn.36), Annex II No. 1. (a) (2005/162/EG), ABl. EG Nr. L 52, S.63 v. 25.02.2005.

5. Further Measures to Handle a Transfer

Summing up one might say, a direct transfer cannot be considered best practice as long as there are no compelling, exceptional reasons. The approach of No. 5.4.4. DCGK concerning the transfer from one chair position to the other recognizes this and offers a good way to handle the direct transfer. The recommendation to justify the transfer at the general meeting might hinder the company to only pay lip service to the nomination. However, the recommendation should be expanded to every transfer from management to supervisory board. This could be combined with the above demanded justification of every nomination in terms of independence, conflict of interest and qualification.

One alternative solution to a transfer to the supervisory board could be to conclude a consultancy contract with the retired management board member.¹³⁷ By this the special knowledge could be kept and a dependency could be avoided. But still, this is no overall possible solution because the former manager might have other offers for example that do not allow him to conclude such a contract. And of course, a contract is limited to certain areas and therefore is not as all-embracing as the supervisory board mandate. Nevertheless, it might be a possible solution depending on the particular case.

However, it will take some time until managers and supervisory board members of German corporations have internalized that a direct transfer is generally not best practice.

III. Seats in Competitors Boards'

Independency can further be put at risk if a member is simultaneously member of the management board of a competitor or is in a similar position at a competitor's company. This has in practice occurred quiet often because it was considered to be one way to serve business relations. Furthermore, it can occur with large enterprises, which operate in many business areas.

Through the simultaneous membership in the boards of competing companies a specific danger is generated that the member will not be able to objectively

¹³⁷ See *Rode*, BB 2006, 341 (343).

decide in the company's best interest. The member is in the situation that both offices oblige him to act in the particular company's interest. This causes a conflict of the contradictory interests and a more or less permanent conflict of interest exists. He or she might even be lead into temptation to use superior knowledge to influence decisions to the best interest of the other company. This conflict may also influence the debate in the supervisory board and therefore affect the work efficiency because an open discussion cannot be achieved if someone closely linked to a competitor is present.

1. Regulations under the AktG

At question is whether the AktG contains a non-competition clause addressed to the supervisory board. It does not contain an explicit regulation as it has under § 88 AktG for the members of the management board. The legislator knew about the issue and had the opportunity to introduce a non-competition clause under the KonTraG or the TransPuG, but knowingly decided not to regulate it under the law.¹³⁸ Therefore, no unintended loophole exists that would allow an analogy.¹³⁹ Quite to the contrary, the legislator decided that the non-competition-clause of § 88 AktG is not applicable to supervisory board members that act as a substitute for a management board member, § 105 Abs.2 Satz 4 AktG. This again shows that under the AktG the supervisory board mandate is considered only to be an additional office. The fiduciary duty can not constitute a non-competition clause either.¹⁴⁰

Another approach to create a prohibition to serve in the boards of rival businesses under the AktG is taken under § 116 Satz 1, 93 AktG.¹⁴¹ It is argued that an adequate and orderly office management is not possible if the member is at the same time member of a board of a rival business and would therefore violate §§ 116 Satz 1, 93 AktG.¹⁴² Hence this view considers the election of a member of the board of a rival business void.¹⁴³

¹³⁸ Cp. Begr. d. RegE KonTraG zu §§ 124 Abs.3, 125 Abs.1, BT-Drs. 13/9712, S.17.

¹³⁹ Cp. *Wirth*, ZGR 2005, 327 (344).

¹⁴⁰ *Möllers* in: *Hommelhoff/ Hopt/ v. Werder*, Hdb. Corporate Governance, 405 (417).

¹⁴¹ *Lutter/ Krieger*, R.21f.

¹⁴² *Lutter/ Krieger*, R.21f. Just as well: *Peltzer*, NZG 2002, 10 (15).

¹⁴³ *Lutter/ Krieger*, R.21f.

This approach cannot be approved. Although it points out correctly that the membership in the board of a rival business inherently contains conflicts of interests. This does not lead to an automatic inability to act with the adequate and orderly care. It falls short to believe that supervisory board members are generally unable to solve such conflicts in an appropriate way. And still, even if such a prohibition would be desirable, the legislator knew about the problem and decided to solve it by enhancing transparency instead of prohibiting it. The assumption of a prohibition under §§ 116 Satz 1, 93 AktG contradicts the legislative will and thus cannot be accepted.

Consequently, the AktG does not forbid members to be in supervisory boards of rival businesses.¹⁴⁴ The law assumes that an arising conflict can be solved under the general rules whereafter the member must act in the company's best interest while exercising his mandate.¹⁴⁵ In addition, every member of the board is obliged to discretion, cp. § 116 Satz 2 AktG, whereby a breach of this duty is even put under penalty, § 404 AktG.¹⁴⁶

2. Regulations under the DCGK

Under No. 5.4.2. Satz 3, Hs.2 DCGK shall supervisory board members “not exercise directorships or similar positions or advisory tasks for important competitors of the enterprise.” Thus, the DCGK considers it not to be best practice to place representatives of rival businesses in the supervisory board. The company has to declare under § 161 Satz 1 AktG whether it followed the recommendation.

a) Representatives of Important Competitors

The Code refers to “directorship or similar positions or advisory tasks”. This includes the membership in the management and in the supervisory board of

¹⁴⁴ Cp. *BGH* v. 21.02.1963 in: BGHZ 39, 116 (123f.); *OLG Schleswig* v. 26.04.2004 in: NZG 2004, 669f.; DCGK(-*Kremer*), Rn.1040; *Möllers* in: *Hommelhoff/ Hopt/ v. Werder*, Hdb. Corporate Governance, 405 (417); *Semler/ v. Schenck (-Marsch-Barner)*, § 12 Rn.141; *Wirth*, ZGR 2005, 327 (344).

¹⁴⁵ Cp. *OLG Schleswig* v. 26.04.2004 in: NZG 2004, 669 (670); *Wirth*, ZGR 2005, 327 (344).

¹⁴⁶ § 116 Satz 2 AktG has been introduced through the TransPuG and clarifies this duty explicitly, Begr. d. RegE zum TransPuG, BT-Drs. 14/ 8769, 18. Cp. *Götz*, NZG 2002, 599 (603); *Ihrig/ Wagner*, BB 2002, 789 (794).

rival businesses as well as all advisory functions, especially consultancy contracts with competitors.¹⁴⁷

The company must only declare under § 161 AktG if the member is connected with an important competitor. Only important competitors must be considered to preserve a freedom of scope concerning potential candidates.¹⁴⁸ A competitor is considered to be an important one if one third or one quarter of the group turnover is affected.¹⁴⁹

Sometimes it can be difficult to determine whether another company is an important competitor. No. 5.4.2 Satz 3 DCGK refers to the “enterprise”, i.e. it must be a competitor of the corporate group. Therefore, not every competitor of a business unit is a competitor of the group.¹⁵⁰ Here, the issue arises, whether the other company is competitor of the group and not only of one company. Those issues can only be evaluated in the particular case, thus a more detailed general rule cannot be found.

b) Representatives and Conflict of Interest

If the company decided to nevertheless elect a candidate that is simultaneously member of a competitor’s board or if the competitor is not an important one or if the competition occurs after the member has been elected, the regulations of the DCGK concerning conflicts of interest can be applied.

According to those, the member must disclose the conflict to the board, and it shall be reported to the general meeting.¹⁵¹ In case of a material conflict of interest it shall result in the termination of office.¹⁵² The Code does not name seats in competitor’s board explicitly as a potential source of conflict of interest.¹⁵³ They are not named because the Code already recommends to not elect such members at all.¹⁵⁴ However, they are a relevant source of conflict of interest and therefore the provisions concerning a conflict of interest should be

¹⁴⁷ DCGK(-*Kremer*), Rn.1043.

¹⁴⁸ DCGK(-*Kremer*), Rn.1044. In accordance: Semler/ v. Schenk (-*Marsch-Barner*), § 12 Rn.143.

¹⁴⁹ DCGK(-*Kremer*), Rn.1044.

¹⁵⁰ DCGK(-*Kremer*), Rn.1044.

¹⁵¹ No. 5.5.2 DCGK and No.5.5.3 Satz 1 DCGK.

¹⁵² No. 5.5.3 Satz 2 DCGK.

¹⁵³ Cp. No. 5.5.2 DCGK.

¹⁵⁴ No. 5.4.2 Satz 3, 2. Hs. DCGK.

applied to them, too. Any other interpretation would cut spirit and purpose of the recommendation short hence would be an undue avoidance. Those recommendations are recommendations that need to be declared about under § 161 AktG.

c) Independency

At question is whether a member who is at the same time member of the board of a competitor can be considered independent under No. 5.4.1 Satz 1 DCGK. He or she could not be considered independent if the membership in a competitor's board would be a "business relation" in the sense of No. 5.4.2 Satz 1 DCGK. An interpretation of the wording considering the recommendations of the *European Commission* leads to the result that only relations that were based on cooperation not on competition in business were business relations in that sense.¹⁵⁵

A member who is simultaneously member of an (important) competitor cannot be considered independent. Independency means the ability to make decisions without being subjected to interests other than the best interest of the particular company. A member of a competitor's board is always subjected to the interests of the rival company and as soon as those interests are contradictory to each other independent decision-making is threatened. Consequently, a member cannot be considered independent if he or she is simultaneously member of the board of an (important) competitor. As already pointed out above, the Code does not explicitly name relations to competitors because it recommends that those are not seated on the board at all.¹⁵⁶ If no adequate number of independent members remains, it must be declared under § 161 AktG.

3. Conclusion

The AktG does not forbid the simultaneous membership in rival businesses. Still it attempts to disclose those by the information that need to be given under §§ 124 Abs.3 Satz3, 125 Abs.1 Satz 3 AktG. The member is bound to the

¹⁵⁵ Cp. Recommendation of the *European Commission* (Fn.36), Annex II No. 1. (e) (2005/162/EG), ABl. EG Nr. L 52, S.63 v. 25.02.2005.

¹⁵⁶ No. 5.4.2 Satz 3, 2. Hs. DCGK.

interest of the particular company while exercising his mandate. This follows from §§ 116 Satz 1, 93 AktG in combination with the general fiduciary duty.

The DCGK does not consider the simultaneous membership best practice, No. 5.4.2 Satz 3, 2.Hs. DCGK, and an aberration needs to be declared under § 161 AktG. If a member is appointed anyway, it must be handled under the recommendations concerning a conflict of interest.¹⁵⁷

4. Personal Statement

The issue of simultaneous membership in boards of rival businesses should be handled in the same way as a transfer from management to supervisory board. It can generally not be considered best practice. If it is intended anyway it should be justified at the general meeting. Therefore, a corresponding recommendation should be introduced into the DCGK.

If the member becomes a representative of a rival business after he has been appointed to the board, the rules of the DCGK concerning the handling of conflict of interest can be applied. Consequently, No. 5.5.2 DCGK should be amended by naming competitors representatives as a potential source of a conflict of interest, too. It must be evaluated very carefully whether a termination of office would not be the appropriate measure.

¹⁵⁷ No.5.5.2f. DCGK.

D. Personal Statement

The independency of the supervisory board and in correspondence the independency of the individual member has in Germany not been at issue until the late 1990's. Since then first legislative steps were taken, but still, the AktG does neither require individual members nor the board as a whole to be independent. The DCGK addresses the issue of dependent supervisory board members very careful and only under the constant pressure of the European Union and the international capital market. Nevertheless, first steps have been taken under the DCGK to make German supervisory boards more independent from the company and other influences.

The DCGK has been well accepted in the past five years.¹⁵⁸ Even though the assumption that the capital market would punish non-compliance did not prove itself true,¹⁵⁹ most of the German corporations follow the recommendations of the Code.¹⁶⁰ That shows that the approach by not-binding self-regulation works out and should be continued.

Nevertheless remain some general problems which hinder the independence of the board. The German supervisory board is composed with representatives of the different stakeholders and therefore will always be subject to different interests. Still, this has been accepted by the legislator and will not be changed in the near future. Therefore, complete independency of the board will not be achieved.

Moreover, the membership is still considered to be only an additional office.¹⁶¹ It might be helpful to create financial incentives to make the membership in the board a profession at least in concern of the chairman of the supervisory board.¹⁶²

However, the careful approach of the Code permits a change in the understanding of the role of the supervisory board. It still has been common

¹⁵⁸ *Du Plessis*, EBLR, 1139 (1140); v. *Werder/ Talaulicar*, DB 2005, 841 (846); *dies.*, DB 2006, 849 (855).

¹⁵⁹ *Nowak/ Rott/ Mahr*, ZGR 2005, 252 (279); already: *Peltzer*, NZG 2002, 593 (599).

¹⁶⁰ Cp. *Werner Sturbeck* „Auf den Kodex-Wächter wartet viel Arbeit“, article published in the F.A.Z on Friday 27, 2007.

¹⁶¹ Dr. Gerhard Cromme is a professional supervisory board member and is insofar an exception.

¹⁶² Cp. *Jungmann*, ECFR 2006, 426 (465).

practice for the chairman of the management board to become the chairman of the supervisory board. This shows that the idea of the independent supervisory board has not settled into the minds of managers and supervisory board members of German corporations, yet. By giving certain recommendations through the not binding Code instead of a prohibition under the compelling law, a real change towards more transparency and more effective control can be achieved. Especially the “independency in mind”, which hardly has been addressed in the juridical literature,¹⁶³ needs to further develop. Independence in mind stands for the thought, that effective corporate governance can only take place if managers and controllers feel obliged to it. Only if the attitude of supervisory board members concerning their role and function changes towards the idea of an independent controller a real change will occur in the composition of German supervisory boards.¹⁶⁴ The recommendation of the DCGK can only be considered to be a first step towards a changed role understanding of supervisory board membership.

¹⁶³ *AKEIÜ*, DB 2006, 1625 (1626) (These 3); v. *Werder/ Wiczorek*, DB 2007, 297 (300) (These 3.5).

¹⁶⁴ Cp. *Schiessl*, AG 2002, 593 (603f.)