european corporate governance institute

Directors' Remuneration in Listed Companies
Germany*, 2008

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German law, regulation and best practices are stated as they stood at October 2008.

Questionnaire

1. General

1.1 Please indicate, as a general reference, the laws, case law, regulations, exchange rules and best practice concerning directors' remuneration in your country with respect to listed companies. Please indicate where these provisions (such as, for example, exchange rules) apply only to domestically-incorporated companies.

- Stock Corporation Act 1965 (*Aktiengesetz – AktG*) published in the Federal Law Gazette Part I 1965 p. 1089. The current version can be downloaded at http://www.gesetze-im-internet.de
- Securities Trading Act 1994 (*Wertpapierhandelsgesetz – WpHG*) published in the Federal Law Gazette Part I 1994 p. 1749, last amended by an enactment of 5 January 2007, Federal Law Gazette 2007 Part I, p. 10. The current version can be downloaded at http://www.bafin.de (an English version is available).
- German Corporate Governance Code, 26 February 2002 (Cromme Code), last amended 6 June 2008. The current as well as all previous versions can be downloaded at www.corporate-governance-code.de (English and German versions). The Cromme Code applies only to domestically-incorporated companies. According to its foreword "the Code presents essential statutory regulations for the management and supervision of German listed companies…"
- Commercial Code 1897 (*Handelsgesetzbuch – HGB*) published in the Federal Law Gazette 1897 p. 219. The current version can be downloaded at http://www.gesetze-im-internet.de
- Stock exchange listing rules no longer provide for specific disclosure requirements regarding remuneration but refer to the applicable legal provisions (e.g. for Prime Standard and General Standard, see http://www.deutsche-boerse.com/).
- BGHSt 50, 331 (*Mannesmann Case)*

1.2 As to best practices, please specify whether they are described in either a private (voluntary or non-statutory) code or other official report, and whether a "comply or explain" principle is applicable to compliance with the relevant provisions by listed companies. Where the "comply or explain" principle applies, please indicate, where such evidence is available, whether companies generally comply with best practices.

The German Corporate Governance Code (Deutscher Corporate Governance Kodex – DCKG) is a non-statutory code. It comprises recommendations, mere suggestions and passages that merely paraphrase existing German law, i.e. rules that have to be observed under applicable German company law. While the Code characterizes recommendations by the use of the word "shall", mere suggestions are indicated by terms such as "should" or "can".

The “comply or explain” principle with respect to the Code applies on a statutory basis. Section 161 of the German Stock Corporation Act – the provision was introduced by Article 1 of the Transparency and Disclosure Law 2002 (*Transparenz- und Publizitätsgesetz*), published in the Federal Gazette Part I 2002 p. 2681 and available for download at http://www.bafin.de http://217.160.60.235/BGBL/bgbl1f/bgbl102s2681.pdf) - stipulates that the executive board and the supervisory board of listed companies shall declare annually that the recommendations of the Government Commission “German Corporate Governance Code” have been and are complied with, or which of the Code’s recommendations have not been or are not applied. See also the governmental explanation accompanying the Transparency and Disclosure Law (BR Drucksache 109/02 p. 51, available for download at http://dip.bundestag.de).

The Code itself provides for the “comply or explain” principle, as well. It stipulates (see DCGK 1.) that companies may deviate from recommendations of the Code, but are then obliged to disclose this annually. Mere suggestions can be deviated from without disclosure. More specifically, the Code (DCGK 3.10) recommends that the management board and the supervisory board shall report each year on the enterprise’s corporate governance in a “corporate governance report” as part of the annual report (“Geschäftsbericht”), including an explanation of possible deviations from the recommendations of the Code. Comments on the Code’s suggestions can also be provided in the corporate governance report.

The company’s declaration of conformity has to be published on the company’s website, at least. Pursuant to section 161 sentence 2 Stock Corporation Act, the most recent declaration shall be made accessible to stockholders on a permanent basis. Companies comply with this requirement by publication on their website. Going beyond that, the Code (DCGK 3.10) recommends that a company shall keep previous declarations of conformity available for viewing on its website for five years. Moreover, the Code (DCGK 6.8) specifies that information the company discloses should be published in English, too.

In addition, the publication requirements pertaining to annual financial reporting (section 325 (1) Commercial Code) require a listed company also to file its annual declaration of conformity with the Electronic Federal Gazette (www.ebundesanzeiger.de). The latter will then forward the declaration to the Electronic Company Register (www.unternehmensregister.de).

1.3 Please describe in summary: the institutional structure for adopting executive remuneration rules or best practice codes; and any major proposals for reform concerning directors’ remuneration.

Rules on executive remuneration are provided for by statute as well as by the German Corporate Governance Code.

The Federal Ministry of Justice set up a Government Commission “German Corporate Governance Code”, made up of 13 experts from different areas of German business (directors of various business firms and financial institutions, two academics and a trade unionist; for its present

members see http://www.corporate-governance-code.de/eng/mitglieder/index.html) and chaired by Dr. Gerhard Cromme (hence "Cromme Code"). The Commission was set the task of developing the Code and, with respect to the future, of revising it continuously. The foreword to the Code (DCGK 1.) specifies that, as a rule, the Code will be reviewed annually against the background of national and international developments and adapted, if necessary.

Publication requirements with respect to executive remuneration were subject to a major legal reform in 2005. As to the Management Board Remuneration Disclosure Act ("Gesetz über die Offenlegung der Vorstandsvergütung"), see question 2.3. At present, statutory caps on executive remuneration are a popular topic in the mass media and are advocated by influential members of both parties forming the present government. Pertinent proposals have not yet been put on the legislator's agenda but are to be expected within the next six to nine months.

2. Disclosure

2.1 Are listed companies required to publish a remuneration report, indicating the details of the remuneration paid to the members of the Board of Directors? How often must it be published and where is it retrievable?

Pursuant to section 285 sentence 1 no. 9 Commercial Code, listed companies have to disclose information on executive remuneration in the notes to the financial statements. A special remuneration report is neither mandated by law nor by the Cromme Code (see following questions for further details). Section 314 (1) no. 6 Commercial Code requires the parent company of a group to make the same disclosure in the notes on the consolidated financial statements on a group-wide basis.

2.2 Must these reports be submitted, or is it recommended that they be submitted, to a Securities Market Regulator or to a public authority responsible for collecting these documents?

Pursuant to section 325 (1) Commercial Code, a company has to file the financial statements with the Electronic Federal Gazette (www.ebundesanzeiger.de). The latter will then forward the declaration to the Electronic Company Register (www.unternehmensregister.de). The same obligation holds true with respect to the consolidated financial statements; see section 325 (3) Commercial Code.

2.3 What information on directors' remuneration, individually and collectively, and on the remuneration committee, must be included, or is recommended to be included as best practice, in the financial reports? Please include in your answer any specific requirements

which apply to particular elements of remuneration, such as stock options, bonuses, and termination payments.

Since 2005, pursuant to amendments introduced by the Management Board Remuneration Disclosure Act ("Gesetz über die Offenlegung der Vorstandsvergütung" (published in the Federal Gazette Part I 2005 p. 2267 and available on http://www.bgblportal.de/BGBL/bgbl1f/bgbl105s2267.pdf)) listed companies are required to disclose extensive information on an aggregate basis, as well as on an individual basis; see section 285 sentence 1 no. 9 and section 289 (2) no. 5 sentence 2 Commercial Code. Whereas disclosure on an aggregate basis is to be made in the notes on the financial statements (section 285 sentence 1 no. 9 sentences 1 to 4 Commercial Code), disclosure with respect to individual remuneration is either also to be made in the notes (section 285 sentence 1 no. 9 sentences 1 to 4 Commercial Code) or in the management report (section 289 no. 5 sentence 2 Commercial Code).

A (listed) parent company that has to draw up and publish consolidated financial statements is subject to the same disclosure obligations on a group-wide basis and has to publish the information in its consolidated financial statements (see section 314 (1) no. 6 Commercial Code).

Pursuant to section 285 sentence 1 no. 9 lit. a Commercial Code, the company has to publish the total remuneration (salaries, profit sharing, preemptive rights and other forms of stock-based payments, expense allowances, insurance benefits, commissions and incidental benefits of all kinds) for the members of the management board, as well as of a supervisory board, making disclosure separately for each group of persons. Total remuneration shall also include remuneration not paid out, but transformed into claims of another kind, or used to increase other claims. In addition to remuneration in respect of the financial year, other remuneration that was granted in the financial year, but was not disclosed in any prior annual financial statements, shall also be disclosed (sentences 1 to 4).

For listed stock corporations, the remuneration of each individual member of the management board shall be disclosed separately, giving his or her name, classified into non-performance-related and performance-related components as well as long-term incentive components. This also applies for compensation arrangements in the event of termination of his or her activities. Furthermore, the main features of the remuneration arrangements shall be described if their legal structure differs significantly form those granted to the employees. Finally, benefits payable or granted to the individual management board member by a third party with respect to his or her activity as board member in the financial year shall also be disclosed (section 285 sentence 1 no. 9 lit. a sentences 5 to 8).

Pursuant to section 285 sentence 1 no. 9 lit. b Commercial Code, the company has also to disclose the total remuneration of former members of the designated bodies and their surviving dependants.

Moreover, contributions to the directors' remuneration on behalf of third parties must be disclosed individually (section 285 sentence 1 no. 9 lit. c Commercial Code).

The disclosures required by section 285 sentence 1 no. 9 lit. a Commercial Code are omitted if so resolved by the general meeting. Such a resolution, which may be adopted for a maximum of five years, requires a majority of at least three quarters of the share capital represented when the resolution is adopted (section 286 (5) Commercial Code).

Generally, in line with section 285 sentence 1 no. 9 Commercial Code, the Cromme Code differentiates with respect to recommendations on additional disclosure in the company's corporate governance report between the members of the management board and those of the supervisory board. However, whereas section 285 requires disclosure to be made in the notes on the financial statements the Code recommends, somewhat less precisely, that disclosure with respect to management board members shall be made in a remuneration report which, as part of the corporate governance report, describes the remuneration system for management board members in a generally understandable way and that disclosure with respect to supervisory board members shall be made in the corporate governance report.

As regards the information to be disclosed, the Code states that the total remuneration of each member is to be disclosed by name, divided into non-performance-related, performance-related and long-term incentive components, unless decided otherwise by the general meeting by a three-quarters majority (DCGK 4.2.4). In addition, the Code (DCGK 4.2.5) recommends that the presentation of the concrete form of a stock option plan or comparable schemes for components with a long-term incentive effect and risk character shall include the value thereof. In the case of pension plans, the allocation to accrued pension liabilities or pension funds shall be stated each year. The substantive content of severance awards for management board members shall be disclosed if, in legal terms, the awards differ not insignificantly from the awards granted to employees. The remuneration report shall also include information on the nature of the fringe benefits provided by the company.

The remuneration of the members of the supervisory board shall be reported individually in the corporate governance report, subdivided according to components. Also payments made by the enterprise to the members of the supervisory board or advantages extended for services provided individually, in particular advisory or agency services, shall be listed separately in the corporate governance report (DCGK 5.4.7)

The corporate governance report shall also contain information on stock option programs and similar securities-based incentive systems of the company (DCGK 7.1.3).

2.4 Is timely disclosure required with respect to stock options, their vesting, exercise, and the sale of the relevant shares to third parties?

Section 15a Securities Trading Act stipulates that persons discharging managerial responsibilities within an issuer of shares, are obliged to notify the issuer and the supervisory authority of their own transactions in shares of the issuer or financial instruments based on the same, in particular derivatives, within five business days. The obligation pursuant to sentence 1 also applies to other parties who are closely associated with such persons. This obligation does not apply as long as the total sum of transactions by a person discharging managerial responsibilities and parties closely associated with them is less than 5,000 euros by the end of a calendar year.

Prior to a substantial revision of the provision in the year 2004, section 15a Securities Trading Act provided for an important exemption insofar as disclosure was not required for purchases carried out on the basis of an employment contract or as part of the remuneration. Despite the changed wording of the provision, the Federal Financial Supervisory Authority has stated that the exemption will continue to apply for a *purchase* of securities, but not any longer for a *sale* of securities (see BaFin, Issuer Guidelines p. 75).

2.5 What are the rules on disclosure of share transactions executed by the company's insiders (such as directors, officers, auditors, etc.)?

With respect to the timely disclosure, see question 2.4. In addition, the Cromme Code (DCGK 6.6), by going beyond the statutory obligation to report transactions in the company's own shares, recommends that the ownership of shares, including options and derivatives, held by individual management board and supervisory board members shall be reported if these directly or indirectly exceed 1% of the shares issued by the company. If the entire holdings of all members of the management board and supervisory board exceed 1% of the shares issued by the company, these holdings shall be reported separately, broken down according to management board and supervisory board. The information shall be published in the company's corporate governance report.

2.6 What information on directors' remuneration must be included in public offer prospectuses and listing particulars?

Information on directors' remuneration in public offer prospectuses is subject to Annex I Article 15 of the EU Commission's Regulation regarding the information contained in prospectuses (EC No. 809/2004). Pursuant to Article 15.1, information has to be provided on the amount of remuneration paid in the last financial year (including any contingent or deferred remuneration and benefits in kind granted to such persons by the issuer and its subsidiaries for services in all capacities to the issuer and its subsidiaries by any person). That information must be provided on an individual

basis, unless individual disclosure is not required in the issuer's home country and is not otherwise publicly disclosed by the issuer.

3. Remuneration of the Board of Directors

3.1 Who fixes the board of directors' remuneration? What are the relevant procedures? (In two-tier systems, please refer to the supervisory board.)

Remuneration of the members of the supervisory board, in general, is fixed by a resolution of the general meeting by the simple majority or the (higher) majority provided for in the articles of association (section 113 Stock Corporation Act; DCGK 5.4.7). The decision on the remuneration of the supervisory board is to be put on the agenda of the general meeting by the management board. Section 124 (3) sentence 1 Stock Corporation Act stipulates that for each item to be resolved by the general meeting, the management board as well as the supervisory board (only the supervisory board in case of the election of members to the supervisory board and auditors) shall make proposals for the text of the resolution in the notice publishing the agenda for the general meeting.

If the articles of association stipulate the amount of remuneration, the general meeting, by resolving an amendment to the articles of association by a simple majority of the votes cast, can reduce the amount of remuneration.

Remuneration for the members of the first supervisory board may only be approved by the general meeting. Such a resolution may only be adopted in the general meeting resolving on ratification of the acts of the members of the first supervisory board and not before (section 113 Stock Corporation Act).

The average amount of remuneration paid by the 30 major companies (DAX 30) has climbed to € 84,000 p.a. in 2007, ranging between a minimum of € 42,000 and a maximum of € 618,000 (source: http://www.towersperrin.com; also see http://www.sdk.org 2005 and 2006). Earlier the average for the largest companies amounted to about 17,500 Euros per annum. The traditional low level of supervisory board remuneration is in part due to the German model of codetermination in the supervisory board (codetermination law under: http://www.bma.de/download/broschueren/a741.pdf). Employee members of the supervisory board, who are members of a union organized within the German Trade Union Federation (*Deutsche Gewerkschaftsbund – DGB,*) are expected to, and indeed do hand over any remuneration in excess of Euro 3,000 per annum to a trade union foundation, the Hans Böckler Stiftung (See Prigge, "A Survey of German Corporate Governance" in Hopt/Kanda/Roe/Wymeersch/Prigge (eds.), *Comparative Corporate Governance*, 1998, p. 964).

3.2 Are there provisions and/or practices as to the amount of the remuneration and its distribution (for example, as to whether distribution should be proportionate) among board members? What types of remuneration are allowed?

The remuneration of the members of the supervisory board ought to be in reasonable relation to the duties, responsibilities and scope of tasks of the members of the supervisory board, as well as the economic situation and performance of the enterprise (section 113 Stock Corporation Act). The exercise of the positions of chair and deputy chair in the supervisory board as well as the chairing and membership of committees shall also be considered (DCGK 5.4.7). In practice, all ordinary members of the supervisory board are paid the same amount whereas the chairperson receives twice that amount.

According to the Cromme Code, members of the supervisory board shall receive fixed as well as performance-related remuneration. Performance-related remuneration should also comprise components based on the enterprise's long-term performance (DCGK 5.4.7). Indeed, section 113 (3) Stock Corporation Act implies that performance-based remuneration is admissible, at least to some extent, since the provision clarifies how to calculate the amount due to members of the supervisory board if they were granted a share in the company's annual profits.

However, recent case law has severely limited the instruments available for tying the board remuneration to stock price performance. In particular, this holds true with respect to the use of so-called contingent capital for the purpose of funding stock options granted to members of the supervisory board. Admittedly, the wording of section 192 Stock Corporation Act on its own does not preclude such use of contingent capital. However, as early as 2001, the Baums Commission on Corporate Governance, in accordance with most of the literature, held that stock options can not be part of the supervisory board's remuneration (see T. Baums (ed.), *Bericht der Regierungskommission Corporate Governance*, p. 104, 236). The main argument given was the following: The use of stock options for members of the supervisory board had been discussed prior to the enactment of the Supervisory and Transparency Law (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich - KonTraG*, published in the Federal Gazette 1994, Part I p. 786 and available on http://www.bgblportal.de/BGBL/bgbl1f/b198024f.pdf). Still, the *KonTraG* only amended section 192 Stock Corporation Act to the effect that contingent capital may be used for the purpose of funding stock options granted to members of the management board but – in contrast to a first draft – failed to also mention the members of the supervisory board. In 2004, the German Federal Court of Justice ('Bundesgerichtshof') ruled that section 192 Stock Corporation Act does not allow the use of contingent capital for the purpose of remunerating the members of the supervisory board. The Court also prohibited companies from resorting to share-buy-back programs as a functional substitute (section 71 (1) no. 8 Stock Corporation Act) and even showed a marked reservation towards any stock-price related remuneration of members of the supervisory board in general (BGHZ Vol. 158, P. 122, 127 f.). The ruling had a mixed reception. Eminent commentators still disagree. See, e.g., Hüffer, *Aktiengesetz*, 8. ed., 2008, 71 N. 19h.

Whether convertible bonds as a more flexible type of remuneration are admissible for remunerating members of the supervisory board (see Baums (ed), *Bericht der Regierungskommission Corporate Governance*, p. 104) was answered in the negative by the German legislator. In 2005, the Act for Greater Corporate Integrity and the Modernization of the Law on Actions to Set Aside Shareholder Resolutions ('Gesetz über Unternehmensintegrität und Modernisierung des Anfechtungsrechts' (UMAG), published in the Federal Gazette 2005, Part I p. 2802 and available on http://www.bgblportal.de/BGBL/bgbl1f/bgbl105s2802.pdf) amended the pertinent provision dealing with the issuance of convertible bonds (section 221 Stock Corporation Act) by incorporating a reference to section 192 Stock Corporation Act, thereby extending the restrictions on the use of contingent capital to convertible bonds, as well.

Against this backdrop, the admissibility of phantom stocks (to be paid in cash) as a means of stock price-related remuneration for members of the supervisory board is also questionable. However, failing any pertinent decisions by German courts, most commentators are willing to accept this type of remuneration for members of the supervisory board.

3.3 Are personal loans to the company's directors and officers allowed?

Yes, they are allowed.

According to the Stock Corporation Act (section 115) and the Cromme Code (DCGK 3.9) the company may extend credit to members of the supervisory board, but only with the consent of the supervisory board. Section 115 also provides that a controlling company may extend credit to members of the supervisory board of a controlled enterprise, with the consent of its supervisory board and a controlled company, on the other hand, may extend credit to members of the supervisory board of the controlling enterprise with the consent of the supervisory board of the controlling enterprise. Such consent may be granted only for specific credit transactions or kinds of credit transactions, and for not more than three months in advance. The resolution on such consent shall make provisions with regard to the payment of interest on, and repayment of, any loan. If the member of the supervisory board carries on a business as a sole proprietor, such consent shall not be required if the credit is extended to finance the payment of goods which the company supplies to his business (DCGK 3.9 does not mention this exception).

Company loans to members of the management board are admissible pursuant to a resolution of the supervisory board (section 89 Stock Corporation Act; DCGK 3.9). Such a resolution may only authorize specific transactions or kinds of credit transactions, and for not more than three months in advance. It shall make provisions with regard to the payment of interest on, and repayment of any loan. Permission to make drawings in excess of the remuneration due to a member of the management board, in particular permission to draw advances on remuneration, shall be deemed to constitute the grant of a loan. This shall not apply to loans which do not exceed an amount equal to one month's salary. Section 89 (2) and (3) Stock Corporation Act extend the requirement of the supervisory board's consent to loans granted to generally authorized officers

and general managers as well as to the spouse or a minor child of a member of the management board or other legal representatives, generally authorized officers or general managers.

4. Executive Directors' Remuneration

4.1 Who fixes the executive directors' remuneration? What are the relevant procedures? Are shareholders required to approve directors' remuneration, the remuneration policy, or the remuneration report (see question 2) on an annual or other basis?
(In two-tier systems, please refer to the management board.)

The supervisory board fixes the remuneration of management board members at a level deemed appropriate, based on a performance assessment, and taking into account any payments by group companies. Criteria for determining the appropriateness of remuneration are, in particular, the duties of the respective member of the management board, his personal performance, the performance of the management board as well as the economic situation and the performance and outlook of the enterprise, taking into account its peer companies (section 87 (1) Stock Corporation Act). Given that the total remuneration may comprise different types of remuneration (see below 4.3), the Cromme Code (DCGK 4.2.3) details the appropriateness-requirement in such a manner that all remuneration components must be appropriate, both individually and as a whole. Moreover, if the financial condition of the company deteriorates to such an extent that future payments of the remuneration previously determined would constitute a hardship for the company, the supervisory board is authorized to make a reasonable reduction. The reduction will not affect the other terms of the contract of employment (section 87 (2) Stock Corporation Act).

The supervisory board may delegate some or all remuneration issues - but neither the appointment nor the revocation of the appointment of the members of the management board (section 107 (3) 2 Stock Corporation Act) - to a remuneration committee (see below question 4.2.).

The general meeting only plays a very limited role in determining the remuneration of the members of the management board. The law neither mandates shareholder approval of directors' remuneration nor approval of the remuneration policy or a remuneration report. The general meeting is even barred from adopting a pertinent resolution on a voluntary basis since the general meeting may only decide on matters concerning the management of the company if requested by the management board (section 119 (2) Stock Corporation Act). Still, shareholders do have a vote with respect to some forms of performance-based remuneration. This holds true for stock options funded by contingent capital, since the general meeting has to adopt a resolution providing for a contingent increase in the registered share capital, as well as for stock options funded by its own shares, if the company first has to acquire the shares, since the power to authorize a share buy-

back program for that purpose rests with the general meeting (section 71 (1) no. 8 Stock Corporation Act).

4.2 Is the board required, or recommended as best practice, to create a remuneration committee?

The Stock Corporation Act does not require the formation of a remuneration committee. However, the Cromme Code indicates that this is good practice for many corporations. Depending on the specifics of the enterprise and the number of its members, the supervisory board shall form committees (DCGK 5.3.1). The subjects the board may (as opposed to “shall”) delegate to be handled by one or several committees include, inter alia, the remuneration of the members of the management board (DCGK 5.3.4).

If yes, please specify:
(i) the committee’s composition (if independent directors should be appointed to this committee, please give the relevant definition and indicate whether any special procedures apply to the appointment of independent non-executive directors)

Statutory provisions dealing with the composition of supervisory board committees in general, as well as the remuneration committee in particular do not exist. However, a committee that takes decisions in place of the whole board must comprise at least three members. Moreover, the remuneration committee of a company which is subject to co-determination in accordance with the Co-Determination Act of 1976 must include at least one worker representative.

In addition, the Cromme Code recommends that the chairman of the supervisory board hold shall the chair in the committee handling the contracts with members of the management board (DCGK 5.2).

As regards independent directors the Stock Corporation Act only prohibits a member of the company’s management board from serving as a member of the supervisory board (section 105 (1) Stock Corporation Act), and the same holds true for a member of a management board of a dependent company (section 100 (2) no. 2 Stock Corporation Act). Moreover, section 100 (2) no. 3 Stock Corporation Act prohibits a cross-directorship, i.e. a member of the management board of a company is barred from serving on the supervisory board if he already serves on the supervisory board of the other company. Conversely, by law, former members of the management board as well as current employees may serve as a member of the supervisory board.

The Cromme Code, in turn, does not recommend in particular that one or more members of the remuneration committee shall be independent. However, the Code (DCGK 5.4.2), does recommend in general that the board shall include what it considers an adequate number of

independent members. Specifically, not more than two former members of the managing board shall be members of the supervisory board, and members of the supervisory board shall not exercise directorships or similar positions, or advisory tasks for important competitors of the enterprise. In general, a supervisory board member is considered independent if he/she has no business or personal relations with the company or its management board which could cause a conflict of interests.

(ii) the committee's competences and which company body it reports to

In general, the supervisory board can arrange for committees to prepare supervisory board meetings and to take decisions in place of the supervisory board (DCGK 5.3.4 and 5.3.5.). As an exception, a committee may not appoint or revoke the appointment of members of the management board (section 107 (3) 2 Stock Corporation Act). Still, the supervisory board can delegate preparations for the appointment of members of the management board to a committee, which also determines the conditions of the employment contracts including remuneration (DCGK 5.1.2). However, the discussion and regular review of the structure of the management board remuneration system is a responsibility of the full supervisory board since, on the proposal of the committee dealing with management board member contracts, the full supervisory board shall resolve and regularly review the management board remuneration system including the main contract elements (DCGK 4.2.2).

The Cromme Commission introduced the full review-recommendation on June 6, 2008 in order to thwart calls for a substantive statutory regulation of management remuneration. The Chairman of the Commission stated: "We have placed even more responsibility on the supervisory board as a plenary body. ... If this board carries out its responsibility properly there is no need for further-reaching statutory provisions". However, the wording of the revised recommendation does not fully corroborate the Commission's intention. The supervisory board shall only become active upon a proposal of the pertinent committee. It is conceivable, that the committee, at least, will refrain from making such a proposal, in particular if a committee does not contain any worker representatives.

The Cromme Code (DCGK 5.3.1) generally provides that the chairman of each committee is to report regularly to the supervisory board on the committee's work.

(iii) how the committee operates

The committee is a part of the supervisory board and the rules for the operation of the committees are basically the same as those for the whole board.

The Cromme Code only makes one recommendation with regard to the operation of committees in general by calling upon the chairmen to report regularly to the supervisory board on the work of the committee (DCGK 5.3.1, see also section 107 (3) 3 Stock Corporation Act).

4.3 Which types of remuneration are permitted? In answering, please consider each of the following:

Neither the Cromme Code nor the German Stock Corporation Act restricts the admissible types of remuneration. According to section 87 Stock Corporation Act the aggregate remuneration of any member of the management board comprises salary, profit participation, expense allowances, insurance premiums, commissions and additional benefits of any kind. The Cromme Code (DCGK 4.2.3) specifies in more detail that the total remuneration includes monetary elements, pension awards, other awards of all kinds and benefits promised or granted by third parties with regard to the management board work. The monetary remuneration elements shall be made up of fixed and variable elements. Variable remuneration should include non-recurring and annually-payable components linked to the business performance as well as long-term incentives containing risk elements. In particular, shares with a multi-year blocking period, stock options or comparable instruments (e.g. phantom stocks) serve as variable remuneration components with long-term incentive effect and risk elements.

Pension payments, addressed by section 87 (1) 2 Stock Corporation Act, are common.

(a) bonuses

Yes (one-time payable components). Furthermore, according to section 87 (1) sentence 1 Stock Corporation Act (additional benefits of any kind) different forms of bonuses may be chosen but a critical view is taken with respect to bonuses related to the corporation's turnover. For appreciation awards and other payments within the context of the termination of contract see below question 4.6.

(b) stock options, including discounted stock options

Yes. See section 192 (2) no. 3 Stock Corporation Act. The Cromme Code (DCGK 4.2.3) specifies that stock options and comparable instruments shall be related to demanding, relevant comparison parameters. Changing such performance targets or the comparison parameters retroactively shall be excluded. For extraordinary, unforeseen developments a possibility of limitation (Cap) shall be agreed for by the supervisory board.

(c) stock grants

Yes. No counter-argument can be derived from the limitation provided for in section 71 (1) no. 2 Stock Corporation Act, according to which a company may only acquire own shares “if the shares are to be offered to former or current employees of the company or an affiliate enterprise”. Admittedly, it is generally accepted that members of the management board do not qualify as such

an “employee”. However, everybody agrees that the provision does not prohibit the company from acquiring its own shares for such purposes, pursuant to section 71 (1) no. 8 Stock Corporation Act.

(d) profit sharing

Yes. According to section 87 Stock Corporation Act the aggregate remuneration of any member of the management board may include a participation in profits. Section 86 Stock Corporation Act which formerly stipulated particular rules on the management’s profit participation was repealed by section 1 of the Transparency and Disclosure Law 2002 (*Transparenz und Publizitätsgesetz*).

(e) benefits in kind

Yes. Section 87 (1) Stock Corporation Act mentions reimbursement of premiums, insurance premiums, commissions and additional benefits of any kind.

4.4 Are there specific rules, including shareholder approval requirements, as to these different types of remuneration?

Profit sharing: The resolution on the appropriation of distributable balance sheet profit shall be adopted by the general meeting (section 58 (3) Stock Corporation Act) on the proposal of the management board, and has to be submitted by the management board to the supervisory board (section 170 (2) Stock Corporation Act). The supervisory board shall examine the proposal (together with the annual financial statements and the annual report) and report on the results of its examination to the shareholders’ meeting (section 171 Stock Corporation Act).

Stock options: Special requirements apply depending on how stock options are funded, i.e. on the way the company grants the stock in case the director exercises the option.

If stock options are funded by contingent capital, the requirements contained in sections 192 (2) nr. 3 and 193 Stock Corporation Act kick in. Section 192 Stock Corporation Act provides that the general meeting may resolve on an increase in contingent capital. However, if the purpose is to grant rights to members of the management board to new shares, the nominal value of the contingent capital may not be greater than ten percent of the registered share capital available at the time of the resolution (as opposed to a 50 % -cap applicable if the increase in contingent capital is resolved for other purposes). In addition, section 193 Stock Corporation Act provides that the general meeting by a majority of not less than three quarters of the share capital represented at the passing of the resolution (the articles of association may stipulate an even larger capital majority and additional requirements) determines the purpose of the contingent capital increase, the persons entitled to subscribe, the issue price on the basis on which such a price shall be calculated and, if the persons entitled to subscribe are members of the management board, the

performance targets that shall be achieved, the periods in which the subscription rights can be granted and exercised, and the waiting period prior to the initial exercise of the subscription rights (at least two years).

If the company plans to acquire its own shares for the purpose of granting those shares to management board members owning stock options, the requirements stipulated by section 71 (1) no. 8 Stock Corporation Act are similar to those just described for an increase in contingent capital. To begin with, the general meeting has to authorize the acquisition of own shares by a resolution that specifies the lowest and the highest purchase price and the maximum portion of the registered share capital to be acquired. Moreover, since the shares acquired are not sold to all existing shareholders, or on the stock exchange, but are granted to the holders of stock options the general meeting, because of the similarity to an exclusion of the preemptive rights of existing shareholders, shall approve this method of disposal of own shares with a majority of not less than three quarters of the share capital represented at the passing of the resolution. In addition, by reference to section 193 (2) no. 4 Stock Corporation Act, the general meeting shall also determine the performance targets that shall be achieved, the periods in which the subscription rights can be granted and exercised, and the waiting period prior to the initial exercise of the subscription rights (at least two years). As to disclosure, the management board shall inform the next shareholders' meeting as to the reasons for and the purpose of the acquisition, the number of shares acquired, their percentage of the share capital and the purchase price for the shares.

The annual financial statements – comprising the balance sheet which is relevant for profit sharing (and may be so for bonuses) - do not have to be established by the general meeting. According to section 172 (1) sentence 1 Stock Corporation Act, if the financial statement is approved by the supervisory board, it will have to be considered as already established unless the management and supervisory boards have resolved that the annual financial statements are to be established by the general meeting.

4.5 Are there any restrictions on how payments are made?

The provisions of the Stock Corporation Act concerning the management board contain no specific rules on how payments to the members of the management board are to be made. Variable remuneration is subject to the power of the general meeting as described in answer 4.4.

4.6 Are there any specific requirements for termination payments made on loss of office, whether through dismissal, retirement, on a takeover, or otherwise?

Section 87(1) sentence 2 Stock Corporation Act stipulates that pension payments shall bear a reasonable relationship to the duties of the member of the management board and the condition of

the company. The appropriateness of the amount paid by the corporation is therefore subject to the discretion of the supervisory board.

However, the supervisory board's scope for discretion was substantially curtailed in 2005 because of the ruling by the German Federal Court of Justice (criminal division) in what has become known as the 'Mannesmann-Case' (BGHSt Vol. 50, P. 331). The core question at issue was the legality of appreciation awards granted in the context of the takeover of Mannesmann by Vodafone plc. in the year 2000. The court stated that, as a general rule, payments of that particular kind (golden parachutes) may only be made if the employment contract between the company and the executive director ex ante provides for such an obligation stipulated ex ante. In the absence of the said clause the company may make such gratuitous payment only if the company will benefit from it. Relevant benefits to be taken into account are only those that are 'simultaneous' and 'adequate'. A payment that does not fulfill these requirements qualifies as a waste of the company's assets, and the members of the supervisory board can be held liable for the criminal offence of a fraudulent breach of trust.

As a consequence some uncertainty has arisen regarding severance awards. Whereas the payment of fixed amounts is considered to be legitimate, performance-related grants are still under discussion. Change of control-clauses, while in principle accepted under German law, may be contracted only prior to a potential merger. The Cromme Code recommends that payments promised in the event of premature termination of contract due to a change of control should not exceed 150% of the severance payment cap (DCGK 4.2.3).

More stringent limitations are recommended by the Cromme Code (DCGK 4.2.3): Payments made to a management board member on premature termination of his/her contract without serious cause should not exceed the value of two years' compensation (severance payment cap) and compensate not more than the remaining term of the contract. The cap should be calculated on the basis of the remuneration for the past full financial year and, if appropriate, also the expected total remuneration for the current financial year.

4.7 Are there any specific requirements concerning directors' service contracts with respect to, for example, their duration and disclosure?

The members of the management board cannot be appointed for a period exceeding five years (section 84(1) Stock Corporation Act). On the other hand, for first time appointments the maximum possible appointment period of five years should not be the rule (DCGK 5.1.2). The appointment may be renewed or the term of office may be extended, provided that the term of each such renewal or extension shall not exceed five years. Such renewal or extension shall require a new resolution by the supervisory board which shall not be adopted any earlier than one year prior to the end of the current term of office, or at least only under special circumstances (DCGK 5.1.2).

The term of office may be extended without a new resolution of the supervisory board only in the case of an appointment for less than five years, provided that the resulting aggregate term of office does not, as a result of such extension, exceed five years. The foregoing shall apply by analogy to the contract of employment; such a contract may, however, stipulate that, in the event of an extension of the term of office, the contract shall continue in effect until the expiry of such a term (section 84(1) Stock Corporation Act).

The disclosure is subject to section 285 and section 314 Commercial Code (see answers above to disclosure).

5. Non-executive Directors’ Remuneration

5.1 Are non-executive directors separately paid for their participation in committees of the board of directors? Do any restrictions apply to the payment of non-executive directors’ *via* stock options?

According to section 113 Stock Corporation Act the remuneration shall bear a reasonable relationship to the duties of the members of the supervisory board and to the condition of the company. According to the Cromme Code (DCGK 5.4.7) the exercise of the chairmanship and membership in committees should also be considered when determining the remuneration.

The admissibility of stock options was the subject of some controversy since the provision on the increase in contingent capital (section 192 Stock Corporation Act) only refers to members of the management board. In 2004, the Federal Court of Justice held that the contingent capital is not available for the funding of stock options granted to members of the supervisory board and, moreover, showed a strong reservation towards the use of stock price-related remuneration in general (see above answer 3.2).

5.2 May a company make payments to non-executive directors, additional to their directors’ fees, for services, such as legal or brokerage services, outside the usual scope of directors’ duties?

Yes. Section 114 Stock Corporation Act stipulates that advisory and other service agreements and contracts for works and services are valid upon approval being granted by the supervisory board, provided that the works or (professional) services to be undertaken are not part of the ordinary activity as a member of the supervisory board. A contract with respect to activities that are a part of a board member's duties is deemed to be void.

The latter restriction leads to difficulties in determining the scope of possible contracts with members of the supervisory board because, on the one hand, the duty of the supervisory board

and its members is to control as well as to advise the management board and, on the other hand, board members are under a duty to make use of any special know-how and knowledge in controlling and advising the management board. However, the German Federal Court of Justice has reconfirmed its aforementioned position in two recent findings (BGHZ Vol. 168, P. 188 and Vol. 170, P. 60).

Payments made by the company to the members of the supervisory board or advantages extended for services provided individually, in particular, advisory or agency services shall be listed separately in the corporate governance report (DCGK 5.4.7).