Corporate Governance Comparative Guide

POELLATH

mondaq
Connecting knowledge & people

Article Author(s)	Contributing Editor
POELLATH	ADDLESHAW GODDARD
	
Eva Nase	**Richard Preston**
	
	Nick Pearey
Germany	Contributing Editor

1.Legal and enforcement framework

1. 1. Which legislative and regulatory provisions and codes of practice primarily govern corporate governance in your jurisdiction?

Germany
POELLATH

The primary sources of corporate governance requirements for corporations (the most common form of company) are:

- the Stock Corporation Act for stock corporations (AGs) and European stock companies (*societates Europaeae* (SEs));
- the European and German legislation on SEs – particularly the European SE Regulation and the German SE Implementation Act;
- the Limited Liability Companies Act;
- the Commercial Code; and
- for certain issues:
    - the Reorganisation of Companies Act;
    - the Securities Acquisition and Takeover Act; and
    - the Securities Trade Act.

The company's articles of association and the rules of procedure for management may impose further requirements. The Corporate Governance Code is an additional, non-binding source of corporate governance rules for listed companies.

Moreover, non-governmental regulations such as applicable listing rules enacted by the stock exchanges also set out corporate governance requirements.

1. 2. Is the corporate governance framework in your jurisdiction primarily based on hard (mandatory) law and regulation or soft (eg, 'comply or explain') codes of governance?

Germany
POELLATH

The corporate governance framework in Germany is mostly based on hard law, whereas the Corporate Governance Code is considered soft law. It sets out corporate governance rules as recommendations and suggestions for listed companies. However, companies must comply with the recommendations set out in the Corporate Governance Code; while deviations must be disclosed and explained in an obligatory declaration of compliance.

1. 3. Which bodies are responsible for drafting and enforcing the rules and codes that make up the corporate governance framework? What powers do they have?

Germany
POELLATH

The primary government agencies for corporate, capital markets and stock exchange law are the federal Parliament and, increasingly, the EU legislature. The Corporate Governance Code and its amendments are prepared and issued by the Government Commission for the Corporate Governance Code. The listing rules of open markets are usually set by the stock exchanges or other listing entities. Capital markets laws and regulations are enforced by the Federal Financial Supervisory Authority.

2.Scope of application

2. 1. Which entities are captured by the rules and codes that make up the principal elements of the corporate governance framework in your jurisdiction?

Germany
POELLATH

Each company must comply with the statutory rules that apply to its legal form. Depending on the size of the company and whether it is listed, further rules apply.

German law distinguishes between capital companies and partnerships. This Q&A focuses on capital companies, as these are the most important and regulated forms of companies in Germany.

Capital companies are legal entities, where the liability is limited to the assets of the company – that is, the shareholders' liability is limited to what they have invested in the company. The most common legal forms of capital companies are the limited liability company (GmbH) and the stock corporation (AG). Other forms of capital companies include the European stock company (*Societas Europaea* (SE)) and the partnership limited by shares (KGaA).

2. 2. What exemptions, if any, from the principal elements of the corporate governance framework are available in your jurisdiction?

Germany
POELLATH

The laws outlined in question 1.1 apply on a mandatory basis; exceptions are only permitted if they are stated in the law.

The Corporate Governance Code differentiates between:

- recommendations, which a company must comply with or explain why it has chosen not to comply and disclose such an explanation on its website and in its corporate governance reporting ('comply or explain' policy); and
- suggestions, from which deviations are allowed without disclosure.

2. 3. What are the principal issues covered by the codes of governance in your jurisdiction?

Germany
POELLATH

A key issue of corporate governance in Germany concerns the allocation of seats of the supervising bodies of certain companies.

Under German law, there are two different kinds of employee representation in supervisory boards AGs, KGaAs and GmbHs: so-called 'co-determination'. Shareholder representatives are generally appointed by the general meeting, while employee representatives in cases of co-determination are generally appointed by employee elections.

If an AG or KGaA exceeds the threshold of, generally, 500 German employees, one-third of the supervisory board members must be employee representatives ('one-third participation'). If an AG or KGaA and its controlled companies exceed, generally, 2,000 German employees in total, the supervisory board must consist of 50% employee representatives ('parity co-determination').

With respect to a GmbH, the establishment of a supervisory board is required only if the co-determination rules apply. Thus, a GmbH with more than 500 German employees must establish a supervisory board, with one-third of the supervisory board members being employee representatives; while a GmbH with more than 2,000 German employees within it and its controlled group must establish a parity co-determined supervisory board with a minimum of six shareholder and six employee representatives.

The German co-determination rules do not apply to SEs. When incorporating an SE by way of the '*numerus clausus*' of incorporation, an agreement on employee participation in the SE must be negotiated with a special negotiating body established specifically for such negotiation, representing employees from the German company and its subsidiaries and branches based in other EU and European Economic Area member states. The rules on co-determination are part of this agreement, with the general principle that the level of co-determination of the German company used to incorporate the SE must be maintained (freezing of co-determination prior to and after principle). For example, if no co-determination exists or needed to exist prior to the incorporation of the SE, then no co-determination will need to be agreed on in the employee participation agreement for the SE.

The principal issues covered by the Corporate Governance Code are as follows:

- management and supervision;
- the appointment of the management board;
- the composition of the supervisory board;
- the working methods of the supervisory board;
- conflicts of interest;
- transparency and external reporting; and
- the remuneration of management and the supervisory board.

3.Ownership and control

3. 1. What are the typical ownership structures in your jurisdiction?

Germany
POELLATH

The German economy is characterised by small and medium-sized enterprises (so-called '*Mittelstand*'). Many of these companies are family owned. Listed corporations sometimes do have block shareholders such as families, investors or other corporations. Generally, however, they have a broad shareholder structure, with different institutional and private investors from Germany and abroad.

3. 2. How are companies typically controlled in your jurisdiction, both structurally and in practice?

Germany
POELLATH

Resolutions of the general meeting are generally passed by a simple majority of votes (+50%) – including, for example, on the election of supervisory board members.

Only very extensive decisions – such as amendments to the articles of association, capital increases or reductions, mergers and other restructurings of the company –require a majority of 75% of the share capital represented at the general meeting.

In practice, a share of 30% in listed companies is often sufficient to be able to exert (significant) influence on the company.

4.The board: structure and appointment

4. 1. How is the board typically structured in your jurisdiction?

Germany
POELLATH

The predominant board structure of stock corporations (AGs), European stock corporations (SE) and partnerships limited by shares (KGaA) is the two-tier system, with:

- a management board that manages and represents the company; and
- a supervisory board that supervises the management board.

In Germany, only SEs can opt for a one-tier system, with one board (an administrative board) that consists of executive and non-executive board members.

Most limited liability companies (GmbHs) only have managing directors, who are all executive directors; but they are also allowed to implement a supervisory or advisory board in their articles of association, resulting in a two-tier structure. However, a supervisory board is compulsory in a GmbH in case of co-determination. A GmbH cannot have a one-tier board.

The management board in a two-tier system consists of one or more members; the same applies to the potential number of managing directors in an SE with a one-tier system and a GmbH, unless the articles of association provide otherwise. The supervisory board must consist of at least three members and up to 21 members, depending on the registered share capital of the corporation. In case of co-determination, the number must be divisible by three. If parity co-determination applies, the minimum number of supervisory board members is 12; this will depend on the total number of German employees. The administrative board of a one-tier SE can consist of two or more members, subject to the amount of the registered share capital.

4. 2. Are board committees recommended or mandated? If so, which areas should/must they cover?

Germany
POELLATH

The supervisory board is entitled to form committees from within itself (eg, an audit committee and a nomination committee). The Stock Corporation Act and the Corporate Governance Code expressly require the formation of these two committees for listed companies. Committees are generally responsible for preparing reports for the supervisory board and implementing resolutions passed by the supervisory board. Sometimes, committees are also entitled to resolve instead of the supervisory board.

However, this is not permitted for certain issues enumerated in statute, such as the remuneration and service contracts of members of the management board. The rules that apply to the supervisory board in a two-tier system must also be adhered to by the administrative board in a one-tier system SE.

Committees of the management board or of a GmbH's managing directors are less common.

4. 3. Are there any requirements or recommendations to appoint independent board members? If so, how is 'independence' defined?

Germany
POELLATH

According to the Corporate Governance Code, in the case of listed companies, the supervisory board must be comprised of a 'reasonable' number of independent members.

For the purposes of this recommendation, a member of the supervisory board will be considered independent if he or she is independent of the company, its management board and any controlling shareholder.

A supervisory board member is independent of the company and its management board if he or she has no personal or business relationship with the company or its management board that may cause a substantial and long-term conflict of interest.

4. 4. Do any diversity requirements or recommendations apply with regard to board composition?

Germany
POELLATH

In a listed *and* co-determined company, 30% of the members of the management board and of the supervisory board must be women and men; while in a listed *or* co-determined company, the supervisory board must determine and annually report on a target percentage for women on the management board and the management board for second/third-line management. The management board of a listed *or* codetermined company must also determine a target percentage for women; where this target is set at zero, the management board must justify this in a clear and comprehensible manner.

The Corporate Governance Code also makes several recommendations regarding the diversity of the management and supervisory board (eg, to consider diversity).

4. 5. How are board members selected and appointed? What selection criteria (if any) apply in this regard?

Germany
POELLATH

The members of the management board are appointed by the supervisory board and, in the case of a one-tier SE, the administrative board. The members of the management board must fulfil basic statutory requirements regarding personal reliability (eg, no criminal record).

The members of the supervisory and administrative board are appointed by the general meeting. However, depending on the size of the company, a certain number of members of the supervisory board must be elected by the employees of the company (ie, co-determination) (see question 2.3).

When selecting appropriate candidates, the gender quota (see question 4.4) must be taken into account.

In a listed company, at least one expert in auditing and one expert in accounting must be members of the supervisory board.

According to the new Corporate Governance Code, the supervisory board must include expertise on sustainability issues that are relevant to the company.

The Corporate Governance Code further recommends that the supervisory board:

- determine concrete objectives regarding its composition; and
- prepare a profile of skill and expertise for the entire board, taking diversity into account.

The proposals of the supervisory board to the general meeting must take these objectives into account.

4. 6. How are board members removed?

Germany
POELLATH

The members of the management board can be dismissed by the supervisory board and, in the case of a one-tier SE, the administrative board (for cause only). The dismissal of members of the supervisory and administrative boards generally requires a resolution of the general meeting with a majority of at least 75%.

4. 7. Do any tenure restrictions or recommendations apply to individual directors?

Germany
POELLATH

The members of the supervisory and administrative boards are appointed by the general meeting, for a maximum term of five years in an AG and six years in an SE. Reappointment is permitted. Members can be dismissed by resolution of the general meeting with a majority of at least 75% of the votes cast, unless the articles of association provide otherwise.

The maximum term of members of the management board is five years (six years in a SE); reappointment is permitted. This may not be renewed or extended until one year before the end of the term.

Other rules apply to the managing directors of a GmbH. The law does not limit the tenure of managing directors, but limited terms of office are common practice.

4. 8. What best practice is recommended when composing the board and appointing board members?

Germany
POELLATH

German law prescribes certain rules (see question 4.4) and requirements on expertise (see question 4.5). However, there is no best practice, except for the fact that each member of a management board will generally have his or her own department of responsibility, while also being jointly and severally responsible and liable with the board in total.

5.The board: role and responsibilities

5. 1. What are the primary roles and responsibilities of the board?

Germany
POELLATH

The supervisory board of a stock corporations (AG) and a two-tier system European stock company (*societas Europaea* (SE)) has the power to appoint and dismiss members of the management board and is responsible for supervising the management board's activities. A supervisory board is entitled to:

- request regular or one-off reports from the management board; and
- define certain transactions and measures in the management board's rules of procedure or in individual cases that are subject to the supervisory board's approval (eg, regarding significant transactions and measures that exceed a certain threshold).

This definition may also be made by the shareholders in the company's articles of association. However, this approval has no effect on transactions or measures with regard to third parties, but only on the internal relationship between the two bodies and the liability of members of the management board.

In an AG and a two-tier system SE, the management board develops and implements the company strategy as part of its original task and duty to manage the affairs of the company. The management board may set and change the strategy insofar as this is in line with the business purpose set out in the company's articles of association.

Similarly, the managing directors of a company with limited liability (GmbH) may set and change the company strategy; however, they are bound by instructions by the shareholders.

5. 2. How does the board exercise those roles and responsibilities?

Germany
POELLATH

Supervisory board: The supervisory board of an AG, a two-tier system SE and a partnership limited by shares (KGaA) decides by way of resolution, generally by simple majority. However, the articles of association or the rules of procedure for the supervisory board may foresee qualifying majority requirements. Supervisory board meetings are held as physical meetings from the statutory starting point.

Remote meetings and mixed-form meetings are also permissible, except for the meeting preparing for the annual general meeting, which must be a physical meeting in the presence of the auditor. Supervisory board members who are not present at a meeting may not be represented by third parties or other supervisory board members, but can only give a written voting declaration. The meeting has a quorum if the majority of members are present – at least three.

Management board: The management board of an AG and a two-tier system SE generally decides in physical or remote meetings, if a certain quorum of – usually – more than half the members of the management board are present or represented, by way of resolution, generally to be passed by simple majority. However, qualifying majority requirements can be set – for example, in the rules of procedure for the management board. In practice, it is common that members of the management board are allocated certain individual responsibilities as part of their department.

Decisions within each department are made by the responsible member of the management board, unless the decision is of a material nature, in which case a resolution of the management board is necessary. This also applies where another member of the management board requests the measure. Finally, the management board may establish committees for specific tasks, although this is not that common in practice.

More or less the same decision-making process applies to managing directors of a one-tier system SE and a GmbH.

5. 3. What specific role does the board play in relation to: (a) Strategic planning? (b) Risk management? (c) Major and related-party transactions? and (d) Conflicts of interest?

Germany
POELLATH

(a) Strategic planning?

The supervisory board in a two-tier AG/SE is not entitled to set and/or change strategy. This entitlement rests solely with the management board in its absolute free discretion. However, the management board must report to the supervisory board at least once a year on the business policy and other fundamental matters of corporate planning (in particular, financial planning, investment planning and human resources planning). The Corporate Governance Code further requires the management board to coordinate the strategy with the supervisory board.

The administrative board of a one-tier SE is entitled to set and change strategy, and the managing directors are obliged to implement this if necessary, based on instructions from the administrative board.

(b) Risk management?

In an AG, an SE and a KGaA, the management board must implement a system to detect and monitor risks to the continued existence of the company. However, it is best practice to maintain several systems and refined rules (eg, through reporting lines and codes of conduct) to ensure internal compliance and effective risk management. Specifically, the management board of a listed company is required by law to establish an internal control and risk management system. Further, the Corporate Governance Code requires the establishment of a compliance management system. The supervisory board will review the existence and effectiveness of such measures. The managing directors of a GmbH are also expressly obliged to take measures for the early detection of a crisis.

(c) Major and related-party transactions?

The articles of association or the supervisory board (eg, in the rules of procedure for the management board) may determine that certain types of business transactions may only be implemented with the supervisory board's consent. Transactions of listed companies with related parties are by law subject to the approval of the supervisory board if they fulfil certain conditions, including if they:

- are not conducted in the ordinary course of business; or
- are conducted under conditions that are not usual in the market.

(d) Conflicts of interest?

According to the Corporate Governance Code, each member of the supervisory board must disclose conflicts of interest to the chairperson of the supervisory board without delay. In its report to the general meeting, the supervisory board must provide information on conflicts of interest that have arisen and how they have been dealt with. Material and long-term conflicts of interest in the person of a supervisory board member will lead to the termination of his or her mandate.

Each member of the management board must also disclose conflicts of interest without delay to the chairperson of the supervisory board and the chairperson/spokesperson of the management board, and inform the other members of the management board thereof.

5. 4. Are the roles of individual board members restricted? Is this common in practice?

Germany
POELLATH

The applicable law does not predefine roles for members of the management board. One member can be and usually is nominated as chairman or spokesperson. Apart from this, it is common for the tasks and duties of the management board and managing directors to be divided between them in several departments – either functional or operational divisions. Thereby, titles such as 'chief executive officer', 'chief financial officer' and 'chief operating officer' are generally attached to the members on their business cards, the company website and company email footers. However, these are not statutorily foreseen and trigger no special further rights or obligations. The overall responsibility remains with the management board or the managing directors.

5. 5. What are the legal duties of individual board members? To whom are these duties owed?

Germany
POELLATH

The members of the management board owe a fiduciary duty to the company and must manage its affairs with the due care of a prudent and diligent businessperson, particularly in accordance with the applicable laws and the articles of association. In case of entrepreneurial decisions, this standard is met if the respective member:

- can reasonably assume to have obtained sufficient information before making the decision;
- is not conflicted; and
- considers to be acting in the company's best interests ('business judgement rule').

The same applies *mutatis mutandis* to the members of the supervisory or the administrative board. While members of both boards and managing directors must act in the company's best interests, these include the interests of its stakeholders (eg, creditors and employees).

5. 6. To what civil and criminal liabilities are individual board members primarily potentially subject?

Germany
POELLATH

The members of the management and supervisory board are personally liable for a culpable breach of duty. The members of the respective board are jointly and severally liable to the company. Thus, individual members may not alleviate themselves from liability because a specific responsibility was delegated to a different member internally. Furthermore, liability is not affected if the members of the respective board have been discharged by the general meeting.

Members of the board may be criminally liable if they violate criminal laws. Such violations may include:

- insolvency offences;
- violation of accounting obligations; and
- breach of trust.

The violation of certain capital market regulations (eg, regarding insider information, insider trading or incorrect *ad hoc* announcements) may also result in criminal prosecution.

6. Shareholders

6. 1. What rights do shareholders enjoy with regard to the company in which they have invested?

Germany
POELLATH

The following selected decisions are reserved by law for the shareholders of a stock corporation (AG):

- the election and removal of the supervisory board members;
- the appointment of an auditor;
- the appropriation of profits;
- formal approval of action for members of both the management board and the supervisory board;
- in listed companies, approval of the remuneration policy and the annual remuneration report; and
- fundamental decisions – in particular, relating to:
    - amendments to the articles of association;
    - liquidation of the corporation;
    - mergers and demergers;
    - changes in legal form;
    - the sale of substantially all the corporation's assets; and
    - the conclusion of corporate agreements (eg, control agreements, and profit and loss transfer agreements).

In addition, shareholders have the right to request information during the general meeting. Furthermore, they have the right to object to resolutions of the general meeting and subsequently to challenge the resolution in court. There are also certain rights to protect minority shareholders.

The following decisions are reserved by law for the shareholders of a company with limited liability (GmbH):

- the election and removal of the managing directors and the conclusion of their service agreements;
- approval of the annual accounts;

- the appointment of an auditor;
- the appropriation of profits;
- formal approval of action for managing directors;
- fundamental decisions – in particular, those relating to:
    - amendments to the articles of association;
    - liquidation of the corporation;
    - mergers and demergers;
    - changes in legal form;
    - the sale of substantially all of the corporation's assets; and
    - the conclusion of corporate agreements (eg, control agreements, profit and loss transfer agreements); and
- instructions to the managing directors.

6. 2. How do shareholders exercise these rights? Do they have a right to call shareholders' meetings and, if so, in what circumstances?

Germany
POELLATH

Shareholders exercise their rights at the general meeting.

Shareholders of an AG or a European stock corporation (SE) that together hold at least 5% of the registered share capital are entitled to request the convocation of a general meeting.

Shareholders that together hold at least 5% of the registered share capital or a nominal value of €500,000 or more may also require a supplement to the agenda of a general meeting which has already been called.

Shareholders of a GmbH are entitled to require a supplement to the agenda of a general meeting which has already been called if they hold at least 10% or more of the registered share capital.

6. 3. What influence can shareholders exert on the appointment and operations of the board?

Germany
POELLATH

Influence on operations: The involvement of shareholders in management measures depends on the legal form of the company. In an AG, SE or a partnership limited by shares (KGaA), the management board acts independently within its reasonable discretion. Shareholders cannot instruct the management to pursue a particular course of action (unless subject to a control agreement). Shareholders are entitled to resolve upon management decisions in a general meeting only if the management board so requests. Effectively, shareholders can only indirectly exert influence on management by appointing the members of the supervisory board or the non-executive directors of the administrative board in a one-tier SE, who in turn appoint, control and advise the management board. However, certain decisions are statutorily and by case law reserved for the general meeting (ie, the shareholders) (see question 6.1).

In a GmbH, shareholders have a much greater influence on management decisions, since they may instruct the managing directors to take or refrain from taking certain actions. The managing directors of a GmbH are internally bound by such instructions by the shareholders.

Influence on appointment: The members of an AG's supervisory board (ie, non-executive directors) are elected by the shareholders at the general meeting. The members of the management board (executive directors) are appointed by the supervisory board – not by the shareholders. This basic structure cannot be altered. Unless the articles of association provide otherwise, members of the supervisory board are elected by simple majority of votes and can be removed with a 75% majority. Unless the AG has entered into a control agreement with its parent company, the supervisory board and the management board act independently and cannot be required by the shareholders to pursue a particular course of action.

Unless its articles of association stipulate otherwise, a GmbH only has managing directors and no supervisory board. The managing directors can be appointed and removed by the shareholders by simple majority vote. The shareholders' meeting can instruct the managing directors to pursue a particular course of action.

The legal forms of an SE and a KGaA are largely comparable to an AG.

6. 4. What are the legal duties/responsibilities and potential liabilities, if any, of shareholders?

Germany
POELLATH

Shareholders owe fiduciary duties towards the company and towards other shareholders. They must refrain from exerting influence on the company, a board member or an authorised agent to act to the detriment of the company or the other shareholders. This is particularly true with respect to a controlling shareholder, unless the disadvantages are compensated or subject to a control agreement.

Shareholders of listed companies are further subject to certain notification requirements regarding the holding of voting rights or major holdings (see question 6.7). Major holdings of more than 25% or 50% of shares in a non-listed AG by legal entities must also be notified and disclosed in order to ensure the transparency of corporate group structures. If investor shareholders are represented on a board, they must disclose potential conflicts of interests or related-party transactions.

Shareholders can only be liable for acts or omissions of the company under exceptional circumstances. This may particularly be the case if:

- a shareholder abuses its influence on the company or on board members to act to the detriment of the company; or
- primarily in a GmbH, a shareholder causes or deepens the bankruptcy of the company under specific circumstances.

However, in principle, shareholders may only be liable towards the company and not towards creditors of the company or other third parties.

6. 5. To what civil and criminal liabilities might individual shareholders be subject?

Germany
POELLATH

In principle, there is a strict separation between the assets of the company and the assets of its shareholders.

Only in exceptional cases are shareholders personally liable.

Examples of this include:

- the unlawful mixing of company and shareholder assets;
- abuse of the legal form; or
- violation of the statutory provisions for raising and maintaining share capital.

6. 6. Are there rules governing the issuance of further securities in a company? Do rights of pre-emption exist and, if so, how do they operate? Can they be circumvented? If so, how and to what extent?

Germany
POELLATH

When issuing further securities of a company, the following rules must be observed.

Resolutions on capital increases must generally be approved by a qualified majority of at least 75%, which relates in a GmbH to the votes cast and in an AG to the present and represented registered share capital. These majority requirements cannot be reduced by the articles of association of a GmbH; and in general, the Stock Corporation Act only allows for the provision of higher majorities in the articles of association. These requirements also apply to resolutions on:

- the creation of authorised capital and contingent capital; and
- the issuances of bonds.

Shareholders in an AG and a GmbH have *pro rata* pre-emption rights to newly issued shares and bonds, which they must waive in order to allow dilution of their shareholding, effectively granting them first rights to the new shares in question.

In an AG, in certain scenarios, the exclusion of subscription rights is also statutorily permitted, subject to the following strict requirements:

- Subscription rights may be excluded by way of resolution of the general meeting, which must be:
  - passed by a 75% majority of the present and represented registered share capital; and
  - accompanied by a written report from the executive board, in particular explaining the reason for the exclusion and the issue price of the new shares in question.
- In the case of listed AGs, the exclusion of subscription rights is allowed, in particular, if:
  - the capital increase does not exceed 10% of the-then registered share capital of the AG; and
  - the issue price of the newly issued shares does not fall substantially short of the stock price.
- In cases where the management board is authorised to issue new shares by executing authorised or

contingent capital, such authorisations must provide for explicit scenarios in which the executive board is permitted to exclude subscription rights. Also, these authorisations must be resolved by the shareholders with a qualified 75% majority.

- The subscription rights of the shareholders of an AG are statutorily protected against potential agreements and undertakings of the company *vis-à-vis* third parties regarding the (future) issuance of new shares.

Similarly, the shareholders' meeting of a GmbH can authorise the managing directors to issue new shares (authorised capital). This authorised capital may not exceed 50% of the registered share capital. Under the applicable case law, the shareholders of a GmbH have pre-emptive rights to acquire newly issued shares, subject to certain exceptions and exclusion mechanisms.

6. 7. Are there any rules on the public disclosure of levels of shareholding and/or stake building?

Germany
POELLATH

The shareholders of listed companies must notify the Federal Financial Supervisory Authority and the issuer if:

- their direct and/or indirect holdings of voting rights reach, exceed or fall below certain thresholds (3%, 5%, 10%, 15%, 20%, 25%, 30%, 50% or 75%); or
- their positions in financial instruments relating to shares reach or cross the above thresholds (except for the 3% threshold).

In particular, voting rights held by subsidiaries or in acting-in-concert scenarios are attributed. The notification must be published by the issuer.

As regards non-listed AGs, major holdings by entities of more than 25% and 50% must be notified *vis-à-vis* the company and disclosed by the company.

Furthermore, subject to anti-money laundering law, all corporates must register their beneficial owners – that is, individuals who directly or indirectly hold more than 25% of the shares and/or voting rights or who otherwise control the company – in the transparency register.

7.Shareholder activism

7. 1. What role do institutional investors and other activist shareholders play in shaping corporate governance in your jurisdiction?

Germany
POELLATH

Institutional investors and proxy advisers are increasingly demanding consideration of environmental, social and governance (ESG) issues. As a result, corporate governance matters are regularly the subject of questions at the general meeting, while the management board and the supervisory board must comment on

these topics. Institutional investors thus play an important role in shaping corporate governance in Germany.

7. 2. Is there any legislation or code of practice which applies to institutional shareholders? If so, what issues does it primarily address and how is it policed/enforced?

Germany
POELLATH

Since the implementation of the Second EU Shareholders' Rights Directive, institutional investors and asset managers must disclose their engagement policy and voting behaviour. In particular, they must provide information on:

- the exercise of shareholder rights within the framework of the investment strategy;
- the exchange of views with the corporate bodies and stakeholders of the company;
- cooperation with other shareholders; and
- how conflicts of interest are dealt with.

7. 3. How do activist shareholders typically seek to exert influence on corporations in your jurisdiction?

Germany
POELLATH

Activist shareholders usually acquire minority stakes and then approach the management with certain demands. If those demands are not met, they will escalate the situation – for example, by launching public campaigns. They may also exercise their shareholder rights to increase pressure on the management – for example, by:

- asking questions at the shareholders' meeting;
- trying to put topics on the agenda of a general meeting, such as a request for special audits to identify violations of the law; or
- seeking the appointment of a member to the supervisory board.

7. 4. Which areas of governance are shareholders currently focused on?

Germany
POELLATH

The topic of sustainability and social responsibility is becoming increasingly significant. In this context, voting guidelines include various ESG criteria. Accordingly, violations of ESG criteria – such as oversight failures with regard to environmental or social matters – may constitute grounds for the rejection of supervisory board candidates.

Moreover, a recommendation for a resolution against the discharge of the management board or the supervisory board can be based on deficiencies in a sustainable corporate strategy.

7. 5. Have there been any high-profile instances of shareholder activism in recent years?

Germany
POELLATH

There have been no high-profile instances of shareholder activism in recent years, although there are activist investors such as Paul Singer (Elliot Management), who has invested as an activist shareholder on a regular basis in Germany in recent years, mainly in the context of takeover offers/going-private transactions.

7. 6. Is shareholder activism increasing or decreasing in your jurisdiction? If so, how and why?

Germany
POELLATH

Shareholder activism – which formerly resulted in a blockade of fundamental resolutions of the general meeting – was limited through changes to the legal framework in the first decade of this century, but continues to play a role in Germany. Activist shareholders are increasingly including smaller and lesser-known companies in their activities. Especially small and mid-cap companies are not yet well prepared for such interactions.

8.Other stakeholders

8. 1. What role do stakeholders such as employees, pensioners, creditors, customers, and suppliers play in shaping corporate governance in your jurisdiction? What influence can they exert on a company?

Germany
POELLATH

In general, the management board of a stock corporation (AG) and the managing directors of a limited liability company (GmbH) owe their legal duties to the company and must, therefore, primarily act in the company's best interests. Unlike the Anglo-Saxon shareholder model, the company's best interests are not limited to the interests of shareholders; nor do the interests of shareholders prevail. Instead, management must consider and weigh the respective interests of shareholders and stakeholders.

Employees play a considerable role through their representation on the supervisory board in case of co-determination (see question 2.3) and its operational co-determination rights via (group or joint) works councils. The works council is endowed with various monitoring, consultation, information and negotiation rights, and mainly represents employees' interests relating to the workplace (eg, working conditions and social issues). The Corporate Governance Code recommends giving employees the opportunity to report legal violations within the company in a protected manner – for example, through an anonymous whistleblowing system.

Debt holders, suppliers and customers generally do not play a direct role in corporate governance, apart from through contractual obligations such as approval rights and financial or operational covenants. This might change regarding suppliers as of 1 January 2023 (see question 12.2).

Stakeholders may also exert indirect influence with regard to their ESG-related expectations.

9.Executive performance and compensation

9. 1. How is executive compensation regulated in your jurisdiction?

Germany
POELLATH

The remuneration of the management board members of a stock corporation (AG) and a two-tier system European stock corporation (SE) is resolved upon by the supervisory board. In doing so, the supervisory board is bound by certain statutory objectives and restrictions. The overall compensation of the individual member of the management board:

- must be appropriate in relation to his or her tasks and performance, as well as to the economic situation of the company; and
- may not exceed the customary remuneration without specific reason.

Further, the remuneration in listed companies must be aimed at the sustainable and long-term development of the company. The Corporate Governance Code provides further recommendations – for example, on:

- the components of variable remuneration (short-term and long-term incentives); and
- severance caps in the event of premature termination of office.

In listed companies, the supervisory board must determine the remuneration principles in a remuneration system, which:

- is subject to approval by the general meeting upon its introduction and any material changes thereto; and
- must be reviewed at least every four years.

In addition, the supervisory board must prepare an annual remuneration report that is also subject to a resolution by the general meeting. However, the resolutions on the approval of both the remuneration policy and the report are non-binding.

The remuneration of the supervisory board members may be determined in the company's articles of association or granted by the general meeting. In listed companies, the remuneration of the supervisory board is also subject to a non-binding vote by the general meeting and must be disclosed in the annual remuneration report.

In a limited liability company (GmbH), the remuneration of managing directors is the responsibility of the shareholders' meeting without any specific legal requirements. Nevertheless, the respective service contract between the managing director and the company (represented by the shareholders' meeting) will commonly provide for a mix of fixed and variable remuneration.

In a partnership limited by shares (KGaA), the general partners generally receive no remuneration for their activities, but are entitled to a fee for incurring the liability of the KGaA *vis-à-vis* third parties.

9. 2. How is executive compensation determined? Do shareholders play a role in this regard?

Germany
POELLATH

The remuneration of the management board members of an AG and a two-tier system SE is resolved upon by the supervisory board and contractually agreed upon in the service contract.

The remuneration of the supervisory board members may be determined in the company's articles of association or granted by the general meeting. In listed companies, the remuneration of the supervisory board is also subject to a non-binding vote by the general meeting and must be disclosed in the annual remuneration report.

The general meeting must vote on the remuneration policy (see question 9.1) at least every four years. While being non-binding, a shareholder vote rejecting the policy triggers an obligation to amend the policy and to present it again at next year's general meeting. Further, a yearly remuneration report must be prepared and voted upon by the general meeting.

In a GmbH, the remuneration of managing directors is the responsibility of the shareholders' meeting.

9. 3. Do any disclosure requirements apply in relation to executive compensation?

Germany
POELLATH

All capital companies must disclose the total remuneration of the management board in the annual financial statements. An exception is made only for capital companies that fulfil at least two of the following criteria (small capital companies):

- The balance-sheet total does not exceed €6 million;
- The sales revenues within the last 12 months amount to less than €120 million; and
- The company employs, on an annual average, fewer than 50 employees.

In a listed company, the features of the remuneration system must be described (see question 9.1). The remuneration system must be published on the company's website for the duration of the application of the remuneration system, and at least for 10 years. In addition, the management board and the supervisory board of a listed company must disclose certain information – such as the fixed and variable remuneration paid to each member of the management and the supervisory board – in the annual remuneration report.

The remuneration report is also published on the company's website for at least 10 years. The Stock Corporation Act requires the remuneration report to be audited.

9. 4. Have any measures to address the gender pay gap been introduced in your jurisdiction?

Germany
POELLATH

There is no requirement to disclose information concerning gender pay gaps. However, companies with generally more than 200 employees are obliged, upon an employee's request, to supply information on:

- the average payment for comparable work; and
- whether comparable work is predominantly done by female or male staff.

Furthermore, companies with more than 500 employees that are under a duty to publish a management report are also obliged under the Payment Transparency Act to publish a report that states their measures concerning the promotion of gender equality and equal pay.

9. 5. How is executive performance monitored and managed?

Germany
POELLATH

Members of the management board are evaluated by the supervisory board based on performance indicators and targets set and agreed upon in the variable remuneration components and/or the remuneration policy. The same applies to managing directors of a one-tier SE in relation to the administrative board.

9. 6. What best practices should be considered with regard to executive performance and compensation?

Germany
POELLATH

- The overall remuneration of individual members of the management board must be appropriate in relation to their tasks and performance, as well as to the economic situation of the company;
- The supervisory board must ensure that the customary remuneration is not exceeded; and
- The remuneration should be aimed at the sustainable and long-term development of the company, and variable remuneration should be granted based on long-term incentives accordingly.

The Corporate Governance Code makes further recommendations with respect to the characteristics of the remuneration. For example, it recommends that the variable remuneration based on long-term incentives exceed that based on short-term incentives. Variable remuneration must be predominantly invested in shares of the company or granted as share-based remuneration.

Regarding members of the supervisory board, the Corporate Governance Code recommends a fixed compensation, taking into consideration the status as chair or deputy chair of the supervisory board and of potential committees.

The remuneration policy should:

- be clear and understandable;
- set a maximum remuneration; and
- include detailed information on different aspects of the remuneration.

10.Disclosure and transparency

10. 1. What primary reporting obligations relating to corporate governance apply in your jurisdiction?

Germany
POELLATH

Listed companies must issue a corporate governance report either as an integral part of the management report or on the company website. This report must address the corporate governance practices within the company, such as:

- cooperation between the management board and the supervisory board;
- the establishment of committees;
- the determination and fulfilment of gender quotas for leadership positions; and
- the company's diversity concept.

Furthermore, listed companies must publicly declare, on a yearly basis, whether they comply with the Corporate Governance Code or, if applicable, why they have deviated from certain recommendations set out by the Corporate Governance Code ('comply or explain'). This declaration is part of the corporate governance report and must be published on the company website. Since the implementation of the EU Second Shareholders' Rights Directive, the remuneration system for the management board and the supervisory board, as well as the annual remuneration report, must be published on the company website for at least 10 years.

Companies that meet certain criteria concerning their size must issue a declaration on non-financial aspects that expands their management report. This non-financial reporting requirement includes information on the company's concepts regarding environmental, social and governance (ESG) criteria and their implementation, such as:

- environmental, employee-related and social issues;
- human rights; and
- action against corruption and bribery.

In the future, once the Corporate Sustainability Reporting Directive (CSRD) has been implemented, even more companies will be required to report their sustainability data and the reporting requirements will be extended (see question 12.2).

Certain non-listed but employee co-determined companies must disclose information on their gender diversity targets as part of their management reports.

Besides annual disclosure requirements, certain corporate governance-related information must be disclosed on an *ad hoc* basis, such as relevant related-party transactions of listed companies.

10. 2. What role does the board play in this regard?

Germany
POELLATH

In general, the management board or the managing directors are responsible within the company for disclosure and transparency.

The declaration of compliance regarding the Corporate Governance Code of listed companies is a joint declaration by the management board and the supervisory board. Separate resolutions of the management board and the supervisory board are required for this.

10. 3. What role do accountants and auditors play in this regard?

Germany
POELLATH

The annual financial statements, the management report, the remuneration report and so on are subject to an audit by an external auditor, which must be independent and is appointed by the general meeting or the shareholders' meeting. While the auditor must assess whether the annual accounts have been prepared in compliance with all applicable rules and reflect a 'true and fair view' of the company, the corporate governance and remuneration reports are only subject to a formal audit.

10. 4. What best practice should be considered in relation to reporting and disclosure?

Germany
POELLATH

Reporting and disclosure should be written in a clear and comprehensive manner.

In addition to the reporting obligations set out in question 10.1, companies can disclose further information on a voluntary basis.

For instance, non-listed companies can fulfil the obligations for listed companies (eg, those of the Corporate Governance Code). Companies can also voluntarily apply the regulations of the upcoming CSRD (see question 12.2).

11.Audit and auditors

11. 1. What rules relate to the appointment, tenure and removal of auditors?

Germany
POELLATH

A company must appoint an external auditor unless it is a small company *(*based on the criteria set out in question 9.3). The key requirements governing the relationship between the company and the auditor are set out in the Commercial Code. The auditor is appointed by the general or shareholders' meeting upon the proposal of the supervisory board only. In a stock corporation (AG) and a two-tier system European stock company (*societas Europaea* (SE)), the supervisory board is also and solely responsible for issuing the actual audit mandate; while in a one-tier system SE it is the administrative board, and in a limited liability company (GmbH) it is the managing directors.

In 2021, the Financial Market Integrity Strengthening Act restricted the tenure of the auditor as follows:

- After 10 years, the external auditor must be changed for companies of public interest.
- The internal rotation period for the audit firm's responsible audit partner was reduced from seven to five years. This mandatory exchange of the auditor also applies to companies that:
    - are subject to supervision by the Federal Financial Supervisory Authority under the Banking Act, the Insurance Supervision Act or the Payment Services Supervision Act; and
    - are not public interest entities.

Once the audit engagement has been accepted by the auditor, the company generally has only limited options for termination. In practice, this rarely happens because the auditor must be newly elected by the general meeting every year.

11. 2. Are there any rules or recommendations that limit the scope of services as regards the provision of non-audit services by an auditor?

Germany
POELLATH

The Financial Market Integrity Strengthening Act has also led to a stronger separation of audit and consulting services,

In order to mitigate the risk of conflicts of interest arising from non-audit services for public interest entities and strengthen the independence of the auditor, additional (tax) consultancy and valuation services are prohibited. This means that the list of prohibited non-audit services contained in Article 5(1)(2) of the EU Auditing Regulation (537/2014) is fully applicable in Germany.

11. 3. Are there any rules or recommendations which cap the remuneration of an auditor as regards payment for the provision of non-audit services?

Germany
POELLATH

If the auditor provides permissible non-audit services to an audited public interest entity or its parent company or subsidiary for more than three consecutive financial years, the fee income from these services may not exceed 70% of the average of the fees earned for audit services in the last three preceding financial years, according to Article 4(2) of the EU Auditing Regulation.

12.Trends and predictions

12. 1. How would you describe the current corporate governance landscape and prevailing trends in your jurisdiction?

Germany
POELLATH

The corporate governance landscape consists of mandatory laws and soft law. The prevailing trend is sustainable corporate governance, which the newly amended Corporate Governance Code puts particular emphasis on. The management board should:

- systematically identify and assess the opportunities and risks for the company associated with social and environmental factors, as well as the ecological and social impacts of the company's activities; and
- take ecological and social goals into account in corporate strategy and planning.

With regard to other companies than listed companies or financial market participants and financial advisers, there is little clear legislation in connection with environmental, social and governance (ESG) issues. Nevertheless, management and supervisory board are already taking ESG issues into account, as these are becoming increasingly important.

12. 2. Are any new developments anticipated in the next 12 months, including any proposed legislative reforms?

Germany
POELLATH

Supply Chain Act: Implementing the United Nations Guiding Principles on Business and Human Rights, the legislature passed the Supply Chain Act in June 2021. According to this law, companies have duties of care with regard to human rights and the environment in their supply chains. For this purpose, companies must:

- establish an appropriate risk management system; and
- in particular, appoint an internal officer for monitoring this system.

Companies must:

- conduct a risk analysis for themselves as well as their suppliers;
- remedy any violations of human rights or environmental obligations which are identified;
- establish a procedure for filing complaints, which allows employees to report human rights violations; and
- publish an annual report on their compliance with their obligations under the Supply Chain Act.

The law came into force on:

- 1 January 2023 for companies with at least 3,000 employees; and
- 1 January 2024 for companies with at least 1,000 employees.

In February 2022, the European Commission presented a draft comparable to the Supply Chain Duty Act at the EU level with even stricter regulations than German law (eg, environmental harm and climate targets are given greater consideration). The regulations under this draft will apply to companies with more than 250 employees and a net turnover of more than €40 million.

Whistleblower Act: In future, whistleblowers will be protected more effectively. The EU WhistleBlower Directive (2019/1937/EU) is due to be implemented into national law. The legislative process in Germany is currently underway. The draft provides that internal and external reporting hotlines must be set up for the reporting of violations within the company. Reporting must also be possible anonymously. In addition, whistleblowers are protected from negative consequences of their actions.

Corporate Sustainability Reporting Directive (CSRD): In April 2021, the European Union presented a proposal to update the CSRD. The European Union aims to become the first climate-neutral continent by 2050. For this purpose, the sustainability reporting of companies will be adapted.

The draft was adopted by a large majority in the European Parliament on 10 November 2022 and finally came into force in January 2023. The directive must be transposed into national law within 18 months.

The CSRD aims to expand the reporting requirements to include additional information on ESG issues. This is intended to increase the influence of the reporting company on sustainability aspects and, vice versa, the impact of sustainability aspects on the development and performance of the reporting company. The reporting obligation will be mandatory. The European Union is currently developing reporting standards for sustainability reporting. With these standards, the European Union intends to specify the requirements for future reporting.

Currently, large listed companies must issue a non-financial declaration addressing aspects related to:

- environmental, labour and social issues;
- respect for human rights; and
- the fight against corruption and bribery.

The scope of the CSRD will be considerably wider. In future, all companies listed on a regulated EU market will be affected, as well as non-capital-market-oriented companies that exceed two of the following three criteria:

- annual turnover of €40 million;
- a balance-sheet total of €20 million; and
- an average of 250 employees.

From 2026, capital markets-oriented small and medium-sized companies will also be required to issue a sustainability report (first report in 2027).

Corporate Governance Code: The Corporate Governance Code was recently updated. The amended Corporate Governance Code came into force on 27 June 2022. Listed companies will have to comply with the new requirements for the first time as of the next (annual) declaration of compliance.

According to the new Corporate Governance Code, the internal control and risk management system must be geared towards sustainability-related concerns.

Further, the company strategy must provide information on how the company's economic, ecological and social objectives will be implemented in a balanced manner; while corporate planning must include sustainability-related objectives in addition to financial objectives. The management board must, among other things, systematically identify and assess the risks and opportunities for the company associated with social and environmental factors, as well as the social and environmental impacts of the company's activities.

Also, the supervisory board must monitor certain sustainability aspects, while its competence profile must include expertise on sustainability issues of importance to the company. In addition, the professional qualifications of the members of the audit committee of the supervisory board must be:

- expanded to include knowledge and experience in sustainability reporting; and
- included in the corporate governance statement.

13. Tips and traps

13. 1. What are your top tips for effective corporate governance in your jurisdiction and what potential sticking points would you highlight?

Germany
POELLATH

In consideration of the trend of increasing corporate governance regulation and the growing importance of sustainability, companies should look beyond the current legal requirements (and recommendations of the Corporate Governance Code) and review even higher standards of best practice corporate governance applied in other countries. As the trend is towards heightened regulation and more extensive reporting requirements, companies can decide whether they wish to voluntarily implement these higher standards in advance and present themselves as forward-looking, well-managed companies.

As a potential sticking point, foreign investors and entrepreneurs should keep in mind the system of German employee participation (see question 2.3).

mondaq

Connecting knowledge & people

Bristol | Essex | New York | Sydney

t: +44 (0) 20 8544 8300
e: enquiries@mondaq.com