



Participation in the meetings of supervisory and management board

Précis and Presentation Notes – Milan May 24th, 2007

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A. Introduction

The scope of this presentation is the formal participation in the meetings of Supervisory and Management Board: What are the position to be filled? Who participates? What are the procedures to be obey? Content of the participation, that is the duties and responsibilities, are only dealt with, as they pertain to question of selection of members or the laws of procedure which govern the two organs.

B. Supervisory Board

The minimum number of board members of the supervisory board (SB) is three.¹ The articles of incorporation can determine any number of members as long as it can divided by 3. The Co-Determination Act imposes rules for companies with a number of more than 2000 employees.² The number of members of the SB is determined by the number of employees of the *Betrieb (plant)*: Up to 10.000 the size is 12, up to 20.000 the size is 16 and with more than 20.000 employees the size is 20 members. Half of the members are employers or delegates from the unions.

In principal the members of the supervisory board are being elected by the general assembly with the (simple) majority of the votes.³ With the Co-Determination rule the general principals only apply to the owner side of the board members. The worker's members of the board are being elected by a ballot-vote of the workers.⁴

¹ § 95 I AktG (see appendix for complete text).

² § 96 I AktG, § 7 MitbestG.

³ § 119 I AktG.

I. Selection of Members

Most evident restriction on being a SB-member is that any member of the management board or with similar authorities equipped person may not be part of the supervisory board.⁵ Apart from these statutory rules there is a supplementing regime of non-statutory rules for corporations, which are listed at a stock-exchange. Via reference to the Corporate Governance Code (DCGK) the self-regulatory comply-or-explain approach has been adopted.⁶

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

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

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

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

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

With Start-Up or family companies and affiliates special requirement apply.

⁴ § 9 MitbestG.

⁵ § 100 AktG.

⁶ § 161 AktG.

II. The Laws of Procedure for the Supervisory board

There are three specifications of how the work of the supervisory board is to be done: The Companies Act, the articles of incorporation and the bye-laws of the SB itself (laws of procedure). Since the SB benefits from the fundamental principle of self-government the Companies Act only statues essential proceedings and the articles of incorporation may contain regulations, but are limited by the right of autonomous organization. The decision on the bye-laws of SB lays therefore in the hands of the SB itself and is made with a simply majority.

Statutory onset is that one of the supervisory board members will be elected by his peers as their chairman.

1. Meetings

With all the caveats of the above remarks the meetings then are the place where numerous tasks are accomplished through resolutions⁷. If well prepared the control and information rights can be discussed and coordinated. The committee can report to contribute to a comprehensive image of the corporation. This in turn can spark ideally strategic discussions. The meeting then is a place of reconciliation of interests. A capable chairman will have supplied the members with the necessary information and functions as a mediator between the different groups and leader of the organ.

2. Committees

With the increasing work-load of a growing company the tasks of the supervisory board become too vast to be handled completely and in detail by a large SB. Therefore the SB is empowered to install committees to prepare the resolutions and negotiations. It is even possible to install a committee with resolution power as long as it is has the minimum number of 3 members.

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

Principal committees⁸: Conciliation Committee, Presidential Committee, The Audit Committee

Since there are no clear statutory regulations on the composition of the committee, the participation of the members delegated by the work-force has been contended. If no such member is part of a committee the information deficit of these members would increase. This in

⁷ §§ 107, 108 AktG.

⁸ § 107 III AktG.

turn could be used as a tool to thwart their interests. Meanwhile the notion seems to prevail that only the discriminatory exclusion of a group is illegitimate.

3. Ongoing Criticism of the German SB culture

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

- With the Co-Determination the size is too big to have efficient results. With 20 members proper discussions are seldom profound. Since the number of meetings is also limited there is an even greater stress and demand on making good decisions in a timely manner. As a result there is no leadership or efficient control.
- The members are considered incompetent. These consideration are not limited to the staff delegates who often do not have the proper skills to exercise the control necessary, but also members voted by shareholders, who, after retirement, do not want to fall into oblivion.
- Even though the number of cross-over mandates have become less since the days of the “Deutschland AG” there are still tight personal networks. The Deutschland AG is derived from the time of a tight knit network of business leaders across virtually all mayor industries during the 50ies until recently; e.g. a couple of years ago the Deutsche Bank decided to discard virtually all strategic holdings of corporations which were not related to their core competencies. With bonds between the relevant players that tight, it becomes improbably that the Chairman of the SB is taking on a tough stand with management.
- The so called structural deficit of the two-tier model: the SB is not sufficiently involved in strategic decisions, has an information deficit and with 4 meetings a year is confined to an ex-post analysis and control.
- The Co-Determination results in a chronically over-staffed company and a loss of company-value of more than 30%. Even the One Third Participation Act should only be applicable to companies with more than 5.000 instead of 500 employees.

C. Management Board

The number of members on the Management Board (MB) has to be defined in the articles of incorporations (AoI).⁹ It is also possible that the AoI lay out specific rules of how the number is to be determined. One of the option is to leave the definition to the discretion of the supervisory board (SB). The board can consist of only one manager. The qualification of the management board is much more homogeneous and highly qualified on average than the supervisory board.

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

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

The laws of procedure should provide that transactions of a certain volume or risk entailing dealings as defined by the bye-laws are to be decided on by the complete MB or at least a special committee of the MB. Also the standardized process and documentation needs to be observed. The result is that ambitious members or members with insufficient distance to business partners are disciplined through the participation of the meetings and compliance to the rules. Participation in the meeting then leads to better and safer decisions for the corporation.

⁹ § 23 III Nr. 6 AktG.

Aktiengesetz – German Stock Corporation Law

§ 23 Establishment of the articles of association

III The articles of association shall stipulate...

- 6 the number of member of the management board or the rules for determining this number.

§ 95 Number of supervisory board members

- 1 The supervisory board consists of three members.
- 2 The articles of association may stipulate a specific higher number.
- 3 Such number shall be divisible by three.
- 4 The maximum number of supervisory board members for companies with a registered share capital of up to € 1.500.000 shall be nine, more than € 1.500.000 shall be fifteen, more than € 10.000.000 shall be twenty one.
- 5 The above provision shall not affect provisions to the contrary contained in the Act on the Codetermination of Employees of May 4, 1976, the Iron Coal and Steel Codetermination Act and the Supplementary Act on the Codetermination of Employees in Supervisory Boards and Management Boards of Enterprises in the Mining and iron and Steel Producing Industries of August 7, 1956. – Codetermination Amendment Act.

§ 96 Composition of the Supervisory Board

- I** The supervisory board shall be composed as follows: in companies to which the Codetermination Act Applies, the supervisory board shall consist of representatives of the shareholders and the employees, in companies to which the Coal, Iron and Steel Codetermination Act applies, the supervisory board shall consist of representatives of the shareholders, the employees and further members, in companies to which sec. 5 to 13 of the Codetermination Amendment Act apply, the supervisory board shall consist of representatives of the shareholders and the employees and one additional member, in companies to which sec. 76 para. 1 of the Works Constitution Act of 1952 applies, the supervisory board shall consist of representatives of the shareholders and employees.
- and in the case of all other companies, the supervisory board shall only consist of representatives of the shareholders.

§ 100 Personal requirements for supervisory board members

I

- 1 Only a natural person with full legal capacity may be a member of the supervisory board.
- 2 Anyone under the care of a custodian who is partially or entirely subject to a requirement to obtain consent concerning the management of his financial affairs may not be a member of the supervisory board.

II

- 1 A person may not be a member of the supervisory board if
 1. he is already a member of the supervisory board in ten commercial enterprises under a legal obligation to form a supervisory board,
 2. he is the legal representative of an enterprise controlled by the company or

3. he is the legal representative of another corporation whose supervisory board includes a member of the company's management board.
- 2 Up to five seats held by a legal representative (in the case of a sole proprietor, the owner) of the controlling enterprise of a group on the supervisory boards of commercial enterprises belonging to the group which are under a legal obligation to form a supervisory board shall not be taken into account when determining the maximum number of seats pursuant to sentence 1 No. 1.
- 3 Supervisory board seats within the meaning of No. 1 shall be counted twice when determining the maximum number of seats pursuant of sentence 1 No. 1 if the member has been elected to the position of chairman.

III-IV ...

§ 107 Internal organization of the supervisory board

I

- 1 The supervisory board shall appoint a chairman and at least one deputy from among its members in accordance with the relevant provisions in the articles of association.
- 2 The management board shall notify the commercial register of the persons elected.
- 3 The deputy shall only have the rights and obligations of the chairman if the latter is being hindered from acting.

II

- 1 Minutes shall be kept of the supervisory board meetings and signed by the chairman.
- 2 The minutes shall state the date and place of the meeting, the persons present, the items of the agenda, the essential contents of proceedings and the resolutions adopted by the supervisory board.
- 3 A violation of sentence 1 or sentence 2 shall not render the resolution invalid.
- 4 A copy of the minutes of the meeting shall be distributed to each member of the supervisory board upon demand.

III

- 1 The supervisory board may appoint one or several committees from among its members for the purposes of preparing the proceedings and resolutions or monitoring the implementation of the resolutions.
- 2 A committee may not be granted responsibility in place of the supervisory board for adopting resolutions relating to the tasks pursuant to para 1 sentence 1, sec. 59 para. 3, sec. 77 para 2 sentence 1, sec. 84 para. 1 sentences 1 and 3, para. 2 para. 3 sentence 1 sec. 111 para. 3, sec. 171 and sec. 314 para. 2 and 3 or resolutions stipulating that certain types o transactions may only be made with the consent of the supervisory board.
- 3 Reports on the work of the committees shall be submitted regularly to the supervisory board.

§ 108 Resolutions of the supervisory board

I The supervisory board shall make decisions by resolution.

II

- 1 The requirements for a quorum in the supervisory board may, to the extent not regulated by law, be stipulated in the articles of association.

2 If the requirements of such quorum are neither regulated by law nor stipulate in the articles of association there shall only be a quorum in the supervisory board if at least half of the total number of supervisory board members stipulated by law or the articles of association participate in the adopting of the resolution.

3 ...

§ 119 Rights of the general meeting

I The general meeting shall adopt resolutions in the case expressly stipulated by law and in the articles of association, in particular

1. the appointment of supervisory board members, unless such members are to be appointed to the supervisory board or elected as employee representatives in accordance with the Codetermination Act, the Codetermination Amendment Act or the Works Constitution Act of 1952;

2. ...

§ 161 Declaration on Corporate Governance Codex

1 The management board and the supervisory board of listed companies shall declare annually that the recommendations of the “Government Commission German Corporate Governance Codex” published by the Federal Ministry of Justice in the official section of the electronic Federal Gazette have been and are complied with or which recommendations have not been or are not applied.

2 The declaration shall be made available to the shareholders on a permanent basis.