

## Boardroom

# 404

*News for supervisory board members*

### **Issue 1, 2018**

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# Zero targets, but not everywhere

## Proportion of women rises

### German government's first report on the proportion of women and men at board level

*The proportion of women at management level and board level in the private and public sectors has risen slightly since the Law on the Equal Participation of Women and Men in Leadership Positions came into force. There are already significantly more women on supervisory boards. At other levels, there is still a considerable way to go.*

The Law on the Equal Participation of Women and Men in Leadership Positions in the Private Sector and the Public Sector was passed in May 2015. It requires companies to issue comprehensive annual reports. The Federal Government has now analysed these reports. Their report draws on statistics provided by 1,747 public listed companies. The government is hoping that its publication will encourage companies to set even more ambitious targets for the next reporting period, up to the end of June 2022.

The report singles out for praise supervisory boards of public listed companies subject to the principle of parity of co-determination, which have had fixed 30% quotas imposed on them since January 2016. However there is a considerable way to go on management boards.

Overall performance figures were as follows: The proportion of women on supervisory boards with fixed quotas rose from 25.0% to 27.3% in 2015. In public listed companies without fixed quotas the proportion was up from 19.5% to 21.2%. The average proportion of women on supervisory boards at all the companies analysed here was 18.6%. However just 59.7% of all companies exempt from the fixed quota have set targets for the supervisory boards.

In many of these cases this target was still 0%. But those companies who did set a target above 0% have been ambitious: In just under 28% of cases the target is above 30%, whilst a third of the companies set it between 15 and 30%.

Women continue to be seriously underrepresented in the management boards of the companies studied, at a proportion of 6.1%. This was unsurprising since just 62% of all the companies analysed set any targets at all for this level, and 70% of these companies set the target at zero. Only a few companies had appointing a woman to the management board as a target at all.

There are major differences between companies that have to fulfil the legal quota for the supervisory board and those that do not. While just under 38% of the companies subject to the quota issued a target above 0% for the management board, the figure is just under eight percentage points lower in the other companies: the Federal Government thus thinks the quota is working.

It also sees this in the other management levels: 92.6% of companies with a fixed quota for the supervisory board still set targets for the management level below those for board level. So far just 57.8% of the other companies have complied with this obligation. As far as the first management level is concerned, 91% of companies with a fixed quota set a target above 0%, 97% aimed for an increase at the second management level too. 80.3% of companies without fixed quotas set themselves a positive target for the first management level and 91% for the second management level. However it is impossible to assess the actual increase since the companies have not published any details of current figures.

In the Federal Government's view there are still too few companies setting targets overall. For a mid to long-term cultural transformation, it says, looking at management levels below board level is essential. In order to increase the proportion of women at board level a significant increase in the proportion of women at these springboard levels is required. A new monitoring report is scheduled for 2018.

# Adding specialist knowledge

## Court-appointed employees' representatives

### Legislators intended to include external trade union representatives

*Court-appointed trade union representatives: Where two trade unions submit a motion of nomination for a post on a supervisory board subject to the principle of co-determination, the court must take them both into account. However, the court has discretion over which motion to uphold. This was confirmed by Stuttgart Higher Regional Court (Oberlandesgericht, or OLG) in a ruling in February 2017.*

In the underlying case the court related to a joint-stock company which was subject to the German Co-determination Act (Mitbestimmungsgesetz). The 20-post supervisory board was consequently divided into ten shareholder representatives and ten employees' representatives. Seven of the employees' representatives must be employees at the company and three must be representatives of trade unions.

Following the departure of one of the trade union representatives, the court was required to fill the vacancy upon motion. An external lawyer who is a member on other supervisory boards as well as a company employee of long standing and whose last post was head of department, stood for election. The court appointed the lawyer, who was nominated by the management board and the larger of the unions represented in the company, as the new supervisory board member. The smaller union had nominated the other candidate and submitted an appeal.

In the court's view, both candidates nominated were suitable to assume the post on the supervisory board in the company. However, the court felt that the balance of the argument was in favour of the lawyer since she would add the required specialist legal knowledge to the supervisory board. Up to that point there had only been one lawyer on the supervisory board. The court also noted that the lawyer has experience of a range of different supervisory board posts.

One of her posts includes that of supervisory board member at a rival company. However the court stated that this did not stand in the way of the appointment. It would be a different matter if the competition situation was permanent and related to all of the company's activities and core business. The court stated that this was not the case here.

The court did not consider it to be a conflict of interest that as a member of the rival company's supervisory board the lawyer would be supervising a member of that company's management board who also sits on the supervisory board of the company to which she was now to be appointed. In the judges' view there is no concrete evidence to show that this arrangement would create a situation of dependency between the supervisory board colleague and the new employees' representative.

The fact that the other candidate is an employee at the company concerned is no bar to her appointment. After all, the trade union representatives on the supervisory board may be employees at the company. Nor was there any legal basis for prioritising an external employees' representative. However, the court held that the German legislators had certainly intended to have external representatives on the employees' side on the supervisory board.

Nor is there any requirement in principle for all of the trade unions represented in a company to have their own representative on the supervisory board. The court therefore exercised its discretionary judgment: The arguments were balanced in favour of appointing the lawyer in this case.

# Who is auditing?

## *EU Commission publishes report on audit reform*

### Focus on activities of audit committees

*The extensive new rules on audit committees of Public Interest Entities (PIEs) in the EU have applied since mid-2016. Last autumn the EU Commission issued its first report on the market situation in light of the new rules. This emphasised the importance of the audit committees of audited companies.*

The EU audit regulation consists of a regulation and a directive. These are designed to improve the quality of audits and increase competition on the audit market. The goal is to increase confidence in the integrity of statutory audits.

A major component of the regulation is the central role of the audit committee in selecting the auditors and monitoring their independence. Article 27 states that the national regulatory bodies shall also supervise the performance of audit committees.

The Commission report looks in more detail at whether and how they do this. It was compiled on the basis of reports from the national authorities responsible for audit oversight, although the Commission identified a number of problems associated with this. These problems were associated with the deadline for the first reports by the individual national authorities, the lack of experience of these authorities and the change in the legal framework. The Commission was therefore unable to assess on the basis of these reports whether and how the authorities collaborate with the audit committees or monitor their activities.

A survey of the competent authorities showed that they actually only monitor audit committees in 15 EU member states, in the Commission's special definition of the term "monitoring". This states that the authorities are permitted to obtain information on whether the audit committees fulfil their obligations under the EU regulation and directive. If they do not, sanctions may be imposed. The Commission did not specify how the monitoring should be performed.

However there are a number of different authorities deemed competent across the member states. In Germany there are three: the Audit Oversight Body (Abschlussprüferaufsichtsstelle, or APAS), the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, or BaFin) and the Federal Office of Justice.

Despite these outstanding issues the report does demonstrate the importance to the Commission of the audit committees' work in relation to statutory audits. The committees are crucially important, it states, in ensuring that the new guidelines on the rotation and independence of auditors of Public Interest Entities are effective. The competent authorities should therefore have appropriate tools to assess the audit committees' performance.

At this stage, engaging in a dialogue with the audit committees is vital. Many national authorities are already doing so by sharing best practice, staging conferences and seminars or holding meetings and discussions. The Commission itself is also considering engaging with the audit committees directly in future.

The Commission is unwilling to set guidelines on how national authorities should fulfil their monitoring obligations. It therefore remains to be seen what steps APAS will take in Germany. Their report, which has been incorporated into the Commission paper, is not publicly available.

As well as including audit committees, the Commission report apparently looks in detail at the market for auditing in the EU and the results of national quality assurance audits. Almost all of the data incorporated in the first complete report were collected before the new guidelines were applied. It therefore only provides a baseline for future analyses by the Commission.

# Time limits, not disenfranchisement

## Court-appointed members of the supervisory board

### Time limit extended to next election

*Where the court appoints a new member of the supervisory board, the view of the Frankfurt am Main Higher Regional Court (Oberlandesgericht, or OLG) is that this should be subject to a time limit. Otherwise the body actually responsible for the elections to the supervisory board would be permanently disenfranchised. The OLG also commented on the calculation of the maximum term of office of supervisory board members.*

Subsequent to the ruling of May 2017 (20 W 147/17), the court appointed a employees' representative to the supervisory board of a joint-stock company subject to co-determination under the German One-Third Employee Participation Act. Following the premature departure of the member's predecessor, the management board of the AG submitted a motion to the court nominating a new member (Section 104(2) AktG). The motion was approved subject to a time limit of six months.

A supervisory board member lodged an appeal, which the OLG allowed. However the time limit was not entirely revoked. The judges instead found that the time limit was necessary but should be extended.

The German Stock Corporation Act (Aktengesetz, or AktG) does not explicitly impose any time limit on court appointments. The German Corporate Governance Code (Deutscher Corporate Governance Kodex, or DCGK) does, however, include a recommendation that public listed companies set a time limit for the court appointment of a supervisory board member, namely by the next Annual General Meeting (No. 5.4.3 DCGK). In the case before the court the management board of the AG – which is presumed not to be public listed – submitted its motion without imposing any time limit.

The judges presiding at the OLG however consider a time limit to be necessary as a general principle. Otherwise, not only the predecessor's remaining term, but the maximum legally permissible term of office would apply to the court-appointed member. This would permanently disenfranchise the body actually responsible for the elections to the supervisory board. That body should in fact be able to hold its own elections at the next opportunity.

With respect to shareholder representatives, it was the OLG's view that a court appointment should therefore be subject to a time limit coinciding with the next Annual General Meeting. The court considered what time limit would apply in the case before it. Since a separate by-election may be held for employees' representatives at any time, the Local Court had considered six months to be sufficient.

However the OLG did not see any legal grounds for this haste in the case law or the literature. In fact, a by-election would tie up considerable resources which were not available at that point, particularly at the works council. The judges therefore considered that timing it to coincide with the next scheduled election would be appropriate and advisable.

Since the approximate time, but not the precise date, was set for this election, the judges decided to impose an absolute time limit for the end of the court appointment. Their judgement took into consideration the case law of the Federal Court of Justice. This court had issued its interpretation of the period a supervisory board member may remain in office without being reappointed.

Section 102(1) of the AktG states that members of the supervisory board may only be appointed for a period up to the adjournment of the Annual General Meeting resolving ratification of their appointment for the fourth fiscal year following the commencement of their respective term of office; the fiscal year in which such term of office commences shall not be taken into account. At that time the Federal Court of Justice had resolved that a term of office as supervisory board member expired automatically if this ratification was not made within the time limit for convening the Annual General Meeting, ie, during the first eight months of the new fiscal year (Section 120(1) AktG).

It also stated that this upper limit on the term applied to the predecessor of the supervisory board member appointed by the court. The OLG therefore imposed the same time limit on the court appointment, which in this case was two years. The judges noted that the term of office of the member of the supervisory board appointed by the court would expire if the workers' representatives were elected as intended before the time limit expired (Section 104(6) AktG).

## About us

Our clients face diverse challenges, strive to put new ideas into practice and seek expert advice every day. They turn to us for comprehensive support and practical solutions that deliver maximum value. Whether for a global player, a family business or a public institution, we leverage all of our assets: Experience, industry knowledge, expertise, high standards of quality, commitment to innovation and the resources of our expert network in 158 countries. Building a trusting and cooperative relationship with our clients is particularly important to us – the better we know and understand our clients' needs, the more effectively we can support them.

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The responsibility and the significance of regulatory bodies have increased significantly in recent years. This development has been accompanied by numerous regulatory changes and a sharp rise in the expectations of the general public. We have introduced PwC Boardroom to keep you up to date on current issues and offer you an exclusive platform for networking and exchanging ideas and perspectives. The programme is aimed at members of supervisory boards, boards of directors and advisory boards with a monitoring function.

## Publications

- *Der Aufsichtsratsvorsitz – Leitfaden für eine wertsteigernde Führung des Gremiums presents the central value drivers of the work of the supervisory board from the chair's perspective (available in German).*
- *Die Unternehmensüberwachung – Überblick und Praxistipps gives you a concise look at the work to be carried out by the supervisory board (available in German).*
- *Der Prüfungsausschuss – Best Practices einer effizienten Überwachung is our standard reference on how to create an audit committee and ensure it functions correctly and efficiently (available in German).*
- *404 – Latest news for supervisory boards is published regularly and keeps you abreast of the latest developments in corporate governance, accounting standards and capital market regulation – short, concise and relevant.*

## Events

- Regular meetings for supervisory board members:  
Exclusive events give you the opportunity to learn about the latest developments and to network with other supervisory board members from companies like yours. At the same time you can also expand your supervisory board network.
- Workshops and seminars:  
Whether you are interested in training on the fundamentals, updates on accounting standards, or seminars on new regulations concerning the supervisory board's work, we can provide the ideal customised solution, from exclusive one-to-one conversations to events for the entire board.

## Imprint

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