

Seminar on Comparative Corporate Law:  
“The Two-Tier System in Italy and Germany” –  
Prof. Dr. Heribert Hirte, LL.M.  
University of Hamburg  
in cooperation with the Università Cattolica del Sacro Cuore  
Summer Term 2007

Handout to the presentation held on May 22, 2007 on:

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

by Christine Ede

**A. Introduction**

The presentation is concerned with the “Two-Tier System and Best Practice” in Germany under the German Corporation Act of 1965 (AktG) and the German Corporate Governance Code of 2002 (DCGK).

The focus is set on the rules and regulations concerning the independency of the supervisory board and its members as well as the solving of conflicts of interests in the supervisory board in terms of best practice.

**B. Issues and Problems Concerning the Independency of the German Supervisory Board**

I. General Issues Concerning German Supervisory Board's

1. The role and function of German supervisory boards has since the 1990's increasingly been subject to national and international objection.
2. German supervisory boards were unable to effectively monitor the management board.

II. Independency and Conflict of Interest as a Key Problem of the German Supervisory Board

1. Independency of the board respectively its members is a key feature for an objective and effective monitoring.
2. Independency is not sufficiently secured through the division of the boards.

3. Independent decision-making is threatened by personal or business relations to the company or the management board as well as relations to clients, suppliers, lenders, or competitors. If relations like this exist conflicts of interest arise.

4. German supervisory boards are composed with representatives of the stakeholders and have been used as a platform to serve business relations. By this numerous interests affected the work of the board.

### **C. Introduction of the DCGK**

I. The DCGK has been introduced to enhance the quality of the German Corporate Governance System and to make it more transparent and understandable to international investors.

II. The DCGK contains three types of provisions: Recommendations, suggestions and provisions which summarize the applicable law. The recommendations contain business behaviours which are generally accepted as best practice while suggestions contain business behaviours which have not generally been recognized as best practice.

III. The DCGK has no direct legal force. The DCGK is anchored into the German law by § 161 AktG. § 161 AktG contains a regulation under which corporations have to declare whether they complied with the recommendations of the DCCGK.

### **D. General Independence Requirements under the AktG and the DCGK**

#### I. Independence Requirements under the AktG

1. The AktG contains only a few independent requirements.
2. Conflicts of interests are supposed to be solved within the board.

#### II. Independency under the DCGK

1. The supervisory board must contain an “adequate number” of independent members.
2. The adequate number of independent members must only be considered in relation to the shareholder representatives.
3. The termination of the “adequate number” is at the discretion of the shareholder representatives.

### III. Further Measures

1. It should be declared under § 161 AktG if less than half of the shareholders representatives are independent.
2. The board should justify its self-assessment at the general meeting.

## **E. General Handling of Conflicts of Interest**

### I. Regulations under the AktG

1. The AktG does not contain explicit regulations but only general duties under which a conflict of interest is solved.
2. The fiduciary duty under company law requires strict loyalty to the best interests of the company while exercising the mandate.
3. Possible solutions to handle an occurred conflict of interest are the exclusion of the voting-right, the absence in the debate or even the termination of office.
4. Those measures are debated controversial and do not offer an overall usable solution.

### II. Recommendations of the DCGK

1. The DCGK tries to solve conflicts by disclosure to the board and the general meeting.
2. The DCGK does not recommend a certain or general procedure to handle occurred and disclosed conflicts. Only in case of a material and/ or permanent conflict a termination of office is recommend.

### III. Further Measures

1. The Code should be amended by suggestions to solve conflicts of interest.
2. The Code should contain a recommendation under which supervisory boards shall set up certain procedures to handle conflicts of interest in the terms of reference.

## **F. Issues affecting Independency**

### I. Personal or Business Relations to the Company

1. A substantial volume of business or a relevant personal relationship between a supervisory board member and the company or the management board makes the member dependent under the DCGK.
2. It does not make a difference whether the business relation is direct or indirect.
3. The DCGK should be amended by a recommendation under which all relevant business relations should be disclosed.

## II. Transfer from Management to Supervisory Board

1. It is common practice in German Corporations to directly transfer from management to supervisory board.
2. It can generally not be considered best practice if a direct transfer from management to supervisory board occurs.
3. The AktG does not prohibit a direct transfer.
4. The DCGK recommends that no more than two former managers shall sit on the supervisory board. It further recommends that it shall not be the rule for the former chairman of the management board to become the chairman of the supervisory board. If this is intended anyway, it shall be justified at the general meeting.
5. A former management board member can generally not be considered independent because of personal relations.
6. Into the DCGK a suggestion should be introduced under which a transfer should only take place after a certain period of time (“cooling-off period”) has passed.
7. The Code should further be amended in the way that every transfer needs to be justified.

## III. Seats in Competitor’s Boards

1. The simultaneous membership in the board of a competing company can not be considered best practice.
2. The AktG does not prohibit the simultaneous membership.
3. The DCGK recommends that no one shall be elected on the supervisory board who simultaneously exercises the directorship or a similar position or advisory task for an important competitor. This includes the membership in the supervisory board of an important competitor.
4. If such a member is appointed anyway he is dependent. Arising conflicts need to be solved by the general rules concerning conflicts of interest.

## **G. Conclusion**

- I. The recommendations of the DCGK are a first step to enhance the independence of the German supervisory board.
- II. The role understanding of managers and supervisory board members need to change.
- III. Most important is the independence in mind.