

German Code of Corporate Governance (GCCG)

**Berlin Initiative Group
German Code of Corporate Governance**

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Preamble

Corporate governance describes the legal and factual regulatory framework for managing and supervising a company. The present code contains recommendations for the arrangement of this regulatory framework, which are intended to promote the quality of company management. These recommendations are based on the consideration that in a globalized economy, the circumstances of successful company management admittedly come closer together. Nevertheless, rules for governance can only then contribute to optimizing management and supervision if they also take into account the specific legal, economic, social and cultural conditions existing in a company's country of registration (country of domicile). In this sense the formulated guidelines form a *German Code of Corporate Governance (GCCG)* which highlights the standards of good management and supervision for companies which develop their value creating activities in and from Germany.

The guidelines tackle problems and processes of company management which from a managerial point of view prove to be particularly critical for the efficiency of corporate governance. The standards listed for this are embedded in the corporation law applicable, which principally includes the law on companies, accounting, capital markets and co-determination in management. The code rules correspond partially with important legal regulations, but mainly deal with detailing and expanding such existing statutory provisions. The formulation of governance principles in a code below the legal level, offers the advantage of being able to adapt standards more flexibly to altered conditions and fresh experiences by way of forward projection of the code. In the end, they thereby serve to de-regulate.

The code rules are to be understood as being management and supervision standards which according to today's level of managerial knowledge (best practices) stand the test of time many times over. They are directed primarily towards large, quoted public stock corporations. Various provisions may however be transferred analogously to companies with other ownership structures (for example, family-owned companies and other close compa-

nies) and applied under affiliated group conditions. Selected features of the corporate governance for close companies and groups are approached in two sections of their own (clauses VII. and VIII.).

Even when concentrating on public corporations, general rules cannot allow for all characteristic features of a company. A divergence from the recommendations of the code can also be made for this reason in an individual case if there are compelling grounds for doing this and there is no binding law which prevents it. Further, the GCCG simply contains core provisions for aspects of the management and supervision which are of central importance for the efficiency of the corporate governance and suggests itself for general company rules. In this, it follows subsidiary thoughts and leaves room for additional individual rules of governance for individual companies.

The standards of the GCCG should attain authority through voluntary unilateral application by the company. When one considers the severe and for the future still growing demands which the stockholders, and also other reference groups too, make on the efficiency and transparency of the corporate governance, it lies within the strategic interests of companies to examine their current terms of management and supervision, to establish appropriate solutions, and actively to communicate these. To this end it would seem that the thing to do is to take the recommendations of the GCCG as a check-list and – in the annual report or in separate corporate principles as to corporate governance – to set forth which guidelines are to be adopted and which rules are not to be followed for which reason. The more consistently the standards of the GCCG are applied in the company (for example, by inclusion in contracts with company officers as well as in the rules of procedure for the Management Board and Supervisory Board) and documented for outside persons, the greater is the chance of securing the long-lasting trust of those with an interest in the company (stakeholder) and therefore in increasing the prosperity of the company over the long term.

I. Basic order of Corporate Governance

1. The basic order determines the company's system of objectives and therefore the upper guideline for the company's management. Further, it stipulates the principle organizational framework for managing and supervising the company.
2. The target of company management is the sustained increase in the value of the company. The value of the company is measured according to its ability to fulfil the demands made by its reference groups – those with an interest in the company. Included among those stakeholders are principally the stockholders, but also included are employees, customers, loan creditors and suppliers, as well as the public at large.
3. Within the circle of those with an interest in the company, particular importance is attached to the interests of the stockholders as venture capitalists. The accentuated position of the stockholders certainly means no single-sided fixing of the company management to a short-term maximization of shareholder value strictly measured by the stock exchange price. On the contrary, the company management has to balance the aims of the different stakeholders out of economic considerations, because in the final analysis, all those with an interest in the company in each case make their contributions to the success of the company. Only companies which are effective as excellent market partners, not only in the capital market but also in other arenas of competition, such as the core market place, labor market (including the market for top executives) and the procurement market, can hence increase their value over the long term and by an above-average amount. Consequently, it is the task of company management to organize the value creation activities of the company in the sense of a "multiple excellence" for all relevant reference groups so attractively that these in each case contribute as far as possible to the prosperity of the company.

4. The organization of the public corporation is characterized by far-reaching delegation of company management from the stockholders to separate executive bodies, as well as the institutional division of management and supervision. What is further distinctive of the constitution of German companies is the graduated inclusion of employees by means of various forms of participation (co-determination).
5. The annual general meeting as the organ of the stockholders decides mandatorily in certain basic questions as well when so demanded by the Management Board. It elects the members of the Supervisory Board in as far as they may be appointed by the stockholders – depending on the co-determination situation, completely, as to two thirds or as to one half (see clause V.). The annual general meeting also appoints the auditor. The Supervisory Board in its turn elects, supervises and advises the Management Board. Its controlling activities are supported and complemented by the auditor who on his own responsibility examines the company's rendering of accounts.
6. The responsibilities in the public corporation as to company management are clearly distributed with this basic structure, which is fixed by statute. The Management Board as the organ of management forms the company's clear locus of decision-making. The Supervisory Board on the other hand, acts as supervisory organ in the sense of checks and balances, which appoints, controls, advises – and where necessary also dismisses – the Management Board. The Supervisory Board consequently does not stand equally ranking next to or even above the Management Board. On the contrary, it serves as counterweight for the purpose of separation of powers, which in the normal case can and should limit the influence of the Management Board on the destiny of the company, but neither to counterbalance nor outweigh it.
7. Guidelines for corporate governance must take into account the exposed position of the Management Board. Because the responsibility for developing the value of the company lies primarily with the organ of

management, the Management Board and its dealings have to stand in the focus of efficiency-promoting rules of governance. On the other hand, a certainly equally important, but rather more a supporting significance, attaches to the standards for supervision. What is inappropriate in particular, is the attempt to want to "check into" the quality of management by concentrating on the organ of supervision and the auditor in the company. Instead of such a control or Supervisory Board overbalance, the aim should rather be to establish terms most promising for success of the management of the company. For this reason the Management Board stands in the focus of appropriate rules for corporate governance for German joint stock companies.

8. Management processes critical of performance are applied in the outlined principal structure of the authorities for company management, which require an interaction from the Management Board and the Supervisory Board (as well as occasionally the annual general meeting) and therefore do not allow themselves to be efficiently controlled from the isolated organ perspectives. Included in these core processes, which are to be formed all-embracing of governing bodies, are (cf. clause II.)
 - the composition of the Management Board,
 - the supply of information to the Supervisory Board,
 - the decision-making on fundamental setting of directions and
 - the promotion of a culture of discussion.
9. Apart from the core processes which affect several organs jointly, the anchoring of good corporate governance also demands separate provisions for the Management Board (clause III.) and for the Supervisory Board (clause IV.). Further, rules for the stockholders and employee participation (clause V.) as well as for transparency and disclosure (clause VI.) belong to corporate governance.

II. Core processes of Corporate Governance

1. Composition of the Management Board

- 1.1. The composition of the Management Board is one of the most important success factors of the company. Particular attention has to be paid therefore to the quality of the decisions on the composition of the Management Board within the framework of corporate governance. At the same time, in particular, a balanced multiplicity of qualifications and the ability of the individual Management Board members to work together as a team, has to be ensured.
- 1.2. The Supervisory Board decides on the selection of the members of the Management Board. Making certain of an optimal qualification of Management Board members belongs to its primary tasks. The decision of the Supervisory Board is prepared by the personnel committee or a search committee (clause IV. No. 3.4.). The personnel committee also undertakes the regulation of contractual relationships with the members of the Management Board, such as contracts for services and pensions.
- 1.3. In order to place the selection of personnel on a basis for the decision which is as sound as possible, the Supervisory Board establishes a systematic appointments procedure which integrates the expert knowledge of the Management Board. In doing this, the terms of the procedure are dependent on whether an appointment is to be made from among the existing members of staff or goes to an external candidate.
- 1.4. Recruiting the members of the Management Board from within the ranks of the company's own executives is the normal case and is the result of a planned training for the next generation. The Management Board should be endowed with a particularly good insight into the current potential of junior management by reason of its position as organ of management. Consequently, it is advisable if the members of the

Management Board (as part of their managerial functions) narrow down the circle of potential successors to a manageable number of persons. The Chairman of the Supervisory Board is kept informed about this from time to time.

- 1.5. The suggestions of the Management Board should certainly not unduly restrict the options of the Supervisory Board as regards personnel. The Supervisory Board can and must more objectively assess the contribution of possible candidates to an optimal qualification profile of the organ of management, by reason of its greater distance. Accordingly, the Management Board's knowledge of personnel matters is to be combined with the neutrality of the Supervisory Board.
- 1.6. In order to allow the members of the Supervisory Board the opportunity of systematically becoming acquainted with potential candidates for membership of the Management Board, the Management Board regularly suggests persons from the inner circle of junior management for presentations in the Supervisory Board and its committees.
- 1.7. As soon as a vacancy in the Management Board becomes evident, the Management Board members in conjunction with the personnel committee of the Supervisory Board, should present concrete appointment proposals. In doing this, several alternatives should, as far as possible, be indicated. Notwithstanding such possible suggestions of the management organ, the Supervisory Board remains master of the appointments procedure. The decision of the Supervisory Board on the appointment of a Management Board member must not be merely a matter of form. In particular, it is contrary to the rules of good corporate governance in a public corporation if the previous Management Board or even alone the Chairman of the Management Board practically co-opts new Management Board members because the organ of appointment remains passive. On the contrary, the members of the Supervisory Board must stamp their mark on the appointment de-

cision by making their own independent judgement on the qualifications of the persons comprising the choice.

- 1.8. If there are no suitable internal candidates available, or if reliable planning for a successor is not guaranteed because there are tensions within the Management Board, or if members of the Management Board suddenly leave, the Supervisory Board or the personnel committee, as search committee, has to take the initiative more forthrightly in seeking personnel. In these cases, the members of the Supervisory Board also frequently fall back on their networks and advisors in order to find qualified persons. For the decision on the appointment itself, the necessity for the Supervisory Board to form its own opinion is particularly important in such situations.
- 1.9. Whether or not a Management Board member is appointed from within the company or from outside, the initial appointment should at first normally be limited in duration to three years at the most. An appropriate statutory regulation is to be recommended in order to ease the practical application of this limitation.
- 1.10. Apart from new appointments, renewals of contracts as well as any removals of Management Board members are also included among the important duties of the Supervisory Board. The Supervisory Board makes these decisions based on an assessment of performance which is as objective as possible. The individual performance of each Management Board member, including the Chairman of the Management Board, is for this purpose to be systematically evaluated annually by the personnel committee. In this, the target-orientated development of the company and the individual contributions made by the Management Board members provide the scale for making the assessment.
- 1.11. Appointments of Management Board members whose performance falls short of the level of performance which may reasonably be ex-

pected, are not renewed. Serious deficiencies in performance and mistakes lead as compelling grounds to premature dismissal.

2. Provision of information to the Supervisory Board

- 2.1. The supply of all information relevant to control to the Supervisory Board, is a decisive pre-condition for efficient supervision. To ensure this necessary basis of information for supervisory duties is the task of the Management Board ("obligation lying in render") and of the Supervisory Board ("obligation lying in collection"). The main responsibility of this lies at the door of the Management Board as a result of the asymmetry of knowledge of both organs.
- 2.2. The Management Board's general duty to provide information arises from the information system specified by the Supervisory Board. The Supervisory Board information system takes up the statutory duties to report and puts the content, frequency and technical provisions of the information to be supplied, in concrete terms having one eye on the actual realities of the company.
- 2.3. The Supervisory Board information system also stipulates that the Management Board reports once a year on the strategic development of the company, and on the key ratios of the running operations for each meeting of the Supervisory Board. In this, the target and actual data for the previous period in each case are to be supplied and significant deviations are to be explained. Further, justified planning of strategic and operative company activities are to be presented from time to time.
- 2.4. In addition, the Management Board informs the Chairman of the Supervisory Board without delay, and the Supervisory Board on a current basis, on unusual events which are of importance in evaluating the position and development, as well as the management, of the company.

- 2.5. The Supervisory Board, particularly its Chairman and its committees, require for their part all information from the Management Board which they in the individual case additionally require in order to carry out efficiently the duties of supervision. The positive definition of the additional requirement of information is an important part of the duties of the Supervisory Board.
- 2.6. The information provided by, or obtained from, the Management Board must be well-founded and succinct. It should contain neither omissions in information which are of importance for supervision, nor distract the watch for what is important, on account of too great a flood of information.
- 2.7. Reports are to be made in writing. The supporting documentation necessary is to be passed in good time to the members of the Supervisory Board, normally one week prior to each meeting at the latest, so that it is possible to make an intensive and uninterrupted appraisal.
- 2.8. Destructive monopolies on information are to be avoided. The exchange of information should not only be restricted to plenary contacts between the full Management Board and the full Supervisory Board as well as to the communication between the heads of both bodies. On the contrary, in order to make the structures of communication more flexible and open, for example, occasional joint discussions between the Management Board and the Chairman of the Supervisory Board are also to be planned. Direct access to a member of staff for information bypassing the Management Board is restricted to (serious) crisis situations and may only be made by the Chairman of the Supervisory Board.

3. Decision-making when setting fundamental directions

- 3.1. Properly understood checks and balances in the company management are expressed in the fact that the Management Board does not

alone undertake the setting of fundamental directions for the company. On the contrary, it consults previously with the Supervisory Board and also presents fundamental issues, subject to certain pre-conditions, to the annual general meeting for the final decision (see No. 3.5.).

- 3.2. The Management Board operates as the initiator of the measures, while the Supervisory Board takes up the role of the informed discussion partner (sounding board). The development of business ideas and the sustained preparation of their implementation afterwards, lie within the Management Board's sphere of liability and its organizational sub-structure. The Supervisory Board on the other hand analyzes the prospects for success of the proposals presented, by which it more particularly tests and examines the plausibility of the prognoses prepared, to see if the relevant risks have been adequately catered for.
- 3.3. The process of discussion between the Management Board and the Supervisory Board should, depending on the stage of planning and importance of the measures, include different groups of members in the supervisory organ and allow the Supervisory Board graded degrees of competence. In the early events leading up to important decisions, all that is accomplished is exploratory talks with the Chairman of the Supervisory Board. As such proposals take a more concrete form, the presiding committee of the Supervisory Board or another committee of the Supervisory Board should normally also be included. During later planning stages, the measures are finally to be brought before the Supervisory Board as a whole.
- 3.4. For setting a direction which is particularly drastic, the Supervisory Board has a right of veto which is to be stated in the rules of procedure for the Management Board. The catalog of measures requiring approval includes, among others, substantial changes in the company's targets, strategic re-orientation in the business portfolio, transactions involving mergers and acquisitions, disposal of substantial in-

vestments, pivotal decisions concerning take-over offers for the company, far-reaching reorganization of legal and organizational structures, massive increases or reductions in the workforce, investments above a certain pre-determined order of magnitude as well as all other decisions which require the approval of the annual general meeting or are reserved for it to pass a resolution thereon.

- 3.5. After approval of the Supervisory Board has been given the Management Board lets the annual general meeting decide in cases expressly provided for by statute, or if fundamental structural and managerial measures affect the core membership rights of stockholders.

4. Promotion of the culture of discussion

- 4.1. Rules on corporate governance can in the end only contribute to increasing the quality of the company's management if they also actually "live" in the code and in the basic principles set forth in the individual company guidelines for governance. In this connection, particular importance is attached to active participation of all officers in the information and decision processes stipulated. It is only with an engaged argument in each case on pending questions of management and supervision that the managerial duties of the Management Board as well as those of the Supervisory Board can be fulfilled in a well-founded manner. Establishing and furthering a culture of open discussion is therefore essential for the proper functioning of corporate governance. This promotes detailed and balanced discussion of the managerial problems to be solved and thereby utilizes the expertise of the members of the Management Board and the Supervisory Board.
- 4.2. The development of a culture of open discussion in managerial and supervisory bodies is the duty of the chairmen of the Supervisory Board and of the Management Board as well as the chairpersons of their committees. The chairpersons in each of these cases encourage the members, in particular, intensively to analyze suggestions for deci-

sions and to contribute their experience, in order to seek out possible points of weakness and chances for improvement. They make it clear that relevant analysis of planned measures is not considered to be negative criticism and disloyalty, but an expression of the engagement desired of the officer.

- 4.3. The Chairman of the Supervisory Board promotes openness of discussion in the Management Board as well as in the Supervisory Board. He forms his own impression of the culture of discussion existing in the Management Board. In the Supervisory Board, he allows for sufficient time for discussing proposals coming from the Management Board.
- 4.4. Representatives of the employees contribute towards balanced discussion in the Supervisory Board. The contribution of their special knowledge of the company and the workforce extends the basis of information and serves the purpose, where possible, of the Supervisory Board of making decisions in consensus and thus eases their implementation.
- 4.5. The Management Board and the committee of the Supervisory Board for corporate governance (clause IV. No. 3.4.) annually debate the efficiency of the discussion process in and between the governing bodies, as well as the possibilities for continual improvement.

III. Governance standards for the Management Board

1. Basic principles of Management Board dealings

- 1.1. The Management Board leads the public corporation, observing the generally accepted principles of proper company management. In particular, it organizes all Management Board dealings along the following three general guidelines:
- 1.2. All Management Board measures are subject to the principle of legal permissibility. According to this, legal rules within their particular terri-

torial areas of application are binding for all Management Board dealings. The interpretation of unclear standards should fluctuate within the limits allowed for interpretation which are common in the particular legal practice.

- 1.3. All Management Board measures are subject to the principle of economic usefulness. They should appear ex ante as effective and efficient as possible in order to increase the value of the company sustainably within the bounds of what is possible. The usefulness of managerial measures is not excluded because they hold reasonably calculated risks and prove ex post to be a mistake.
- 1.4. The Management Board should be aware of social responsibility to a reasonable extent and take account of all ethical conceptions without which a social market economy cannot survive.

2. Tasks of the Management Board

- 2.1. The core tasks of the Management Board are to give direction to the general tendency of the company's activities within its scope of competence as well as in agreement with the Supervisory Board and the annual general meeting, and to assemble purposeful infrastructure for the process of creating wealth. Further, the Management Board makes decisions in individual cases and exercises communication as well as control obligations in as far as these activities cannot be delegated.
- 2.2. The Management Board determines the general tendency of the company's activities by putting the company's targets in concrete terms and by formulating the basic strategies for achieving the aims.
- 2.3. The Management Board ensures the infrastructure by establishing purposeful legal and organizational structures which, when necessary, are adapted to changed circumstances. Further, it provides for the setting up and further development of useful planning and control systems. A risk management system is also included in this.

- 2.4. The Management Board has to pass those resolutions and put its stamp on its content, which because of their importance to the company as a whole, may not be delegated to subordinate executives. This also applies in particular to important decisions concerning personnel as well as for the crisis management.
- 2.5. The Management Board should personally exercise communication tasks which have an important effect as regards the company's image, on the stakeholders.
- 2.6. The Management Board supervises itself systematically the success of its decisions (preparatory to and in addition to the Supervisory Board). Further, it gathers its own impression of the efficiency of the control systems and of the quality of delegated activities in the company on signs of irregularities, by making random checks.

3. Organization of the Management Board

- 3.1. The company is directed by a Management Board consisting of several persons. Normally, it has at least three and at the most, nine members.
- 3.2. The Management Board has rules of procedure (clause IV. No. 2.2.). Among other things, the basic structure of the distribution of responsibilities between the members of the Management Board is fixed in the standing rules. At the same time the below-mentioned organizational basic principles receive attention.
- 3.3. The members of the Management Board participate in the management of the company on equal terms, according to the principle of collective responsibility. The Management Board should have a chairman or a speaker. The Chairman of the Management Board or the speaker, respectively, is *primus inter pares* (and not "CEO"). In particular, he does not have right of command over the other members of the Management Board.

- 3.4. Decisions of fundamental importance for the company (basic decisions) are the responsibility of the Management Board as a whole. Included with the basic decisions are, in particular, the ascertainment of the company's targets, the determination of company strategies, as well as the setting of important infrastructural directions. Decisions which provide the basic decisions with more detail (detailing decisions) may be delegated by the Management Board to individual Management Board members or committees.
- 3.5. The individual Management Board members receive in each case particular spheres of responsibility for which they are competent as spokesperson (without their own powers of decision outside of the executive body as a whole) or as head of department (with authority to make decisions which relate to the area of responsibility). Tailoring the areas, depending on the degree of diversification of the company and the geographical extent of its activities, should ensure that the important functions, products and markets are represented on the Management Board.

4. Decision-making and forming intention

- 4.1. The chairman or speaker of the Management Board sets the agenda for the meetings of the Management Board. Each member of the Management Board may include on the agenda points for discussion and decision by way of the chairman or speaker. In cases where speed is required, the Management Board chairman or speaker in particular, but also all other members of the Management Board, may extend ad hoc the agenda for the Management Board meeting. If the time available to deal with all items on the agenda is insufficient, a date is fixed immediately for a further meeting of the Management Board.
- 4.2. The Management Board makes its decisions on the basis of systematic preparation. Management Board decisions are discussed in the

Management Board before being made. The discussion is to be conducted with the results still open and must not already be practically prejudiced by pre-conceived notions as against third persons.

- 4.3. A well-founded preparation for the decision requires before anything else, that the expectations for the success of the planned measures are justified in detail. In doing this, apart from the chances, the risks attaching to the measures also must be taken into account in an objective and balanced way.
- 4.4. All members of the Management Board receive information and supporting documentation relevant to the decision in good time before the Management Board meetings.
- 4.5. Measures which are not connected to each other – for example in technical or market terms – are decided each time individually, so as to avoid inefficient package solutions.
- 4.6. The Management Board strives to reach decisions unanimously. If this cannot be achieved, it decides by simple majority after a period of waiting of at least 24 hours. A Chairman of the Management Board may defer a majority decision with a veto. The veto of the Chairman of the Management Board may be overruled at the next Management Board meeting, by a majority of members.

5. Personal conduct

- 5.1. Members of the Management Board always personally remain loyal to their company. They must not pursue their own interests which conflict with the interests of the company. Even the suspicion of conflict must be avoided.
- 5.2. Members of the Management Board in particular may neither directly nor indirectly through persons connected with them, take advantage of the company's business chances, assist competitors or undertake

commercial transactions with the company which do not correspond with normal market conditions.

- 5.3. Participation by members of the Management Board in other companies must be revealed to the Chairman of the Supervisory Board and has to be examined for any possible conflict of interests.
- 5.4. The Chairman of the Supervisory Board must approve acceptance of a seat on the Supervisory Board of another company, as well as engaging in significant ancillary activities.
- 5.5. The Management Board appoints a representative who issues guidelines for the sale and purchase of shares in the company and who supervises their observation (compliance officer). All members of the Management Board acknowledge in writing the rules applicable for insider dealings as well as these guidelines.

6. Remuneration of the Management Board

- 6.1. The remuneration of members of the Management Board is made at a reasonable level and is related to performance. Criteria for assessing the reasonableness of the emoluments are, in particular, the commercial situation, the success and future prospects of the company, its size and importance as well as the relationship to the remuneration of the senior executives in the company.
- 6.2. The remuneration of the members of the Management Board embraces fixed and variable components. The basis for determining the variable components of remuneration is systematic evaluation of the individual members of the Management Board carried out periodically by the personnel committee of the Supervisory Board (clause II. No. 1.10.).
- 6.3. The variable remuneration can also be paid as to part, according to stock option schemes or comparable schemes orientated towards the

market price of the stock. The following four points apply to these forms of remuneration:

- (1) The components of the remuneration oriented towards the market price replace at a reasonable level the emoluments paid previously. They are not purely in the nature of additional remuneration.
- (2) The option scheme refers to a sectoral index. It ensures that option profits only arise if the long-term average performance of the company's shares lies above the performance of the index. There is no retrospective lowering in the option prices (re-pricing).
- (3) The option schemes are scheduled for the long term. Options may only be exercised in each case after a waiting period of at least two years. Shares obtained by exercising an option must be held for more than three years at least, before they may be sold.
- (4) The option scheme sets an upper limit for the profit of the individual Management Board member from share options (cap).

6.4. Apart from the emoluments of the total Management Board, the company also discloses the fundamentals of the system for remuneration. In this are included, in particular, the procedure and the standards of comparison for evaluating the performance of the Management Board, as well as the form of any market price orientated compensation systems.

IV. Governance standards for the Supervisory Board

1. Basic principles of Supervisory Board dealings

- 1.1. The Supervisory Board exercises its duties in observance of the generally accepted principles of proper supervision. It orientates all activities particularly towards the following three general guidelines:
- 1.2. All measures taken by the Supervisory Board are subject to the principle of legal permissibility. They must therefore not infringe the appropriate provisions of the law applicable.
- 1.3. All measures taken by the Supervisory Board are subject to the principle of economic usefulness. They should accordingly contribute to this within the bounds of what is possible, to increase the value of the company sustainably.
- 1.4. The Supervisory Board should when carrying out its duties, be aware of social responsibility to a reasonable extent and take account of all ethical conceptions without which a social market economy cannot survive.

2. Tasks of the Supervisory Board

- 2.1. The essential tasks of the Supervisory Board include the composition of, the control over and advice to the Management Board.
- 2.2. The Supervisory Board stipulates at least the fundamentals of the standing rules for the Management Board (clause III. No. 3.2.).
- 2.3. In the course of control, the Supervisory Board supervises the quality of Management Board management measures, both carried out and planned. In doing this, it checks in particular whether the dealings of the Management Board increase the value of the company sustainably and correspond with the generally accepted principles of proper company management. Where there are deviations from generally recog-

nized management standards which are not substantiated, the Supervisory Board compels observance of the principles.

- 2.4. With important proposals, whether they require approval or not, the Supervisory Board advises the Management Board by which it brings its expert knowledge and experience actively into the discussions on the prospects for success of the intended measures. The discussion process follows the principles for co-operation between the Management Board and the Supervisory Board for setting fundamental directions for the company, described in clause II. No. 3.
- 2.5. The composition of the Management Board is reached by the selection of new Management Board members as well as through decisions on renewing appointments and on any dismissals. In order to ensure the highest possible level of quality for the composition of the Management Board, the Supervisory Board applies the rules stipulated in clause II. No. 1. for the participation of the members of the Management Board.
- 2.6. The Supervisory Board subjects its activities to systematic evaluation at regular intervals in order continually to improve them.

3. Organization of the Supervisory Board

- 3.1. The Supervisory Board makes rules of procedure for itself which are directed towards the highest possible efficiency in the supervisory organ.
- 3.2. The Supervisory Board has – in as far as it is permissible – six or nine members. If the number required by law is higher, the Supervisory Board should in the normal case not exceed the minimum size stipulated by statute.
- 3.3. The Supervisory Board forms committees in order to increase working efficiency. The committees should have at least three but no more than five members. The Chairman of the Supervisory Board co-

ordinates the activities between the committees, in consultation with the chairpersons of the committees.

- 3.4. The number and tasks of the committees depend on the size of the Supervisory Board and the respective realities of the company. This includes principally the size of the company as well as the type, degree of diversification and geographical extent of its value creating processes. Normally, there is to be established at least one business committee for managerial key policy issues, a personnel committee for all matters affecting the personnel of the Management Board and if necessary, a committee pursuant to § 27 (3) of the Co-determination Act 1976, an investment and finance committee, an audit committee and a committee for corporate governance. Next to these are committees to be considered for particularly important functions (such as research and development), products and markets of the company.

4. Personnel appointments to the Supervisory Board from the side of the stockholders

- 4.1. The Supervisory Board allows itself to be guided by the consideration in its proposals to the annual general meeting for the election of new members as well as re-appointments to office, that in the suitability of the persons appointed, the decisive factor is his efficiency. In order to ensure the necessary quality in the proposals for appointment, they are discussed and decided by the Supervisory Board on the basis of transparent criteria for the assessment of the candidates who come up for election.
- 4.2. In particular, the Supervisory Board makes certain with its proposals as to appointments that the representatives of the stockholders possess those various qualifications which are required for competent control of the Management Board according to the realities of the company.

- 4.3. If the work of a member of the Supervisory Board displays serious flaws, it is the Supervisory Board that causes him to be removed.
- 4.4. Members of the Supervisory Board may not exercise any mandates in other undertakings which are competitors for the company. Further, they must not sit on the Management Board of a company or be employed by it where a Management Board member of the company belongs to its Supervisory Board. The move to the Supervisory Board of the company by retiring Management Board members is normally restricted to one member.
- 4.5. Members of the Supervisory Board should be in a position in the long run both in terms of time and health personally to fulfil with proper diligence the requirements made by supervisory tasks. They should normally not exhaust the legally permissible maximum number of their Supervisory Board mandates and not exceed the retirement age of 70 years.

5. Procedure of supervision

- 5.1. The Supervisory Board normally meets on six occasions annually. Extraordinary events may require a higher number of meetings. The frequency of committee meetings is taken into account when determining the number of meetings of the entire Supervisory Board. The duration of the meetings should allow proper exercise of supervisory tasks.
- 5.2. The exercise of supervision – apart from contacts of the Chairman of the Supervisory Board with the Management Board – is primarily made in the meetings of the Supervisory Board and its committees. Separate preliminary discussions of the representatives of the stockholders and the employees, if they take place, should ease the process of shaping opinion, but not lead to actual pre-arrangements.
- 5.3. In order to promote openness of discussion, the Supervisory Board meets at times for one sitting per year without the Management Board.

- 5.4. The Chairman of the Supervisory Board prepares a systematic schedule of supervision which stipulates the sequence and main focus of the topics more precisely to be discussed in the individual meetings of the Supervisory Board or its committees. The items and required standards of supervision to be included in the schedule result in particular also from the basic principles of proper company management which form a grid of characteristics of careful Management Board dealings (control checklist).
- 5.5. The schedule of supervision separates subjects of supervision to be discussed periodically from permanent aspects of supervision. To the subjects which may be finished off successively in the meetings normally of two-year supervisory periods, are included, in particular, the fulfillment of various core tasks of the Management Board (clause III.), the Management Board organization, the composition of the Management Board and its co-operation with the other organs of the company. In view of these elements of control, it should be examined in general to see if the measures in question are legally permissible, economically useful as well as socially and ethically reasonable too. Further, particularly with important Management Board decisions, the grounds for the decision is also always to be monitored (clause III. No. 4.3.).
- 5.6. All members of the Supervisory Board receive the schedule of supervision before each supervisory period.
- 5.7. The chairpersons stipulate the agenda for the individual meetings of the Supervisory Board and its committees on the basis of the schedule of supervision as well as current developments.
- 5.8. All documentation which is necessary for proper discussion of the items of the agenda pending, is delivered to the members of the Supervisory Board or the committees in good time before each meeting.

6. Personal conduct

- 6.1. Members of the Supervisory Board always personally remain loyal to the company. They must not pursue their own interests which conflict with the interests of the company. Even the suspicion of conflict must be avoided.
- 6.2. Members of the Supervisory Board in particular may neither directly nor indirectly through persons connected with them, take advantage of the company's business chances, assist competitors or undertake commercial transactions with the company which do not correspond with normal market conditions.
- 6.3. All members of the Supervisory Board acknowledge in writing the rules applicable for insider dealings as well as the company guidelines for the sale and purchase of shares in the company. The compliance officer (clause III. No. 5.5.) also monitors to see that the Supervisory Board members comply with these rules.

7. Remuneration of the Supervisory Board

- 7.1. The remuneration of members of the Supervisory Board is made at a reasonable level and is related to performance. Criteria for assessing the reasonableness of the emoluments are, in particular, the commercial situation, the success and future prospects of the company, its size and importance as well as the relationship to comparative services. Even if taking into consideration the fact that Supervisory Board remuneration is only tax deductible up to one half, it should be adjusted upwards if it is unreasonably low.
- 7.2. The basis for assessing the performance of the individual members of the Supervisory Board is the extent of their duties. What has to be taken into account in doing this is, in particular, the chairmanship in the Supervisory Board, the number of memberships in its committees and the frequency of participation in meetings.

- 7.3. Supervisory Board members do not receive stock options or similar remuneration related to market price of the stock, in order to maintain the necessary distance to managerial measures taken by the Management Board. An exception here is emoluments equivalent to remuneration for Supervisory Board members of young companies (start ups).
- 7.4. The company also publishes, apart from the total remuneration, the principles of the remuneration system of the members of the Supervisory Board.

V. Governance standards for stockholders and employees

1. Rights of the stockholders

- 1.1. All stockholders have the same powers of influence over the public corporation according to their holding in the company. The precept of equal treatment within the limits of the extent of the participation also applies in particular against institutional investors on the one side and private small stockholders on the other.
- 1.2. The stockholders exercise their influence at the annual general meeting. They operate with an awareness of their responsibility towards the interests of the company.
- 1.3. Depositary banks have a particular responsibility for safeguarding the interests of the stockholders. They must keep clear of possible conflicts of interest which, for example, can result from simultaneous customer relations to the company or its own holdings of capital. Proper representation of the rights of the stockholders is also a duty of the protection associations.
- 1.4. The Management Board, the Supervisory Board and the auditor participate in the annual general meeting.

- 1.5. The company takes all sensible measures to relieve the stockholders of having personally to safeguard their rights. To this end, it enables them normally to follow the annual general meeting with modern means of communication (for example, on the Internet) as well to cast votes electronically.
- 1.6. The stockholders alone decide whether to accept or reject offers of acquisition. The Management Board and the Supervisory Board are obliged to present the chances and risks of the offers in a balanced manner. The chief measure for evaluation in this, is the presumed development in the prosperity of the company on an acquisition or with independence. Securing the independence of the company is not normally a material aim of the company.

2. Employee co-determination

- 2.1. The employees and those who represent their interests are institutionally anchored in the corporate governance as a result of co-determination. Co-determination is exercised not only at plant level (involvement with work) but also at company level (involvement in the enterprise).
- 2.2. Co-determination at plant level according to the Labor-Management Relations Act is carried out in the individual company plants by separate organs representing employees' interests. The employees elect a works council in every plant with at least five employees owned by the company. The works council has certain rights of participation and co-determination which are related to selected social, personnel and commercial matters of plant management.
- 2.3. Co-determination at enterprise level takes place in the Supervisory Board. With the exception of special regulations which apply to the coal, iron and steel industries, the employees elect either a third or the half of the members of the Supervisory Board, depending on the size

of the corporation. They thus participate in all responsibilities of this organ. The one third equal footing co-determination applies, according to the Labor-Management Relations Act 1952, to all corporations with at least 500 but fewer than 2,000 employees, and parity co-determination according to the Co-determination Act 1976, in companies with a workforce exceeding 2,000.

- 2.4. A member of the Management Board is responsible for the core activity of work and social services within the ambit of the Co-determination Act 1976 (director for employee relations). The director for employee relations is an equally ranking member of the Management Board and may also undertake further duties. He is not the representative of the employees but on a par with the other Management Board members in every respect and obligated to the overall interests of the company.
- 2.5. The co-operation between the representatives of the stockholders and of the employees in the Supervisory Board is based on consent. It is the joint discussions in Supervisory Board committees which offer the chance of preventing or breaking up dysfunctional formations of factions between the two sides.
- 2.6. In the case of insurmountable divergences of opinion between the representatives of the stockholders and of the employees in a Supervisory Board where the members have parity, the Chairman of the Supervisory Board, who is normally appointed from the stockholder side, has a second vote for resolving the stalemate situation. Such divisive voting should be avoided. The exercise of the second vote is however necessary if the search for a compromise has proved abortive, and thus only in this way can the Supervisory Board's capacity to act on behalf of the company be maintained.

VI. Governance standards for transparency and auditing

1. Financial reporting and disclosure

- 1.1. The public corporation does not restrict itself with information for the stockholders and other reference groups, in fulfilling the minimum statutory requirements which arise from the appropriate regulations concerning financial reporting and disclosure. Rather, the company establishes an integrated system of external communication which covers properly addressed, topically, soundly and succinctly the legitimate information needs of the various stakeholders of the company.
- 1.2. The communication system extends in particular to the supply of information for the actual and potential investors (investor relations), the workforce (employee relations), the consumers (customer relations), and the public at large (public relations).
- 1.3. All stockholders receive access to the same information without regard to the extent of their particular shares. The precept of equal treatment with information also applies particularly to institutional investors on the one side and private small investors on the other.
- 1.4. The stockholders receive access to all information which has been provided to financial analysts and similar addressees.
- 1.5. The company also uses modern means of telecommunication such as the Internet for current and consistent information to the various stakeholders of the company. Provided that it is commercially justified, it opens up the possibility of being able to follow press and analyst conferences directly over the new mediums.
- 1.6. The company reports at regular intervals on, amongst other things, the company's strategy and periodically on the realized as well as the planned development of important managerial ratios in the individual sectors of business.

- 1.7. The company also makes the existing risks for the present and for the business activities planned for the future, transparent. The risk communication keeps in mind that a sober discussion about risk does not damage the image of the company but is just an expression of a responsible company management.
- 1.8. Company information should not be ambiguous, equivocal or misleading. Above all else, it contradicts the precept of a fair and confidence-building company communication, untruthfully to confirm or to deny supposedly or actually planned company measures. In as far as company plans are not yet ready for announcement, for reasons of necessary confidence, the company has also to refrain when requested for a statement (no comment).

2. Annual audit

- 2.1. The auditor is an independent guarantor of open disclosure for the reference groups of the company, and in addition to that, is a supportive partner to the Supervisory Board in the supervisory process. He controls separate parts of Management Board dealings but is also available to the Management Board as advisor.
- 2.2. Regular audit covers in essence the company's financial reporting and the risks attaching to its business activities.
- 2.3. It is for the auditor to establish whether the financial reporting accords with the appropriate regulations and accurately reflects the company's asset, financial, earnings and risk situation.
- 2.4. In the case of a public corporation with a stock market quotation, the auditor also has to assess the efficiency of the risk management. In doing this, it must in particular be examined as to whether the company has the availability of an integrated risk management system which allows a complete identification, evaluation and management of the different supposed risks from business activities (for example, per-

ils concerning sales, development, liability, disruption and foreign exchange rates).

- 2.5. Apart from the audit certificate required by statute, the auditor also prepares a report for the Management Board noting the weak points in the company (management letter). The management letter reveals shortcomings which lie below the threshold of the statutory obligation to report and do not affect the certificate of audit, but which have been noticed during the course of auditing and should be redressed. The management letter is taken note of by the Chairman of the Supervisory Board.
- 2.6. The independence of the auditor is essential for a consistent and reliable control. Hence, the auditor takes all reasonable steps to safeguard his neutrality. Before anything else, he ensures that the extent of the mandate for audit as well as any additional business relationships with the company to be audited (for example, consultancy contracts) does not affect his economic independence.
- 2.7. The Supervisory Board should also take into consideration, on the recommendation for the appointment of the auditor, whether the work of the auditor should undergo evaluation by an expert third party at regular intervals (peer review).

VII. Corporate governance in private companies

1. The standards of governance of this code describe in the main, generally valid terms for good company management (best practices). Therefore they may also be applied in principle to companies which are not listed public corporations. In doing this, the special characteristics of such private companies should certainly be taken into account in order to reach proper solutions.
2. Private companies appear in numerous variations (for example, family companies) and legal forms, so that specific adjustments have to be

made in each case to the code rules described here. In doing this, in particular, the given company law organs and their responsibilities, the number and structure of the stockholders or proprietors, a possible lack of division between functions of management, supervision and investor, as well as the size of the company, have to be taken into account.

3. Companies with more than 500 employees should formulate guidelines for the management and supervision of the company, on the same lines as the present code, and which are tailored to the particular characteristics of the company. They submit these guidelines to a regular review.

VIII. Corporate governance in a group

1. In a group of affiliated companies, the governance standards of this code apply analogously to all organs at the different group levels. Special characteristics result, principally from the different areas of responsibility of the organs of the parent company on the one hand and the subsidiaries on the other.
2. The Management Board of the parent company manages the controlling company. At the same time, it exercises leadership over the group according to its legal and actual possibilities of influence on the dependent companies (duty of group management). The managing bodies of the dependent companies manage their companies in each case within prescribed (in part narrower, in part wider) limits, through the legally permissible decisions of the parent company's Management Board.
3. The sphere of supervision of the Supervisory Board of the parent company follows the area of responsibility of the Management Board of the parent company. It supervises the management of the controlling company as well as the group management also, through the

Management Board of the parent company. The supervisory organs of the dependent companies supervise in each case the measures of the managing bodies of their company.

4. The efficiency of the typical group system of graduated but interlinked managerial and supervisory tasks of the parent company organs and dependent companies pre-supposes that the organ responsibilities for the individual levels of the group do not come to nothing. Consequently in the normal case, the company law units (member companies in the group) and the organizational units of the group (managerial areas) should not fall apart substantially. Where consistency is lacking, organizational or – as far as is permissible – legal restructuring should be carried out in order to synchronize the organizational and legal structure.
5. In the interests of a clear delimitation in the areas of responsibility, personnel interlocking between the Management Board of the parent company and managerial organs of dependent companies are avoided in the normal case, in as far as the members of the Supervisory Boards of the dependent companies are at the same time members of the Management Board of the parent company (corporate interlocking). Equally, members of the Supervisory Board of the parent company should not be members of the Supervisory Board of the subsidiary companies.

Berlin Theses on Corporate Governance

- (1) A German code of corporate governance (GCCG) strengthens the quality and transparency of the management of German companies.**

Notwithstanding the comprehensive regulations for the memorandum and articles of association of German companies, formulating an independent German code of corporate governance (GCCG) is to be recommended. Such a code is effective through voluntary unilateral engagement of the company and offers clear advantages of flexibility as opposed to rigid statutory regulations. It contains important recommendations for forming company management structures and processes in the sense of best practice (regulative function). Further, with a compact GCCG, the German rules of company management and company supervision can even be made particularly transparent for foreign investors too (communication function).

- (2) A GCCG must take into account the special context of German companies in a globalized economy.**

In a globalized economy the conditions of successful company management come closer together. Nevertheless, rules of governance can then only contribute in optimizing management and supervision if they take into account the specific legal, economic, social and cultural characteristics of the country where the company is registered. In this sense, a GCCG should point out standards of good management and supervision for companies which develop their activities in and from Germany.

- (3) An effective GCCG has a demonstratively managerial perspective.**

Recommendations for corporate governance can sustainably improve the quality of company management only if they cope with operational requirements of management and supervision within the framework of statutory pro-

visions. The necessary managerial perspective manifests itself principally in an integrated view of questions and correlations of corporate governance. It demands a complete concept which considers as a whole the problems and processes of company management, which arise in and between the organs of management.

(4) Rules on corporate governance must be tailored to the particular characteristics of companies, principally their legal forms and owner structures.

The GCCG is primarily directed towards large, public corporations quoted on the stock exchange. Numerous provisions may, however, be applied directly or analogously to private companies (for example family companies) as well as under group conditions. Further, the recommendations made by the code can be extended by guidelines specifically for the company in order to develop tailor-made solutions for the terms of company management.

(5) The Management Board stands at the center point of the GCCG guidelines.

The Management Board forms the clear leadership center of the public corporation as the organ of management. Its dealings decisively determine the success of the company. The GCCG must therefore focus on the Management Board particularly, and before all else, contain guidelines which promise the greatest possible quality in its work and co-operation with the other organs of the company. Rules for the supervision of the Management Board by the Supervisory Board are certainly also of importance, but they must not take center stage and dominate the understanding of corporate governance. In the final analysis, an excellent company management does not allow itself to be "checked into".

- (6) The Supervisory Board plays an important role in company management with its selection and supervision of the Management Board. It does not however have any managerial function.**

The composition of the Management Board represents one of the most important factors in the company's success. Ensuring optimal qualification of the Management Board member therefore belongs to the primary tasks of the Supervisory Board. Furthermore, the Supervisory Board serves as supervisory authority which controls and advises the Management Board in the sense of "checks and balances". In this, it is not on an equal footing next to or even above the Management Board. The Supervisory Board serves rather as counterweight to the Management Board which can and should limit, but normally neither counterbalance nor outweigh, the influence of the organ of management on the destiny of the company.

- (7) Rules of governance must be actually lived. A culture of open discussion in the Management Board and the Supervisory Board as well as between the organs is a decisive success factor of corporate governance.**

Rules for corporate governance can then only develop positive effects if they are practiced in earnest. Particular importance is thereby attached to active participation of all members of organs in the intended processes of information and decision. By establishing and supporting a culture of open discussion in and between the boards, it may be ensured that the tasks of management and supervision are fulfilled in a well-founded manner and after exploiting the expertise of all officers.

- (8) The company management must sensibly balance out the interests of the various stakeholder of the company.**

Among those with an interest in the public corporation are principally the owners (stockholders) but also the employees, the customers, the loan

creditors and suppliers as well as the public at large. Within the scope of this reference groups, particular significance must be attached to the stockholders as providers of risk capital. The prominent position of the stockholders certainly does not mean an ill-balanced commitment by the company's management to a strict, short-term maximization of shareholder value, as measured against the quoted price. On the contrary, the company management must sensibly balance out the aims of the various reference groups for reasons of economics, because ultimately all stakeholders in each case make their contributions to the success of the company.

(9) Information on the efficiency of the company ensures the confidence of the stakeholders and is therefore of strategic importance.

Adequate information on the terms, results and planned developments of the company's activities, for the stockholders and other reference groups, is a pre-condition for reinforcing the trust, and with it the necessary support, of those interested in the company. This applies not least to information on the chosen form of corporate governance. Consequently, it lies in the strategic self-interest of each company, to seize the recommendations of the GCCG and to document the extent to which the guidelines are to be implemented.

(10) Regular evaluation promotes continuous improvement in the corporate governance of a company.

Given the great importance of good corporate governance for the success of the company, there exists an important task for the governing bodies in the constant search for opportunities to increase efficiency in management and supervision. Assessments of the management structures and processes carried out periodically can contribute towards continual improvement in the company's management and to adjusting to new conditions.

(11) The German model for governing a company is competitive also in a global economy.

Companies with different basic patterns of corporate governance are competing in the globalized economy. Not one of the different systems can claim to be clearly superior to the other solutions for constitutions. If the statutory German model for company management is taken up according to the recommendations of the GCCG, practiced professionally by competent persons and also further developed in the future, a thus modernized constitution by international comparison, offers a good basis for competitiveness.