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Client Letter

Update Corporate Law / Mergers & Acquisitions

v. BOETTICHER | HASSE | LOHMANN

Speed Read:

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- Remuneration to be determined by the entire Supervisory Board rather than by a Supervisory Board Committee only
- Liability of the members of the Supervisory Board for agreeing on excessive remuneration of Management Board Members

New provisions and recommendations on corporate governance

- Directors & Officers' insurances to contain a deductible of 10 %, capped at not less than the Management Board Member's salary for one and a half years
- Appointing former Management Board Members to the Supervisory Board will be restricted
- Management Board Members recommended to hold not more than three Supervisory Board positions in listed companies outside the group

Corporate restructuring facilitated

- Shareholder Rights Directive expected to be implemented in German law on 1 August 2009
- Corporate restructuring in Germany will be accomplished faster
- New regulations restrict so-called predacious shareholders in delaying the entry of restructuring measures into the Commercial Register

Easements in National Merger Control

- Additional threshold of EUR 5 million domestic turnover

New provisions and recommendations on Management Board remuneration

As part of the legislative reforms following the financial crisis, the German Federal Parliament adopted on 18 June 2009 a new "Law on the Fairness of Management Board Remuneration" (*Gesetz zur Angemessenheit der Vorstandsvergütung – VorstAG*), which introduces new rules regarding the remuneration of members of the Management Board (*Vorstand*) of German Stock Corporations (*AGs*). The German legislator is of the opinion that the previous regime allowed excesses which contributed to the financial crisis and decided to implement stricter rules which are supposed to secure a more sustained corporate management.

Simultaneously with the adoption of the new Law on the Fairness of Management Board Remuneration, the German Corporate Governance Code (*GCGC*) has been amended. The GCGC contains recommendations of good governance. German listed Stock Corporations are obligated to render an annual compliance declaration in which they declare whether or not – and why not – they adhere to the recommendations of the GCGC (*Comply or Explain*). The amendments to the GCGC now adopted introduce recommendations which go even beyond the new statutory regime.

The new rules and recommendations regarding Management Board remuneration comprise, in particular, the following:

- Management Board remuneration has to be determined in proportion not only with the respective Management Board Member's responsibilities and the corporation's financial state, but also with the respective Management Board Member's individual performance.
- The Management Board remuneration must not exceed "customary" levels, unless such is justified by specific reasons. The legislative materials as

well as the new GCGC suggest that the Management Board remuneration shall be both (a) in line with remunerations paid by other corporations of the same branch, size and country of origin and (b) in proportion with the salaries paid to other employees within the corporation.

- In the case of listed corporations, the remuneration system must be designed to foster sustained business development. Variable remuneration components shall set targets for several years and there shall be the possibility of caps in the case of unexpected developments. The legislative materials and the new GCGC further specify that variable remuneration components shall be influenced by both positive and negative business developments and any remuneration shall not incentivize the assumption of inappropriate risks.
- The statutory minimum waiting period to be safeguarded before stock options may be exercised, has been extended from two to four years.
- If the financial situation of the corporation deteriorates after the remuneration has been agreed, and if the continued payment of the remuneration originally agreed would appear unfair from the point of view of the corporation, the remuneration shall be appropriately reduced.
- The Management Board remuneration must now be determined by the entire Supervisory Board (*Aufsichtsrat*) rather than by a Supervisory Board Committee only.
- The members of the Supervisory Board are personally liable for agreeing on excessive remuneration of Management Board Members.
- The Shareholders' Meeting of listed Stock Corporations may pass declaratory resolutions regarding the Management Board remuneration system. Such resolutions are, however, non-binding and do not release the Supervisory Board from its responsibilities in determining the remuneration.
- The GCGC recommends that external advisors rendering advice as to Management Board remuneration be independent from the Management Board and the corporation.
- In the future, the notes to annual and consolidated financial statements must, in addition to existing accounting requirements, contain also specific disclosures as to agreed severance payments (including the assessment of their cash value and provisions made), of amendments to remuneration commitments agreed during the business year and of payments made to former Management Board Members.

New provisions and recommendations on corporate governance

Besides provisions on the remuneration of Management Board Members, the new Law on the Fairness of Management Board Remuneration and the new GCGC implement also important amendments regarding corporate governance:

- A Directors & Officers' insurance (*D&O-insurance*) must now contain a deductible of 10 % of the damage, the cap being not less than one and a half of the respective Management Board Member's annual fixed salary. The GCGC recommends the same deductible for the D&O-insurance of members of the Supervisory Board.
- Following a highly controversial discussion the new law now mandates a "cool-off-period" of two years for former Management Board Members before they are allowed to be appointed as members of the Supervisory Board. Prior to the expiration of such two years cool-off-period a former Management Board Member may only be appointed to the Supervisory Board if such appointment is proposed by shareholders which hold more than 25 % of the voting rights. Additionally, the GCGC recommends that appointing such person as Chairman of the Supervisory Board be an exception and the reasons for such appointment be explained to the Shareholders' Meeting.
- The new GCGC recommends that, in addition to the statutory limitations already in place (one individual not to hold more than 10 Supervisory Board positions, Chairman positions counting double), a Management Board Member of a Stock Corporation shall not assume more than three Supervisory Board positions in listed companies outside of the group (previously: five positions).
- Furthermore, the GCGC recommends a higher degree of "diversity" within the Management Board and Supervisory Board. Even though the GCGC fails to define the term "diversity", a statement of the Government Commission responsible for adopting the GCGC indicates that this recommendation is supposed to sponsor the appointment of women and foreigners to Management Board and Supervisory Board positions. Hence, the GCGC recommends a more international composition of both boards and the inclusion of women.

Corporate restructuring facilitated

The German Federal Parliament adopted also a bill to implement the Directive 2007/36/EC of the European Parliament and the Council as of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (*Shareholder Rights Directive*). It is expected that the new law will be effective as of 1 August 2009. One of the aims of the new law is to facilitate the use of new media in connection with Shareholders' Meetings and the exercise of shareholders' rights. In particular, listed companies have to publish documents related to the Shareholders' Meeting on their website and to remit the invitation to other media for Europe-wide distribution. The Articles of Association can furthermore allow a shareholder to attend the Shareholders' Meeting and vote electronically.

Beside these facilitations for shareholders, a second task of the new law is to facilitate corporate restructuring. Under German law, the squeeze-out of minority shareholders, capital increases, profit and loss transfer agreements as well as mergers, splits or spin-offs of companies become effective only after a respective resolution of the Shareholders' Meeting has been adopted and registered in the Commercial Register. Such entry into the Commercial Register can be delayed as long as lawsuits of (minority) shareholders demanding a rescission of the Shareholders' Resolution are pending. In the past, shareholders holding only a few shares took advantage of this legal situation and notoriously filed lawsuits against restructuring resolutions with the aim of delaying the process. Such plaintiffs' intention was to create a "nuisance value" and be paid for withdrawing their action (*predacious shareholders* or *professional plaintiffs*).

The new law intends to cope with such abuses by implementing, inter alia, the following changes:

- Corporations faced with a lawsuit filed by a minority shareholder against a restructuring measure have the possibility of applying to the court in a summary proceeding to have the restructuring measure cleared for its entry into the Commercial Register (*Clearing Proceeding*). The court will clear the restructuring measure if the minority shareholder's complaint is (a) inadmissible or (b) obviously without merits or (c) if an expedited registration of the restructuring measure appears necessary in order to prevent damages of the corporation and its shareholders. The Clearing Proceeding has now been concentrated in one instance: Pursuant to the new law, the respective Court of Appeals (*Oberlandesgericht*) decides exclusively on the motion to clear the restructuring measure. Such court's decision could typically be made within a period of three months. By virtue of the new law, such decision is final and non-appealable. This should accelerate corporate restructuring measures.
- The Clearing Proceeding described above has further been facilitated by introducing an obligation of the court to approve the restructuring measure for entry into the Commercial Register if the plaintiff does not prove that it holds, and has held since convocation of the respective Shareholders' Meeting, shares in the corporation with a nominal value of at least EUR 1,000. This means that pursuant to the new law only a minority shareholder which holds shares with the nominal amount of at least EUR 1,000 has the possibility to delay restructuring measures. If a share with a nominal amount of EUR 1 has, for example, a stock exchange value of EUR 5, EUR 10 or EUR 20, predacious shareholders would have to invest EUR 5,000, EUR 10,000 or EUR 20,000, respectively, in order to be able to delay restructuring measures. This should shy predacious shareholders away from filing lawsuits and make restructuring measures accomplished easier and faster in the future.
- The new law is directly applicable to restructuring measures of German Stock Corporations. It is also applicable to mergers, splits and spin-offs of a German Limited Liability Company (*GmbH*). Currently, it is not clear, however, whether it is further applicable to lawsuits against capital increases and profit and loss transfer agreements of a GmbH.

Easements in National Merger Control

A recent change in the German merger control rules easily goes unnoticed. Among a whole range of regulatory and tax easements meant to relieve small and midsized companies, the "Third Act on Easements for Small and Mid-Sized Companies" *(Drittes Mittelstandsentlastungsgesetz* – BGBl. I No. 15 of 24 March 2009 p. 550) introduced a further threshold which needs to be exceeded in order for a merger to come under the German merger control provisions and in particular under the notification requirement. Prior to such change a business combination was subject to German merger control where in the last business year preceding the combination

- the combined aggregate worldwide turnover of all participating undertakings was more than EUR 500 million, and

- the domestic turnover of at least one participating undertaking was more than EUR 25 million.

Both thresholds were easily met where an international business group acquired a business in Germany (even if this German business was only a small part of the total acquired business).

As from 25 March 2009 the domestic turnover of one participating undertaking needs to exceed EUR 25 million and *additionally* the domestic turnover of another participating undertaking needs to exceed EUR 5 million. It remains to be seen whether this extremely low threshold will indeed lead to a significantly lower number of notifications in Germany.

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