CORPORATE GOVERNANCE WITH FOCUS ON THE POSITION OF THE BOARDS IN PUBLIC STOCK COMPANY IN GERMANY AND SLOVAKIA

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Abstract

This paper intends to give an overview of the position of both Management and Supervisory Boards from the point of view of Corporate Governance. It cover the jurisdictions of Germany and Slovakia. The reader can go throu the raw definitions of the Corporate Governance in general, historical and institutional backround behind German and Slovak Corporate Governance Codes. It shows the Boards position from their formation through the decisionmaking process to their revocation. The postion of Management and Supervisory Boards in their interaction and in connection with shareholders was emphasised, in order to cover the most of the aspects of Boards existence.

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Introduction

Today, the world of business is in under constant pressure both from outside statutory and market regulations and from inside through the nervous atmosphere that spreads between the shareholders. What one should really think about is not only where and how to invest, but also to know what is going on in the company you considered trustworthy enough invest into. Now more than ever words like transparency, fairness and disclosure play a vital role in comparing the business. Because what one day may appear like a gold mine can become a worthless mud hole, just like cases of Enron and others keep on reminding us. And this heavily depends on the bodies of each and every company. Most importantly on The Boards, both management and supervisory.

The existence of quality corporate governance codes is no longer seen as „popular“ or „in“, it has become a „must“. Their growing importance, and complexity were one of the reasons for me to write this paper, dealing with the field of corporate governance. There are not many countries where Corporate Governance would have such a long and successful tradition as in Germany. The corporate governance debate started intensively already in the 1990s. German company law was used as a pattern for development of Slovakian commercial code and strongly inspired the whole commercial and business environment. Which appears to be the second reason for writing on this topic. Slovakia has an export-oriented economy, with the major business partner being Germany. And most of the “big players” in the export/import industry disclose their compliance with either German Corporate governance Code or the Corporate Governance Code for Slovakia, depending on their country of origin. In this thesis I would like to give an overview of the position of Management Board and Supervisory Board

of a public stock company as it is described in the Corporate Governance Codes of Germany and Slovakia. When the rules or recommendations of the codes are not very different in their impact (which is most of the time), I decided to blend formulations from both jurisdiction into each Section, with remarks on the origin of each of them.

In the first chapter my aim is to show and explain what exactly the words "corporate governance" mean, where they come from, and how some of the professionals in the field define their substance. After becoming familiar with terminology I intend to give an overview on corporate governance development and history in both jurisdictions. This may seem redundant but I decided to do so after finding out that there is no published book, explaining, summarizing and analyzing the Corporate Governance topics in Slovakia. This is really a shame after having our Corporate Governance Code for almost 7 years.

The second chapter is focused on substance of the topic which is the position of The Boards within a public stock company. I will first introduce the two basic board systems which are one-tier and two-tier systems. The one-tier model fuses the management and supervisory bodies into one Administrative Board. The latter one is used in both jurisdictions with slight differences and modifications. I will not try to give judgments on which one of these systems is better or worse, I will rather explain the separation of management and supervisory powers as prescribed by the statutes and corporate governance codes of both countries.

Next, I will move on to examine in more detail the position of the Management Board, starting with it's composition from the view of the norms from both jurisdictions and, moving on, to the tasks and responsibilities. The main issues discussed here will be the question of independent management, company's strategy planning and risk management. Overlooking

the management is the Supervisory Board. I will focus on describing it's composition, board members requirements with election process. Talking about the composition of the Supervisory Board, one should not the forget the co-determination, which has, especially in Germany a long and complex tradition. That is why a separate section is devoted to this issue of labor representatives in supervisory body of the company. I also decided to add a short historical overview on the German co-determination to better show the situation which exists now. To have the separation of management and supervisory powers is one thing but without their close communication and cooperation, a good outcome would be hard to achieve. And that is where the inter-board cooperation comes into place. I will take a closer look on the issues of voting and proper communication. Duties must be fulfilled. This is emphasized even more when we talk about the duty of care and duty of loyalty for the boards members and the business judgment rule. I will elaborate on the basic understanding of these concepts enriched by a case study note to bring a more complex points to the theoretical back round. It seems now that the era of extremely high salaries for executives is looking for a place in the history, but for how long? Now that is the question of the future. One of the last sections is focused on the questions of remuneration of board members, voting principles for the reward and compensation schemes and others.

The last section in the second Chapter of my paper is aimed on the Boards-Shareholders relationship, summing up both active and passive rights of the company shareholders from the view of Corporate Governance codes of both Germany and Slovakia.

Chapter 1

What is Corporate Governance?

Etymological roots

The etymology of the words *corporate governance* is derived from ancient Greek and Latin (though there are similar words in most languages).[1] The word *corporate* is derived from the Latin *"corpus"* meaning body, and comes from the Latin word *corporare* to form into one body, hence a corporation represents a body of people, which is a group of individuals who are authorized to act as one. The word *governance* is from latinised Greek *gubernatio* meaning management or government, and this comes from the ancient greek kybernao to steer, to drive, to guide, to act as a pilot. This etymological concept of the concept of corporate governance captures a creative meaning of collective endeavor that defies the contemporary inclination to place a passive and a regulatory emphasis on the phrase.[2]

Defining Corporate Governance

Corporate governance , stands as a term that barely existed before 1990s. Now it is coming up wherever business or financial questions are discussed.[3] It includes a general framework of governance rules and regulations which are to be specified on different levels of

[1] What is Corporate Governance /John L. Colley,JR., Jaacqueline L. Doyle, George w. Logan, Wallace Stettinius McGraw-Hill, New York, 2005

[2] *International Corporate Governance : a comparative approach / Thomas Clarke*, Routlage, New York, 2007, p 1-2

[3] Corporate governance: Accountability, Enterprise and International Comparisons. Edited by K. KeaseyS. Thompson and M. Wright, 2005 John Wiley & Sons, Ltd. ISBN 0-470-87030-3

regulation.[4] Sir Adrian Cadbury explained in a 1992 Report on Financial Aspects of Corporate Governance:

> *„Corporate governance is the system by which companies are directed and controlled.…Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting.*"[5]

With the revised principles published in 2004 the OECD develops the definition to include the relationships, context and benefits of good governance:

> *"Corporate governance involves a set of relationships between company's management, its board , its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interest of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system within an individual company and across an economy as a whole , helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result the cost of capital is lower and firms are encouraged to use resources more efficiently , thereby underpinning growth*."[6]

However corporate governance covers evan wider scale. It is critical to social and economic well being , by providing the important set of rules and advices vital for a successful business.[7] What it also brings is higher level of accountability and transparency in wealth distribution. Cadbury also offeres a definition which incorporates the broader social significance of the corporate governance:

> *"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The governance framework*

[4] Handbook on international corporate governance : country analyses / edited by Christine A. Mallin, Northampton, Mass. : Edward Elgar Publishing, 2006

[5] The financial aspects of corporate governance, The 1992 Committee on financial aspects of the corporate governance. Gee (a division of Professional Publishing Ltd) ISBN 0 85258 913 1

[6] *International Corporate Governance : a comparative approach / Thomas Clarke,* Routlage, New York, 2007, p 1-2

[7] Brian Cole ,Corporate Governance Essentials, ICSA PUBLISHING, 2008, p. 25

is there to encourage the efficient use of resources and equally to require the accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society".[8]

Berlin Initiative Code preamble gives German view on the very core of the corporate governance stating that : "*Corporate governance describes the legal and factual regulatory framework for managing and supervising a company."*

History and developement of CG in Germany

In the past German Two-tier system was facing much of critique. Issues like difficulties in setting boundaries and defining the relationship between the supervisory and management board and the labour represantation. At first the discussion over Corporate Governance issues took place on academical ground. Bad situation in which many large german companies were in during the 90´s was very easy to blame on remissness of management and supervisory boards of that time. Uniform federal company law, partialed regulation of securities and several stock exchanges with their own regulation were reality in Germany in early 90s of the last century. Both accounting and disclosure norms provided insufficient regulation. [9]

It was the large banks which monitored the management boards. Germany had a system known for its bank-centered orientation, high concentration of ownership and extensive cross-shareholding networks.[10]

[8] *International Corporate Governance : a comparative approach / Thomas Clarke,* Routlage, New York, 2007, p 2

[9] *7 German Law Journal No. 6* (1 June 2006) - Corporate Governance Reform, Regulatory Politics, and the Foundations of Finance Capitalism in the United States and Germany

[10] Id.

In 1996, as a reaction to the situation in the field and growing debates was a „Ministrial Draft Bill“ which covered issues of transparency and powers of control within public corporations. The Draft Bill became Law two years and many ammendments later.[11] At this time people started to realise that ever-changing the statutes is not as flexible as voluntary or „self-imposed“ good corporate governance practices.[12]

Government being aware of the situation appointed a corporate governance commission lead by Prof. Theodor Baums. Accompanied by experts among main interest groups, he was in charge of the project which outcome was to be a code of best practices in German Corporate Governance.[13] Succesor of his work was Dr. Gerhard Cromme whose „permanent commission on Corporate Governance adopted a „Code of Best Practices“. Its main achievement among over 150 recommendations, including strict separation of boards or improvements on transparency and disclosure, was the „Comply or Explain“ rule. After being enacted by Parliament the firms had to either comply with the Code or publicly disclose an explanation for not doing so. Questions of codetermination were taken away from commision´s agenda due to political reasons.

For quite a while many people thought that its not really necessary to have a Corporate Governance code . The reason for this was that important governance issues that are usually addressed by these codes, are already implemented into german law. Nevertheless, some private initiatives lead to composition of voluntary-based corporate governance – a Code of

[11] Jean Jacques du Plessis , James McConvill, Mirko Bagaric, Principles of contemporary corporate governance Cambridge [England] ; New York : Cambridge University Press, 2005, p. 308
[12] Jean Jacques du Plessis , James McConvill, Mirko Bagaric, Principles of contemporary corporate governance Cambridge [England] ; New York : Cambridge University Press, 2005, p. 309
[13] Dr. Gerhard cromme – 6th German CG code conference, http://www.corporate-governance-code.de/eng/download/Rede_Cromme_en_6.pdf

Best Practice for Germany.[14] Meanwhile in 2001 the federal ministry of justice appointed a government-based commission under the chairmanship or Gerhard Cromme to draft a uniform code for German listed companies

At the time of the 1. Corporate Ggovernance conference which took place in Berlin in 2002, lack of management transparency , its complicated interaction with unqualified supervisory boards and low account of shareholder interest, were up for a lot of criticism.[15]

The OECD Principles of Corporate Governance were revised in 2004 to respond to corporate governance developments including corporate scandals that further focused the minds of governments on improving corporate governance practices. Since they were first issued in 1999, the OECD Principles of Corporate Governance have gained worldwide recognition as an international benchmark for sound corporate governance.[16] They are actively used by governments, regulators, investors, corporations and stakeholders in both OECD and non-OECD countries and have been adopted by the Financial Stability Forum as one of the Twelve Key Standards for Sound Financial Systems. The 2004 revision of the OECD Principles reflects not only the experience of OECD countries but also that of emerging and developing economies.[17]

History of Corporate Governance in Slovakia

[14]Jean Jacques du Plessis , James McConvill, Mirko Bagaric, Principles of contemporary corporate governance Cambridge [England] ; New York : Cambridge University Press, 2005, p 310
[15] Dr. Gerhard cromme – 7th German CG code conference, http://www.corporate-governance-code.de/eng/download/Rede_Cromme_en_6.pdf
[16] International Corporate Governance : a comparative approach / Thomas Clarke, Routlage, New York, 2007, p 75
[17] Kirkpatrick, Grant,The Revised OECD Principles of Corporate Governance and their Relevance to Non-OECD Countries. Corporate Governance: An International Review, Vol. 13, No. 2, pp. 127-136, March 2005

The last almost twenty years were years of many important changes for Slovakia. The separation from former Czechoslovakia brought independence on one hand but also problems with the transformation from planned to market economy. The success of the privatization is also questionable as most of the then privately held companies main aim was creation of profit without long term sustainability. Luckily this has changed on the way. Learning from success of foreign economies with developed Corporate Governance rules, combined with higher level of competition lead to progressive changes in legislation.

Slovakia was not the only state where Stock Exchange took the initiative to draft a national code of corporate governance

In the year 2001, the Bratislava Stock Exchange together with FIRST Initiative Management Unit, London, Financial Market Authority, INEKO economic institute, representatives of professional associations and listed companies started hosting communication meetings. Two drafts of the code were discussed – one drafted by INEKO and second by the Bratislava Stoc Exchange. The outcome of fruitfull sessions, and broad consensus of participants, was the first"Unified Code of Corporate Governance", which draft of was released in September 2002. Seven months later, "The Unified Code of Corporate Governance was incorporated into the Stock Exchange Rules for Shares Admission to the Listed Market."[18]

The reccomendations of the code had to be brought to life, so the Bratislava Stock Exchange established association which main aim was to observe the changes in development of Corporate governance and to create a professional environment for discussion and education

[18] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

of board members. In October 2004 the movement led to a foundation of the Central European Corporate Governance Association.

In 2004, after the release of new OECD principles in connection with the European Commission recommendations for corporate governance, followed by some legislation changes the Unified Code of Corporate governance needed to be updated. CECGA called for professionals from Ministry of Justice, Ministry of Finance, National Bank and Slovak Banking association to work together on the revision of the code. They created an executive committee. Five members from CECGA formed a working group which drafted the the new code following the international patterns in development of corporate governance. The new draft was posted online opened for public and professional discussion. The outcome of collaboration between the Executive Committee, the Workgroup and the Professional public was the new Corporate Governance Code for Slovakia introduced in January 2008.

The group which worked on drafting the code, has based its efforts mostly on the 2004 OECD Principles,the European Commission Recommendation No 2004/913/EC fostering an appropriate regime for the remuneration of directors of listed companies and on Recommendation No 2005/162/EC on the role of non-executive or supervisory directors and on the committees of these boards. The Slovakian regulations in force were also considered, as well as European Commission initiatives supporting the "Action Plan - Modernization of Corporate Law and Enhancement of Corporate Governance in the European Union" released in 2003.[19]

[19] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

The German corporate governance code

At the time of the 1. Corporate Ggovernance conference which took place in Berlin in 2002, lack of management transparency, its complicated interaction with unqualified supervisory boards and low account of shareholder interest, were up for a lot of criticism.[20]

The main reason was to further improve the governance quality and german corporate governance rules transparency with the future beneficiers being both the national and international investors. This German Corporate Governance Code was adopted on 26th February 2002.

In Germany the obligation to „comply-or-explain rule" was introduced through a statutory provision. Section 161 of the Stock Corporation Act requires The Boards of all listed companies to publicly comply with the Code's recommendations once a year through the so-called comply-or-explain rule. Soon after brought into practice, the Code has brought some huge changes of businesses behavior.[21]

Since the codes introduction in 2002, the 2008 German Corporate Governance Code represents the 7th ammendment of the original code. It gives statutory regulations for both the management boards and supervisory boards of listed companies in Germany and incorporates internationally respected measures for fair and transparent governance. The Code´s main goals are transparency and understandability of the German Corporate Governance system. „Its purpose is to promote the trust of international and national investors, customers, employees and the general public in the management and supervision of listed German stock corporations."[22] Not only that it clarifies the shareholders rights, but also sets the accounting

[20] Dr. Gerhard cromme – 7th German CG code conference

[21] Status and Development of Corporate Governance in Germany by Dr. Gerhard Cromme , availible at *www.**corporate-governance**-code.de/eng/download/CGC_Conference_Berlin_2004_**Dr_Cromme**.**pdf***

[22] Status and Development of Corporate Governance in Germany by Dr. Gerhard Cromme /pdf/, availible at *www.**corporate-governance**-code.de/eng/download/CGC_Conference_Berlin_2004_**Dr_Cromme**.**pdf***

standards on the „true and fair view“ principle which represents much realistic view on the condition of an enterprise.

For the recommendations the Code uses the word "shall". Companies can divart from them, but with an obligation to disclose it every year. „This enables companies to reflect sector and enterprise-specific requirements.“[23] Suggestions for enterprises which can be diverted from with no need for disclosure are acompanied by the term “should” or “can”. The rest of the Code that does not contain the above mention terms, is confirming requirements under existing Law concerning public corporations.[24]

Primar targets of the Code are listed corporations. It is considered a good practice also for the non-listed companies to respect the Code. „As a rule the Code will be reviewed annually against the background of national and international developments and be adjusted, if necessary.“[25]

Chapter 2.

Board structure - 1 tier vs. 2 tier system - internal Corporate Governance

The very center of internal corporate governance is the board. We recognise two different board systems. These are the one-tier and the two-tier board. Many articles are trying to persuade the reader about the advantage of one system compared to the other. In many cases

[23] German Corporate Governance Code 2008, foreword,
[24] For Code stipulations relating to not only the listed company itself but also its group companies, the term “enterprise” is used instead of "company". GCGC 2008
[25] as amended on June 6, 2008 (convenience translation) German Corporate Governance Code

each evaluators´s home state system is often found to be the one better, more rational and best to be followed.[26]

The one-tier system may bring a closer relation and advanced exchange of informations between the supervisory and managerial members. On the other hand, the two-tier system´s contributions are formal and clear separation between the supervision and management[27]
In the public debate the differences between these two systems are often neglected. Corporate government principles with its legal backround mean, that the one-tier system can hardly be implemented into German practice without a certain amount of reflection.[28] This will be discussed in more detail in parts dealing with the independence of supervisory board members.[29]

Under German company law, public corporation (Aktiengesselschaft) has a dual board structure in which the supervisory board is fully separate from the management board, with no dual membership. The supervisory board (Aufsichtsrat) appoints, supervises, monitors and replaces the managing board (Vorstand) and approves some of the major corporate policies, decisions and strategies. The shareholders meeting (Annual General Meeting) disposes the right to receive proper information concerning the life of the company and vote on a wide circle of issues, like mergers, capital increases, and major changes in business strategiesof the company.[30]

[26] ***Joseph A. McCahery , Corporate governance regimes : convergence and diversity,*** Oxford : Oxford University Press, 2002
[27] Comparative Study Of Corporate Governance Codes Relevant to the European Union And Its Member States availible at http://ec.europa.eu/internal_market/company/docs/corpgov/corp-gov-codes-rpt-part1_en.pdf
[28] Alternatively the European Company (SE) gives enterprises in Germany the possibility of opting for the internationally widespread system of governance by a single body (board of directors) – German Corporate Governance Code
[29] Status and Development of Corporate Governance in Germany by Dr. Gerhard Cromme availible at *www.**corporate-governance**-code.de/eng/download/CGC_Conference_Berlin_2004_**Dr_Cromme**.**pdf***
[30] Id.

The dual management system dominates also in the Slovakia. It divides the management and supervisory functions into two independent boards. The executive board[31] holds dominant responsibility for planning business strategy and ensuring adequate return of Shareholder´s investments. The supervisory board, on the other hand is responsible for monitoring and supervising of the executive board and other managers, who are not members of the executive board. The supervisory board members cannot (just like in Germany) hold a dual board membership. The supervisory board consists only of non-management members. The executive board, consists only of management members.

One-tier system is in Slovakia allowed only for European forms of commercial partnerships, it is important to mention, that it combines the functions of both supervisory and executive board into one administrative board. Due to high concentration of powers within one board, it is important that those who perform supervisory duties don´t participate in company´s daily management. Looking at this pattern we can see that their capacity is very similar to the capacity of the two-tier system´s supervisory board. *„At the same time, the capacity of the administrative board chairman should belong to a member who is not involved in management of the company, and under no circumstances should this capacity be linked with the capacity of the company's Chief Executive Officer .“*[32] Labour representation is not unknown in the one-tier system, but as members of an Administrative Board, they shall only be given supervisory functions.

„The company bodies are not only accountable to the company and its shareholders, but also must act to their best interest. The company bodies are also expected to apply due care towards and to treat fairly other stakeholders, including employees, creditors, customers, suppliers and local communities“[33]

[31] Corporate Governance Code for Slovakia which was introduced in January 2008 uses the word „executive“ rather than „management“. The latter is used in both the German Stock Corporation act and the German Corporate Governance Code

[32] Corporate Governance code for Slovakia, section V, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

[33] Id.

In this context, it is also very important to focus on the social backround and it´s standards. 34

Composition of Management Board

Management Board holds the responsibility for managing the company throughout its whole existence. For this reason its composition plays a very important role in how successful will the company and the shareholders be.

The German Stock Corporation Act allows only natural persons /with full legal capacity/ to be a member of the management board.[35] It also sets on several limitations on prospective member´s criminal history, which involves bankruptcy crimes and court prohibitions.
According to the German Corporate Governance code the board shall consist of several persons and have a Chairman or Spokesman.[36] It is also understandable that the same person cannot be a member of both boards (Supervisory and Management) of the same company. Management board member cannot instruct other board members. This includes the Chairman, who is nominated by supervisory board or by management board itself. His position can be described as „*primus inter pares*", which means that he can only coordinate but not give instructions to the rest of the board.[37]

„Traditionally, in large German firms, managers (and especially the Vorstandssprecher and Vorstandsvorsitzender, who correspond broadly with Chief Executive Officers, CEOs) have been controlled mainly through the voice-based participation of other stakeholders in decisions: banks and employees impose their influence through the upper-tier board (Aufsichtsrat) and shareholders are usually tied to the firm in the long term. This all suits the German national culture of moderately high levels of uncertainty avoidance and collectivism."[38]

[34] Id.
[35] §76(3) No. 1 AktionGesetz.
[36] 4.2.1 German Corporate Governance Code 2008
[37] Christine A. Malin, Handbook on International Corporate Governance : Country analyses, Edward Elgar , p 31
[38] CORPORATE GOVERNANCE, PATH DEPENDENCE AND NEO-INSTITUTIONALISM:

In § 194 the Commercial Code of Slovakia gives the power to appoint the members of the Management Board primarily to the General meeting. Nevertheless it is considered best practice if this power is delegated to the supervisory board by the articles of association. The main reason for this is higher level of flexibility concerning the possible errors of executive board members. This of course cannot affect the general meeting from active participation, as the Shareholders must always have the last word.[39] The term for which a member of the management board serves the company shall not exceed 5 years.

Tasks and Responsibilities of the Management Board

The German Corporate Governance code enumerates the Tasks and Responsibilities of the management board quite shortly but that more clearly compared to the Corporate Governance code for Slovakia. The German code recognises four basic duties of the management board. First the board's responsibility for independent management of the enterprise. While doing this, it must to always act in the best interest of the enterprise.

Second, the Board is responsible for development and maintenance of the enterprise's strategy. This should be done in close coordination with the Supervisory Board. The chosen strategy should be then properly implemented.[40]

Third, the Management Board makes sure that all legal provisions are followed and that enterprise work to achieve not only its own goals but also the goals of the whole group. The state legislature is not the only system which gives boundaries to the company´s Boards

[39] Corporate Governance code for Slovakia, V.D 3- notes, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

[40] ***Thomas W. Joo , Corporate governance : law, theory, and policy,*** Durham, N.C. : Carolina Academic Press, 2004, p. 64

activity. It´s alo the company's internal legislation[41] drawn down in articles, internal statutes ethics codes and others. They set up rules for decision making processes, individual duties and responsibilities of board members, and coordination of the company´s board meetings.[42]
Fourth and the last duty of The Management Board in this section of German Corporate Governance code is to ensure appropriate risk management and risk controlling in the enterprise. [43]

Corporate Governance code for Slovakia does not have a separate section devoted only to the Management Board. Instead, the authors created one combined section name „Responsibilities of the Board" where they blended recommendations for both Boards.
In its text "boards" refers to the executive board and supervisory board or the administrative board (in the one-tier system).[44] Another obvious difference is the use of the word „executive" compared to German „Management", for naming the same corporate body.

Corporate Governance code for Slovakia describes the executive board as a body that has the main responsibility for defining the business strategy and adequate return of Shareholder´s invested capital. It is composed, exclusively of management members.[45]
Members of both Boards are expected to apply due care and fair treatment other stakeholders. "*This includes employees, creditors, customers, suppliers and local communities*."[46]

Acording to the code The Board should maintain functions, which includes guidance of corporate strategy, major actionplans, risk policy, annual budgets, setting performance

[41] §191 and following, Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation
[42] [42] Corporate Governance code for Slovakia, notes, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249
[43] germCGC08
[44] [44] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249
[45] Id
[46] Id 34

standards, controlling the company´s performance and effectiveness of governance practices within the company.[47]

A solid move forward in the text of the Corporate Governance code for Slovakia is the direct incorporation of high ethical standards which both boards should apply. "*High ethical standards are in the long-term interest of the company, as they are important for increasing the company's trustworthiness not only for ordinary operations, but primarily for long-term liabilities."*[48]

Composition Of The Supervisory Board

The supervisory board shall, at all times, consist of members with relevant experience, skills and knowledge to be able to fulfill all their duties. By selecting the prospective members the Shareholders (after an announcement of proposed candidates) should take into consideration not only the personal and mental attributes but also their age and possible conflicts of interest.[49] At least some of the Supervisory Board's members should be independent. By stating that the board member is independent one means that he is in no relationship (private or business-like) with the company or its Management Board. The opposite would lead to above mentioned conflict of interest.

The Corporate Governance Code for Slovakia in its Notes enumerates quite extensively what should be fulfilled for one to become independent. It also requires regular publishment of

[47] Id 34
[48] Id 35
[49] 5.4.1 German Corporate Governance Code 2008 - http://www.ecgi.org/codes/documents/cg_code_germany_june2008_en.pdf

reasons for which the supervisory board members (or members of it´s committees) are deemed independent. This evaluation is done by the Supervisory Board. The rules regarding the issue of independence also consider the past of the candidate stating that : „Not more than two former German Corporate Governance Code members of the Management Board shall be members of the Supervisory Board and Supervisory Board members shall not exercise directorships or similar positions or advisory tasks for important competitors of the enterprise.„[50] It is not advisable for the former Supervisory board chairman to become the Management board chairman. If it anyway comes into consideration it shall be disclosed at the annual general meeting.[51]

One of the German Corporate governance rules limits the number of Supervisory board mandates for one person, outside the listed company (in a non-group listed) to five. Taking into account the time one has to devote to take care of a single position the 5 mandates seem still a high number to me. The corporate governance code for Slovakia does not mention this rule.

Tasks and Authorities of the Chairman of the Supervisory Board

As far as the Slovak corporate governance code is concerned, the position of the Chairman of the Supervisory board is mentioned only once in connection with expected independence.[52] German Corporate Governance code is much richer in describing the position and duties, especially towards Management Board. This position involves coordination of the supervisory board's work and preparation of meetings. The Chairmanship shall also be combined with

[50] Id. 5.4.2
[51] Id. 5.4.4
[52] [52] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

leading the committees which handle the agenda of Management board members contracts, with whom he should maintain regular contact, in particular with the chairman or Spokesman of the Management Board. When mentioning the committees The Chairman of the supervisory board should not lead the audit committee. The information channel between the Boards shall be maintained through the Chairmen.[53]

Tasks and Responsibilities of German Supervisory Board

The duties of the supervisory board are strictly separate from those of the management board and the general shareholder's meeting or , if employees´ representatives are on the supervisory board, from those of the employees.[54]

The main task of the Supervisory Board is to advise on a regular bases and supervise the Management Board in managing the enterprise.[55] Management functions may not be delegated to the supervisory board.[56]

Although the day-to-day decisions about the running of an enterprise are the privilege of the management board, the supervisory board must have the say in all fundamental decisions of the enterprise.

The Supervisory Board appoints, dismisses and remunerates the members of the Management Board.[57] This must be done in as formal and transparent way as possible. Existence of a long-term succession planning shall be ensured by both Boards. Appointment of new members of the Management Board, can be delegated by the Supervisory Board to an appointment

[53] German Corporate Governance Code 2008
[54] Ruster, Bernard (Ed.), „Business Transactions in Germany", Looseleaf, Mathew Bender, New York, First published 1983, The stock corporation (updated 01/2004), 24-85
[55] German Corporate Governance Code 2008
[56] Ruster, Bernard (Ed.), „Business Transactions in Germany", Looseleaf, Mathew Bender, New York, First published 1983, The stock corporation (updated 01/2004), 24-85
[57] The Handbook on international corporate Governance – a definitive guide, London ; Sterling, VA : IOD : Kogan Page, 2004, c2005

committee. The committee is than competent to set up the remuneration and employment conditions. The Rules of Procedure shall also be issued by the Supervisory Board.[58]

Tasks and Responsibilities of Slovak Supervisory Board

Maybe the most important duties of the Supervisory board in Slovakia, just like in Germany is to select, compensate, monitor and, when necessary, replace key executives and oversee succession planning.[59] The question for Corporate Governance code is how it should be done to achieve the best results. First of all, a formal and transparent board nomination and election process must be ensured.

By the law, the election and replacement of the board members is primarily in the competence of the general meeting. It is viewed a good practice if the Supervisory Board is, by articles, entrusted with this power. The reason for doing so is more effective monitoring and higher level of flexibility in reactions on errors of the executive board members.[60] This delegation cannot affect the general meeting's possible choice to actively participate in this process.[61]

"The supervisory board should reflect potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions."[62]

[58] German Corporate Governance Code 2008
[59] [59] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249
[60] §187 Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation
[61] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249
[62] Id.

A significant duty of the company boards, especially of the supervisory board, is to monitor financial reporting and corporate assets usage. The main reason to do so is the prevention from inappropriate transactions with related parties.[63] In order to efficiently supervise the management, the supervisory board should be composed of independent members. The best practice would be if the whole supervisory board was independent.[64] The one who should always be independent is the supervisory board chairman. The decision about who should be deemed independent is completely in hands of the Supervisory Board.[65]

Co-determination

One of the significant patterns of the German corporate governance is the position, which it reserves for the labour representatives, through the co-determination system.

This is also one of the issues which often comes up in the European Union context with reference to the German corporations law and the corporate governance model.[66]

Work representatives are part of the supervisory board, together with shareholder representatives who are elected during the general meeting. This principle of co-determination has three scenarios: in the iron, steel and mining industries, the co-determination law of 1951 provides for equilibrium between the representatives of shareholders and employees. The board member in charge of labor-related questions is named by the employee representatives alone. The co-determination law of 1976 sets sub-parity for firms with more than 2000 employees. In this case the president of the upervisory Board is elected by Shareholders. In

[63] Id.
[64] *Mark J. Roe ,Corporate governance : political and legal perspectives,* **Northampton, Mass. : Edward Elgar Publishing, 2005**
[65] Id
[66] J.J. du Plessis, James McConvill, Mirko Bagaric, Principles of contemporary Corporate Governance, Cambridge university press, 2005

case of a deadlock during the Board´s voting procedure, his vote counts as two. The constitutional law of 1952 extended the co-determination principle to all companies with a workforce of 500-2000 employees. In this case only 1/3 of Supervisory Board seats belong to the workers representatives. The law of 1976 is the most important of the three, as it affects 4:5 million workers compared with 1.5 million for the law of 1951, and 1 million for the law of 1952. [67]

The Work representatives are also obliged to act in the enterprises best interest as are the representatives of shareholders.

Slovakian legislators, thanks German company law influence, incorporated the co-determination rules into the Slovak commercial code. § 200 which contains information about the members of the supervisory board, states in particular that 2/3 of the board members are representatives of shareholders, elected by the general meeting and 1/3 are the workers representatives. This rule only applies when the company has more 50 full-time employees at the time of elections. This rule can be modified by the Articles of association in the way that, the number of the workers representatives will be higher than 1/3 of all board members, but at the same time it cannot be higher than the number of the shareholder's representatives.[68]

Slovakian commercial code does not make differences between industries, as far as the number of workforce representatives on the supervisory board is concerned. Presence of employee's representatives is not without a danger, as they may be more open to corruption. One of the leading German cases in this field is the 2005 Volkswagen bribery scandal. The

[67] Michael Aglieta, Antoine Rebérioux, Corporate Governance Adrift : A critique of shareholder value, Edward Elgar publishing, p 57, 2005

[68] §200 Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation (authors translation)

investigation showed that the Volkswagen managers spent over 2.9 million on Klaus Volkert, who was a supervisory board member and labor boss. Volkert than used the Money to organize expensive parties and exotic trips for him and other labor representatives on the board. Volkert was charged with 48 counts of incitement to breach of trust. Later on he wrote a letter authorizing payments to him, signed by Piëch, who was the chief executive and by Peter Hartz a former personnel chief. Hartz took full responsibility on authorizing 2.9 million in illegal payments to win labor support for management plans. Hartz ended dup being suspended - two-year sentence in January and fined $855,000 for his part in the scandal. At the end, Volkert was sentenced to 2 years and 9 months in jail.

Cooperation between Management Board and Supervisory Board

To have higly qualified and skilled people in positions on Boards is one thing. But without a proper cooperation, u will not be able to get the best of them. The German Corporate Governance Code devotes one whole section to this vital issue. The approach of the the makers of the Slovakian Corporate Governance Code was a bit different. The is not an exlusive part of the code dealing with the issue of Boards cooperation. The advises are rather spread across the notes which accompany the principles, which makes it rather hard for the reader to follow. The agenda on which both the Management Board and The supervisory Board should cooperate is marked in the text using the word „Boards“. I tis a common sense that the Boards should cooperate in most of their agenda, but in my opinion the German Corporate Governance Code gives better set, easier to follow instructions. Thats why in this section I decided to follow It´s structure while giving the overview over the Boards main cooperation processes.

The answer to the question why this cooperation is so important is quite easy to answer : because more cooperation brings more quality choices which means more profit for the enterprise. In doing so each, certain strategy must be chosen, implementation of which must be discussed with the Supervisory Board on regular basis.[69]

The decisions of crucial importance which has direct fundamental impact on the finances of corporation require the consent of Supervisory Board. Provided that both Boards have sufficient information they are jointly responsible for their actions („violating the due care and diligence of a prudent and conscientious Managing Director or Supervisory Board member" [70])

The management Board provides The Supervisory Board with information on a regular basis in ways which shall be specified by the latter. [71]

In communication between the Boards and their members, confidentiality plays an important role. This obligation transfers to the staff employed by the Boards members.

Codetermination effected Supervisory Boards should make shure that their meetings are prepared separately by the shareholders and labour representatives.[72]

Takeover offer may be huge turnover for every enterprise. If this situation occurs the Shareholders must be adequately informed so the German corporate Governance code prescribes the Boards to submit their „statement of reasoned position"[73]. After the takeover is being offered The management Board is prohibited to do anything which could possibly prevent the future succes of the offer, unless this action would be authorised by general

[69] 3.2 German Corporate Governance Code 2008
[70] Id. 3.8
[71] Id. 3.4
[72] Id. 3.6
[73] German Corporate Governance Code 2008

meeting or approoved by the supervisory board. A takeover offer is one of the reasons when management board should convene an extraordinary General meeting. Enterprises compliance or explanations shall be reported in the Annual report by the Boards

Duty of Care

Under the Slovak Commercial code , members of the board of directors are obliged to act with „due care", which incorporates duty to perform with „professional care", and in compliance with the interests of company and all its shareholders.[74]

The commercial code shows two other duties which are close to the duty to act with a Professional care. One of them is to make informed decisions.[75] This means to do research and gather all retrievable information. But to what extent? The codes reamin silent on this. The second is not to disclose any information which could harm the interests of the company or its shareholders.

One of the principles of the Corporate Governance Code for Slovakia states that „ Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders."[76] This rule incorporates both the duty of care and the duty of loyalty. The same goes for German corporate Governance Code, which adds that if they dont do so, they are liable to the company for damages.[77]

[74] §194 (5) Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation
[75] Id.
[76] Corporate Governance code for Slovakia, V. A, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249
[77] 3.8 German corporate Governance Code 2008

The duty of care primarily incorporates the obligation to act in good faith and with due professional care towards the company, and the obligation to obtain and take into account all available information related to the object of business.

„According to good practice, it means that the board members should be convinced that the company's key information and control systems are in principle trustworthy."[78]

Duty of Loyalty

Duty of loyalty involves pretty much the duties and obligations in both German and Slovak Coorporate Governance Codes.

The duty of loyalty under Slovak commercial code requires directors to subordinate their personal interest to those of the corporation and all its shareholders[79] The directors are of course under obligation not to compete with the company.[80] This cannot be loosend and circumvent by agreements or articles of association.[81] They shall not act as directors or members of any corporate organ of other company which is engaged in a similar business. This rule does not include the situation if these companies are part of the same group.[82]

They also shall not be general partners in any other company regardless their field of activity. The reason is very simple – unlimited personal liability of the general partner towards the company.

Last but not least, directors are not allowed neither on their behalf nor on behalf of others , engage in any trade that is in line with the company´s business.[83] Also transactions within the enterprise with

[78] Corporate Governance code for Slovakia, V. A –notes, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

[79] §194 (5) Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation

[80] Id. §196

[81] Corporate governance and directors' liabilities : legal, economic, and sociological analyses on corporate social responsibility / edited by Klaus J. Hopt, Gunther Teubner
Berlin : W. de Gruyter, 1985, c1984

[82] §196 Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation

[83] Id. §196

members of mamnagement board being one of the sides must fall within standard customs in the field. Those of particular importance shall be approved by the Supervisory Board.[84]

Corporate Governance Code for Slovakia states *„Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation".*[85] Members of the executive/supervisory boards are obligated to inform the boards of which they are members about their business, family or other relations outside the company, which (relations) could affect their decisions concerning a concrete transaction. If an executive/supervisory board member informs of his/her potential involvement in a transaction, best practice is for that person not to participate in the decision-making process related to that particular transaction.[86] *„ Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.*"[87]

The duty of loyalty does not allow the board members to follow own, third parties or certain shareholders interests, instead of interests of the company.[88] They also must remain silent on confidential information which-if disclosed to 3rd parties-could possibly cause harm to the company or endanger the interests of the shareholders.

„The obligation of loyalty supports effective implementation of other principles related, for example, to fair treatment of shareholders or monitoring of transactions with related parties or remuneration of board members and key managers of the company."[89]

[84] 4.3 German Corporate Governance Code 2008
[85] Corporate Governance code for Slovakia, C, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249
[86] Id.
[87] Id.
[88] ***Corporate governance and economic performance / edited by Klaus Gugler*** Oxford : Oxford University Press, 2001, p 112
[89] Id.

Under certain conditions, the violation of the duty of loyalty can become a crime. [90] The Mannesmann case shows exactly this situation.

The German Federal Supreme Court held that directors of the German company, Mannesmann AG, did breach their duty towards the company when awarded a bonus of $17 million to the outgoing CEO - whose actions played an important role in creating a gain of over $50 billion for the Mannesmann shareholders. The Düsseldorf criminal trial court had previously stated that the directors who were members of „Präsidium“ - responsible for compensation - had breached their duty in awarding the bonus, they were not criminally liable. The trial court found their breach of duty was not an "aggravated" one, because of high profits of the company. Also the future profitability was not at risk. The decision by which the compensation was given was made diligently, transparently and the Supervisory Board members didn´t have and unlawful purpose. After an appeal, The Federal Supreme Court reversed the acquittal. The court´s opinion was that there was a breach of duty, because of no contractual obligation to award the bonus. The Supreme court did not agreed with the trial courts observation that only „aggravated“ breach of duty violates the Penal Code. The case was returned for a retrial on a „ignorance of the law“ defense which exists under the German Penal Code. The way for the defendants to escape conviction was to prove that, it was because of an unavoidable error, that they didn´t know they were breaching their duty. The case never reached this point because of the settlement, by which defendant agreed to pay 5.8 mil. €.

[90] Lectures held by Dr. Cecilia Carrara on German Company Law Academic Year 2008-2009 http://docenti.luiss.it/company-and-business-law/files/2008/11/lectures-held-by-dr-cecilia-carrara-on-german-company-law-academic-year-2008-2009.doc.

Business Judgment Rule

Management is there to make decisions.[91] Sometimes the issues to be decided are of a long-term character. This kind of decision-making involves in it a certain amount of risk and sometimes a risk can mean loss. What we can be sure about is, that the shareholders will not like it and at least some might think about compensation.

It is a common sense that, where there is a risk of possible loss there is always a chance of gain as well. So for example new product development or to expansion to foreign countries might turn out to be great or disastrous – you never know in advance. The problem is that if the management has to make decisions under the stress of a possible claim for compensation, their decisions will tend to be more conservative. An old saying states that the one who goes slowly makes it further sounds nice but this kind of thinking brings the risk that chances are not taken. A solution of this problem is offered by the so-called Business Judgment rule. [92]
In the German Stock Corporation Act there exists until now a somewhat stricter rule, saying that "*the management board shall employ the care of a diligent and conscientious manager in managing the business of the stock corporation.*" [93]

However, the Federal Supreme Court (Bundesgerichtshof) has ruled that a management decision shall not be deemed to be a violation of these duties if the management board member reasonably believes that he - or she - acted for the good of the company and if the decision was based on appropriate information. [94] This Business Judgment rule was part of the

[91] ***Joseph A. McCahery, Corporate governance regimes : convergence and diversity,*** Oxford : Oxford University Press, 2002, p. 123

[92] Christian Armbrüster Recent Developments in German Corporate Law, *www.luiss.it/siti/media/1/20060308-Developments-German-Corporate-Law.pdf*

[93] § 93 I 1 Aktiengesetz, Authors translation

[94] BGHZ 135, 244, 253 = ZIP 1997, 883, 885. - Federal Supreme Court´s decision

Corporate Law Reform project in 2005.4 It set a new standard for the liability of the management board members towards the Company. [95]

There is no violation of duties when the management board member reasonably believes that he acted for the good of the company – does this mean the same as a behavior that is not negligent? This question is up to the Courts to decide. [96] Speaking about liability of the Company's management, there is another aspect that should be mentioned, and that is insurance, or more precisely the D&O (Directors and Officers) Insurance. 97 Recently its quite usual that the management's contracts already include the company's obligation to cover the D&O insurance. So in the end, it will cost the shareholders anyway.

In Slovakia, director's decisions can be challenged at the court, with director-as a defendant being the one who has a burden of proof.[98] Director's liability for the damage the company suffered by the violation of their duties is a strict liability, in the sense that director is responsible regardless his culpability.[99]

There are two ways how to exclude director's liability. Firstly, director will not be liable for his actions, proving that he acted with professional care and in good faith that his action is in

[95] Corporate governance : accountability, enterprise and international comparisons / edited by Kevin Keasey, Steve Thompson, and Mike Wright
Chichester, West Sussex, England ; Hoboken, NJ : John Wiley, c2005
[96] Christian Armbrüster Recent Developments in German Corporate Law, *www.luiss.it/siti/media/1/20060308-Developments-German-Corporate-Law.pdf*
[97] Id.
[98] § 194 (7) Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation
[99] Peter Čavojský, Poznámky k uplatneniu zodpovednosti za škodu v kapitálových spoločnostiach, 2/2004 , Obchodné právo 16 (2004)

the best interest of the company.[100] It's important to understand that the good faith is a psychological category which needs to be proven by objective criteria.[101]

Secondly, director's liability is exclude in case of decisions by which he implements the shareholder's meeting resolution, provided that such resolution does not violate the law of articles of association.[102] The authorization of a transaction by the supervisory board will not by itself exempt the members of the board of directors from their liability.[103]

Remuneration of the Board members

One of the high goals of good corporate governance is the transparency in the remuneration of the directors.[104] And it is truth that the Shareholders are those to be interested in facts regarding remuneration of company executives and board members, especially to those related to the performance of the company. The question is how and by which means should it be done. This will be left solely to each company. The recommendation should be restricted to prescribe only approval and disclosure requirements.

In connection with provisions of the German Corporate Governance code the overall compensation of every member of both the management and supervisory board is to be disclosed individually and by name. It has to be divided into performance and non-performance related parts and long-term incentive components, if general meeting does not

[100] § 194 (7) Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation
[101] Mária Patakyová a kol., Obchodný zákonník komentár /commercial code commentary/, 475 (C.H.Beck, 1st ed. 2006)
[102] Id
[103] Id
[104] Kevin Keasey and Mike Wrigh,Corporate governance : responsibilities, risks, and remuneration, New York : Wiley, c1997, Cambridge, UK : Cambridge University Press, 2000

decide differently by three quarters majority.[105] These figures shall be individualized by tasks, responsibilities and position. Compensation of the members of the management board is determined by the supervisory board.[106] According to § 192 Aktg, any stock-option rights for the managing directors must be authorized by the general meeting.[107] As far as the supervisory board members' remuneration is concerned, No. 5.4.6 of the German Corporate Governance code provides that these compensations are specified by resolution of the general meeting or in the articles of the association. All compensations shall be reported in the Corporate Governance Report.[108]

The disclosure of high amount of information connected with directors' remuneration will surely lead to higher level of transparency and control for shareholders and investors, but will also restrict the directors' personal privacy as far as their income is concerned. However, these restriction of directors' privacy is a fair price to be paid for an amplified corporate governance rules which shall be instituted on an EU level.[109]

A principle that Shareholders should be able to take effective part in decision-making with regard to the compensation patterns for board members and key executives is fully established in Corporate Governance code for Slovakia. The remuneration policy along with any major changes of to it, should be disclosed separately during general shareholder meeting.[110] This includes any rights related to shares of the company.

[105] German Corporate Governance Code 2008
[106] 4.2.2 German Corporate Governance Code 2008
[107] § 192 II 3 AktG. – authors translation
[108] 5.4.6 German Corporate Governance Code 2008
[109] 5 German Law Journal No. 10 (1 October 2004) - European & International Law Recent Developments of Corporate Governance in the European Union and their Impact on the German Legal System
[110] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

The committee for remuneration set by the Supervisory Board should consist only of members of the Supervisory Board, a more than a half of whom should be independent. This committee should submit proposals for the patterns and forms of remuneration of the executive board members, as well as to monitor the remuneration of individuals and it´s compliance with the company's remuneration rules.[111]

In case of voting on remuneration in the form of shares or similar types of remuneration the general meeting´s approval should be present. It is considered a good practice if this procedure takes place also on voting on remuneration of individual members of the Board or other important executives.[112] The general meeting should also approve other long term reward-like schemes which do not apply to other employees under same conditions schemes.

"It is the responsibility of the board to ensure that executive compensation is reasonable and aligned with shareholder interests (for example, through the use of stock grants tied to achievement of sustainable results). Disclosure of executive compensation should be encouraged as shareholders and the media can pressure companies into reining in compensation that is viewed as excessive. However, compensation disclosure can have the unintended consequence of increasing compensation levels – no CEO wants to be at the median or in the lower quartile and a company may be required to meet those compensation demands if it wants to attract the best talent."

Niall FitzGerald[113]

[111] Id. V.E 4 b
[112] Corporate Governance code for Slovakia, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249
[113] Executive Board Renumeration, Managing excessive CEO compensation Using the OECD corporate governance: A boardroom guide- © OECD 2008, availible at http://www.oecd.org/dataoecd/20/60/40823806.pdf

Boards – Shareholders Relationship

Shareholders execute their rights towards the company through the general meeting. In the upcoming lines I will try to point out some of the most important issues concerning the relationship between Shareholders and the boards.

The Corporate governance Code for Slovakia enumerates some of Shareholders rights, most of which are already being incorporated to the Commercial code. From taking a closer look at them, one can divide them into two basic categories. One is rather passive, which includes rights to obtain certain information on the condition of the company or to receive invitation for general meeting. Second, the active one is the shareholders right to elect and remove the members of the boards and to have the opportunity to participate in certain decisions concerning the board members and fundamental corporate changes[114]

Section I part A 3 and following contains the right to be informed about the corporation. This should be done on annual and semi-annual basis, using the statements and reports issued by a Management Board. Some important information such as planned acquisition, development of a new product or extraordinary transactions should be communicated directly with the shareholder.

The German Corporate Governance code in section 2.3.1 advises for the general meeting to be called at least once a year by the Management board, which is supposed to give detailed information about the agenda. „A quorum of shareholders is entitled to demand the convening

[114] §184 ; §187 Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation

of a General Meeting and the extension of the agenda.„[115] All documents required by the law concerning the agenda of the General Meeting shall be published by the Management Board. This shall be done so in an accessible way.

The Management Board should make sure that invitation for the general shareholder meeting are sent at least 30 days in advance to all shareholders. The number of shares plays no role while ensuring this. The advantage of modern Technologies – if possible, should also be used for participation on general shareholder meeting [116]

The code also enumerates more „active" rights which Shareholders possess. Probably the most significant one of these is the right to elect and remove members of the Boards.[117]

> *„In compliance with the company articles and in compliance with the rules of the appointment board, the board members should be voted by shareholders at a general shareholder meeting to which the board members will then be accountable for their activity. The election of the company board members should be attended by all shareholders who have decided to exercise their rights. This is of great importance particularly in the case of independent board members whose authority is based on their being elected also by minority shareholders. It is necessary to vote separately on all resolutions concerning the appointment of board members, as well as on every new member."[118]*

In the German Corporate governance Code the right to elect the members to the supervisory board is extended for a rule to appoint the auditors.

The trust which Shareholders vested to the Boards certainly has its limits. Dealing with questions like amendments to the statutes, new shares authorisation remuneration policy some

[115] 2.3.1 German Corporate Governance Code 2008
[116] §180 - §189, Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation
[117] Id. § 187
[118] Corporate Governance code for Slovakia, V.5 D, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249

extraordinary transactions, shareholders should have the right, not only to be appropriately informed, but also to effectively participate on.[119]

The remuneration policy should always be an issue discussed separately during the general meeting. „Regardless of the fact that decisions on remuneration of individual members of company boards can be made by the executive or supervisory board, shareholders should always have the opportunity to make their views known on the overall remuneration policy.“[120]

Last but not least is the right of the Shareholders to ask the boards members questions related to the matters of the company, of the persons engaged by the company and question related to the issues discussed during the general meeting. The Shareholders also have the right to make proposals.[121] Logically not every shareholder will always be in the position to personally attend the voting process during the General meeting. That's why the company should give adequate assistance in voting „in absentia“ or by the use of proxies.[122]

The German Federal Supreme Court did deal with some of the above mentioned issues in praxis. It has set up „Holzmüller“' doctrine through two decisions in 2004, by which it enhanced transaction clarity for stock corporations. First of them was the „Holzmüller decision“. The Federal Supreme Court by its decision strongly affected the rights of shareholders. It held that, without the consent of shareholders meeting,the management cannot make material decisions by which it would change the structure of the corporation.

[119] Id.I. B, C
[120] Corporate Governance code for Slovakia, I. C, January 2008, availible at http://www.ecgi.org/codes/code.php?code_id=249 ; § 187 SCC
[121] § 180 (1) Commercial Code: – Act No 513/1991 (Coll.) – Commercial, Code as amended by subsequent legislation authors translation
[122] 2.3.3 German Corporate Governance Code 2008

Unfortunately it launched quite a wave of uncertainity due to absence of any pattern for defining the word „material". A number of questions was raised e.g. what should the base and the treshhold for the materiality. Another question was on which type of voting majority is required by the Shareholders Meeting. The reaction was that the management didnt want to risk personal liability so the preference was given to the approval of shareholders meeting. This procedure was on the other hand time-consuming which put the transaction in danger.

Over 20 years after the Holzmüller judgment was issued, the Federal Supreme Court has taken the opportunity to clarify this ruling. Second, the - Gelatine decisions dealed with the transfer of direct subsidiaries to a lower level within a group of companies.

The Federal Supreme Court held that:

„The approval of the shareholders meeting is only required in exceptional cases which constitute a fundamental structural change equivalent to an amendment to the company's articles of association. The disposal of less than 50% of the assets involved does not trigger this requirement (exact threshold and valuation parameters were left open), and
where shareholder approval is required, the measure must be approved by a (qualified) majority of 75%."[123]

[123] Oleg de Lousanoff , Supreme Court Clarifies Holzmüller Ruling, August 18, 2004
http://www.internationallawoffice.com/newsletters/detail.aspx?g=48da8690-62f0-46e2-92b5-a4439ae1eb18

Conclusion

As we can see, the purely statutory rules are not always sufficient for proper, fair and transparent corporate governance. The scandals of Enron and others who went from the top to the bottom in almost no time are the best evidence. And that's where the Corporate Governance Codes come into place. Even that they are not mandatory for all companies, the number of those who comply with its rules and recommendations is increasing annually. And that's says something. In my work i tried to give an overview on the core principles which help both Supervisory Board and Management Board to maintain a balance in a day-to-day business decision making. The differences in the one-tier and two-tier systems are quite big. In my opinion it would be foolish to argue about which one is better or worse. They both have their shortcomings as well as advantages. I guess one should focus more on not finding the differences, but rather on continuous development of the good parts and alteration of those which seem not to fulfill their originally expected tasks. As I was going through the materials concerning the composition I was really happy to see quite high standards for selection of the Boards members including the extensive elaborations on who should be deemed independent. The question here may be if giving the decision power about this issue solely to the hands of Supervisory Board is the best possible practice. At this point I think that combined with the corporate governance codes suggestion and recommendations this system represents a solid base for such decision. This view of things may of course change over time. Question of high ethical standards is also very interesting. The common problem is that for many people, simple ethics or moral values are bending easier than grass in the wind.

Co-determination seems to be one of the topics in which a further deeper elaboration could be done especially in Slovakia. Setting out more patterns for the incorporation of labor representatives into the Supervisory Board, my help to develop the relations between the workforce and the company. On the other hand, I would not like to see the labor

representatives being not more than just puppets to those who offer more. This is more a question of internal education and sophisticated selection. It will be really interesting to see how the development of the Supervisory chairman and management board spokesman will go on. Should they get more power within the body? What could be the impacts for the company? Time has shown that entrusting too much power into single or few hands may be a dangerous move. So if the recommendations will take this path the enhanced system of internal and external breaks will have to be redeveloped. Recent years brought an amazing development of communication technologies. What would back in the days take weeks now takes days or even hours. A good thing is that the companies are taking advantage of the tech inventions not only to increase their profits but also to make the communication between Boards and Shareholders more effective and transparent. The recent global crisis made all the companies to re-consider not only their budgets but also their long term plans. As far as the budgets are concerned the key executive's salaries were over the top, money were basically being thrown out of the window and the whole top management environment could easily be called an high end holiday. But these times are over, not only that companies cut down the expenses in some cases they started to ask for the money paid out to their executives as bonuses. One of the examples is IKB Industriebank AG which asked the four executives for their already paid out bonuses of hundreds of thousands €. I do not want to judge but from the number that come out almost every day in the news it seems like it was really about the time for awakening.

As the times will change the Corporate Governance recommendations will also. Their advantage is the flexibility and very close relation with the business background. They are less dependent on the political pressures[124] and more follow the patterns needed by the

[124] Mark J. Roe ,Corporate governance : political and legal perspectives, Northampton, Mass. : Edward Elgar Publishing, 2005 p. 97

business environment. I just hope that corporate Governance becomes more publicly known and discussed topic especially in Slovakia.

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