A Close Look at the Mannesmann Trial

By Stefan Maier[*]

A. Introduction

In German post-war history, hardly any other trial concerning economic criminal cases attracted as much interest as the so-called Mannesmann trial.[1] This is for two main reasons. First, the facts that form the basis of the decision, that is, the hostile takeover of the German Mannesmann AG by the British Vodafone, attracted much attention and sparked public discussion about eliminating the very possibility of hostile takeovers in general in Germany.[2] Second, interest in the case was due to the magnitude of the bonuses granted and the significance this had for the public at large. As a consequence of this trial and the settled payments, the debate around the appropriateness of executive compensations, existing prior to the case, grew more acute.[3] After all, the current draft law to disclose executive pay resulted from these debates about the size of the compensations.[4]

Over the past years, criminal offences in the area of economic law, particularly with regard to breach of trust according to Section 266 of the German Criminal Code, have increased in practical importance.[5] As a result of the Mannesmann trial, public

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[1] BGH, Decision of 21 December 2005 3 StR 470/04 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 522 (2006); Kolla, *The Mannesmann Trial and the Role of the Courts,* 5 GERMAN LAW JOURNAL No. 7 (1 July 2004); see for the decision of the regional court (Landgericht Düsseldorf) in the first judgement Landgericht Düsseldorf, Decision of 22 July 2004 – 28 Js 159/00 the note of Rolshoven, The Last Word? – The July 22, 2004 Acquittals in the Mannesmann Trial , 5 GERMAN LAW JOURNAL No. 8 (1 August 2004).

[2] Brauer/Dreier, *Der Fall Mannesmann in der nächsten Runde - Zur Geltendmachung von Ersatzansprüchen gegen die ehemaligen Organmitglieder,* in: NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (NZG) 27 (2005).

[3] Thüsing, *Auf der Suche Nach Dem Iustum Pretium der Vorstandstätigkeit,* ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (ZGR) 457, 458 (2003).

[4] See, the bill about the disclosure of executive compensations, (Vorstandsvergütungs-Offenlegungsgesetz), available at http://www.bmj.bund.de/offenlegung.

[5] See, Schünemann, *Die „gravierende Pflichtverletzung" bei der Untreue: dogmatischer Zauberhut oder taube Nuss?,* in: NEUE ZEITSCHRIFT FÜR STRAFRECHT (NSTZ) 473 (2005), 473; Rönnau/Hohn, *Die Festsetzung (zu) hoher Vorstandsvergütungen durch den Aufsichtsrat – ein Fall für den Staatsanwalt*?, NSTZ 113, 2004.

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advertence concerning this matter reached its peak level. The case is also of interest for legal purposes, as it resulted in a judgment about salary concerns, prosecuted before the courts, apparently for the first time.[6] Both criminal and civil law aspects of this judgment are analysed and described as follows. Economic penology and the *corpus delicti* concerning breach of trust in particular bears substantial reference to matters subject to civil law, given that the question of what is and is not allowable is only to be answered using civil law standards.[7] Thus, based consequentially on the penal judgement, the judgement under civil law is discussed in advance.

B. Civil Law Judgement

I. Principle of Appropriateness of Executive Compensation according to Section 87 (I) 1 German Stock Corporation Act (AktG)

Executive compensation in German stock corporations is regulated by Section 87 (I) 1 of the *Aktiengesetz, or AktG* (the German Stock Corporation Act) insofar as the supervisory board, which fixes the payments, must ensure that total remuneration bears an appropriate relationship to the executive responsibilities and the company's performance. The outcome of this is, however, still inexplicit, as the definition of 'appropriateness' concerning this matter lacks precise criteria.[8] The German Corporate Governance Kodex guidelines do not enable an accurate salary fixing, even if the relevant criteria is explicit.[9] In light of the underlying facts of the sentence imposed in the decision, it is questionable whether the appropriateness of the payments was a crucial factor in punishing the offences.[10] The central matter of the decision was in fact the extra payment of so-called *kompensationslose Anerkennungsprämie* (appreciation awards), in addition to stipulated claims for compensation for services rendered by members of the executive board during the takeover battle. Hence, the sentence does not deal with the appropriateness of the monetary compensations as agreed to by contract (e.g. for the former CEO Dr. Esser, just under 15 million euros), but with the question of whether the additional granting of appreciation awards (amounting to approximately 16 million euros for the former CEO Dr. Esser) were assigned lawfully.

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[6] Rönnau/Hohn, *supra,* note 5.

[7] *Id.*.

[8] See, for the question of the appropriateness of executive compensation, *supra,* note 3.

[9] See, 4.2.2. to 4.2.4. of the German Corporate Governance Kodex, available at: http://www.corporate-governance-code.de/ger/kodex/indesx.html.

[10] The question, if the compensation was appropriate, is still without a judgement.

II. Generic Legislation of Appreciation Awards

Appreciation awards involve non-contractual supplementary grants, which are exclusively remunerative for work performed, non-profitable for the company and paid in addition to the stipulated salary.[11] The payments' legitimacy are controversial.

Such appreciation awards for work performed are allegedly justifiable according to much literature on the topic of stock corporation law, as long as the respective board member's total remuneration is within the bounds of appropriateness according to Section 87 (I) 1 AktG.[12] This claim is partly substantiated by contending that the company's interest only leads to certain prohibitive and imperative acts in case of threat to asset and the permanent profitability of the business.[13] From an alternative point of view, the approval of appreciation awards due to the board members' additional labour during takeover arguments can be justified. This labour, seemingly not covered by the remuneration as provided in the contract, should be refunded separately.[14]

However, a preferable notion views appreciation awards as unlawful in principle, irrespective of their concrete magnitude. This contention is based on the failure of these payments to consider the waste of public funds that results.[15] By approving such awards, the company's agency would neglect its duty to manage assets. The general public and legal community should not accept the notion that no breach of fiduciary duty exists in default if a threat to the assets of a company exists. The agency is obligated to protect the company's interests in all entrepreneurial decisions, particularly with regard to granting payments, irrespective of the question of threat to asset and the permanent profitability of the business.[16] The *Bundesgerichtshof, or BGH,* (German Federal Court of Justice), adjudicating in the judgement at hand held that the general principles of civil law, that is, that the

[11] See, *supra* note 1 at 3.

[12] Kort, *Das Mannesmann-Urteil im Lichte von para. 87 AktG,* NJW 333 (2005); Liebers/Hoefs, *Anerkennungs- und Abfindungszahlungen an ausscheidende Vorstandsmitglieder,* ZIP 97 (2004).

[13] *Hüffer, Mannesmann/Vodafone: Präsidiumsbescchlüsse des Aufsichtsrats für die Gewährung von „Appreciation Awards" an Vorstandsmitglieder,* Sonderbeilage 7 zu BETRIEBSBERATER (BB) 2003, 20.

[14] Liebers/Hoefs, *supra*, note 12.

[15] Rönnau/Hohn,(note 5), 113 and 120; BGH,(note 1).

[16] See, the Decision of the *Bundesgerichtshof* (Federal Court of Justice) , (BGHZ) 135, 244 (Decision of 21 April 1997 II ZR 175/95).

agency managing borrowed capital has to act exclusively in the interest of the initial company, also applies to the stock corporation law.[17]

Similarly, the concept of accepting extra payments for labour during takeover bids is not convincing. Even though the aforesaid labour might be extra work, it is questionable whether taking countermeasures against a hostile takeover bid is actually part of the management board's task. On closer examination, the decision to take countermeasures is outside the management board's reference, and under the responsibility of the shareholders. This is due to the conflict of interest between the members of the executive and the supervisory board, as both are facing loss of employment in the event of a successful takeover bid.[18] The members of the management board participate regularly in the success of the company by means of stock options, so that extra pay is not provided.[19]

C. Criminal Law Judgement

The potential penal sanctions for granting appreciation awards must be assessed in light of the fact that the offence under consideration, breach of fiduciary trust, Section 266 of the *Strafgesetzbuch* or *StGB* (German Criminal Code[20] repeatedly meets with criticism due to its indefiniteness and the resulting breach of privilege of definiteness according to Article 103 (II) of the *Grundgesetz – GG*.[21] However, the

[17] BGH, *supra*, note 1.

[18] Maier, *Der neue Vorschlag der europäischen Kommission für eine Übernahmerichtlinie,* Forum Neues Wirtschaftrecht (NWIR) 1 (2003), available at www.nwir.de.

[19] See, for a brillant overview on stock options, Hueffer, *Aktienbezugsrechte als Bestandteil der Vergütung von Vorstandsmitgliedern und Mitarbeitern – gesellschaftsrechtliche Analyse,* 161 Zeitschrift für das Handelsrecht und Wirtschaftsrecht (ZHR) 214 (1997). See also Section 33 (III) WpÜG.

[20] ***Section 266 StGB reads as:***

Section 266 Breach of Trust

(1) Whoever abuses the power accorded him by statute, by commission of a public authority or legal transaction to dispose of assets of another or to obligate another, or violates the duty to safeguard the property interests of another incumbent upon him by reason of statute, commission of a public authority, legal transaction or fiduciary relationship, and thereby causes detriment to the person, whose property interests he was responsible for, shall be punished with imprisonment for not more than five years or a fine.

(2) Sections 243 subsection (2), 247, 248a and 263 subsection (3), shall apply accordingly.

[21] See, TRÖNDLE/FISCHER, STGB, Section 266 margin number 5 (53rd ed. 2006)

Article 103 (II) GG reads as:

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prevailing legal principles and case law admit of a deviant interpretation whilst conforming to the privilege of definiteness.[22] This applies all the more as the consulting on guidelines and valuations subject to private law is required with this form of breach of fiduciary trust in particular.[23] This is so because the precondition, that the relevant person in charge of managing the property of a third party, (here the award granting members of the executive board), neglects its duty and hence causes pecuniary detriment, must be met in order to approve of the corpus delicti of breach of fiduciary trust according to Section 266 (I) 2nd alternative StGB.

I. Neglect of Duty of Asset Management by Grant of Appreciation Awards

In conformity with an accepted definition, the duty of asset management is an economically important matter involving business activity treated as both a personal responsibility and major duty.[24] These preconditions apply for the governing body of a stock corporation as it is connected with a highly important duty to manage committed assets.[25] The members of the supervisory board, voted in by the share holders, are bound to safeguard the company's fixed reserve. Besides supervising the executive board's management according to Section 111 (I) of the AktG, the supervisory board has an entrepreneurial duty if alienated by the AKtG.[26] According to Section 87 (I) 1 of the AktG, the fixing of the management's remuneration is within the board's legal authority. Hence, the supervisory board has the authority and obligation to manage assets as it relates to decisions regarding the executive board's compensation.[27]

(l) In the courts every person shall be entitled to a hearing in accordance with law.

(2) An act may be punished only if it was defined by a law as a criminal offense before the act was committed.

(3) No person may be punished for the same act more than once under the general criminal laws.

[22] Schünemann, NStZ 473 (2005); Tröndle/Fischer, *supra,* note 20 at para. 266.

[23] Rönnau/Hohn, (note 5), 113, 114.

[24] *Id.* ; Lenckner/Perron, *in* StGB, Section 266 MN (*Schönke*/Schröder, 27th. ed. 2006), 23ff.

[25] Decisions of the Federal Court of Justice (note 15), 244, 253,; Lenckner/Perron,, *supra* note 23.

[26] Decisions of the Federal Court of Justice (note 15).

[27] Rönnau/Hohn, NStZ 2004, 113, 117, (supra note 5).

Whether the board members of the former Mannesmann AG met their obligation is now under the BGH's consideration. The board members have a certain scope of discretion as regards their decision making power in regards to the executive board's compensation.[28] This scope is considered indispensable as such decisions are business decisions, due to their future orientation, inevitable uncertain and insecure. Still, it is a moot question whether granting the appreciation awards actually depends on compliance with the scope of discretion, or whether granting the awards themselves was unlawful. A neglect of duty to manage assets by the supervisory board members exists if granting appreciation awards is economically un- justifiable. A decision is economically un-justifiable if the decision to pay appreciation awards, even if granted within the scope of discretion, is not in the interest of the company.[29]

As epitomised in considering the problem of appreciation awards subject to civil law, their granting, not technically in exchange for labour or services, is not actually in the interest of the company. Therefore, the grant of appreciation awards constitutes a breach of fiduciary duty to manage assets by the members of the supervisory board of the Mannesmann AG.

II. No Requirement of Serious Breach of Fiduciary Duty

The defence of the members of the supervisory board argued that the authority to punish only arises in cases of serious breach of fiduciary duty according to Section 266 (I) of the StGB.[30] This statement is justified by reference to two verdicts by the BGH on the question of breach of duty in case of betrayal of confidence.[31] The BGH held in the Mannesmann finding that both previous verdicts did not imply that breach of duty in case of betrayal of confidence is only punishable upon an evident serious breach of duty. Though the first of the two relevant verdicts contained a statement concerning the requirement of serious breach of fiduciary duty, it does not, however, refer to the requirement of neglect of duty of asset management, but to the requirement of serious neglect of duty of information and examination.[32] There is no basic principle of this kind to be seen in the second

[28] This results from § 93 AktG in connection with § 116 AktG.

[29] Lenckner/Perron(note 23), 35a, 36 .

[30] This was also the opinion of the regional court (*Landgericht* Düsseldorf) in the first judgement. *Landgericht* Düsseldorf, Decision of 22 July 2004 – 28 Js 159/00. See the note by Rolshoven, *supra,* note 1.

[31] See Decisions of the Federal Court of Justice in Criminal Matters, 47 BGHSt 148 (Decision of 15 November 2001 – 1 StR 185/01) and 47 BGHSt 187 (Decision of 6 December 2001 – 1 StR 215/01).

[32] 47 BGHSt, 148, *supra*, note 30.

consulted verdict either, as it is an individual case in connexion with company donations from which no generalisations as to requirements of serious breach of fiduciary duty can be made.[33]

III. Existence of (Preventable) Erroneous Misapprehension

Finally, there is need for further investigation as to whether the members of the supervisory board who made the decision to pay appreciation awards, were under an erroneous misapprehension according to Section 17 of the StGB.[34] According to Section 17, the guilt (and thus punishability) of the delinquent is not applicable if they were unaware they were committing an illegitimate offence. However, this is only valid if the misapprehension was not preventable.[35] Thus, presuming an erroneous misapprehension, the precondition of the supervisory board's unawareness of the illegitimateness during decision-making is required. As maintained by the BGH, it is virtually in-conceivable that the members of the supervisory board, due to their leading position in the German business world assumed that by acceding to appreciation awards in this form they may dispose of the company's assets.[36] Thus, the plea of the defence, that the misapprehension - if existent - was not preventable, can be easily dismissed. Basically, the misapprehension about the interpretation of law as an absence of a general appreciation of doing something wrong (so called *Unrechtsbewusstsein*) is accepted as well.[37] As already described, the granting of appreciation awards is regarded as legitimate in literature dealing with company law.[38] Even if the defendants were to be under an erroneous misapprehension, this could have been avoided. The auditing company KPMG, who oversaw the operation, demurred to the legitimacy of granting appreciation awards to the members of the supervisory board.

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[33] 47 BGHSt 187, *supra*, note 30.

[34] Section17 StGB reads as:

Section 17 Mistake of Law

If upon commission of the act the perpetrator lacks the appreciation that he is doing something wrong, he acts without guilt if he was unable to avoid this mistake. If the perpetrator could have avoided the mistake, the punishment may be mitigated pursuant to Section 49 subsection (1).

[35] Tröndle/Fischer (note 20), para. 17 MN 1; Cramer/Sternberg-Lieben, *Section 17 MN 5, in*: (Schönke/Schröder, 27th. ed., 2006).

[36] BGH (*supra,* note 1).

[37] TRÖNDLE/FISCHER, (note 20) Section 17 margin number 6.

[38] Kort (note 12), 333; Liebers/Hoefs (note 12), 97.

D. Conclusions

Contrary to popular opinion, the BGH's verdict in the Mannesmann trial makes no statement as to the appropriateness of executive remuneration. However, as has been attempted to be shown through an analysis of the facts and arguments put forward in the case, it is evident that the granting of appreciation awards should not be tolerated. Appreciation awards are supplementary grants not provided for by contract, are superfluous to other stipulated compensation for work and do not benefit the company in the future. Moreover, the BGH declares that, should the corpus delicti of betrayal of confidence prove true according to paragraph 266, Section 1 2. alt. StGB, no serious breach of fiduciary duty of managing assets is required.

On the whole, the BGH's reasons for this decision are likely to convince. Hopefully, Düsseldorf's Regional Court, to which the case has been referred back for rehandling, is not closed to the arguments of the BGH. Though dreaded by some sectors of the German economy, there is no economic disadvantage to be afraid of. In fact, the German courts could, if in line with the BGH, contribute in a manner so that fixed capital in German stock corporations is only for the purpose of the company, not for the management body.