CHAPTER ONE
INTRODUCTION TO THE GERMAN AG

§ 1 General

The German stock corporation (*Aktiengesellschaft*/"AG") is a corporation that has a nominal share capital denominated in euros, which is divided into shares. As a corporation it may, in its own name, acquire property and other rights and conduct legal proceedings. The AG generally is subject to full liability for all actions taken by its corporate bodies and employees in the course of the exercise of their duties. The shareholders of an AG cannot be held personally liable for liabilities of the AG.

The AG has three corporate bodies: the shareholders' meeting (*Hauptversammlung*), the management board (*Vorstand*) and the supervisory board (*Aufsichtsrat*). The AG is subject to the most rigid legal regime of all German corporation types: the shareholders may deviate from or supplement the statutory requirements by way of different or additional provisions in the articles of association only in the cases expressly provided by law.[1] In particular, none of the statutory requirements designed to ensure creditor protection may be changed.

Historically, the AG was created in order to provide a vehicle for a joint business undertaking by a large group of investors. By contrast, the German limited liability company (*Gesellschaft mit beschränkter Haftung*/"GmbH") presents an option for a small number of persons intending to set up a business. Due to simplifications of the formation requirements, it is now, however, possible for a single individual to form an AG.

The European stock corporation (*Societas Europaea*/"SE") and the limited partnership represented by shares (*Kommanditgesellschaft auf Aktien*/"KGaA") are alternatives to the AG, which in many respects are subject to the same legal regime as the AG.

§ 2 Share capital

The AG must have a nominal share capital of at least EUR 50,000. The share capital may be subscribed by way of contribution in cash or in kind. If the AG's founders contribute cash, at least one-quarter of the nominal share capital must immediately be paid-in. Contributions in kind must be fully contributed. A special valuation report must generally be prepared by an accounting expert for non-cash contributions. Shareholders generally have no obligation to contribute additional capital or other funds to an AG if the AG needs additional capital during its term.

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1 Aktiengesetz [AktG] [Stock Corporation Act] 1965 § 23, ¶ 5 (F.R.G.).

The shares of an AG may be registered or bearer shares. In recent years, registered shares have become more popular even for listed AGs because they facilitate the identification of and the communication with shareholders.[2] Shares are generally represented by certificates, which, in the case of listed AGs are global certificates usually deposited with Clearstream Banking AG, the German central securities depositary.[3]

The Stock Corporation Act (*Aktiengesetz*/"Stock Corporation Act") provides for two basic types of shares: shares with voting rights, *i.e.*, common shares (*Stammaktien*), and shares without voting rights. Most AGs have issued only common shares. In Germany, the primary purpose of non-voting shares is to raise new capital while enabling the holders of the voting shares (or one or more such holders) to preserve their influence on the AG. Non-voting shares are only permissible under German law if their holders are given preferential dividend rights in order to compensate for the lack of voting rights.[4] By definition, non-voting shares of an AG are thus preferred shares (*Vorzugsaktien*). Shareholders owning preferred shares may vote at shareholders' meetings only if their rights are affected or the preferential dividend has not been paid in full for two consecutive fiscal years. Compared to Anglo-Saxon jurisdictions, the terms of both common and preferred shares of AGs are highly standardized. In particular, shares generally are not redeemable. AGs also rarely issue different classes of common or preferred shares, although from a legal perspective this would be possible.

§ 3 Shareholders' rights

The shareholders of an AG exercise their rights primarily in shareholders' meetings. Shareholders' meetings require physical attendance by a shareholder (or his proxy) in order to exercise voting rights, although the Stock Corporation Act was changed recently to allow AGs to provide for online participation in shareholders' meetings.

AGs must hold an ordinary general shareholders' meeting once a year, at which the shareholders vote on recurring agenda items, such as the appropriation of profits and the general discharge (*Entlastung*) of the acts of the management and supervisory board. Extraordinary items, such as capital and structural measures (*e.g.*, mergers, spin-offs or carve-outs) as well as fundamental changes, may also be resolved at the ordinary annual meeting or a separate extraordinary general shareholders' meeting. Due to the administrative effort and cost of preparing and holding shareholders' meetings, extraordinary general shareholders' meetings are only called if the interest of the corporation so requires (*e.g.*, the measures to be resolved cannot wait until the next ordinary meeting or the AG is in financial difficulties).

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2 The draft of the Act amending the Stock Corporation Act as of November 2010 contemplates that unlisted AGs must have registered shares. Existing bearer shares must be transformed into registered shares until December 31, 2014. The reason is that greater transparency is desired in the combat against money laundering and terror financing.

3 *Cf.* § 6 as to the term "listed AG".

4 The draft of the Act amending the Stock Corporation Act as of November 2010 contemplates that non-cumulative preferred shares are introduced, *i.e.*, preferred shares that do not bear the right that unpaid dividends are accumulated and must be paid at a later stage.

Generally, each voting share grants one vote. For AGs that are not listed, the articles of association may limit the voting rights of the common shareholders, providing that irrespective of the individual shareholders' number of shares, a single shareholder cannot control the AG (*Höchststimmrecht*).[5] Granting individual shareholders more votes than which correspond to their capital participation (*Mehrfachstimmrecht*) is not permitted regardless of whether the AG is listed or not.[6]

The powers of the shareholders' meeting are limited to those provided by law.[7] The shareholders' meeting cannot issue instructions to the supervisory board or the management board. Only in exceptional circumstances, it may adopt resolutions regarding management measures.

Apart from voting, the shareholders of an AG have a right to information.[8] Shareholders also may challenge unlawful resolutions adopted by the shareholders' meeting.[9] That right often gives rise to frivolous claims by minority shareholders and (potentially lengthy) lawsuits.

In certain cases, shareholders can be liable to an AG for exerting undue influence on the affairs of the AG.[10]

§ 4 Management board and supervisory board

The administration of an AG is assigned to two bodies, the management board and the supervisory board (so-called two-tier system).

The management board manages the AG and represents the AG *vis-à-vis* third parties. It has an obligation to serve the interests of the AG.[11] Members of the management board are appointed and removed from office by the supervisory board.[12] If a management board member violates his duties *vis-à-vis* the AG by failing to exercise the due care of a conscientious business manager, the member is liable to the AG for damages and may be dismissed.

The principal role of the supervisory board is to supervise the management board. The supervisory board may also provide advice to the management board. It may not, however, issue instructions to the management board. By contrast, it is permissible (and general practice) to subject certain actions of the management board, such as major investments or financings, to the prior consent of the supervisory board.[13]

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5 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 134, ¶ 1, sentence 2 (F.R.G.).
6 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 12, ¶ 2 (F.R.G.).
7 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 119 (F.R.G.).
8 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 131 (F.R.G.).
9 Aktiengesetz [AktG] [Stock Corporation Act] 1965, §§ 241 *et seq.* (F.R.G.).
10 Aktiengesetz [AktG] [Stock Corporation Act] 1965, §§ 117, 302, 311, 317 (F.R.G.).
11 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 93 (F.R.G.).
12 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 93, ¶ 2 (F.R.G.).
13 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 111, ¶ 4 (F.R.G.).

The members of the supervisory board are elected by the shareholders' meeting.[14] If the number of employees of an AG exceeds certain thresholds, the supervisory board is also comprised of employee representatives in addition to shareholder representatives (co-determination). Depending on the size and structure of the AG, the employees select a maximum of half of the supervisory board's seats (co-determination on a parity basis). In a supervisory board co-determined on a parity basis, the chairman, who as a result of the statutory election process generally is a shareholder representative, has a casting vote.

§ 5 Capital increase

German law provides for various forms of capital increases of an AG: ordinary capital increase against contribution in cash or kind, issuance of new shares out of authorized capital, issuance of new shares out of conditional capital and capital increase out of company funds. Conditional capital may be used only for the specific purposes provided by law. In an ordinary capital increase or an increase out of authorized capital, the existing shareholders are generally entitled to acquire the newly issued shares (subscription rights). The subscription rights can only be excluded in limited circumstances. There is a large body of case law by the German courts dealing with the requirements for excluding subscription rights in different circumstances.

In practice, the management board is frequently authorized by the ordinary shareholders' meeting to increase the capital within a period of up to five years at one or more points in time chosen by the management board (*genehmigtes Kapital*/"authorized capital"). This flexible form of raising new capital enables the management board to procure new equity at times, when market conditions are favorable or the AG requires additional capital (*e.g.*, for an acquisition). The issuance of new shares by an AG (whether by the use of authorized capital or on another legal basis) is a complex process, generally requiring action by the supervisory board in addition to the management board, as well as registration in the commercial register.

§ 6 Listed and privately-held AGs

AGs may apply for admission of their shares for trading on a stock exchange. The principal stock exchange in Germany is the Frankfurt Stock Exchange. The Frankfurt Stock Exchange has different markets for the admission and trading of shares and other securities: Large AGs (including all companies included in the DAX, the MDAX and the SDAX) are listed on the regulated market in the so-called Prime Standard. Smaller AGs can opt for the General Standard of the regulated market. The main difference between the two standards is the scope of ongoing listing obligations. In particular, only AGs listed in the Prime Standard must publish quarterly reports and issue corporate information in the English language (in addition to the German language). Issuers whose shares or other securities are admitted to and traded on a regulated market of a German securities exchange are subject to a variety of statutory obligations, in connection with the initial listing or the issuance of additional shares as well as on an ongoing basis, to ensure the adequate information of the capital market (in addition to obligations imposed by the exchange).[15] By contrast, issuers whose shares and other securities

14 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 101, ¶ 3, § 133 (F.R.G.).
15 *Cf.* §§ 117 *et seq.*

(if any) are only listed and traded in the unofficial market (called regulated unofficial market by the Frankfurt Stock Exchange), are primarily subject to capital market-related disclosure obligations imposed by the exchange. AGs that have shares listed and traded on the regulated market of a German stock exchange or a stock exchange of another member country of the European Economic Area are hereinafter referred to as "listed AGs" (*börsennotierte AGs*). As a legal matter, some of the statutory provisions applicable to listed AGs also apply to AGs whose shares are only listed on a stock exchange in a third country (*e.g.*, the New York Stock Exchange) and not listed on an European Economic Area stock exchange. Given the very small number of such AGs, the provisions that also apply to non-European Economic Area listed AGs are not specifically identified.

There are also AGs in Germany that are privately-held, but have issued bonds or other securities that are listed and traded on a regulated market (*e.g.*, privately-held banks in the form of an AG that issue bonds for funding purposes). Such AGs are subject to some of the statutory requirements that apply to listed AGs, such as the ad-hoc disclosure obligations of the Securities Trading Act (*Wertpapierhandelsgesetz*/"Securities Trading Act") and the requirement of the Commercial Code to prepare consolidated financial statements based upon international accounting standards.[16]

16 *Cf.* §§ 117 *et seq.*

CHAPTER TWO
MANAGEMENT BOARD OF THE GERMAN AG

§ 7 The management board of the AG

An AG has a tripartite corporate structure: the shareholders' meeting (*Hauptversammlung*) is responsible for the most fundamental decisions regarding the AG such as amendments to its articles of association (*Satzung*), changes to the corporate structure and the decision regarding the appropriation of the annual profits, the supervisory board (*Aufsichtsrat*) is in charge of control and oversight, and the management board (*Vorstand*) determines the corporate strategy and manages the AG on a day-to-day basis.

The Stock Corporation Act vests each of these corporate bodies with rights and obligations *vis-à-vis* the other two bodies to ensure that all corporate bodies are able to perform their tasks. For example, the shareholders' meeting has the power, based upon the articles of association, to limit the management board's authority to act by requiring the consent of the supervisory board for certain actions. The supervisory board, among other things, has the right to require the management board to supply information necessary to perform its control-related duties.

I. Composition of the management board

§ 8 Number of members of the management board

The management board may consist of one or more natural persons.[17] An AG's articles of association must provide for the number of members on its management board, or the rules for determining such number. It is possible to specify a minimum or maximum number of board members, thus giving the supervisory board the power to determine such number within the given range. The management board of an AG with a share capital of over EUR 3 million must consist of at least two members, unless the articles of association provide that it consists of only one. The management board also must have at least two members if an AG is subject to employee co-determination on a parity basis and thus is required to appoint a labor director.[18] AGs that are banks, financial services firms or insurance companies must have at least two members of the management board pursuant to applicable regulatory requirements (irrespective of their co-determination status).

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17 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 76, ¶ 2 (F.R.G.).

18 The role of the labor director is discussed further in § 11.

§ 9 Chairman of the management board

If the management board consists of more than one member, the supervisory board may appoint a chairman of the management board (*Vorstandsvorsitzender*).[19] Only the supervisory board as a whole may make such appointment. This authority cannot be delegated to a committee of the supervisory board. The supervisory board may also appoint a deputy chairman of the management board.

The Stock Corporation Act does not provide much guidance with respect to the chairman's legal status, function or authority. In practice, an AG's articles of association and/or the rules of procedure of the management board (*Geschäftsordnung*) govern the chairman's position. The tasks assigned to the chairman usually include representing the AG in public, coordinating the management board's work with the supervisory board and exercising certain formal functions within the management board, such as chairing board meetings.

The chairman may not issue instructions to other management board members. He may be given the right to cast the tie-breaking vote with respect to resolutions passed by a majority of the management board provided that the management board consists of more than two members. It is uncertain whether the chairman may be given the right to veto majority resolutions passed by the management board. A temporary veto right postponing the agenda item in question to the next management board meeting should be permissible, at least in an AG that is not co-detemined on a parity basis and thus has no labor director.[20] However, even in a co-detemined AG the chairman may call for a repeat vote on one and the same subject within a short time frame.

§ 10 Spokesman of the management board

If the supervisory board does not appoint a chairman of the management board, either the supervisory board or the management board itself may appoint a spokesman (*Vorstandssprecher*) of the management board. The spokeman's legal status is not expressly dealt with in the Stock Corporation Act. His duties and powers should be set forth in the rules of procedure of the management board. The Corporate Governance Code (which applies to AGs that have their shares listed on a regulated market) recommends that listed AGs appoint a spokesman or a chairman of the management board.[21]

§ 11 Labor director

The German Co-Determination Act (*Gesetz über die Mitbestimmung der Arbeitnehmer*/"Co-Determination Act") requires AGs that are subject to co-determination on a parity basis (more than 2000 employees of the AG or the corporate group of the AG) to appoint a board member responsible for personnel matters, the so-called labor director (*Arbeitsdirektor*).[22] The labor director plays a key role in all personnel matters and social responsibility issues.

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19 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 84 (F.R.G.).
20 *Cf.* § 69.
21 *Cf.* § 6 as to the term "listed AGs".
22 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 76, ¶ 2 and § 84, ¶ 4 (F.R.G.).

The labor director has the same rights as the other members of the management board and is appointed and dismissed in the same way as other members, *e.g.*, by the supervisory board.[23] Neither the AG's workforce nor the employee representatives on the supervisory board or trade unions have any special rights with regard to the labor director's appointment, such as rights to propose or veto the appointment (or dismissal). An exception to this rule applies to AGs that operate in the coal and steel industry (and thus are subject to a special co-determination regime, the Coal and Steel Co-Determination Act), whose labor director may not be appointed contrary to a majority vote by the employee representatives on the supervisory board.

§ 12 Deputy management board members

The supervisory board may also appoint deputy management board members.[24] The term "deputy management board member" is, however, misleading. Under the Stock Corporation Act, deputy board members have all the rights and duties of ordinary board members and are "genuine" members of the management board. Deputy members do not act as *Prokuristen*[25] or holders of a commercial power of attorney (*Handlungsbevollmächtigter*), or assume the responsibilities of absent or indisposed ordinary board members. The designation "deputy" merely indicates an internal hierarchy within the management board based upon the internal rules of procedure of the management board, which usually restrict the authority of deputy management board members to manage the AG's affairs.

Some companies use the title "divisional board member" (*Bereichsvorstandsmitglied*). In many cases, such divisional board members are not members of the management board, but senior executives with regional or divisional responsibility below the level of the management board.

II. Appointment to the management board

§ 13 Distinction between appointment and service agreement

Management board members generally have two legal relationships with the AG:[26] the appointment (*Bestellung*) to the management board as an act of corporate law and the service agreement (*Anstellungsvertrag*) creating the contractual relationship between the AG and the board member.[27] The appointment makes a person a member of the management board, creates the rights and duties under corporate law, and grants legal authority to a management board member to represent the AG *vis-à-vis* third parties. The service agreement sets out the terms of the contractual relationship between the management board member and the AG, including the rights to compensation and benefits.

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23 The appointment procedures are set forth in more detail in §§ 22 *et seq.*, the dismissal is discussed in §§ 30 *et seq.*

24 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 94 (F.R.G.).

25 An authorized signatory with a general commercial power of attorney defined by law.

26 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 84 (F.R.G.).

27 The service agreement is discussed in more detail in §§ 36 *et seq.*, *cf.* Form of Service Agreement for management board members of the AG attached in Chapter Seven: Annex I.A.

Although the appointment to the management board and the execution of the service agreement often coincide, these two legal relationships differ in terms of the requirements to make them effective, and their commencement and duration. An effective board appointment can be made without a service agreement. Conversely, terminating the service agreement does not necessarily terminate the appointment as a member of the board (and *vice versa*). However, it is standard practice to draft the service agreement in order to achieve a correlation between the appointment and the service agreement, *e.g.*, by specifying that dismissal from the management board automatically terminates the service agreement.

A. Prerequisites for becoming a board member

§ 14 Natural person with full legal capacity

The supervisory board generally has broad discretion in its choice of persons to serve on the management board. Such persons must be natural persons, whose legal capacity is unrestricted.[28] Specific requirements apply to AGs that engage in regulated activities such as banking.[29]

§ 15 No convictions

Anyone convicted of a certain type of insolvency offense is barred from serving on the management board of an AG for five years after the conviction becomes legally binding.[30] In addition, a candidate for the management board may not be subject to a court or other governmental order prohibiting the conduct of a business similar to the activities of the AG. If such conviction or prohibition takes effect while a management board member is in office, the appointment becomes ineffective, and the management board member is barred from reappointment for five years.

§ 16 Nationality, residence and work permits

Candidates of all nationalities may become members of the management board of an AG. However, the candidate must be able to fulfill the legal duties of a management board member, at least to a material extent, within Germany. Therefore it is generally advisable to appoint only persons who may freely reside and work in Germany.

§ 17 Additional qualifications for banks and insurance companies

Management board members at banks, financial services firms and insurance companies must meet certain additional qualifications. Whenever the supervisory board has the intention of making an appointment to the management board of such banks, financial services firms and insurance companies, the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, "BaFin") must be notified, together with the submission of the candidate's *curriculum vitae* and other supporting documentation. The BaFin may veto the appointment if the candidate lacks sufficient qualifications or personal reliability. In practice,

28 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 76, ¶ 3 (F.R.G.).
29 *Cf.* § 17.
30 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 76, ¶ 3 (F.R.G.).

it is common to discuss a proposed appointment formally with the BaFin prior to submitting a formal notice in order to exclude the risk of a negative decision.

§ 18 Additional qualifications specified in the articles of association

Although less common in practice, the articles of association of an AG may specify additional personal qualifications. Such requirements may, however, not impose undue restrictions on the supervisory board's discretion.

§ 19 Memberships on multiple management boards

German law does not prohibit persons from serving on the management boards of two or more AGs at the same time.[31] However, the supervisory boards of both (or all) AGs must agree to the multiple appointments. This rule also applies to multiple intra-group appointments or to appointments to the management boards (or equivalent bodies) of other German or foreign companies. In certain circumstances, a member of the management board who is also appointed to another management board (or an equivalent body) of another company may be barred from voting in management board meetings of one or both companies in order to avoid conflicts of interest.

§ 20 Simultaneous and successive membership on management and supervisory board

The supervisory board's task is to control and advise the management board.[32] It cannot do so effectively if management board members are simultaneously also members of the supervisory board of the same AG. Such simultaneous appointments are thus prohibited as they conflict with the two-tier structure of the AG.[33]

The supervisory board may, in exceptional circumstances, however, appoint one of its members to substitute for an indisposed management board member to fill a vacancy on the management board for a fixed period of time. The appointment may be renewed or extended provided that the aggregate term does not exceed one year. Supervisory board members delegated to serve on the management board are barred from actively serving on the supervisory board while being members of the management board. During their term on the management board, their powers are the same as those of the management board members for whom they act as a substitute.

Within a group of AGs, a member of the management board of the controlled AG may not serve on the supervisory board of the controlling AG. By contrast, it is permissible, and indeed common, for management board members of a parent AG to be appointed as members of the supervisory board (or equivalent bodies) of group companies.[34]

Overlapping board memberships are also impermissible outside the context of intra-group relationships: a person may not be a member of the management board of AG "A" if he is a member of the supervisory board of AG "B" and at the same time a management board member

31 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 88 (F.R.G.).
32 Aktiengesetz [AktG] [Stock Corporation Act] 1965, § 111, ¶ 1 (F.R.G.).
33 Aktiengesetz [AktG] [Stock Corporation Act] 1965, §§ 100, 105 (F.R.G.).
34 *Cf.* § 205.