



Adequate compensation for managing directors of stock corporations

The German law concerning the adequateness of compensation for managing directors of stock corporations (Gesetz zur Angemessenheit der Vorstandsvergütung – VorstAG) has entered into force on August 5, 2009. It contains important changes for the role of the members of the supervisory board concerning the determination of compensation of managing directors.

1. Compensation of managing directors of stock corporations

The compensation of managing directors of a stock corporation must correspond in an adequate way with the performance of the managing director and may not exceed the usual compensation without specific reasons. It must also correspond to the responsibility of the managing director as well as to the situation of the company. With the “adequate” test, the legislator not only refers to the branch and size of the company, but also to the salaries paid within the company.

In case of publicly listed companies, the continuity of the development of the company has to be taken into account as well. Thus, especially variable compensation schemes have to be based on the performance over several years. Further, the supervisory board has to provide for caps concerning extraordinary developments.

In the future, only the whole assembly of the supervisory board may fix the compensation of the members of the managing board. Only preparatory measures may be delegated to a committee of the supervisory board. This will result in necessary changes of the statutes of the company and the internal regulations of the supervisory board.

The supervisory board, further, is entitled to reduce the compensation of the managing directors, if the financial situation of the company is becoming worse so that the continued payment of the agreed salaries would be unjust for the company. This is, for instance, true if the company has to lay off personnel or cannot distribute any profits; in case of an insolvency or a financial crisis these requirements are met anyhow.

The liability of the members of the supervisory board has been increased. If the supervisory board does fix an inadequate compensation for the managing directors, the supervisory board becomes liable vis-a-vis the company.

2. Deductible in case of D&O insurances

Members of the supervisory board must agree on a deductible (net retention, a specified amount of each loss) of at least 10 % of the damages caused to a company, at least, however, in the amount of 150 % of the fixed annual compensation of the managing director. It is discussed, whether such risk may be insured personally by the managing directors. The law does not rule this out. In fact, there are already insurance companies which cover the risk of the deductible.

3. No direct change from the managing board into the supervisory board

Hitherto, managing directors may not become members of the supervisory board for a period of at least two years (“cooling-off period”). This should rule out conflicts of interests. However, this rule does not apply if the managing director is voted into the supervisory board by shareholders holding more than 25 % of the votes in the company.

4. Does the law also apply for limited liability companies?

It is discussed, whether the new rules also apply for the supervisory board of a limited liability company (GmbH) or a limited partnership (GmbH & Co KG). The prevailing view presently is that the law does not apply for limited liability companies with a facultative supervisory board or in case of companies with more than 500 and less than 2.000 employees having a so-called one-third-participation in the supervisory board of the employees. In case of companies with more than 2.000 employees where a mandatory equal participation of the employees in the supervisory board is provided, the application of the new law is rather affirmed in the legal discussion.

5. Summary

There are many questions concerning the new law on the compensation of managing directors. In our office, attorneys Dr. Theodor Seitz and Dr. Christoph Knapp would be glad to advise you thereon, if you have any questions in this regard.