

Corporate Governance Report

The German Code of Corporate Governance recommends the Boards of Management and the Supervisory Boards of joint stock corporations listed on the stock exchange to make an annual report on corporate governance at their companies (item 3.10 of the Code). This recommendation is not aimed directly at the Board of Management and Supervisory Board of PAUL HARTMANN AG since the company is not listed on the stock exchange in the sense of section 3 paragraph 2 of the German Stock Corporation Law (AktG). Nevertheless, the Board of Management and the Supervisory Board have agreed to set out the company's corporate governance at this point.

Management and control structure: the Board of Management and the Supervisory Board

The Board of Management is the leading Group board. It is duty-bound to act in line with the interests of the company, the statutory regulations and the Statutes, and to seek to enduringly increase the company's value.

The Board of Management at PAUL HARTMANN AG currently consists of five members. In the year under review, both Friedrich Pohl and Dr. Thomas Wurster retired from the Board on March 31, 2006. The Supervisory Board appointed as deputy members of the Management Board Michel Kuehn and Dr. Wolfgang Neumann with effect from April 1, 2006. As of Sept. 1, 2006, the Board has been complete, with the appointment of Dr. Felix Fremerey. All these new appointments were for a period of three years. The names of the Management Board members are given on page 9.

PAUL HARTMANN AG's Supervisory Board has 12 members. Under the terms of the German Codetermination Act (MitbestG) it consists of equal numbers of representatives of the shareholders and the employees. The names of members of the Supervisory Board are listed on page 9.

The representatives of the shareholders are elected by the annual general meeting. For all members of the Supervisory Board, their period of office ends at the end of the annual general meeting in 2008. Representatives of the shareholders can only be elected if they have not reached the age of 75 at the point when they are elected.

The Supervisory Board has elected committees from amongst its own ranks whose members are chosen on a balanced basis to reflect shareholders and employees and which fulfil certain functions instead of the full Supervisory Board as well as preparing the resolutions to be made by the entire Supervisory Board. The Board of Directors' committee is responsible for personnel matters. The Audit Committee monitors both the auditors and internal accounting procedures and financial management. There is also an Arbitration Committee in accordance with section 27 paragraph 2 of MitbestG.

The Board of Management and the Supervisory Board work closely together for the good of the company.

At PAUL HARTMANN AG the directors & officers insurance (D&O insurance) for the Board of Management and the Supervisory Board does not require cost-sharing on the part of its members with the exception of a liability reimbursement for any claims in the United States. The Board of Management and the

Supervisory Board at PAUL HARTMANN AG are constantly aware of the full responsibility they bear for their actions. The introduction of cost-sharing would not enhance the motivation and sense of responsibility of its members. Added to this, not least for reasons of costs, the insurance policy covers not only the Board of Management and the Supervisory Board at PAUL HARTMANN AG, but also a large number of managers in Germany and abroad which means that in this case differentiation would not be appropriate, particularly since this kind of cost-sharing is not usual in other countries.

It is the Board of Directors' committee, consisting of two representatives of the shareholders and two of the employees from the Supervisory Board, and not the full Supervisory Board, that provides advice on the structure of the remuneration system for members of the Board of Management at PAUL HARTMANN AG and monitors the latter system regularly. This method of procedure has proved its worth in the past since the best forum for discussing such matters is the Board of Directors' committee with its particularly well-qualified members.

With effect from Jan. 1, 2007, the Supervisory Board fundamentally revised and updated its Rules of Procedure. Compared to the past, there is now a far larger number of transactions requiring its approval, ensuring that the Supervisory Board can discharge supervision and control duties far more intensively. Moreover, these Rules stipulate an upper age for members of the Board of Management, something practised to date but not given a legal basis.

Remuneration of the Board of Management and the Supervisory Board

Members of the Board of Management are remunerated in accordance with the functions performed by the relevant Board member, the latter's performance and how well the HARTMANN GROUP is performing in comparison with other similar companies. The basic guidelines for Board of Management remuneration are explained in the annual financial statements and will also be published in detail at the annual general meeting if there is sufficient demand. In accordance with the recommendations of the Government Commission, overall remuneration is composed of one fixed and one variable component. However, it does not contain any "components with a long-term incentive effect or a risk character", such as share option packages or any similar equity-oriented incentive systems. Since PAUL HARTMANN AG shares are only traded on the Frankfurt stock exchange's open market and have relatively low liquidity, the share price cannot be used as a general basis for assessing this kind of remuneration components. Since in this case there are no remuneration components with a long-term incentive effect or a risk character the other recommendations of item 4.2.3. of paragraph 3 of the German Code of Corporate Governance are not applicable.

Overall remuneration of the Board of Management is indicated in the annex to the consolidated financial statements on page 100. The supplementary sections to the German Commercial Code introduced on Aug. 3, 2005, with the "Act on Disclosure of Management Board Remuneration" according to which individualized disclosure shall be made of Management Board remuneration, applies only to publicly-listed companies and thus not to PAUL HARTMANN AG. The same is true for the regulation of item 4.2.4 of the German Code of Corporate Governance, with which we likewise do not comply. This is not only out of respect for the privacy of members of the Board of Management but also because no noteworthy additional information of relevance to the capital market can be derived from the statements outlined there. For this reason, contrary to the recommendation of item 4.2.5. of the German Corporate Governance Code no remuneration report is published. Given the basic situation, namely that PAUL HARTMANN AG is under no legal obligation to disclose the remuneration for individual Board members, a declaration of these differences to the recommendation of the German Corporate Governance Code is not necessary.

Remuneration of the Supervisory Board is governed by the Statutes and supplementary resolutions by the general meeting. Remuneration is composed of one fixed and one variable component. Members also receive an attendance fee for their presence at the individual meetings. The Chairman and the Deputy Chairman of the Supervisory Board and the Chairman and membership of the Audit Committee are handled separately. In the case of multiple membership, the higher remuneration shall be paid in each case. In no cases shall remuneration be accumulated.

Members of the Audit Committee receive remuneration for each meeting that does not take place on the same day as meetings of the Supervisory Board. By contrast, to date apart from the Chairman no other members of the Audit Committee receive separate remuneration, and members of the Board of Directors Committee or the Arbitration Committee are not paid separate remuneration or attendance money. In the past, the Arbitration Committee was not required to convene and the expenses for the members of the Board of Directors Committee or the Audit Committee has only risen in recent years. In due course, a proposal will be tabled on adjusting remuneration for all the committees established by the Supervisory Board for the general meeting to pass judgment on.

Supervisory Board remuneration for the financial year 2006 is made up as follows (exclusive of VAT):

- The Chairman of the Supervisory Board received fixed remuneration of EUR 15,000 and a variable emolument of EUR 37,500. EUR 15,000 was paid for attending meetings and EUR 2,000 for taking part in meetings of the Audit Committee.
- The Deputy Chairman received a fixed emolument of EUR 10,000 and variable remuneration of EUR 25,000. Attendance money came to EUR 10,000 (Board of Directors Committee) and EUR 2,000 for the Audit Committee.
- The Chairman of the Audit Committee received a fixed emolument of EUR 10,000 and variable remuneration of EUR 25,000. Attendance money came to EUR 8,000 (Board of Directors Committee) and EUR 2,000 for the Audit Committee.
- The other nine members of the Supervisory Board each received a fixed emolument of EUR 5,000 and variable remuneration of EUR 12,500. Total attendance money paid was EUR 45,000, of which seven of the nine members received EUR 5,000 each, one member EUR 4,000, and one member EUR 6,000 (including attendance money for the Audit Committee).

This spells total emoluments for the Supervisory Board of EUR 364,000; of this figure, EUR 80,000 was for fixed emoluments, EUR 200,000 for variable remuneration, and EUR 84,000 for attendance money.

The employee representatives on the Supervisory Board state that a notable part of their emoluments and remuneration is donated to the Hans Böckler Stiftung.

Advisory Council

In line with the authorization of the general meeting of 2006, the Management Board has established an Advisory Council to which it appointed four experts; moreover, HARTMANN's Honorary Chairman is a permanent observer on the Council. The Council's brief is to advise the Management Board. The Advisory Council had two meetings in 2006.

The Advisory Council is chaired by the Chairman of the Company's Supervisory Board in order to ensure the close involvement of the Council in issues that are crucial to the Company. The Chairman of the Supervisory Board receives no remuneration for this additional duty; the other members of the Council receive attendance money of EUR 1,500 each per meeting.

Shareholder relations

The shareholders exercise their decision-making and controlling rights at the annual general meeting where every share is accorded one vote. Shareholders have the opportunity of exercising their voting rights themselves or of appointing a proxy. PAUL HARTMANN AG supports its shareholders in the exercise of their voting rights by offering them a voting rights proxy.

Shareholders receive the necessary documentation for the annual general meeting directly from the company. The annual report of the HARTMANN GROUP and the annual financial statements of PAUL HARTMANN AG, the invitation, the agenda for and other documentation connected with the general meeting are made available on the HARTMANN Web site.

However, in individual cases we reserve the right to take advantage of any available simplifications of the German Companies Act with regard to invitations to annual general meetings and the holding of such meetings and to supply our shareholders directly with certain documents, e.g., individual corporate contracts and the associated reports. We shall continue to do this in future, in particular when the publication of such documents beyond the scope of our shareholders could have an adverse effect on the interest of the Company (item 2.3.1).

Given our shareholder structure and the regular presence at our general meetings of more than 85 % of the share capital, we at present see no appropriate benefit from transmitting the general meeting by modern communications media commensurate with the costs. For this reason, we do not avail ourselves of such media.

PAUL HARTMANN AG has not in the past produced any interim reports in the sense of section 40 of the Stock Exchange Act, as the Company is not a publicly-listed corporation in the sense of section 3, para 2, AktG.

As of business 2007, the regulation on producing interim reports pursuant to section 40 of the Exchange Act has been annulled by the Transparency Directive Implementation Act and has been replaced by a duty to prepare six-monthly financial reports pursuant to section 37w para 1, sentence 1 of the Securities Trading Act as well as to disclose quarterly financial reports or interim communications from management in line with section 37x paras. 1 and 3 of the same act.

As in the past, PAUL HARTMANN AG does not intend to publish six-monthly or interim reports, as this could disadvantage it compared with the competition. However, we do inform the public about the company's performance by means of press releases on a quarterly basis. In parallel with this we inform our shareholders of company performance by means of a quarterly letter in the first three quarters of every year. These letters to shareholders will likewise be posted on the Company's Web site as of 2007.

Since PAUL HARTMANN AG is not listed on the stock exchange as a company in the sense whereby the stipulations relating to publishing ad hoc disclosures and directors' dealings and the obligation to publish any significant changes to shareholdings in accordance with the German Securities Trading Act would apply, items 6.1 and 6.2 of the German Corporate Governance Code do not apply. The Board of Management and the Supervisory Board have also decided against disclosing details of their possession of company shares or associated financial instruments in accordance with item 6.6 of the German Corporate Governance Code, in order to preserve the privacy of the respective Board members.

In our individual company financial statement and our consolidated financial statements we publish a list of shareholdings indicating names, locations and our respective stake in the capital. We refrain from stating the equity capital and the earnings for the past financial year in the AG's company financial statement as PAUL HARTMANN AG takes advantage of the exemption regulations laid out in section 286 paragraph 3 sentence 1 German Commercial Code HGB.

PAUL HARTMANN AG only maintains shareholdings that are governed by section 285 number 11 of the German Commercial Code (HGB) but not by 7.1.4 of the German Code of Corporate Governance.

Audit of annual financial statements

On May 19, 2006, the PAUL HARTMANN AG general meeting appointed the PricewaterhouseCoopers Aktiengesellschaft accountancy firm in Stuttgart to audit our annual financial statement and our Group financial statement for business 2006. As a first step, the Audit Committee verified whether the auditors displayed the necessary impartiality. After the election, the Audit Committee recommended to the Supervisory Board that they award the auditing commission accordingly. This included a recommendation with regard to arranging a fee. The Audit Committee decided on the focus of the audit, called the auditor in for consultations about the annual financial statements and the Group financial statements and instructed him to report on the basic results of his audit.

Voluntary declaration of conformity

Section 161 sentence 1 of the German Corporation Act obliges the Boards of Management and the Supervisory Boards of companies listed on the stock exchange to make a declaration every year that they have complied or will comply with the recommendations published by the "Government Commission on the German Code of Corporate Governance" (hereinafter referred to as "the Code") or to state which recommendations they have not adhered to or will not be adhering to on a permanent basis.

Even though PAUL HARTMANN AG is not a company listed on the stock exchange in the sense of section 3, para. 2 AktG, the Board of Management and the Supervisory Board agreed for the first time as regards business 2005 to make a voluntary declaration concerning the recommendations of the Government Commission on the German Code of Corporate Governance.

On March 27, 2007, the Board of Management and the Supervisory Board for the second time made a voluntary declaration in compliance with the German Corporate Governance Code in keeping with section 161, AktG. In fact, PAUL HARTMANN AG complies with most of the provisions of the Code. There is however a series of provisions with which PAUL HARTMANN AG does not comply because of certain specific features of the company. This declaration of compliance has been published on the Internet in the Investor Relations section of www.hartmann.info and is updated whenever there are any changes. Declarations of compliance that are no longer valid can be accessed here for five years.

The voluntary declaration is worded as follows: