



Corporate Governance in Germany – Is there a revolution coming up?

In the nineties Germany seemed to be an “underdeveloped” country with respect to international standards for Corporate Governance: neither the term “Corporate Governance” was known in the country nor were there any Codes of Best Practice in sight. But things have been changing since the old times.

News about Corporate Governance in Germany

- Corporate Governance in Germany – Is there a revolution coming up?
- The most important recommendations of the Government Commission on Corporate Governance
- Review on this year's AGM-Season
- The new Takeover Law

- **ATTENTION !!:** FROM 2002 ON WE WILL SEND OUT OUR NEWSLETTER BY MAIL (to guarantee immediate delivery please make sure that we have your correct email address and contact pk@dsw-info.de)

Step no. 1: The Control- and Transparency Law (KonTraG)

The Control- and Transparency law of May 1998 was the starting point of a big move in the German Corporate Governance system.

Since then Germany is stepping ahead towards internationally recognized standards.

Step no. 2: The first Corporate Governance Codes have been developed

Beside the DSW-Guidelines the very first Code of Best Practice was developed by the Frankfurt commission in February 2000, including members such as Ulrich Hocker from DSW. This code mainly covered the relationship of management to the supervisory board and towards the auditor.

Later that same year another code followed, this time by a Berlin commission, dealing mainly with the duties of management.

Step no. 3: The Chancellor's Commission on Corporate Governance

Then all the sudden, Chancellor Schröder discovered the hot topic “Corporate Governance” and founded in summer of 2000 a government commission led by Professor Theodor Baums. This commission (**Baums-Commission**), which also included a DSW representative, worked from fall 2000 until the summer of 2001 on any issue somehow connected to Corporate Governance. The result was

presented in July 2001: a 320 page report consisting of nearly 150 recommendations (for the most important recommendations see page 2-3).

Following the old saying: "Once the Germans start to act, they do it as precise and profound as possible!" The recommendations distinguish between proposals, which should be further developed as part of a new code and recommendations directed to the lawmaker in order to be soon enforced by law.

Step no. 4: The new Code Commission (Cromme-Commission)

In September 2001 a newly formed commission, this time led by Gerhard **Cromme** (chair-

man of ThyssenKrupp), started its work on further developing the recommendations of the Baums-Commission as key element for a new Code of Best Practice. Again Ulrich Hocker from DSW is the only representative of a shareholder association being represented in this commission.

The final code is expected to be published in February/March 2002. This Code would then be the first set of nationally recognised rules on Corporate Governance.

Step no.5: New legislation to come

Apart from the Code of Best Practice the legislator is demanded to act. While just recently the new

The most important recommendations of the Government Commission on Corporate Governance

I. INDEPENDENCE

1. Supervisory board

The Government Panel is in favor of including a recommendation in the Code of Corporate Governance that would prohibit a person who serves on the supervisory boards of five other non-affiliated companies from becoming a supervisory board member of a publicly listed company.

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2. Management/Supervisory board

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It should be required that remunerations or benefits paid by the company, its parent company or its subsidiaries to members of the supervisory board for personal services rendered, in particular for consultation and brokerage services, be disclosed in the Notes to the annual (consolidated) financial statements.

3. Auditor

The Government Panel recommends setting forth in the HGB that the designated auditor of companies having a supervisory board, and for which an audit is mandatory, must provide details to the supervisory board or its audit committee regarding any circumstances (professional, financial, family ties to the company, the members of its management and supervisory boards or affiliated companies) that may give reasonable grounds to suspect partiality. At any rate, until such a legal obligation has been introduced, precautionary measures should be taken in the Code of Corporate Governance to be drafted for publicly listed companies. Such Code should also provide that any grounds for suspecting incompatibility or partiality occurring during

the time that the auditor is retained by the company must be reported promptly to the chairman of the supervisory board.

The Government Panel recommends that the supervisory board, prior to its proposal to the shareholders' meeting of the auditor to be appointed, provide the shareholders' meeting with information regarding remuneration of the auditor and regarding the kind of auditing and non-auditing services performed by the auditor during the preceding fiscal year. In addition, the auditor should be required to inform the supervisory board of additional non-audit assignments he or she may receive from the management board while the audit is being performed. In addition, provision should also be made for the supervisory board to report to the shareholders' meeting within the scope of its reporting duties pursuant to § 171(2) AktG on the ratio of remuneration paid to the auditor for auditing and non-auditing services, and to state whether, in the opinion of the supervisory board, the auditor's independence may be in doubt.

II. INTERNET

The Government Panel proposes that the information provided to German investors on foreign companies listed on German stock markets be improved. Once the unified electronic access portal (the "German Company Register") has been installed, the previously used newspaper publication (for calls to meetings) should be replaced by electronic publications. Foreign issuers who are listed on German stock markets should be required to provide the data required for stockholder communication to the stock market or the Federal Gazette electronically.

The Government Panel proposes that the federal government create a unified electronic access portal ("German Company Register") which will give the business world and capital market participants access to official corporate information published to meet disclosure requirements (commercial register, relevant federal gazette announcements, database of reported shareholdings maintained by the Federal Supervisory Authority for Securities Trading (Bundesaufsichtsamt für Wertpapierhandel).

The Government Panel recommends that access to the "voting rights data base" of the Federal Supervisory Authority for Securities Trading be provided via the German Company Register internet portal.

III. ANNUAL GENERAL MEETING

The Government Panel proposes that the announcement of counter motions by stockholders (§ 126 AktG), including the management's positions thereon, no longer be made pursuant to § 125 AktG, but should simply be made available in a generally accessible form, such as on the company's website, and only if the motion was sent to an address made known to the stockholders in the call to the shareholders' meeting.

Takeover Law was adopted and will be enforced on 1st of January 2002, further laws are on their way:

- > “4. Finanzmarkt-Förderungsgesetz” (4th law to promote the financial market), which mainly covers issues such as the prevention of market manipulation and insider trading, the introduction of a compensation claim vs. management in case of false or a lack of immediate release of price sensitive information,
- > “Transparenz- und Publizitätsgesetz” (law for transparency and publication), which shall cover most of the recommendations of the Baums-Commission.

The sooner these upcoming laws will be enforced the better the system of Corporate Governance will develop in Germany. There is only one risk: politics, or let us better say the beginning of the election period in 2002, which could prevent any further activism until September 2002.

These ongoing developments since 1998 might not be seen as a revolution, but as major steps forward towards a comprehensive and efficient set of standards for German Corporate Governance – a necessity in the world of global capital markets.

To inform about there recent developments in Germany and Europe, DSW will organize its Third Corporate Governance Conference in December 2002. For further information see page 8.

IV. RIGHT TO INFORMATION

Section 131 AktG should be expanded to allow the management board to refuse a request to provide information that is available on the company website up to the end of the shareholders' meeting and, at the same time, has been made available in written form at the shareholders' meeting.

The Government Panel recommends that it should be possible to limit, in the articles of association or in procedural rules (§ 129 AktG), the number of questions that stockholders may ask during the shareholders' meeting. In this case, at least five questions must be admitted per stockholder and agenda item. The articles of association or procedural rules should further provide that stockholders who intend to ask more than five questions regarding one agenda item must submit them to the company up to five days before the shareholders' meeting.

V. COMMUNICATIONS WITH SHAREHOLDERS

The Government Panel recommends facilitating communication between stockholders in cases where the law requires a certain minimum shareholding or minimum amount of voting rights for the exercise of stockholder rights. The company's website offers a good medium for this. Management should be permitted to refuse any publication on the grounds specified in § 126(2), sentence 1, nos. 1-3, and sentence 2 AktG, or if a request has already been made based on the same facts. The stockholder must advance the publication costs, which the company must reimburse if the minority petition is approved.

VI. LEGAL ACTIONS BY SHAREHOLDERS

1. individual compensation claims

Legislation should provide that the members of the management and supervisory boards of publicly listed companies will incur civil liability for releasing false information about the state of the company intentionally or in a grossly negligent manner.

The Government Panel recommends to provide for common representation of damaged investors if false information is released intentionally or in a grossly negligent manner. Any obligation to join such a collective representation should be excluded, as should be any commercialization of the claim by multiple representations or contingency fee.

2. legal action vs. resolutions taken at the AGM

The Government Panel recommends that a minimum shareholding be required to commence an action for rescission of a shareholders'

resolution based upon a violation of a duty to provide information (reporting or disclosure duties). The claimant in an action for rescission or, in the case of a class action, the claimants must either own shares constituting one per cent of the capital stock, or having an exchange or market value of 100,000 euro.

The judicial procedure for enforcing disclosure (§ 132 AktG) should be extended to violations of other obligations to disclose (such as reporting duties).

The Government Panel suggests to provide for a formal freeze on registration following the example given in § 16(2) UmwG when an action for rescission against a capital increase or decrease is filed (in the case of both publicly listed and privately held companies) and against other corporate actions requiring registration, except for simple amendments to the articles of association and declarative entries, and, moreover, for a curative effect of the register entry in such cases in line with § 20(2) UmwG. In addition, it is recommended that a release procedure before the trial court be introduced in these matters following the example of § 16(3) UmwG.

3. Compensation claims vs. members of the management/ supervisory board in the course of management

The Government Panel recommends to revise the right to commence derivative suits pursuant to § 147 AktG.

VII. OTHER ISSUES

1. Preemptive right of shareholders in case of the Initial Public Offering of a daughter company

In order to address the concern of stockholders of a parent company who may be exposed to the risk of value impairment (watering) of their shares when one of the parents' subsidiaries or sub-subsidiaries makes an initial public offering, the Committee to be established for drafting a Code of Corporate Governance is recommended to highlight this risk and emphasize that the management board is responsible, on the basis of its duty of care and duty of loyalty, for confronting this risk by either granting the stockholders preemptive rights to the offering or pursuing proper pricing procedures in line with market practice.

2. Quarterly reporting

The Government Panel advises providing for an audit review of interim reports by an auditor/auditing firm that generally should be the same as the auditors for the previous, full fiscal year.

Review on this year's AGM-Season

DSW, Germany's leading shareholders' association, for the first time visited more than 1000 annual general meetings during the year 2001. With our speakers we successfully represented our members and shareholders from Germany and abroad.

In total, DSW voted in more than 130 cases against the proposals of the administration. Against 13 companies we even filed 26 counterproposals and oppositions to underline our critics. Three times DSW applied for a special investigation; this was the case at EM.TV & Merchandising AG, Mannesmann AG and Deutsche Telekom AG.

The annual general meeting of Deutsche Telekom surely was the most turbulent one during this year. The administration of the company had to face massive critics from its shareholders on the background of immense stock price losses and a questionable evaluation of its real estates. In February, Deutsche Telekom had to inform its investors about an adjustment of the declared value for 4 billion marks.

But against the vote of the majority shareholder, the Federal Government, it was impossible to launch a special audit by the initiative of DSW. Also the discharge of the management and supervisory were government-backed and passed against the vote by DSW. But DSW gained the support of more

AGM season 2001
stock option and repurchase programs among DAX-30 companies

company	repurchase program	new stock option program approved		
© Deutsche Schutzvereinigung für Wertpapierbesitz e.V.			only absolute targets	absolute and relative targets
Adidas-Salomon	no	no		
Allianz	yes	no		
BASF	yes	yes		X
Bayer	yes	no		
Bayerische HypoVereinsbank	yes	no		
BMW	no	no		
Commerzbank	yes	no		
DaimlerChrysler	yes	no		
Degussa	no	no		
Deutsche Bank	yes	yes	X	
Deutsche Lufthansa	yes	no		
Deutsche Post	no	no		
Deutsche Telekom	yes	yes	X	
E.ON	yes	no		
Epcos	no	no		
Fresenius Medical Care	no	no		
Henkel	yes	no		
Infineon	no	yes	X	
Linde	yes	no		
MAN	no	no		
Metro	yes	no		
MLP	no	no		
Munich Re	yes	no		
Preussag	yes	no		
RWE	yes	no		
SAP	yes	no		
Schering	yes	yes		X
Siemens	yes	yes	X	
ThyssenKrupp	no	no		
Volkswagen	yes	no		

than 4 million shares for the special audit as well as against the proposed stock option plan and the discharge of the administration.

Also at the AGM of DaimlerChrysler, DSW gained a high support of German and international investors for its counter proposal concerning the discharge of management and supervisory board.

Further on, DSW has analysed the resolutions of the general meetings in 2001 among the 30 DAX companies concerning repurchase and stock option programs:

Repurchase programs

As repurchase programs in Germany are valid only for 18 months, most of the German companies have share buy back approvals on their AGM agenda every second year. In 2001 the AGM of two third of the DAX-30 companies approved a resolution to repurchase up to 10% of the company’s capital stock. In most cases (75%) the company’s management uses the option to buy back shares as a “carte blanche” to protect the company against possible takeovers.

Stock option programs

This year only six of the 30 DAX companies had a stock option program on their agenda. But it is to

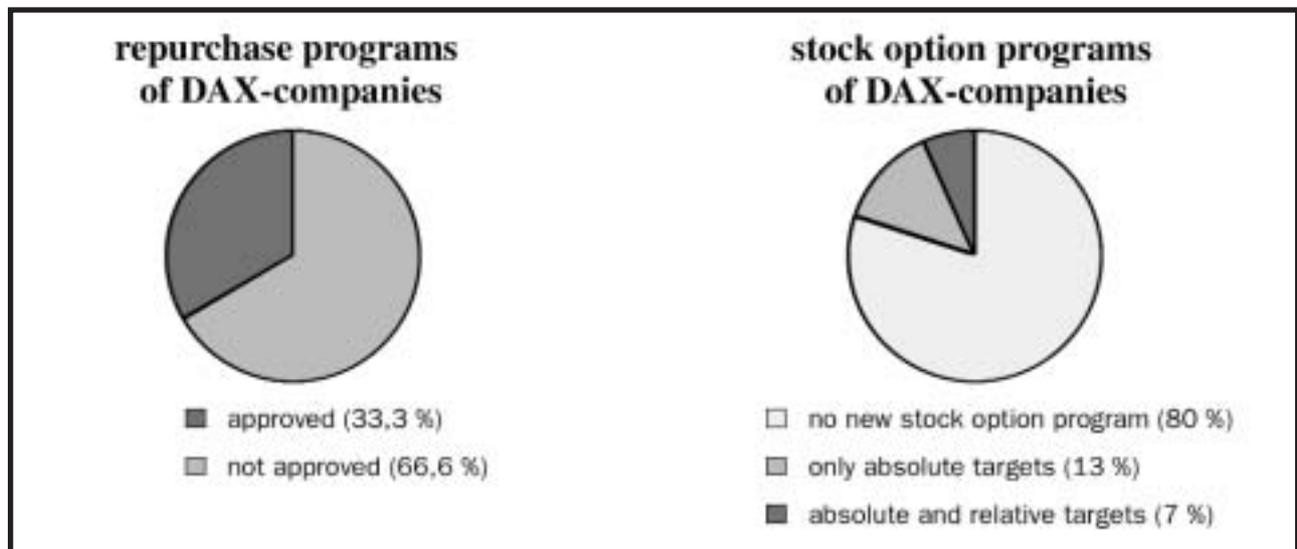
criticise that only two of the six companies implemented absolute and relative performance targets as exercise hurdles because the coupling of the subscription rights only with absolute parameters may lead to unjustifiable windfall profits for the beneficiaries which do not represent an incentive coupled with the valorisation of the company.

Further Declining Turnouts at AGMs

The capital present at the annual general meetings of German companies has been further decreasing. DSW has focussed on this topic during the last years, and although a few companies introduced registered shares, the present AGM-season is no exception. Compared to 1999, the average turnout dropped by more than 3 points from 56,36 per cent to 53,03 per cent. As the last analysis of DSW shows, the danger of takeovers for undervalued shares is still existing. Policy decisions might be taken by accidental majorities at the AGM.

For nearly half of the DAX companies, a potential bidder might easily have the single majority at the AGM and hereby the effective control over the company with less than 30 per cent of the share capital. As a possible countermeasure, the new German takeover law foresees a 30 per cent-hurdle for a public offer to all shareholders.

As the last column of the table on the following page shows, this still falls short of its effect.



Foreign Investors Welcome

But what is the principle “one share, one vote” worth, if shareholders (especially foreign investors) do not exercise their right to vote at the AGM? To improve the turnout at German annual general meetings, DSW offers all interested institutional and private investors in Germany and abroad the possibility to exercise their vote. Since DSW has been engaged for several years in the voting procedure at

the general meetings and is always present with one of its speakers, DSW can guarantee that also foreign votes are actually exercised in the way the investor chose it.

On a European level, ECGS, the European Corporate Governance Service with its head office in London, can offer the possibility of proxy voting in further European countries besides Germany.

(For further information and details, please get in contact by mail to ben@dsw-info.de).

© Deutsche Schutzvereinigung für Wertpapierbesitz e.V.	1999 in %	2000 in %	2001 in %	3-Year-Average	50 % of 3-Y-Average
adidas-Salomon AG	43,90	45,44	30,00	39,78	19,89
Allianz Holding AG	69,06	60,60	53,70	61,12	30,56
BASF AG	49,48	46,02	43,59	46,36	23,18
Bayer AG	44,79	37,53	35,90	39,41	19,70
Bayerische HypoVereinsbank AG *	59,10	51,99	53,48	54,86	27,43
BMW AG	73,00	64,40	64,04	67,15	33,57
Commerzbank AG	43,91	55,97	56,07	51,98	25,99
DaimlerChrysler AG **	39,02	39,00	36,92	38,31	19,16
Degussa AG ***	70,86	82,82	75,86	76,51	38,26
Deutsche Bank AG	37,50	31,73	34,44	34,56	17,28
Deutsche Lufthansa AG	34,60	35,25	34,90	34,92	17,46
Deutsche Post AG	–	–	76,18	–	–
Deutsche Telekom AG	82,67	75,86	69,52	76,02	38,01
Dresdner Bank AG	61,72	59,75	–	–	–
E.ON	–	–	39,01	–	–
Epcos AG	–	42,60	44,88	–	–
Fresenius Medical Care AG	(67,88)	64,79	61,06	64,58	32,39
Henkel AG (Vz.)	66,75	83,24	84,50	78,16	39,08
Hoechst AG	62,68	–	–	–	–
Infineon	–	–	74,74	–	–
Karstadt-Quelle AG	65,65	68,46	–	–	–
Linde AG	56,46	54,40	52,67	54,51	27,26
MAN AG	59,81	55,80	50,62	55,41	27,71
Mannesmann AG	45,51	–	–	–	–
Metro AG ****	77,72	87,53	66,93	77,39	38,70
MLP (Vz.)	(77,89)	(79,22)	75,38	77,50	38,75
Münchener Rück AG	72,33	69,80	65,60	69,24	34,62
Preussag AG	66,87	39,30	37,21	47,79	23,90
RWE AG	67,15	63,90	65,09	65,38	32,69
SAP AG (Vz.)	53,36	56,70	50,85	53,64	26,82
Schering AG	47,01	43,33	37,40	42,58	21,29
Siemens AG	44,97	24,93	22,00	30,63	15,32
ThyssenKrupp AG *****	55,90	64,13	61,26	60,43	30,22
Veba AG *****	46,44	40,41	–	–	–
Viag AG *****	54,99	65,47	–	–	–
Volkswagen AG	37,62	34,39	36,99	36,33	18,17
Average	<u>56,36</u>	<u>54,85</u>	<u>53,03</u>		

* since 1999, formerly Bay.Vereinsbank AG, ** since 1999, formerly Daimler Benz AG, *** since 1999, formerly Degussa AG, **** since 1997, formerly Kaufhof AG, ***** since 1999, formerly Thyssen AG, ***** After the merger of Veba and Viag, E.ON as well as Infineon entered the DAX on 17.06.2000.

The new Takeover Law

In November 2001 the German Bundestag has passed the new German Takeover Law. This new law had to come quickly. Only lately, Credit Suisse Boston discloses that it expects an increase in hostile takeovers in Germany because international investors are seeing the boards of German companies in a new light since corporate governance had begun to play a more important role at German groups. But only two months before the new law will be set into force in January 2002, the Federal Government rewrote the draft law in a night and fog tactics. The key elements of the new law are the following:

1. Obligation to stay neutral

In case of a takeover attempt the management now has the possibility to initiate counter-measures only with the Supervisory Board's approval.

DSW: One of the most important proposals of the responsible Government Panel had been thrown overboard, as with that the shareholders' rights, as the owners of a company (which have less influence than shareholders in other European countries anyway) are radically curtailed. Furthermore but not less important it means that the obligation of the management to stay neutral in case of a take over attempt has become invalid. Therefore DSW calls upon the management boards of German companies to publicly bind themselves to neutrality in case of a takeover attempt as a sign of good corporate governance.

2. "Carte blanche" resolutions

The management has the possibility to ask for the approval of the shareholder's meeting to take various defensive measures during the takeover procedure (like e.g. capital increases, repurchase programs). It is only required to inform the shareholder's meeting about the kind of measure to be approved not about the further and measure-immanent conditions.

DSW: This means a "carte blanche" for the management, since shareholders at the time of the resolution are not informed about the concrete measure to be taken.

3. Mandatory offer

In the event that 30 percent of a company's voting shares are to be acquired, an offer must be made to all shareholders. Exceptions apply to certain cases.

DSW: In 2001 at almost half of the DAX companies a voting power of less than 30% would have been sufficient to reach the simple majority at the General Meeting (see page xy for statistics). Therefore an offer should also be mandatory at a holding of less than 30 % of the capital, if at the preceding three General Meetings of the company a voting power of less than 30 % had been sufficient to control the company because this leads to the suggestion that the bidder will have the simple voting majority at the next General Meeting and thereby would control the company in its major decisions.

4. The bidder's offer

In principle, the bidder is free to offer shares in payment for the targeted company's stock. The shares must however be liquid and be traded on a stock exchange in Europe. The bidder is obliged to make a cash offer to all shareholders when he has acquired more than 5 % of the target company's shares or voting rights within the last three months prior to submitting the takeover bid or acquires and pays cash for more than 1 % of the target company's shares or voting rights during the takeover procedure.

5. Price regulation

The value of the bidder's consideration must amount to at least the target company's average weighted share price. In the event that the bidder has acquired shares of the target company, the level of his offer must be taken into account. If the bidder acquires shares at a higher level during the takeover or within one year after the announcement the bidder's offer has to be raised as well.

DSW: The one year time limit is too short because it paves the way for the major shareholder for strategic tactics which could be followed by an unequal treatment of the minority shareholders.

6. Information

The bidder will be required to inform the target company's shareholders and employees about the acquisition and its effects in detail and in a German-language offer statement.

7. Sanctions

Sanctions like suspending the bidder's voting rights, payment of interest on the payment which the bidder owes minority shareholders or adequate fines are to be used to ensure observance of the legal requirements.

8. Squeeze-out rule

In order to enable the acquisition of all of a company's shares, an acquiring company that holds at least 95 percent of all shares should be able to pay off the remaining shareholders.

DSW: A squeeze-out should be an exceptional case in Germany, so DSW proposes a squeeze-out hurdle of 98 %. Furthermore it has to be secured that the price offered to the shareholders left over is part of a special legal investigation.

Right direction but not far enough

As Germany does not have a binding legal framework governing corporate takeovers at the moment the new Takeover Law will set hurdles for major shareholders that target German companies. But unfortunately, the law has major deficits, especially regarding the management rights in case of a takeover attempt.

European directives in front of the door

But the German "solo" may have a short life in Europe. After the failure of the last European Guideline the EU Commission and the European Parliament are working on a new directive. A draft shall be submitted in early 2002 and the directive shall already be set into force in early 2003. Objective is the creation of similar positions in all EU countries. Germany is the only EU country which completely prohibits multiple voting rights or voting right limitations from 2003 on (the only exception is still the Volkswagen law). Similar conditions for takeovers and also possible takeover devices would consequently mean that in all EU countries any voting limitations or violation of the rule "one share – one vote" must be abolished. This would lead to a European wide standard for takeovers and would guarantee the obligation of the management to be neutral and not act against shareholders interests. It would also mean the end of the German "solo"!

DSW's THIRD CORPORATE GOVERNANCE CONFERENCE

will take place on **4th and 5th of December 2002 at the Kurhaus Wiesbaden.**

The conference will give information on recent developments in the Corporate Governance System in Germany and in Europe. Speeches will be held by keynote speakers from Germany and also abroad.

This conference especially addresses to all foreign institutional investors and other organisations, or persons from all over the world.

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Hamborner Straße 53, 40472 Düsseldorf (e-mail: dsw@dsw-info.de, Internet: <http://www.dsw-info.de>)
responsible editor: Jella S. Benner-Heinacher, managing director of DSW, e-mail: ben@dsw-info.de
editor: Christiane Hölz (e-mail: chs@dsw-info.de), Petra Krüll (e-mail: pk@dsw-info.de)
layout: Diana Siebert, e-mail: siebert@wertpapier.de