Taking a hard line

Austria's corporate governance regime is becoming less focussed on voluntary compliance and now includes more mandatory provisions. Albert Birkner and Clemens Hasenauer of Cerha Hempel Spiegelfeld Hlawati explain

Austrian rules on corporate governance are contained in statutory provisions regulating corporate and capital markets law, such as the Austrian Stock Corporation Act (Aktiengesetz) and the Stock Exchange Act (Börsegesetz), and in soft law such as the Austrian Corporate Governance Code.

The Austrian Corporate Governance Code was presented to the public in 2002 by the Austrian Working Group for Corporate Governance. The Austrian Corporate Governance Code was not enacted as a legally binding framework for companies seated or listed in Austria, but as a voluntary framework primarily addressing companies listed in Austria. The Austrian Corporate Governance Code follows the idea that all shareholders must be treated equally under the same conditions (Rule 1). While some of the rules are based on statutory provisions, the compliance with the Corporate Governance Code as a whole is mandatory. The Corporate Governance Code stipulates rules for the control and management of enterprises. Since August 2004 prime market rules of the Vienna Stock Exchange have included the requirement for listed companies to declare whether they are complying with the Austrian Corporate Governance Code or not. Unlike most Austrian statutory laws, the Austria Corporate Governance Code is available both in English and German, while the German version remains exclusively binding.

Structure of the Code

The Code contains three different types of rules: legal requirement rules (L), comply or explain rules (C) and recommendation rules (R). Each rule of the Code is marked L, C or R. So it is easy to figure out whether a rule is also statutorily binding for listed companies or only binding for companies willing to comply with the Code.

Legal requirement rules (L) are based on mandatory legal provisions. Companies must comply with these rules not only for the sake of compliance with the Code, but also pursuant to a mandatory legal provision of Austrian corporate or stock exchange law. Therefore these rules have an informative character, because compliance with them is mandatory, independent from the validity of the Code.

Comply or explain rules (C) are not based on mandatory legal provisions. Only companies willing to comply with the Code need to follow them. So these rules are autonomous provision of the Code and companies that want to comply with the Code and not just the mandatory legal provisions of Austrian corporate and stock exchange law need to follow these rules. Deviations from these rules need to be explained and reasons have to be stated why the respective company is not complying with the rules. Otherwise the company is no longer in compliance with the Code.

Recommendation rules (R) are the weakest provisions of the Code. Compliance with these rules is of voluntary nature. Like comply or explain rules, recommendation rules are also not based on mandatory legal provisions, but autonomous provision of the Code. Unlike comply or explain rules, it is not necessary for companies to comply with recommendation rules to stay in accordance with the Code. Non-compliance is not even subject to any explanations. Companies not complying with these rules are not in danger of facing any sanctions, making compliance with recommendation rules voluntary.

The 2005 amendment

In 2005 many provisions regulating Austrian corporate law were amended. The main purpose of the amendment was to make several autonomous provisions of the Code mandatory legal provisions. Some of the new provisions target only listed companies, while others appoint all stock corporations and some target all corporate entities. So many provisions of the Code have been implemented into the Stock Corporation Act, making autonomous soft law provisions of the Code mandatory legal provisions. As a result of this amendment of corporate law, the Code was amended accordingly in January 2006. The respective comply or explain rules were changed into legal requirement rules. The updated version of the Code was effective from January 1 2006.

Management and supervisory boards

The main purpose of the corporate law amendment in 2005 was to make supervisory boards and auditing more independent. The total number of supervisory board members of stock corporations has been capped to 20. The Code still has a stronger comply or explain rule limiting the number of supervisory board members to 10. Employees' representatives are not included under the regime of the Code.

Non-compete obligations for members of management boards were also included in the Stock Corporation Act. Members of management boards are not allowed to hold supervisory board mandates and other leading positions in companies that are not part of the same group or associated, except with prior approval of the supervisory board. Also, members of management boards may not deal independently from their companies on their own or a foreign account within the scope of their companies' fields of business and are not allowed to become general partners of other companies without approval of the supervisory board. These changes are in accordance with the respective rules of the Code, which were changed from comply or explain rules to legal requirement rules.

A rule appointing the independence of members of supervisory boards was also implemented into the Stock Corporation Act. Members of supervisory boards of listed companies are not allowed to hold more than eight mandates at the same time. Acting as chairperson of a supervisory board counts as two mandates. The total number of supervisory board mandates per person for companies that are not listed remains at 10, while the function as chairperson also counts twice. However not all provisions restricting the number of supervisory board mandates per person of the Code were implemented

"Many provisions of the Code have been implemented into the Stock Corporation Act, making autonomous soft law provisions of the Code mandatory legal provisions"

Author biographies

Albert Birkner
CHSH
Cerha Hempel Spiegelfeld Hlawati

Albert Birkner is managing partner of CHSH Cerha Hempel Spiegelfeld Hlawati and a member of the banking and corporate finance team.

Albert Birkner is the chairman of the M&A practice group of CHSH. He has been with the firm since 1995. His main area of practice is mergers and acquisitions, in particular takeovers, private equity and corporate restructurings. Albert Birkner has represented numerous national and international clients in takeover proceedings and matters generally relating to M&A and takeover issues before the Austrian Takeover Panel. He regularly advises on private equity transactions and company law issues, in particular transaction-related restructuring. Albert Birkner also regularly advises clients in CEE in his areas of practice.

Albert Birkner graduated from University of Vienna (Mag iur 1992, Dr iur 1995) and from University of Cambridge (LLM 1995). He worked as an academic assistant at the University of Vienna, Institute for Tax Law (1991/92). Albert Birkner is the author of numerous publications in Austrian and international law journals in his areas of expertise. He also is an author and co-editor of a standard publication on commercial precedents under Austrian law and author of the Austrian Corporate Governance Handbook. Albert Birkner is a university lecturer.

Founded in 1921, CHSH Cerha Hempel Spiegelfeld Hlawati is a leading Austrian law firm, with offices in Bratislava, Brussels, Budapest, Bucharest, Gdansk, Katowice, Poznan, Warszawa and Wroclaw. The firm represents Austrian and international companies in the fields of telecommunications, energy, transport, new media and financial services. Cerha Hempel Spiegelfeld Hlawati is regarded as one of Austria's leading law firms in mergers and acquisitions, banking and capital markets, real estate, litigation and arbitration. The firm is a member of Lex Mundi.

The firm was awarded Austrian law firm of the year in 2004 as well as 2005 by the *International Financial Law Review*.

Clemens Hasenauer
CHSH
Cerha Hempel Spiegelfeld Hlawati

Clemens Hasenauer is partner and member of the banking and corporate finance team at CHSH. His broad experience includes numerous negotiated mergers and acquisitions transactions and complex corporate reorganizations, in particular relating to large international joint ventures and takeover proceedings. Clemens Hasenauer has regularly advised on private equity transactions, and has structured and negotiated numerous cross-border transactions, including inbound and outbound investments and acquisitions. Recently, Hasenauer advised OMV on the $1.1 billion purchase of a 34% stake in Petrolofisi.

Clemens Hasenauer graduated from the University of Vienna (Mag iur 1994, Dr iur 1996) and from New York University School of Law (LLM 1997) as a Fulbright Scholar. For more than three years he gained professional experience in New York and London and is also admitted to the Bar of New York. Clemens Hasenauer has written numerous publications in his areas of expertise and is a frequent speaker at seminars and lectures.

He chairs one of the leading Austrian mergers and acquisitions conferences.

Founded in 1921, CHSH Cerha Hempel Spiegelfeld Hlawati is a leading Austrian law firm, with offices in Bratislava, Brussels, Budapest, Bucharest, Gdansk, Katowice, Poznan, Warszawa and Wroclaw. The firm represents Austrian and international companies in the fields of telecommunications, energy, transport, new media and financial services. Cerha Hempel Spiegelfeld Hlawati is regarded as one of Austria's leading law firms in mergers and acquisitions, banking and capital markets, real estate, litigation and arbitration. The firm is a member of Lex Mundi.

The firm was awarded Austrian law firm of the year in 2004 as well as 2005 by the *International Financial Law Review*.

into the Stock Corporation Act. Unlike the Code, the Stock Corporation Act retained the system of privileged supervisory board mandates. Privileged mandates do not count for the total number of mandates per person. According to this principle, supervisory board mandates of companies, which further the economic interest of the federal Republic of Austria, Austrian states or municipalities or companies that are part of the same group or affiliates are privileged. So these mandates do not count for the maximum number of 10 supervisory board mandates. Despite this, the maximum number of privileged mandates is capped at 10 mandates. So it is possible for one person to hold a total of 20 supervisory board mandates under the regime of the Stock Corporation Act, while the Code only allows a total of eight mandates.

A new provision of the Stock Corporation Act not descending from the Corporate Governance Code extends the contradictoriness of supervisory and management board membership from the same company to its subsidiaries. Members of supervisory boards are not allowed to become members of management boards as well as other leading positions of the same company and its subsidiaries. Analogue provisions were also included into the Code, which did not include an according restriction previously.

A recommendation rule of the Code restricting cross integrations (*Kreuzverflechtungen*) of companies was implemented in an alleviated way to the Stock Corporation Act. Members of the supervisory board of one company may not become members of the management board of another company, if a management board member of the second company is already a supervisory board member of the first company, unless the other company is part of the same group or associated by shareholding. The text of the Stock Corporation Act does not say anything about the height of the participation, but the explanations to the government bill (which may be used to interpret the law) state a participation of at least 20%. This alleviated version of cross-integration restrictions was also implemented into the Code as a legal requirement rule. However it is not clear whether the participation height of 20% may also be used to interpret the Code or not.

Another rule targeting the independence of the supervisory board was also implemented from the Code into the Stock Corporation Act. Before their election, proposed members of the supervisory board have to present their expert qualifications and professional functions to the general meeting. They also have to disclose all circumstances that could raise concerns of partiality. A new comply or explain rule, which has not been included in the Stock Corporation Act, also stipulates that candidates for the supervisory board must be notified to the company in a timely manner so that they can be announced on the company's website at least one week in advance of the general meeting.

A rule restricting the conclusion of contracts between members of the supervisory board and the company outside of the supervisory board's activities was included into the Stock Corporation Act. So service contracts between members of the supervisory board and the company require the consent the supervisory board as a whole.

Audit committee

Another main goal of the recent amendments to the Stock Corporation Act and the Code was to secure the independence of auditing. According to a new provision of the Stock Corporation Act, supervisory boards with more than five members and supervisory boards of listed companies must set up an audit committee. The Code clarifies that this requirement covers listed companies irrespective of the size of the supervisory board. In addition, the competences of audit committees were expanded. The audit committee is responsible for the auditing and preparation of the approval of the financial statements. It has to audit consolidated financial statements and make a proposal for the appointment of the auditor. Audit committees of listed companies are required to include at least one financial expert (special knowledge and practical experience in finance, accounting and reporting). The chairperson and the financial expert are not allowed to be former members of the management board or former auditors of the company for at least three years. Provisions securing the independence of auditors were strengthened, regarding the company's internal (personal) rotation of auditors after five consequent audits and further provisions securing the independence of auditors.

Other changes to the Code

The amendment of the Austrian Corporate Governance Code in 2006 not only consisted of changes resulting from the implementation of the Code's rules into the Stock Corporation Act but also changes due to new EU guidelines. According to a legal requirement rule based on a mandatory provision of the Austrian Corporations Act (UGB), the total remuneration of the management board for a business year has to be reported in the notes to the financial statements. A comply or explain rule further stipulates additional publication requirements for the remuneration of the management board to the annual report. According to this rule, the principles of the performance-based payments, the relation of fixed to performance-linked payments, the principles of the management board's retirement plan and the principles of eligibility and claims in case of termination of the management board function need to be disclosed.

"New comply or explain rules securing the independence of the supervisory board were included in the Code"

New comply or explain rules securing the independence of the supervisory board were included in the Code. Supervisory boards need to include a sufficient number of independent members. A member is deemed independent if it does not have business or personal relations to the company or its management board. For companies with high percentages of free float the Code contains fixed guidelines. Companies with a free float of more than 20% are required to have at least one independent supervisory board member. Companies with a free float of more than 50% have to have at least two independent supervisory board members. Independent members must have no ties to shareholders with a stock of more than 10%. The annual reports of the companies need to clarify which members of the supervisory meet these impendence requirements. Also, the chairperson of the supervisory board must not be a former chairman of the management board, unless a period of two years since the termination of the management board chairship has expired.

Future developments

Effective April 2007, the Transparency Directive was implemented in Austria. Austrian corporate governance is likely to be amended accordingly. According to a draft published on the website of the Austrian Working Group for Corporate Governance, Rules 63 to 66 will be amended. Rule 63 is likely to include the obligation to draw up the financial statements according to international financial reporting standards (IFRS). This section will also go along with the respective sections of the Stock Exchange Act requiring half-yearly financial reports and quarterly management statements. The Code is also likely to include a comply or explain rule requiring quarterly statements to be in accordance with the international financial reporting standards as adopted by the EU. The company's website will be expressly quoted as a communication structure to meet information needs in a timely adequate way and companies will be required to disclose financial statements and interim reports on their websites.