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Corporate Governance 2022

Germany: Law & Practice
and
Germany: Trends & Developments

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GERMANY

Law and Practice

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1. INTRODUCTORY

1.1 Forms of Corporate/Business Organisations

German law differentiates between capital companies and partnerships. The following chapter will focus on capital companies, as these are the most important and regulated forms of companies in Germany.

Capital Companies

Capital companies are legal entities, where the liability is limited to the assets of the company – ie, the shareholders' liability is limited to what they have invested in the company. The most common legal forms of capital companies are the limited liability company (*Gesellschaft mit beschränkter Haftung* or GmbH) and the stock corporation (*Aktiengesellschaft* or AG). Other forms of capital companies are the European stock company (*Societas Europaea* or SE) and the partnership limited by shares (*Kommanditgesellschaft auf Aktien* or KGaA).

The KGaA is a capital company, but also has some elements of a partnership.

Partnerships

Partnerships are characterised by the personal liability of the partners. The most popular legal form of a partnership is the limited partnership (*Kommanditgesellschaft* or KG), consisting of limited partners whose liability is limited to a certain amount agreed and disclosed in the commercial register, and general partners with unlimited liability. However, the general partner may have the legal form of a capital company, thereby limiting its liability.

German law also acknowledges the partnership under civil law (*Gesellschaft bürgerlichen Rechts* or GbR) and the general partnership (*Offene Handelsgesellschaft* or OHG), with unlimited liability of their partners.

1.2 Sources of Corporate Governance Requirements

The primary sources for corporate governance requirements for capital companies in Germany (GmbH, AG, KGaA, SE) are:

- the German Limited Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* or GmbHG);
- the German Stock Corporation Act (*Aktiengesetz* or AktG);
- the European and German acts on SEs (in particular the European SEVO and the German SEAG);
- the German Commercial Code (*Handelsgesetzbuch* or HGB);
- the Reorganisation of Companies Act (*Umwandlungsgesetz* or UmwG);
- the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz* or WpÜG);
- the Market Abuse Regulation (*Marktmissbrauchsverordnung* or MAR); and
- the Securities Trade Act (*Wertpapierhandelsgesetz* or WpHG).

Beyond this, the German Corporate Governance Code (*Deutscher Corporate Governance Kodex* or DCGK) sets out further corporate governance rules for listed companies, which differentiate between recommendations and suggestions. In 2020, the DCGK introduced the category of principles which precede the recommendations and suggestions regarding a certain subject matter and outline the fundamentals of the applicable law.

Most recently, the DCGK has been amended, substantiating some ESG aspects as well as the guidelines on internal controlling in response to new legislation on financial integrity.

Moreover, non-governmental regulations such as applicable listing rules enacted by the stock

exchanges also establish corporate governance requirements.

Certain industry sectors (eg, banks) are subject to further regulation with respect to, inter alia, their corporate governance.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Shares of an AG, SE and, less commonly, a KGaA may be listed on a stock exchange. The primary source for corporate governance requirements concerning listed AGs and KGaAs, as well as (to a lesser degree) SEs, is the AktG, as it differentiates between rules for listed and non-listed companies. Its requirements are mandatory. The HGB, WpHG, WpÜG, the European and German Securities Prospectus rules (the European WPVO and the German WpPG), the Stock Exchange Act (*Börsengesetz* or BörsG) and the MAR provide for further mandatory regulation, inter alia, in relation to listed companies' corporate governance.

To promote a high corporate governance standard, the DCGK contains corporate governance standards in the form of recommendations and suggestions for listed companies with a two-tier corporate governance system; however, the rules of the DCGK shall also be applied correspondingly by listed companies with a one-tier corporate governance system (see **3.1 Bodies or Functions Involved in Governance and Management**). The DCGK is not enacted by the legislature, but by the German Corporate Governance Commission and is therefore not a statute or an ordinance, but rather "soft law", so the standards set in the DCGK are principally voluntary. Recommendations shall be complied with and, if not, deviations have to be explained and disclosed (principle of "comply or explain") in a declaration of compliance (*Entsprechenserklärung*), to be resolved upon annually by the responsible corporate governance bodies of the listed company.

The declaration of compliance is to be included in the declaration on corporate governance which itself is part of the management report. The issuance of the declaration of compliance is obligatory. Deviations from suggestions are allowed without disclosure. In practice, listed companies seek to comply with the standards set out in the DCGK, in particular the recommendations.

2. CORPORATE GOVERNANCE CONTEXT

2.1 Key Corporate Governance Rules and Requirements

Over and above the corporate governance rules this article will focus on, German law provides for the following particularity changing the (allocation of seats of the) supervising body of certain companies.

Under German law, there are two different kinds of employee representation in supervisory boards of an AG, KGaA and GmbH – the so-called codetermination (*Mitbestimmung*).

If an AG or a KGaA exceeds the threshold of, generally, 500 German employees, one third of the supervisory board members of the company must be employee representatives, ie, the one-third participation (*Drittelbeteiligungsgesetz* or DrittelbG). If an AG, KGaA or GmbH and its controlled companies exceed, generally, 2,000 German employees in total, the supervisory board must consist of 50% employee representatives, ie, the parity codetermination (*Mitbestimmungsgesetz* or MitbestG).

Shareholder representatives on the supervisory board are generally appointed by the general

meeting, while employee representatives in cases of codetermination are generally appointed by employee elections.

GmbHs

With respect to a GmbH, the establishment of a supervisory board is only required if codetermination rules become applicable. Thus, a GmbH with more than 500 German employees must establish a supervisory board with one third of the supervisory board members being employee representatives. Also, a GmbH with more than 2,000 German employees within it and its controlled group must establish a parity codetermined supervisory board with a minimum of six shareholder and six employee representatives.

SEs

German codetermination rules do not apply to the SE. When incorporating an SE by way of the "numerus clausus" of incorporation, an agreement on the participation of employees in the SE (the so-called employee participation agreement) has to be negotiated with the special negotiating body, which is established particularly for such negotiation, representing employees from the German company, its subsidiaries and branches that are in EU and EEA member states other than Germany. The rules on codetermination are part of the agreement, with the general principle that the level of codetermination of the German company used to incorporate the SE shall be maintained (freezing of codetermination prior to and after principle) – eg, if no codetermination exists and needed to exist prior to the incorporation of the SE, then no codetermination would need to be agreed upon in the employee participation agreement for the SE, etc.

2.2 Environmental, Social and Governance (ESG) Considerations

Under the HGB, larger listed capital companies with more than 500 employees are under the duty to issue a non-financial declaration that expands their management report. This declaration has to briefly describe the business model of the company. Moreover, it has to refer to other aspects of corporate social responsibility, at least to environment-related, employee-related and social matters as well as to the respect of human rights and the fight against corruption and bribery.

In April 2021, the EU made a proposal to update sustainability reporting (*Corporate Sustainabilty Reporting Directive* or CSRD). The aim is to bring corporate sustainability reporting in line with the EU's ambition to become the first climate-neutral continent by 2050. The finalisation of the CSRD shall take place by June 2022, and the implementation into national law by the end of 2022. Therefore, this new sustainability reporting will have its first effect in the financial year 2023.

The scope of the CSRD will be significantly wider compared to the current scope of the non-financial declaration. In future, all companies listed on a regulated EU market as well as non-capital-market-oriented companies that exceed two of the following three criteria will be affected: (i) EUR40 million annual turnover; (ii) EUR20 million balance sheet total; and (iii) an average of at least 250 employees. The CSRD aims to expand the reporting requirements to include further information on environmental, social and governance matters in addition to the already-known aspects concerning environmental, labour and social matters, respect of human rights and the fight against corruption and bribery.

Companies with limited liability and employee codetermined supervisory boards must include in their annual report information on the achievement of their gender diversity targets.

ESG criteria are becoming more and more important, and not only in the voting guidelines of voting advisors. In June 2021, the Federal Govern-

ment passed the so-called Supply Chain Act (*Lieferkettensorgfaltspflichtengesetz*). It intends to implement the UN Guiding Principles on Business and Human Rights and aims to prevent the violation of human rights by companies. Therefore, it obliges companies to respect human rights as well as the environment throughout the global supply chain, and remedy violations.

For this purpose, companies must establish an appropriate risk-management system and conduct a risk analysis for themselves and suppliers. The first is ensured by the appointment of an internal officer for monitoring the system. Additionally, companies must establish a procedure for filing complaints concerning human rights violations. Finally, companies must publish an annual report on their compliance containing fulfilment of their obligations under the Supply Chain Act. The law will come into force on 1 January 2023 for companies in Germany with at least 3,000 employees, and on 1 January 2024 for companies with at least 1,000 employees.

3. MANAGEMENT OF THE COMPANY

3.1 Bodies or Functions Involved in Governance and Management

Management Board

The predominant board structure of an AG and an SE follows the two-tier corporate governance system, with a management board (*Vorstand*) managing and representing the company, and a supervisory board (*Aufsichtsrat*) supervising the management board, in each case accompanied by the third corporate body, the general meeting (*Hauptversammlung*). The management board manages the company under its own responsibility and at its own discretion. It is not subject to any instructions from the supervisory board or the general meeting.

However, the management board is subject to the prior approval of the supervisory board for certain business transactions and measures, either foreseen in the articles of association of the company or by the supervisory board itself, eg, in the rules of procedure for the management board.

Administrative Board

A one-tier corporate governance system primarily known in other jurisdictions with one board is only allowed in Germany within an SE. The board is called the administrative board (*Verwaltungsrat*), and consists of executive and non-executive board members. The administrative board is responsible for the management and supervision of all material company matters (*Oberleitung*) as well as the determination of guidelines for the SE's business, and appoints managing directors (*Geschäftsführende Direktoren*), who are responsible for the day-to-day management of the company.

The managing directors may be members of the administrative board if and to the extent that the majority of the members of the administrative board continue to be non-executive. The administrative board is entitled to issue internally binding instructions to the managing directors.

General Partner

The peculiarity of a KGaA is that the general partner is responsible for the management. The general partner, being a shareholder of the KGaA, may be one or more natural persons or, more common in practice, a capital company itself, eg, a GmbH, AG or SE. The corporate governance system of such a capital company is to be differentiated from the corporate governance of the KGaA.

The corporate governance of the general partner company follows its applicable principle. The KGaA has in any case a supervisory board that

is responsible for the supervision of the management, but in case of a capital company as general partner it is responsible for neither the appointment, dismissal and service contracts of the management of the general partner nor for the determination of the financial statements.

The general meeting of an AG, SE and KGaA has no corporate governance powers.

Managing Directors

A GmbH generally has managing directors (*Geschäftsführer*) and the shareholders' meeting (*Gesellschafterversammlung*), but no statutorily required supervising body. The managing directors are responsible for the management and representation of the company. In principal, they decide autonomously.

However, the shareholders' meeting is – in contrast to the situation in an AG – the supreme decision-making body of the GmbH, and has the authority to issue internally binding instructions to the managing directors. In a GmbH, a voluntary supervisory or advisory board may be implemented. Apart from this, a supervisory board is to be installed only in the case of codetermination (see **2.1 Key Corporate Governance Rules and Requirements**).

3.2 Decisions Made by Particular Bodies

Management Board

In an AG and a two-tier system SE, the management board responsible for the management of the company decides on any and all business transactions and measures within and outside the ordinary course of business under its own responsibility and discretion. However, material measures within and measures outside the ordinary course of business are subject to the prior approval of the supervisory board. For this purpose, applicable law provides that a catalogue containing those approval rights has to be established, either by the general meeting in the articles of association or, alternatively and – in practice – more relevant, by the supervisory board itself in the rules of procedure for the management board, which is an important part of supervising the management board.

Besides the supervision of the management board, the supervisory board is responsible for the appointment and dismissal of the members of the management board, for their service contracts, and for the review and determination of the financial statements.

Administrative Board

In a one-tier system SE, the administrative board is responsible for fundamental management issues, such as long-term business goals, the organisational structure, and the strategy and general guidelines of the SE, as well as the budgeting, whereas the managing directors are "only" responsible for the day-to-day management. The administrative board has the authority to issue internally binding instructions to the managing directors.

General Meeting

Only selected decisions are reserved by law for the general meeting of an AG and an SE. With respect to the annual ordinary general meeting, such decisions include the appropriation of profits, the appointment of the auditor, the formal approval of action for members of both the management board and supervisory board, and the vote on the annual remuneration report; with respect to fundamental, extraordinary decisions, such decisions include the election and removal of the supervisory board members, amendments to the articles of association, and resolutions on restructuring measures and the sale of substantially all of the corporation's assets, as well as on corporate agreements (profit and loss pooling agreements).

Managing Directors

Managing directors of a GmbH can principally make day-to-day management decisions without consulting the shareholders. However, as the shareholders' meeting is the supreme body, a broader catalogue of decisions is reserved by law for the shareholders' meeting of a GmbH than for a general meeting of an AG: all decisions that the ordinary general meeting of an AG has to take plus the review and determination of the financial statements and all fundamental, extraordinary decisions of the general meeting of an AG, as well as the right to instruct the managing directors.

3.3 Decision-Making Processes

Management Board

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

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

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

Supervisory Board

The supervisory board of an AG, a two-tier system SE and a KGaA decide by way of resolution, generally with a simple majority. However, the articles of association or the rules of procedure for the supervisory board may foresee qualifying majority requirements. Supervisory board meetings shall be held as physical meetings from the statutory starting point.

Electronically set-up meetings as well as mixture forms are permissible, except for the meeting preparing the annual general meeting, which must be a physical meeting in the presence of the auditor. Supervisory board members not present in a meeting may not be represented by third persons or other supervisory board members, but can only give a written voting declaration (*Stimmbotschaft*). The meeting has a quorum if the majority of members are present – at least three.

The supervisory board is entitled to form committees from within itself, eg, an audit committee and a nomination committee. The DCGK expressly requires the formation of these two committees for listed companies. Committees are generally responsible for preparing supervisory board topics and consummating resolutions passed by the supervisory board. Sometimes, committees are also entitled to resolve instead of the supervisory board.

However, this is not allowed in statutorily foreseen topics, eg, upon the remuneration and service contracts of members of the management board. Rules applying to the supervisory board in a two-tier system also have to be adhered to by the administrative board in a one-tier system SE.

4. DIRECTORS AND OFFICERS

4.1 Board Structure

Management Board

There is no legally predefined structure for the management board of an AG or two-tier system SE, nor for the managing directors of a one-tier system SE or GmbH. The management board can consist of one or more natural persons, unless the articles of association require a minimum number of members; the same applies to the number of the managing directors.

Supervisory Board

The supervisory board of an AG, KGaA and a two-tier system SE, and the administrative board of a one-tier system SE, has to consist of at least three members, or a higher number up to nine, 15 or 21 members, depending on the registered share capital of the corporation, to be set in the articles of association. The number of members must not be devisable by three (any further), unless in the case of codetermination (see **2.1 Key Corporate Governance Rules and Requirements**), in which the number of members must be divisible by three. In case of equal codetermination, the minimum number of supervisory board members is 12, and beyond this depends on the total number of German employees.

4.2 Roles of Board Members

The applicable law does not predefine roles for members of the managing bodies. One member of the management board can be and usually is nominated as chairman or spokesperson. Apart from this, it is common for the tasks and duties of the management board and managing directors to be divided between them in several departments, either functional or operational divisions. Thereby, names like CEO, CFO and COO are generally attached to the members on their business cards, the website, and in the email footer; however, these are neither statutorily foreseen nor do they trigger any special further rights or obligations.

With respect to the supervisory board of an AG, and a two-tier system SE or an administrative board of a one-tier system SE, only the following rules have to be considered. Generally, each member has the same rights and duties, and must be familiar with the relevant business sector of the company. However, according to applicable law, boards of listed companies must have two members with certain skills, one with accounting expertise and the other with auditing expertise.

4.3 Board Composition Requirements/ Recommendations

Management Board/Managing Directors

Beyond the requirements set out in **4.1 Board Structure** and **4.2 Roles of Board Members**, there are no other statutory rules governing the composition of the management board of an AG or a two-tier system SE, nor of the managing directors of a one-tier system SE or GmbH. However, if such a company is listed on a stock exchange as well as codetermined and consists of more than three members as of 1 August 2022, at least one new member must be female and one must be male.

With respect to the management board of an AG, and a two-tier system SE or an administrative board of a one-tier system SE, that is listed on a stock exchange or codetermined, the supervisory board must determine a target percentage for women on the management board and the management board for the second/third line management as well as deadlines by when such percentage is to be reached. In the case of a set target of zero, the management board must justify this in a clear and comprehensive manner. If at the time of the determination the percentage of women on the management board is below

30%, the target percentage may not be lower than the present percentage.

These corporations must include a declaration on corporate governance in their management reports. The DCGK recommends taking diversity into account when composing the management.

Composition of Supervisory Boards

In AGs, SEs and KGaAs that are parity codetermined and listed on a stock exchange, the supervisory board (or, in the case of a one-tier system SE, the administrative board) shall be composed of at least 30% women and at least 30% men. The minimum percentage shall be complied with by the shareholder and employee representatives on the board in its entirety. Furthermore, corporations that need to fulfil the aforementioned gender criteria must include information on whether the company has complied with the portion requirements for the appointment of women and men as supervisory board members in their declaration on corporate governance.

With respect to the supervisory board of an AG, and a two-tier system SE or an administrative board of a one-tier system SE, that is listed on a stock exchange or codetermined, the supervisory board must also set a target for women on the supervisory board as well as deadlines by when such a target is to be achieved. With regard to a target of zero or below 30%, the same applies to the supervisory board as to the management board as described above.

At least one member of the supervisory board must have expertise in the field of accounting and at least one other member of the supervisory board must have expertise in the field of auditing. Sufficient expertise can also be assumed for financial directors, expert employees from the fields of accounting and controlling, analysts as well as long-standing members of audit committees or works council members who have acquired this ability in the course of their work through further training.

The DCGK recommends, among other matters, that the supervisory board determines concrete objectives regarding its composition and prepares a profile of skill and expertise for the entire board, but taking diversity into account.

It is recommended that both are taken into account for the supervisory board's proposals to the general meeting. The DCGK further recommends that a certain number of members of the supervisory board as well as certain members, eg, the chairperson, are independent (see **4.5 Rules/Requirements Concerning Independence of Directors**). The implementation status of the objectives and the profile of skill and expertise as well as the number of independent members deemed to be appropriate by the supervisory board are to be included in the corporate governance report.

4.4 Appointment and Removal of Directors/Officers

In an AG and an SE, the respective supervisory or administrative board is responsible for appointing and generally dismissing the members of the management board or the managing directors. The maximum term of office is five years in an AG and six years in an SE; a reappointment or extension is principally permitted.

The members of the supervisory and administrative board are appointed by the general meeting, for a maximum term of office of approximately five years in an AG and six years in an SE. Reappointment is permitted. Dismissal could happen by resolution of the general meeting with a majority of at least three quarters of the votes cast, unless the articles of association provide otherwise.

The appointment and dismissal of the managing directors of a GmbH is, in principle, the responsibility of the shareholders' meeting. The term of office may be indefinite.

4.5 Rules/Requirements Concerning Independence of Directors

Management Board

The members of the management board of an AG are subject to a duty of loyalty to the company, must observe the best interests of the company, and are bound by a non-compete obligation for the duration of office. They shall disclose conflicts of interest to the supervisory board without undue delay. The DCGK also makes statements to that effect. In certain situations, members of the management board should thus either abstain from casting votes or not even participate in the meeting or the relevant topic.

Supervisory Board

The members of the supervisory board of an AG, and a two-tier system SE and of the administrative board of a one-tier system SE, are also bound by a duty of loyalty, but there are no mandatory statutory provisions that require and define independence. However, a few restrictions aiming at independence prohibit an individual from becoming a member of the supervisory or administrative board – eg, where the individual is part of the management of a subsidiary of the company. Nevertheless, the DCGK requires a certain degree of independence to avoid conflicts of interest.

In this respect, the supervisory board shall determine an appropriate number of independent members. The DCGK gives indicators for determining the independence of members of the supervisory board. These include personal or business relationships with the company, the management board, controlling shareholders and major competitors that may cause a substantial or not merely temporary conflict of interest.

4.6 Legal Duties of Directors/Officers

Members of management bodies shall conduct the company's affairs with the due care of a prudent and diligent businessman, in particular in accordance with the applicable laws and the articles of association (duty of legality, including and of ever-increasing importance the duty to establish and maintain an effective compliance management system). In the case of entrepreneurial decisions, the so-called business judgement rule applies in order to eliminate hindsight bias when legally evaluating the management bodies' past conduct. This means that members of the management board may be exempt from liability if they had reasonably assumed that they were acting on the basis of adequate information and in the best interests of the company.

The same applies to the members of the supervisory and administrative board. However, their differing tasks and roles in the corporate governance of the respective company lead to a different emphasis of duties.

4.7 Responsibility/Accountability of Directors

In principle, members of management and supervising bodies owe their duties primarily to the company; they always have to act in the best interests of the company and its group. However, the interests of the company include, to a certain extent, the interests of all stakeholders (like creditors and employees) of the company (the German "stakeholder model" in contrast to the Anglo-Saxon "shareholder model").

4.8 Consequences and Enforcement of Breach of Directors' Duties

In an AG and SE (with a few exceptions in special statutory rules, eg, in the event of an insolvency, and in the context of wilful misconduct),

creditors and shareholders cannot enforce a breach of duties of members of management and supervising bodies. The members of the bodies are rather jointly and severally liable in the internal relationship towards the company due to their joint responsibility. Thus, individual members of a management and supervising body may not alleviate themselves from liability because a certain task or responsibility was delegated to a different member internally.

Furthermore, such a breach may lead to a dismissal and, with respect to the management members, a termination of their service contract.

In principle, the supervisory board is responsible and – according to case law – even has a duty to assert damage claims to the management board members. The company may waive its damage claims or enter into settlement arrangements on these claims only if three years have lapsed since the claim arose and the general meeting resolved thereupon without a minority of the shareholders (at least 10% of the share capital) raising an objection.

In the event that members of the supervisory board culpably breach their duties, the management board is responsible for pursuing possible damage claims against the supervisory board members jointly and severally.

Claims Against Members of Corporate Governance

The rights and obligations on asserting claims against members of corporate governance bodies in an AG, SE and KGaA are independent of whether or not the members of these respective bodies have been discharged. Another particular consequence of a breach of duty in a listed company is that the company may be obliged to disclose it to the capital market by way of ad hoc notification.

In case of a GmbH, the consequences of a breach of the duties of managing directors are, to a great extent, comparable to an AG. In general, the managing directors, like the management board members, are not directly liable to the creditors of the company. The shareholders' meeting has the right to pursue damage claims and to decide about the dismissal of managing directors and the termination of the service contract.

In contrast to the situation in the AG, if the shareholders' meeting has discharged the managing director knowing the facts underlying such a breach, the discharge leads to an exclusion of liability.

4.9 Other Bases for Claims/ Enforcement Against Directors/Officers

Certain special law remedies and, in the case of wilful misconduct, general civil law remedies, exist. From the company's point of view, these do not generally extend claims any further than those under corporate law. Since shareholders do not have a direct claim against the members of management and supervising bodies under corporate law, in certain situations (eg, capital market fraud) general civil law remedies may provide an opportunity for claims of shareholders.

However, the courts have traditionally been cautious in recognising such claims.

Liability

The liability of a member of a management and supervising body in an AG, SE and KGaA cannot be limited, as this would in particular qualify as an impermissible waiver by the company upfront, ie, prior to the expiry of the three-year period (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**). However, D&O insurance for the members of the management and supervising body is permissible and common in practice in order to protect them against

risks arising from their professional activities for the company. Premiums are generally paid by the company, although members of the management board of an AG, SE and KGaA are obliged to bear a deduction of at least 10% of the damage to one-and-a-half times their annual fixed salary at maximum.

4.10 Approvals and Restrictions Concerning Payments to Directors/ Officers

Remuneration

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

In listed companies the supervisory board has to determine the principles of the remuneration of the members of the management board in a remuneration system, which is subject to approval by the general meeting upon its introduction and any material changes thereto, at least every four years. However, the resolution on the approval is non-binding. If the general meeting does not approve the remuneration system, a reviewed remuneration system has to be presented at the next annual general meeting for approval.

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With respect to the contents of the remuneration system, the AktG only requires a few elements to be included in every remuneration system (eg, a maximum total remuneration of the management board) but provides for further rules with respect to its contents relating to different aspects of the remuneration of the management board if those aspects are foreseen in the remuneration system. However, the DCGK makes several recommendations with respect to criteria to be described in the remuneration system, eg, the ratio between the fixed remuneration and the variable remuneration based on short and long-term incentives, as well as the performance and non-performance indicators to determine payment of variable remuneration.

The supervisory board then determines the actual remuneration of each member of the management board based on the remuneration system. The supervisory board and the management board have to prepare a remuneration report regarding the past financial year which is subject to a non-binding approval by the annual general meeting. Neither the resolution on the remuneration system nor the resolution on the remuneration report can be objected to by means of a contesting action or an action for annulment by a shareholder.

Restrictions

As regards restrictions on the remuneration of the members of the management board, the AktG requires that the overall remuneration of individual members of the management board is appropriate in relation to their tasks and performance as well as the economic situation of the company. In addition, the supervisory board shall ensure the customary remuneration is not exceeded. Further, the remuneration in listed companies has to be aimed at a sustainable and long-term-oriented development of the company, and variable remuneration should be granted based on long-term incentives accordingly.

Characteristics

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

The DCGK further recommends that payments to members of the management board due to early termination of their activity do not exceed twice the annual remuneration (severance cap) and do not constitute remuneration for more than the remaining term of the contract. One recommendation is that change-of-control clauses shall not be agreed upon.

Management Board

The remuneration of the supervisory board members may be specified in the articles of association or granted by the general meeting. It should be appropriate in relation to the tasks of the members of the supervisory board and the company's economic situation. In listed companies, the general meeting has to resolve on the remuneration of the supervisory board members at least every four years, also in a non-binding manner, with the resolution including or referencing the same details that are to be included in the remuneration system of the management board with respect to the remuneration of the supervisory board members, if applicable. The DCGK further recommends taking into consideration the status as chair or deputy chair of the supervisory board or committee in this context. It is suggested that the supervisory board remuneration is a fixed remuneration.

Managing Directors and General Partners

In a GmbH, the remuneration of managing directors is the responsibility of the shareholders' meeting, which must not adhere to any restricting rules.

In a KGaA, the general partners generally receive no remuneration for their activities, but are entitled to receive a fee for taking over the liability of the KGaA vis-à-vis third parties. In the case of a capital company as general partner, the remuneration of its management members is to be set according to the rules applying to the respective legal form of such a capital company.

4.11 Disclosure of Payments to Directors/Officers

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

- the balance sheet total does not exceed EUR6 million;
- the sales revenues within the last 12 months amount to less than EUR120 million; and
- the company employs, on an annual average, fewer than 50 employees.

In a listed company, the features of the remuneration system must be described (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**). The remuneration system has to be published on the company's website for the duration of the application of the remuneration system; however, at least for ten years. In addition, the management board and the supervisory board of a listed company must disclose certain information, such as the fixed and variable remuneration paid to each member of the management and the supervisory board, in the annual remuneration report.

The remuneration report is also published on the company's website for at least ten years. The AktG requires the remuneration report to be audited.

The AktG now also requires ad hoc and annual disclosure of related party transactions, including transactions of the company with its various members of corporate bodies.

5. SHAREHOLDERS

5.1 Relationship Between Companies and Shareholders

The purpose of the company is determined by its shareholders in the articles of association. The shareholders can only exert influence on the decision-making process by way of resolutions. The general meeting of an AG, SE and KGaA has fewer rights and powers than the shareholders' meeting of a GmbH, in particular due to their ability to instruct the managing directors (see **3.2 Decisions Made by Particular Bodies**).

Furthermore, the shareholders have fiduciary duties towards the company and the other shareholders, and so have to promote the purpose of the company and may not act to its detriment.

5.2 Role of Shareholders in Company Management

The involvement of the shareholders in the management of a company differentiates according to the legal form of the company.

AGs, SEs and KGaAs

In an AG, SE and KGaA, the general meeting is entitled to appoint the members of the supervisory and administrative board, generally by simple majority, and to dismiss them by 75% of the share capital represented. However, the members of the management board and the managing directors in a one-tier system SE are appointed by the supervisory board, respectively the administrative board. The general meeting cannot instruct the supervisory or administrative board, or the management board.

If the management board so requires, the general meeting is entitled to resolve upon management affairs. In practice, such requests do not happen. Apart from this, the general meeting does not have any influence on the management.

Listed Companies

Listed companies also do not engage with their shareholders, in particular not outside the general meetings. In preparing such meetings, the CEO has calls with shareholder representatives and potential proxy voters, but abstains from providing them with any information that has not already been disclosed in the invitation or that the CEO does not intend to disclose in the general meeting to all other shareholders. However, the DCGK suggests that the chairman of the supervisory board should, to an appropriate extent, be in regular conversation with investors on supervisory board-related issues.

Non-listed Companies

Conversely, non-listed companies typically do engage with their shareholders.

GmbH

In a GmbH, the involvement of the shareholders in the management is also statutorily more extensive. In contrast to the AG, the shareholders' meeting resolves upon the appointment and dismissal of the managing directors and on the conclusion of their service agreements. Also, the shareholders of the GmbH are able to direct the managing directors to take or refrain from taking certain actions in the business by way of internally binding instruction.

5.3 Shareholder Meetings

Annual General Meetings

An annual general meeting is mandatory in an AG and KGaA within the first eight months of a financial year, and in an SE within the first six months of a financial year. The annual meeting has to resolve upon the ordinary topics (see **3.2 Decisions Made by Particular Bodies**) and upon the remuneration system, the latter resolution being non-binding (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**). Further extraordinary topics on fundamental decisions can also be put on the

agenda of the annual general meeting, or can be passed in an extraordinary general meeting.

Apart from this, general meetings are to be convened if necessary for the welfare and going concern of the company. The general meeting has to be convened no later than 30 days prior to the date of the general meeting, or no later than 36 days prior to the meeting if shareholders are required to register for the general meeting. In an AG and a two-tier system SE, the convening is generally the obligation of the management board, or exceptionally the supervisory board.

Within a one-tier system SE, the administrative board is responsible for the convening. However, shareholders whose share is equivalent to at least 5% of the registered share capital may also demand the convening of a general meeting. Shareholders whose share in the share capital is that high or corresponds to a nominal stake of EUR500,000 may demand that certain additional items are put on the agenda.

The demand has to be received by the company 24 days prior to the general meeting at the latest, or no later than 30 days prior to the general meeting for listed companies.

COVID-19

For temporary changes to the above-stated rules in response to the current COVID-19 pandemic, the Federal Government passed a law enabling AGs, SEs and KGaAs to hold virtual general meetings, ie, by way of audio and video streaming and carrying out submissions of votes either electronically or in written form, even where the articles of association do not provide for such meetings. The general meeting has to be convened no later than 21 days prior to the date of the general meeting. In addition, the annual general meeting no longer has to take place within the first eight months, but can also be held later within the fiscal year. This COVID legislation continues to apply until 31 August 2022. The virtual annual general meeting will in future presumably be possible as an alternative to the physical annual general meeting. Shareholders' rights at the virtual shareholders' meeting are to correspond as far as possible to those at a physical shareholders' meeting. The relevant draft bill has already been amended and shall be resolved upon shortly for an uninterupted transition.

Annual General Meeting Invitation

The invitation has to fulfil a lot of formalities, like setting out the business name and seat of the company, the time and place of the general meeting, and the agenda. For listed companies, the invitation has to provide further information, eg, about the rights of the shareholders in respect of the general meeting.

Votes and Resolutions

Unless stipulated otherwise in the articles of association, the general meeting should be held at the seat of the company. Resolutions may not be taken by written consent, but the articles may provide that shareholders may cast votes in written form. Shareholders may be represented by a proxy/proxy voter at the general meeting, or may exercise their rights via electronic communication; the latter option is only available if the articles of association allow this form of attendance and voting.

In listed companies, each resolution adopted by the general meeting is to be recorded in the minutes of the meeting prepared by a notary public. For non-listed companies, it is sufficient to have the minutes signed by the chairman of the supervisory board as long as no resolutions are adopted for which applicable law requires a majority of 75% of the votes cast or a greater majority.

GmbHs

In a GmbH, the regulations in respect of the shareholders' meeting are not as strict as in the AktG for AGs, SEs and KGaAs. Resolutions generally have to be passed in a meeting of the shareholders, but can also be made in writing. The shareholders' meeting generally has to be convened by the managing directors by registered letter.

In the case of a meeting, the invitation must be sent at least one week before the meeting, and the agenda of the shareholders' meeting has to be announced in the invitation. However, these formalities on the invitation can be waived or amended in the articles of association.

There are no special requirements for the holding and conduct of shareholders' meetings. Shareholders may submit their vote in writing or may grant proxy. It is also permissible to hold meetings via electronic communication.

Due to the COVID-19 pandemic, the Federal Government has simplified the submission of votes in writing. Therefore, in contrast to the AG, SE and KGaA, the Federal Government has not regulated the virtual shareholders' meeting by law. Virtual shareholders' meetings in a GmbH require a corresponding provision in the articles of association.

5.4 Shareholder Claims

Shareholders generally do not have any direct claims against members of corporate governance bodies (see **4.8 Consequences and Enforcement of Breach of Directors' Duties** and **4.9 Other Bases for Claims/Enforcement Against Directors/Officers**).

Appealing Resolutions

Any shareholder who holds only "one" share may appeal resolutions (*Anfechtungs- und Nichtigkeitsklage*) of the general or shareholders' meeting for breach of law or the company's articles of association. Another objection shareholders can try to bring forward in such lawsuits is the violation of the (majority) shareholder's duty of good faith. As these duties are not statutorily defined, the chances of success are based on case law. The defendant is the company, not the other shareholder(s) who has (have) voted in favour.

By filing such objection and voidance claims in court, minority shareholders can block the completion (ie, entry into the commercial register) of, for example, corporate and integration measures. Registration will take place when the minority shareholders' court challenges are overcome by a so-called release proceeding, which the company must file (*Freigabeverfahren*). The company will particularly prevail in the release proceeding and thereby achieve registration in the commercial register if minority shareholders cannot prove that they hold more than a nominal value of EUR1,000 of the registered share capital of the company since the announcement of the convocation of the general meeting.

If in the context of a resolution the company or a majority shareholder has to offer to acquire shares of minority shareholders at fair value based on an IDW S1 valuation, those resolutions cannot be objected to (any more) with the argument that the valuation is too low. However, minority shareholders are entitled to challenge the adequacy of the price in court in a special shareholder compensation proceeding (*Spruchverfahren*).

Appointing a Special Auditor

Also, shareholders can request (by demanding either an invitation of an extraordinary general meeting or the adding of a topic on the agenda, see **5.2 Role of Shareholders in Company Management**) that the general meeting shall – with a simple majority of the votes cast – appoint a special auditor (*Sonderprüfer*) to analyse statu-

torily specified decisions of the executive and supervisory board. If the general meeting rejects the motion to appoint a special auditor, and if facts and circumstances justify severe breaches of tasks and duties by the management, minority shareholders who together hold 1% of the registered share capital or a nominal value of at least EUR100,000 can file for the appointment of the special auditor in court.

Damage Claims

Also, minority shareholders may influence the assertion of damage claims against management and supervisory board members following breaches of tasks and duties if, in a first instance, the general meeting resolves with a simple majority to assert such claims. Minority shareholders who together hold 10% of the registered capital or a nominal value of at least EUR1 million can then judicially file for the appointment of a special representative (*besonderer Vertreter*) to assert these claims. Minority shareholders who together hold 1% of the registered share capital or a nominal value of EUR100,000 or more can also apply in court for admission to assert these claims of the company in their own name.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Shareholders of listed companies have to notify the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin) and the issuer if their direct and/or indirect holdings exceed or fall below certain thresholds (3%, 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75%) and if their positions in financial instruments relating to shares exceed or fall below the aforementioned thresholds (except for the 3% threshold). The notification is to be published by the issuer and can be viewed on its website at any time. Shareholders of listed companies who directly or indirectly hold at least 10% must notify the issuer of the objectives pursued with the acquisition and the origin of the funds used within 20 trading days of reaching or exceeding this threshold.

6. CORPORATE REPORTING AND OTHER DISCLOSURES

6.1 Financial Reporting

Except for small partnerships, companies have to prepare an annual financial statement. Capital companies additionally have to prepare a management report, unless the company is a small company (based on the criteria set out in **4.11 Disclosure of Payments to Directors/Officers**). The annual financial statements and the management report differ in that the annual financial statements are primarily for presentation purposes, whereas the management report is more of an analysis and commentary.

The management report includes information on the risk profile of the company and its risk management system. For large listed companies, the HGB requires a declaration on corporate governance and a non-financial declaration including statements on environmental, social and labour-related concerns, among other matters.

In addition to preparing the annual financial statements and the management report, listed companies are also required to prepare and publish a half-year report. Some stock exchanges may require further reporting with respect to a certain market segment.

Certain industry sectors – for example, banks and other financial institutions – are subject to further reporting requirements.

6.2 Disclosure of Corporate Governance Arrangements

The declaration on corporate governance includes information on how the management

board and the supervisory board conducted their duties, and also has to address other issues, such as whether quotas for female members of the management and supervisory board have been met, and whether or not the company has a diversity concept (see **4.3 Board Composition Requirements/Recommendations**). Furthermore, listed companies have to publicly declare each year whether they comply with the DCGK (see **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**). The declaration is part of the declaration on corporate governance and must be published on the website.

As described, the remuneration system as well as the remuneration report must be published on the company's website for at least ten years. Further, the principal features of the management remuneration system and the remuneration of the management board and the supervisory board must be disclosed in the annual financial statement and in the management report thereto.

The annual financial statement also has to include information on related party transactions that were not at arm's length. Certain related party transactions also must be disclosed on an ad hoc basis.

6.3 Companies Registry Filings

A company must file the following with the commercial register (*Handelsregister*):

- the articles of association, including the company's business name and legal form, registered seat, purpose of the enterprise and registered share capital;
- the names of the legal representatives, their place of residence and dates of birth;
- if existent, the name and place of residence of authorised officers (*Prokurist*);
- in an AG and SE, a list of supervisory and administrative board members;
- in a GmbH, a list of shareholders; and
- subsequent amendments to the above-mentioned points.

Those filings are publicly available at www.handelsregister.de, which contains all entries in the commercial register filed since 2007.

7. AUDIT, RISK AND INTERNAL CONTROLS

7.1 Appointment of External Auditors

A company has to appoint an external auditor unless it is a small company (based on the criteria set out in **4.11 Disclosure of Payments to Directors/Officers**). The key requirements governing the relationship between the company and the auditor are set out in the HGB. The auditor is appointed by the general or shareholders' meeting. In an AG and two-tier system SE, the supervisory board is responsible for issuing the actual audit mandate, while in a one-tier system SE it is the administrative board, and in a GmbH it is the managing directors.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

In an AG, SE and a KGaA, the management board must install a system to detect and monitor risks to the continued existence of the company. However, it is best practice to maintain several systems and refined rules (for example, through reporting lines and codes of conduct) to ensure internal compliance and effective risk management. Specifically, the management board of a listed company is required by law to establish an internal control and risk management system. The supervisory board will review the existence and effectiveness of such measures. Managing directors of a GmbH are also

expressly obliged to take measures for the early detection of a crisis.

According to German case law, effective compliance management systems are also required in order to fulfil the duty of care owed to the company.

POELLATH is an internationally operating German law firm of more than 150 lawyers and tax advisers in Berlin, Frankfurt and Munich, providing high-end legal and tax advice. The firm advises on all transaction-related areas, including corporate, M&A, private equity, funds, real estate, private clients, succession planning and tax-related matters. POELLATH's corporate advice includes corporate law and group company law, reorganisations, capital market rules, corporate litigation and compliance. POELLATH advises publicly listed and private companies on preparing and conducting their general and shareholder meetings on all matters, including mergers, spin-offs and hive-downs, conversions of legal form, and on all corporate advisory matters related to corporate governance. A further core area is public takeovers with subsequent corporate integration. Key clients include Deutsche Telekom AG, shareholders of Porsche Automobil Holding SE, PUMA SE, Wacker Neuson SE, Eckert & Ziegler Medizintechnik, Nemetschek SE, GERRY WEBER, Münchener Hypothekenbank, BayWa, Giesecke+Devrient, Fiege Group, KME Group and Groz-Beckert.

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Trends and Developments

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Introduction

Digitalisation and environmental, social governance (ESG) are the dominant topics in recent legislation on corporate governance, after the last two years were primarily affected by the COVID-19 pandemic. The experiences from the COVID-19 pandemic, and the accompanying digitalisation, has had a significant influence on new legislative developments. In addition, the implementation of the laws on the promotion of women in leadership positions and the amendments to modernise the law on partnerships, which were addressed in the previous issue, took place. The growing importance of ESG matters, especially regarding corporate governance, has reached its peak so far. The recently amended German Corporate Governance Code (DCGK) dated 27 June 2022, the coming Corporate Sustainability Reporting Directive (CRSD) and the coming Supply Chain Act *(Lieferkettensorgfaltspflichtengesetz*) reflect their growing influence. This article will shed light on these new trends and developments.

COVID-19 Legislation/Virtual General Meetings

General meetings of the shareholders *(Hauptversammlung*) of a stock corporation *(Aktiengesellschaft* or AG) and a European stock corporation *(Europäische Aktiengesellschaft* or SE) were required to be held physically prior to the COVID-19 pandemic. Due to the pandemic, the Federal Government statutorily permitted these companies to hold general meetings virtually via videoconference. At the end of August 2022, the COVID-19-related special legislation, in particular regarding virtual general meetings of an AG and SE, will expire. The virtual annual general meeting will remain possible as an alternative to the physical annual general meeting under a draft bill that the legislature shall resolve upon shortly.

Since the format of the virtual general meeting has met with a positive response in practice and digitalisation is advancing in all areas of law, the possibility of virtual general meetings is to be permanently regulated in the Stock Corporation Act *(Aktiengesetz*) in the future. However, meetings in person will continue to be the basic form of general meetings.

Draft bill

The Federal Government has, therefore, decided to continue to allow virtual general meetings. To date, the Federal Cabinet adopted a draft bill for this purpose on 27 April 2022, based on a draft of the Federal Ministry of Justice dated 9 February 2022.

Requirements

The draft bill provides for an AG and SE to be able to make use of virtual general meetings on a permanent basis in the future, provided that certain requirements are met, as follows.

- The articles of association provide for the possibility of a virtual general meeting, or the management board is authorised to hold such a meeting by a provision in the articles of association; such authorisation is limited to a maximum of five years.
- The holding of the meeting with full video and audio transmission.
- The secured exercise of shareholders' voting rights by means of electronic communication.
- The possibility of speaking by means of video communication and submitting proposals and

raising objections during the general meeting by means of electronic communication.
- Shareholders have the opportunity to submit comments in text or video form in advance of the general meeting.
- The report of the management board or its main content has been made available to the shareholders six days before the general meeting.
- Shareholders are granted the right to information by means of electronic communication during the general meeting. However, the management board can decide that shareholders must send their questions up to three days before the general meeting; in this case, the company has to answer these questions up to one day before the general meeting at the latest. In the general meeting, shareholders may ask questions on new matters and follow up questions on the company's answers.

By this, and in relation to the shareholders' rights, the draft bill goes far beyond the draft of the Federal Ministry of Justice. There are, however, practical concerns that changes to the articles of association to ensure digital meetings will not reach the required 75% majority.

Technical feasibility

In order to avoid the virtual annual general meeting not being used due to concerns about its technical feasibility, the draft provides for a limitation of the right of challenge. A challenge due to technical malfunctions is to be largely limited to intent and gross negligence on the part of the company.

Criticism

The proposed regulation on the shareholders' right to ask questions is heavily criticised from a company's perspective. Currently, shareholders have to submit their questions in advance of the virtual general meeting. This allows for good preparation of the answers and leads to an equalisation of the virtual annual general meeting. According to the draft bill, the right to ask questions at the virtual general meeting shall be aligned with the right to ask questions at the physical general meeting. Some companies fear that excessive use of the right to ask questions on new matters and follow up questions on the company's answers during the virtual general meeting could lead to very long general meetings. In practice, it remains to be seen whether the criticism regarding the shareholders' right to ask questions is justified.

Digitalisation

Last year, the legislature passed law on the digitalisation of company law in execution of the EU-Company Law Package I (Gesetz zur Umsetzung der Digitalisierungsrichtlinie) (DiRUG). Most recently, the legislature made additions to the DiRUG exceeding the EU-Guidelines (Gesetz zur Ergänzung der Regelungen zur Umsetzung der Digitalisierungsrichtlinie) (DiREG). Both laws will come into force on 1 August 2022 with some additions of the DiREG delayed to 1 August 2023.

Online incorporation

While video communication has become indispensable, especially regarding corporate law advice, it is still not possible to form a limited liability company (GmbH) online. Such an incorporation requires a personal visit to the notary. With the DiRUG, the legislature has enabled notarisation by videoconference in the future. This means that from 1 August 2022 the incorporation of a GmbH can also be carried out from home by means of video communication. However, online incorporation will initially only be possible for GmbHs, but not for an AG or SE. Initially, online incorporation will only be possible by way of cash incorporation. However, starting 1 August 2023, share capital for the incorpora-

tion may be provided in kind, eg, as shares of an existing corporation.

Additional Online Proceedings

Under the DiREG, shareholder resolutions on amendments to the articles of association, in particular capital measures, will also be possible online, starting 1 August 2023. Further, starting 1 August 2022, all legal entities may register with the Commercial Registry in an online proceeding.

Women's Quota in Corporate Bodies

In last year's issue we discussed the planned changes due to the draft of the so-called Second Leadership Positions Act (FüPoG II) to increase the proportion of women in leadership positions and to close existing gaps. On 12 August 2021, the FüPoG II came into force.

At least one woman in the management board

Due to the FüPoG II, there must be at least one woman and at least one man on the management board of an AG and dualistic SE, as of 1 August 2022, provided that the management board consists of more than three members. In the case of the monistic SE, this applies accordingly to the managing directors. Existing mandates may be exercised until their scheduled end. This requirement applies solely to companies that are publicly listed and at the same time subject to parity codetermination. An appointment in violation of the minimum participation requirement is void (so-called *Leerer Stuhl* (*empty chair*)).

For publicly listed or codetermined companies, for medium-sized companies or family-run limited liability companies, there is a flexible quota, because they should have more flexibility regarding the organisation of their respective executive bodies. However, the FüPoG II tightens the disclosure and justification requirements in this respect.

The determination of a zero target for the management board, the two top management levels below the management board, and the supervisory board, remains lawful. However, the determination of a zero target must be explained. The decision of the management board or supervisory board must be explained in a clear and comprehensible manner. The statement of reasons should consider the exceptional nature of the zero target.

The Federal Ministry of Justice had examined the effects of the fixed quota on the economy. According to its survey, the creation of the FüPoG I and II has contributed significantly to increasing the number of women in management positions.

Stay-On-Board

So far, there was no legal basis for members of management bodies to take a temporary leave due to maternity time, parental time, caring for a family member or illness. Their only option was to resign from office in order to avoid liability risks. A right to reappointment did not exist. For these cases of temporary leave of absence due to special circumstances, the federal government created the Stay-On-Board regulation. The regulation applies to all public limited companies, European public limited companies and limited liability companies irrespective of stock exchange listing and codetermination.

For example, a member of the management board of an AG not only has the right to request the supervisory board to revoke his or her appointment if he or she is unable to fulfil his or her duties due to maternity leave, parental leave, the care of a family member or illness, but also to ask for a reappointment. In these cases, the supervisory board must assure the member of the management board of reappointment until a certain period of time. For the assurance of reappointment due to maternity leave, the pro-

tection periods of the Maternity Protection Act apply (in principle, six weeks before childbirth to eight weeks after childbirth). In cases of parental leave, care of family members or illness, the right to revocation of the appointment and assurance of reappointment remains only for a period of three months.

The supervisory board may only deny the request of a member of the management board to revoke his or her appointment due to parental leave, care of family members or illness if there is good cause. Good cause may exist if important decisions that could lead to damage to the company are imminent. However, in the context of maternity leave nothing can be held against the member's request to revoke her appointment.

MoPeG (Modernisation of Partnership Law)

In last year's issue we also reported on the so-called *Mauracher draft*, which provided for extensive changes in the law on partnerships. Based on this draft, the legislature passed the Act on the Modernisation of Partnership Law (MoPeG) at the end of July 2021. The MoPeG will come into force on 1 January 2024 and is the most significant reform of partnership law in decades.

New register for civil law partnerships

As already envisaged by the *Mauracher draft*, a new register for partnerships under civil law (GbR) acting externally will be created. The key points of the company, such as the registered office, representation and partners, will have to be registered in the same way as for a commercial partnership *(Kommanditgesellschaft* or KG). Registration is not mandatory. However, registration is necessary insofar as the GbR wants to acquire rights registered in public registers (eg, GmbH shares, real property or shares). Registration in the new register will also trigger the obligation for companies to report the beneficial owner to the transparency register.

Law on resolutions for partnerships

The creation of a new law on defects in resolutions is another key item of the MoPeG. Up to now, all resolutions breaching the requirements of the articles of association or applicable law have been null and void. In the absence of statutory time limits, such defects can be asserted for an unlimited period of time. The MoPeG eliminates this legal uncertainty by differentiating between voidability *(Anfechtbarkeit*) and nullity *(Nichtigkeit*) of resolutions. Nullity only results from significant breaches. Legal actions for voidance *(Anfechtungsklagen*) shall be possible within three months.

Change of the DCGK Due to ESG/CSR

The DCGK has most recently been changed. The amended DCGK came into force on 27 June 2022. The DCGK sets corporate governance rules as recommendations and suggestions for listed companies and is considered *soft law*. Companies shall however comply with the recommendations set in the DCGK, while deviations must be disclosed and explained in an obligatory declaration of compliance. Due to the growing importance of ecological and social sustainability as well as changes in the AktG as a result of the FISG (see last year's issue), the DCGK has been adapted. Listed companies will have to complay with these new requirements for the first time as of the next (annual) declaration of conformity.

According to the new DCGK, the internal control and risk management system shall be geared to sustainability-related concerns.

Further, the company strategy shall provide information on how the economic, ecological and social objectives are to be implemented in a balanced manner, while corporate planning shall include sustainability-related objectives in addition to financial objectives. The management board shall, among other things, systematically

identify and assess the risks and opportunities for the company associated with social and environmental factors, as well as the social and environmental impacts of the company's activities.

Also, the supervisory board shall monitor certain sustainability aspects, while its competence profile shall include expertise on sustainability issues of importance to the company. In addition, the professional qualifications of the members of the audit committee of the supervisory board shall be expanded to include knowledge and experience in sustainability reporting, and be provided in the corporate governance statement.

Corporate Sustainability Reporting Directive (CSRD)

In April 2021, the EU presented a proposal to update the Corporate Sustainability Reporting Directive (CSRD). The EU aims to become the first climate-neutral continent by 2050. For this purpose, the sustainability reporting of companies shall be adapted. The EU intended to finalise the CSRD by June 2022 and implement it into national law by the end of 2022. So far a provisional politcal agreement has been reached between the Council and the European Parliament. Affected companies will presumably have to take the new requirements into account for the business year 2023.

Scope

Currently, large listed companies have to issue a non-financial declaration addressing aspects related to environmental, labour and social issues, respect of human rights and the fight against corruption and bribery. The scope of the CSRD shall be considerably wider. In future, all companies listed on a regulated EU market will be affected, as well as non-capital-market-oriented companies that exceed two of the following three criteria: (i) EUR40 million annual turnover; (ii) EUR20 million balance sheet total; and (iii) an average of 250 employees. From 2026, capital market-oriented small and medium-sized companies will also be required to issue a sustainability report.

Sustainability reporting

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

Supply Chain Act

Implementing the UN Guiding Principles on Business and Human Rights, legislators passed the Supply Chain Act in June 2021. According to this law, companies must observe compliance with human rights as well as environmental standards throughout the global supply chain and remedy any breaches. The law will come into force on 1 January 2023 for companies with at least 3,000 employees, and on 1 January 2024 for companies with at least 1,000 employees.

Compliance with human rights and environmental standards

Companies must ensure compliance with human rights in their own business operations as well as vis-à-vis their direct suppliers. This obligation only applies to indirect suppliers if the company has substantiated knowledge of human rights violations. In order to comply, companies must:

- set up an appropriate risk management system;
- conduct a risk analysis for themselves and their suppliers;

- appoint an internal representative to monitor the risk management system;
- set up complaint possibilities regarding alleged human rights violations;
- carry out a risk analysis on an ad hoc basis, but at least once a year; and
- publish an annual report on compliance with their due diligence obligations under the Supply Chain Act.

Breaches

If breaches are identified, eg, in the case of child labour or forced labour, companies must take remedial action. This may also require termination of the business relationship with a particular supplier. The Federal Office of Economics and Export Control (BAFA) will monitor compliance with the obligations under the Supply Chain Act. Breaches will be punished by means of a fine. The fine can be up to EUR8 million or 2% of the annual turnover for companies with more than EUR400 million. Public authorities must take compliance with these obligations into account when awarding contracts.

Additional work and expenses for companies

As a result of these newly created obligations and the corresponding increase in responsibility, the Supply Chain Act will lead to additional work and expenses for companies. As a preventative measure, companies affected in the future should include appropriate clauses in the supply contracts with their suppliers regarding the obligation to respect human rights. In addition, companies should agree on certain codes of conduct with their suppliers.

Outlook

In practice, it remains to be seen whether the Supply Chain Act will actually have the desired effect in terms of improving human rights and environmental aspects along supply chains. In February 2022, the EU Commission presented a draft comparable to the Supply Chain Duty Act at the EU level with even stricter regulations than German law. The regulations under this draft shall apply to companies with more than 250 employees and a net turnover of more than EUR40 million. Therefore, a further expansion of the regulations concerning compliance with human rights and environmental due diligence obligations is to be expected in the future.

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