Michael Kling, Marburg*

The appropriateness of directors' compensation under Para. 87 of the German Stock Corporation Act 2009

– Outline –

A. Introduction 3
I. The origins of Para. 87 SCA 3
II. Reform under the Appropriateness of Directors' Compensation Act 2009 (VorstAG) 4
B. Individual questions 7
I. The four criteria of the “appropriateness test” under Para. 87 Sect. 1 7
1. The functions of the director 7
2. The performance of the director 8
a) Development 8
b) Definition 9
c) Critical issues 11
3. The condition of the company 13
a) Definition 13
b) Companies in need of restructuring 14
4. Customariness of the compensation 15
a) The horizontal level 15
b) The vertical level 17
5. Miscellaneous criteria 21
II. Sustainability and longevity as elements of the compensation structure .. 23
1. Definition of “sustainability” 23
2. Variable compensatory elements versus rigid deadline-dependant compensation 25
a) Summary 25
b) Extended holding periods for stock options 26
III. Retroactive reduction of directors’ compensation under Para. 87 Sect. 2 SCA 27
1. Summary of the changes 27
2. Factual requirements for reduction 28
3. Outlook 30
IV. Competence and legal consequences of a breach 31

* Originally published in Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht 2010, p. 221 et seqq. as “Die Angemessenheit der Vorstandsvergütung gemäß § 87 AktG n.F.” The article has since been slightly modified and updated by the author for the purpose of a lecture at Sungkyunkwan University (College of Law), Seoul, Korea, on April 2, 2012.

1. Competence 31
a) Summary 31
b) Evaluation of the new provision 32
2. The supervisory board's liability under Paras. 116, 93 SCA 34
a) Principles of liability 34
b) D&O insurance 35
V. Does Para. 87 SCA apply to other types of companies? 36
1. Cooperatives 36
2. Private limited companies (GmbH) 37
C. Conclusion 38

A. Introduction

I. The origins of Para. 87 SCA

German civil law and German commercial law are both characterised by the principle of private autonomy in controlling one's own legal affairs, although this principle is subject to the general limitations in Paras. 134 and 138 of the German Civil Code. These limits are occasionally considered insufficient in certain areas of the law, prompting the legislature to act swiftly to impose more specific restrictions which are better suited to solve the legal conflict in question. The German law on stock companies has been subject to this treatment many times. Even in the early 1930s, the extensive freedoms granted by this law already resulted in directors receiving very high salaries and participation rights, regardless of their functions and contributions, and which were paid out even if

– the company's economic situation was hopeless,

– the employees were forced to work reduced hours or

– were made temporarily or permanently redundant.[1]

As a result, statutory principles for the compensation of directors were introduced for the first time in Para. 78 Sect. 1 of the Stock Corporation Act of 1937 (SCA 1937)[2], which were intended to protect the company and all parties participating in it.[3]

---

[1] *Kort*, in: Großkommentar zum Aktengesetz, 4th edition 2008, para. 87 no. 7 ff.; *Spindler*, in: Münchner Kommentar zum Aktiengesetz, 3rd edition 2008, para. 87 no. 6.

[2] Reichsgesetzblatt (hereafter RGBl.) 1937, p. 107, 121. Para. 78 SCA dates back to part 4, chapter III para. 1 Sect. 1 of the Third Decree of the President of the German Reich for Securing the Economy and Finances, dated 6 October 1931 (RGBl. 1931 I, S. 537, 557). The law maker responded to the world economic crisis by regulating the possibility of reducing the remuneration. The provision was originally named: "Reduction of excessively high compensation" and read: "If an employer has been obliged to pay compensation according to a contract of employment in which he entered before the provisions of this chapter came into force and the agreed payment is excessively high considering his business and financial situation or the changed economic situation, any further payment is against an act of good faith and therefore can not be reasonably expected which is why the employer is entitled to reduce the compensation of the employee down to a reasonable margin by a written statement."

This was closely linked to the possibility of reducing directors' salaries in the event that the condition of the company deteriorated significantly (Para. 78 Sect. 2 SCA 1937).[4] The cited provisions of the 1937 SCA were incorporated into Para. 87 of the 1965 SCA without any significant changes.[5] Since then, Para. 87 Sect. 1 of the SCA 1965 has contained a limitation on the freedom of contract in the form of an appropriateness requirement,[6] which exceeds the general limitations of Paras. 134 and 138 of the German Civil Code.[7]

II. Reform under the Appropriateness of Directors' Compensation Act 2009 *(VorstAG)*

The "Act on the Appropriateness of Directors' Compensation" (hereafter AADC) ("Gesetz zur Angemessenheit der Vorstandsvergütung", hereafter abbreviated as VorstAG) passed by the German Parliament ("Deutscher Bundestag" in German) on June 18, 2009 is one of a number of important amendments with regard to the law of

---

[3] *Spindler*, in: Münchner Kommentar, 3rd edition 2008, para. 87 no. 6; official justification for the SCA of 1937, printed in *Klausing*, Aktienrecht, 1937, p. 64; *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 1.

[4] Para. 78 Sect. 2 SCA of 1937 had the following wording: "If a significant deterioration of the economic business condition occurs after the determination of the total amount of remuneration for each individual member of the management board has taken place, maintaining such compensation would be highly inequitable for the company which is why the Supervisory Borad is entitled to reduce the total remuneration down to an appropriate amount. The contract of employee is not affected by such a measure. However, each member of the management board may terminate the employment contract by the end of the following calendar quarter within a cancellation period of 6 weeks."

[5] Para. 78 SCA of 1937 included no specific National Socialist unjustice. Nonetheless, former scholars interpreted the National Socialist principle "public welfare befort private interest" into it, see *Schlegelberger/Quassowski*, Aktiengesetz 1937, 3rd edition 1939, para. 78 no. 1.

[6] More precisely: A limitation – being rather flexible than stiff – is drawn by the appropriateness requirement at the discretion of the supervisory board being responsible for the determination of the remuneration of the management board, see *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 1.

[7] *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 1 and no. 8. Thus, breaches of para. 87 sect. 1 SCA do not invalidate the employment contract according to para. 138 of the German Civil Code; this may only lead in extreme exceptional cases to the invalidity according to para. 138 of the German Civil Code.

public companies in the last ten years. The law came into force on the 5th of August 2009.

The AADC is a direct legislative consequence of the financial crisis and insofar a result of the legislature identifying “fallacious incentives in the compensatory system” as “one of the factors which abetted the financial crisis”. It was of the opinion that many companies had been too focused on reaching short-term goals such as increased turnover figures or raising stock prices by arbitrary deadlines. The management of companies were thus considered to have lost sight of the long-term well-being of their companies. This was also identified as having been conducive to the taking of unreasonable risks. This is why it is one of the goals of the AADC to “boost incentives in the directors' compensatory structure in favour of management which promotes sustainability and longevity”.[8] Therefore, the reforming legislature is thus explicitly referring to the successes which were achieved with the introduction of the appropriateness limitation by the SCA 1937.[9] The revised version of Para. 87 Sect. 1 SCA of 2009 is meant to achieve this goal by forcing companies to offer potential directors better incentives for promoting sustainable company growth[10] when their compensation is being negotiated.

The decisive criterion of appropriateness contained in Para. 87 Sect. 1 SCA remains unchanged, but is now supplemented by *four* instead of just *two* additional criteria (more on this presently under B. I.). Furthermore, the changes made to Para. 87

---

[8] Resolution and report of the German Legal Committee, German Bundestag Printed Paper (hereafter BT-Drs.) 16/13433, p. 1.

[9] BT-Drs. 16/12278, p. 5.

[10] More about the definition in *Hoffenstatt/Kuhnke*, Zeitschrift für Wirtschaftsrecht 2009, p. 1981, 1982: Para 87 sec. 1 SCA addresses to the quality of the defined objectives. Sentence 2 of the provision includes the determination of goals or rather parameters showing an appropriate indicator for a sustainable corporate development. In contrast, sentence 3 of the provision subjects only the period of the remuneration rules. In particular, para. 87 sect. 1 sentence 2 SCA aims to avoid that the board takes inappropriate risks only to optimize its compensation but which are not in line with the interests of the corporation

Sect 2 SCA in 2009 will make it easier to reduce directors' compensation where the company's condition has deteriorated.

The reforming legislature has refrained from prescribing a specific amount of compensation or fixing a general cap for permissible compensation in the Stock Corporation Act.[11] In addition, supervisory boards shall only agree on the possibility of a cap under Para. 87 Sect. 1 sentence 3 SCA in case of “extraordinary developments”[12] and this can only be done by listed public companies. The Minister for Justice at the time, Mrs. *Brigitte Zypries*, was of the opinion that determining the amount of directors' compensation was not a matter for the state but for the contractual parties. The fundamental perception that the law is not suited to determining a “fair price” thus remains valid, especially in a market economy characterised by the interaction of supply and demand.[13] In addition, scholars believe that the circumstances in which the directors of public companies find themselves are simply too diverse to make any numerical stipulation possible. This does not apply to the structure of the appropriateness test, the essentials of which can at least be elaborated on using a variety of clarifying criteria.

---

[11] Contrary to a legal obligation to cover the remuneration quantitatively, see already *Dreher*, RWS-Form 25 Company Law 2003, 2004, p. 203, 216 f.

[12] It addresses obviously *extraordinary* developments. This includes, for example, company takeovers, the sale of company shares, the recognition of hidden reserves or external influences, see *Annuß/Theusinger*, Betriebs-Berater 2009, p. 2434, 2437 with reference to the point of view of the Legal Committee of the German parliament.

[13] See *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 20; *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 3; *Hohenstatt*, Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1357.

B. Individual questions

I. The four criteria of the "appropriateness test" under Para. 87 Sect. 1 SCA

The term "appropriateness of compensation" is not legally defined. It was evaluated on the basis of two criteria under the previous version of Para. 87 SCA: firstly, the functions of the director in question and, secondly, the condition of the company. Both of these criteria have been retained under the new 2009 version of Para. 87 SCA, but were supplemented by two additional criteria, namely the performance of the director on the one hand and, on the other hand, whether or not the amount of compensation is customary.[14] As it was previously the case, only the total compensation and not the individual earnings of the director are relevant for this evaluation.

We will not consider any and all conceivable individual elements of compensation here. To aid in the understanding of the following deliberations, it should be borne in mind that granting high participation rights and a high pension can be justified by a low base salary during a director's term in office.[15]

1. The functions of the director

The first point of reference in the "appropriateness test" is the function of the director in question. This initially depends on the types of tasks that are entrusted to the director on his appointment. For example, if a director is appointed as the chairman

---

[14] The situation is a slightly different with respect to the compensation of the members of the supervisory board. According to para. 113 sect. 1 sentence 3 SCA it is determined, that the remuneration must be "in a reasonable proportion to the duties of the members of the supervisory board and the economic situation of corporation".

[15] *Spindler*, in: Münchner Kommentar, 3rd edition 2008, para. 87 no. 22.

of the board by the supervisory board, it is very likely that it will be appropriate to pay him a higher level of compensation.[16]

Additionally, gradations among the individual directors may be justified by the differing importance of the functions with which they are entrusted.[17] Scholars are of the opinion that special skills, knowledge, experience, length of service as a director and the extent of the responsibility assumed can justify differential treatment. This also applies where different areas of responsibility make greater demands on the relevant directors.[18] For instance, the responsibilities of the chief financial officer will probably outweigh those of most other board members.[19] Stipulating individual job profiles and performance specifications does not contradict the principle of the board's collective responsibility.[20]

2. The performance of the director

a) Development

Making a director's compensation dependent on his performance is new aspect to the *law*, although performance-based compensation has long been accepted by the German courts before.[21] The performance criterion of Para. 87 Sect. 1 sentence 1

---

[16] *Spindler*, in: Münchner Kommentar, 3rd edition 2008, para. 87 no. 28; *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 4; *Kort*, Neue Juristische Schulung 2005, p. 333; *Schwark*, Festschrift Raiser, 2005, p. 377, 384.

[17] *Semler*, Festschrift Budde, 1995, p. 599, 601 f.: special and important duties for the corporation as well as an additional responsibility has justified higher performance-related amounts of remuneration. Significant unjustified differences with reference to the amount of compensation between individual members of the board were inadmissible. This prohibits, for instance, enhancing the position of board members that are shareholders or relatives of shareholders.

[18] *Spindler*, in: Münchner Kommentar, 3rd edition 2008, para. 87 no. 28.

[19] *Dreher*, RWS-Form 25 Company Law 2003, 2004, p. 203, 210.

[20] *Spindler*, in: Münchner Kommentar, 3rd edition 2008, para. 87 no. 28; *Schwark*, Festschrift Raiser, 2005, p. 377, 383 f.

[21] *Kort*, in: Großkommentar zum Aktengesetz, 4th edition 2008, para. 87 no. 30 ff.; *Lutter*, Zeitschrift für Wirtschaftsrecht 2006, p. 733, 735; *Fleischer*, Neue Zeitschrift für Gesellschaftsrecht 2009, p. 801, 802; *Suchan/Winter*, Der Betrieb 2009, p. 2531, 2533. So far, in practice performance characteristics

SCA is derived from the German Corporate Governance Code ("Deutscher Corporate Governance Kodex", referred to as DCGK hereafter),[22] which is only applicable to listed companies. The principle of appropriateness or commensurability just benefits is "a fundamental principle of the free market economy and an indispensable axiom for its moral justification".[23] In light of this, the reasons for incorporating the performance criterion into the law appear to be convincing.

b) Definition

The exact meaning of the term "performance" has not yet been sufficiently clarified. Additionally, the explanatory note accompanying the Act is also silent on this question. However, this throws up a number of questions from the industry's point of view: criteria like the number of work hours (based on the equation "performance = work per time period") or a director's managerial style surely cannot be decisive factors, although there are some who qualify successes in the field of "soft skills" as being worthy of emolument.[24] It is further questionable whether the quality of decision-making and execution should or may be taken into account. This in con-

---

have been partly "smuggled into" the law by using the criterion in para. 87 sect. 1 SCA (old version) concerning the duties of the board members. Some scholars have even quite open qualified the defined characteristics in the provision as incomplete, see *Schwark*, Festschrift Raiser, 2005, p. 377, 384; "The legal criterions on remuneration are mainly viewed by scholars as insufficient and not exhaustive." *Hofmann-Becking* has named it once as "strange" that the former version of the provision considered the duties, but not the performance factor. It seems incomprehensible that – according to the wording of the provision – it is disregarded how good or bad a member of the board performans its defined duties; the statutory wording may be rather seen as a failure of the legislature, see *Notz*, Diskussionsbericht zum Referat *Dreher*, RWS Forum Company Law 2003, 2004, p. 247, 248. Already at the times of the SCA of 1937, the performance of the board members have been acknowledged as an assessment factor for the amount of remuneration, see *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87, no. 6.

[22] As amended on 6 June, 2009.

[23] *Peltzer*, Festschrift Lutter, 2000, p. 571, 586.

[24] *Annuß/Theusinger*, Betriebs-Berater 2009, p. 2434 with reference to *Goette,* Stellungnahme zum Entwurf des VorstAG, 17 May, 2009, p. 4.

trast raises the question of practicability and the supervisory board's ability to assess the latter.[25]

Scholars have been asking the critical question: Should the definition of the term performance really (only) refer to the input a director has in the value creation process or should it actually be taken to mean the results he has achieved? In other words, should the relevant factor not be how successfully the director fulfils his function? It cannot be denied that a result-based approach is sensible from a legal perspective. However, from an economics perspective this interpretation of the term "performance" is considered to be "economically inconsistent as the performance on the one hand and the result on the other hand cancel each other out as bases of assessment."[26]

Actually, it is internationally quite common to have a not-inconsiderable amount of a director's compensation linked to the prosperity of his company and the personal success of the respective director.[27] The relevant figure by which the prosperity of the company and the successfulness of its directors are measured is always its results, i.e. its profitability[28] and not the share price it has on a particular deadline.[29] Scholars have proposed the following compensation-related criteria for assessing a director's success: "success spanning several periods of time",[30] "raising the company's value"[31], and furthering "complementary company business ob-

---

[25] *Suchan/Winter*, Der Betrieb 2009, p. 2531, 2532.

[26] *Suchan/Winter*, Der Betrieb 2009, p. 2531, 2533.

[27] See *Thüsing*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 462 with reference, *inter alia*, to the regulations of Great Britain and Belgium.

[28] See *Schwark*, Festschrift Raiser, 2005, p. 377, 386; "The economic situation of the corporation is more likely to be determined by its profitability."

[29] Like this already *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 470, 478 ff.

[30] *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 4 c, although with the restriction, that an increase of the enterprise value is not necessarily connected to it.

[31] Concisely *Semler,* Festschrift Budde, 1995, p. 599, 602.

jectives such as safeguarding employment, raising profits and increasing market shares"[32].

c) Critical issues

One critical issue with the performance requirement is the admissibility of pure fixed salaries since they are not suited to rewarding future performance. However, despite these problems, scholars agree that the legislature did not intend to prohibit pure fixed salaries with the AADC.[33] They are consistent with the telos of the Act insofar as a director who receives a fixed salary has no cause to pursue short-term results in order to positively influence his own compensation.[34] However, despite suggestions to the contrary, it is questionable whether it is wise to agree on a pure fixed salary for a new director's initial employment phase due to the fact that it won't be possible to assess his performance until later.[35] Recent experience seems to have confirmed that there is a general trend towards agreeing higher fixed salaries while simultaneously reducing the amount of variable elements of directors' compensation.[36]

The German Corporate Governance Code (abbreviated as DCGK in German), on the other hand, recommends a combination of fixed and variable compensation elements under No. 4.2.3. The division of compensation into three components, namely

---

[32] *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 489.

[33] *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1350; *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2537.

[34] *Thüsing,* Die Aktiengesellschaft 2009, p. 517, 519; *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2537.

[35] See *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2533, who want to leave the performance criterion out of consideration; different *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1350 suggesting that a not inconsiderable amount of payment is to be configured variably and that it should be oriented on the personal performance of the board members or the entire board.

[36] *Hohaus/Weber,* Der Betrieb 2009, p. 1515, 1520 with further citation.; see also *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1350; *Hohenstatt/Kuhnke,* Zeitschrift für Wirtschaftsrecht 2009, p. 1981, 1982.

a fixed salary, an annual bonus[37] and a long term incentive plan[38], is definitely in line with present widespread practice. Currently, there is no apparent reason to compel anyone to abandon this division, although there are good reasons to shift the rules on directors' compensation in the direction of the sustainability requirement (more on this under B. II.).[39]

It must be noted that appreciation awards for directors' past performances are prohibited since the controversial and disputed "Mannesmann" judgment by the German Federal Supreme Court ("Bundesgerichtshof", abbreviated as BGH in German*)*, where the awards are exclusively rewarding in nature and the company has no future benefit from the activity of the retired director.[40] The commentaries, in reference to No. 4.2.2. of the German Corporate Governance Code, mention in respect of Para. 87 SCA: "Superior past performances justify very high future compensation. (...) This is not in any way invalidated by the fact that the board of directors is collectively responsible for the success of the company, as the individual performance of a director is ultimately reflected in the collective performance of the board."[41]. It must be assumed that these principles remain valid, i.e. that appreciation awards for past performance are still prohibited, while a director's past successful actions will continue to be allowed to affect his future compensation.[42]

---

[37] The traditional annual bonus is considered to be permissible in the future after the law maker included the required clarification in the explanation of the recommended resolution (BT-Drs. 16/13433), although it did not become part of the law itself, see *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1351.

[38] *Hohenstatt/Kuhnke,* Zeitschrift für Wirtschaftsrecht 2009, p. 1981, 1986.

[39] *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1357.

[40] BGH, decision of 21 December 2005 – 3 StR 470/04, BGHSt 50, 331 = Neue Juristische Schulung 2006, p. 522 with a discussion by *Fleischer,* Der Betrieb 2006, p. 542; detailed and critical see *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 21ff.; see further *Schwark*, Festschrift Raiser, 2005, p. 377, 380 clarifying correctly that such token of appreciation is in fact an ex post increase of the remuneration which is paid to individual board members for the past and thus not a compensation.

[41] *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 29.

[42] See in particular *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 24 f.; *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 4; cf. also *Hohaus/Weber,* Der Betrieb 2009, p. 1515, 1516.

3. The condition of the company

a) Definition

The third criterion for assessing the appropriateness of directors' compensation is the current condition the company is in. This term includes the economic situation of the company, particularly its actual financial situation, its earnings and its future development.[43] This means that a company's predicted development that has already been laid out is taken into account when assessing the appropriateness of its directors' compensation.[44] The size of the company and the economic sector it belongs to also matter.[45] According to the wording of Para. 87 SCA, the deterioration “in the company's condition” is the key factor. According to the literal interpretation of the provision, corporate development must be ignored.[46] However, it has also been argued that an overall view must be applied when assessing the appropriateness of the compensation of directors who hold multiple mandates within a company. This is in order to avoid any distortion, since running affiliated companies is also part of a director's duties.[47] As a result of this, No. 4.2.2. of the German Corporate Governance Code states that remuneration from other companies in the same group of companies must be taken into account when making an assessment under Para. 87 (“taking into account any group remuneration”). It seems as if the condition of the entire group of companies cannot be completely ignored when making the assessment of appropriateness. However, the situation that the company employing the director is in is still the most important aspect; even in case of double mandates, the decisive per-

---

[43] *Spindler*, in: Münchner Kommentar zum Aktiengesetz, 3rd edition 2008, para. 87 no. 31; *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 5; LG Düsseldorf, Neue Juristische Schulung 2004, p. 3275, 3278; *Schwark*, Festschrift Raiser, 2005, p. 377, 384; *Dreher*, RWS-Form 25 Company Law 2003, 2004, p. 203, 210.

[44] *Schwark*, Festschrift Raiser, 2005, p. 377, 384.

[45] *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 31; *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 2; *Lutter,* Zeitschrift für Wirtschaftsrecht 2006, p. 733, 735.

[46] *Diller,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 1006.

[47] *Spindler*, in: Münchner Kommentar zum Aktiengesetz, 3rd edition 2008, para. 87 no. 32; *Spindler,* Deutsches Steuerrecht 2004, p. 36, 39; *Schwark*, Festschrift Raiser, 2005, p. 377, 384; *Fleischer,* Deutsches Steuerrecht 2005, p. 1279, 1280.

spective for assessing each level of compensation is always the condition of the relevant company.[48]

b) Companies in need of restructuring

The mere fact that a company is having financial difficulties does not necessarily mean that it is only allowed to agree to low levels of compensation with its directors. The "condition" of the company doesn't only include its earnings, despite the fact that they are often the deciding factor.[49] A company in need of restructuring may have to find a person with the ability to lead it out of its crisis. In that case it can be appropriate to grant the director a high level of compensation despite the company's poor financial condition as doing so is in keeping with his special tasks, the risk he has assumed and the extraordinary situation the company is in.[50] Put simply, the high market value of "star company restructuring experts" with above-average success rates in their past employments is reflected in their compensation. However, in principle the rule is that where a company is in a bad state its directors' compensation can and must be adjusted downward accordingly. This follows from No. 4.2.2. of the German Corporate Governance Code, which allows taking the company's future prospects into account.

---

[48] *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 32.

[49] *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 33.

[50] *Kort*, in: Großkommentar zum Aktiengesetz, 4th edition 2008, para. 87 no. 35; *Hoffmann-Becking,* Neue Zeitschrift für Gesellschaftsrecht 1999, p. 797, 798; *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 2; *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 33.

4. Customariness of the compensation

The fourth and final sub-criterion of appropriateness is the question of how customary the level of a director's compensation is.[51] According to the wording that eventually became law, the total emoluments received may not surpass the customary level of compensation. It was originally envisioned that specific compensation should be guided by customary compensation or to be exact, that each director's total emoluments should be reasonably proportionate to the customary level of compensation.[52] However, this idea was eventually – and rightly – dropped due to the fear of its effect on the price/wage spiral.[53] The Act’s explanatory note shows that the reforming legislature took two levels into account when defining the term “customary compensation”, namely a vertical and a horizontal level.

a) The horizontal level

The horizontal comparison refers to “what is customary in the industry, for the size of the company and in that country”[54]. This means that companies which belong to the same sector which are comparable in size[55] and complexity are to be considered when assessing a director’s compensation.[56] The Act’s explanatory note explicitly focuses in particular on what is customary “within the Act's area of application”[57], i.e.

---

[51] Rejecting this criterion see *Lutter,* Handelsblatt no. 85, 5 May 2009, p. 8; *Lutter*, Stellungnahme zum VorstAG, 20 May 2009, p. 2; *K.-P. Müller,* Schriftliche Stellungnahme zum Entwurf eines Gesetzes zur Angemessenheit der Vorstandsvergütung (VorstAG), 20 May 2009, BT-Drs. 16/12278, p. 2.

[52] BT-Drs. 16/12278, p. 3, 5.

[53] BT-Drs. 16/13433, p. 15.

[54] Decision-Recommendation and Report of the Legal Affairs Commitee, BT-Drs. 16/13433, p. 10.

[55] The size of enterprise is according to a rather older study the most important determinant for the level of the remuneration of top managers, see *Kienbaum,* Vergütungsstudie 97/98, 1998, S. 9; *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 470; *Schwark*, Festschrift Raiser, 2005, p. 377, 386 stating that the enterprise size as measured by the numbers of jobs within the company has “an outstanding importance ... for the level of remuneration”.

[56] BT-Drs. 16/13433, p. 10.

[57] BT-Drs. 16/13433, p. 10.

in Germany. The legislature clearly wanted to cut German top managers off from opportunities to earn exorbitant incomes by working for Anglo-American companies.[58] Indeed, the permissibility of these opportunities was already discussed under the previous legislation; in some cases the invocation of the USA's rules on directors' compensation was rejected with reference to the considerable differences between the US and German systems.[59]

In practice, one must also consider that only a small number of German directors are in a position to make the switch to managing a US company, while the reverse is far more likely.[60] There is certainly no "real international management market" at this time.[61]

It is also doubtful whether Para. 87 SCA prohibits granting compensation above the nationally customary level: Firstly, the criterion of being customary within Germany is not contained in the wording of the law itself, but only in the explanatory note. Secondly, the possibility of a potential director earning more money abroad can be a special reason within the meaning of Para. 87 Sect. 1 sentence 1 SCA, which justifies the payment of an above-average and therefore (when measured against the German standard) non-customary compensation.[62] In order to successfully avail of this exception, the director will probably have to either be able to show that he actually received a better offer from abroad or that he at least had good prospects of a better-paid position in another country.[63] Past employment abroad can be circumstantial evidence thereof, but no more than that. Having been educated abroad to

---

[58] *Hohaus/Weber,* Der Betrieb 2009, p. 1515, 1516.

[59] *Spindler*, in: Münchner Kommentar zum Aktiengesetz, 3rd edition 2008, para. 87 no. 20, fn. 15.

[60] *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 471; see also *Schwark*, Festschrift Raiser, 2005, p. 377, 385 f. with further citiation; see also *Härtel,* Wirtschaftsdienst 2004, p. 347, 350 with reference to the banking sector.

[61] *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 468; *Thüsing.,* Stellungnahme zum Entwurf eines Gesetzes zur Angemessenheit der Vorstandsvergütung (VorstAG) (BT-Drs. 16/12278), p. 3.

[62] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2535.

[63] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2535; *Thüsing,* Stellungnahme, loc. cit. (fn. 63), p. 3.

some extent (for example: having been at a boarding school or having studied in Great Britain or the USA) is not in itself sufficient to justify making an exception.[64]

The online research service www.verguetungsregister.de[65], operated by the Federal Gazette (“Deutscher Bundesanzeiger” in German), as well as the "Managergehälter 2009" (Managers' Salaries 2009) study it published provide helpful points of reference for determining what is customary on the horizontal level. The use of an independent[66] compensation consultant is also a possibility.[67] The supervisory board is not obligated to use a consultant, but if it chooses to do so, it must first satisfy itself as to his independence.[68]

b) The vertical level

For the purposes of the vertical level of comparison, the legislature prescribes "taking into account the company's wage and salary structure"[69]. When assessing the appropriateness of directors' compensation, care must be taken "to avoid the company's remuneration scale losing its sense of moderation and relatedness to the remuneration conventions and the remuneration system of the company as a whole where its directors' are concerned"[70].

---

[64] The question is controversial: *Wagner/Wittgens,* Betriebs-Berater 2009, p. 906, 907 for whom an international training or a former employment relationship abroad is enough to be a ground for the exceptional regulation, while this is rejected by *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2535 who rather point out concrete offers or sufficient prospects for a better position abroad.

[65] *Bosse,* Betriebs-Berater 2009, p. 1650: “particularly helpful and practical”.

[66] A compensation consultant is only independent if he has no relation with the company and its board that would create a conflict of interest see *Fleischer,* Betriebs-Berater 2010, p. 67, 71.

[67] *Fleischer,* Betriebs-Berater 2010, p. 67 ff.; *Baums,* Die Aktiengesellschaft 2010, p. 53 ff.

[68] *Fleischer,* Betriebs-Berater 2010, p. 67, 74.

[69] BT-Drs. 16/13433, p. 10.

[70] BT-Drs. 16/13433, p. 10.

This is a new aspect in the interpretation of the compensation rules of the German law of public companies. It seems that the legislature wanted to react adequately to the envy-based debate which led to massively inflated directors' remuneration in the recent past as well as having driven a wedge between management and employees to some extent.[71]

In this context, scholars have elaborated on this issue by showing that the ratio between directors' compensation and the average wage in companies rose from 50-fold in 1997 to 240-fold in the years between 2001 and 2003.[72] According to a newspaper headline, the “salaries of the DAX-bosses have risen exorbitantly”[73], namely by up to 483% in ten years. Employees have not been able to achieve similar gains; in fact, actual earnings have fallen in some cases. Blessed is he who is a “DAX-boss”!

These figures are unmistakably clear and, at first glance, appear to support the legislature's chosen method of taking the vertical level into account. However, there are also notable dissenting voices which claim that the growing gap between management remuneration and average wages could be a consequence of changed circumstances of the market, meaning the wage pressure on simple manual labour in manufacturing brought about by China. It is asserted that management activities are not exposed to this kind of pressure from additional competition.[74] Critical voices have also given rise to doubts whether a proper standard by which to assess the appropriateness of directors' compensation can be derived from the extracts from the Act's explanatory note cited above.[75] They fear the "serious threat of inappropriate simplifications"[76]. Critics are particularly unimpressed by the use of a fixed multiplier such as

---

[71] Cf. references by *Semler,* repeated by *Notz,* loc. cit. (fn. 23), p. 247, 250.
[72] *Härtel,* Wirtschaftsdienst 2004, p. 347, 348.
[73] See title at www.focus.de, 30 May 2010.
[74] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2534.
[75] *Goette,* loc. cit. (fn. 26), p. 4 criticises that the manager performance can not be compared with activities, where it is not crucial by which person these are provided.
[76] *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1351.

"20 times the wages of a skilled worker"[77]. The predefinition of such a multiplication factor does in fact seem somewhat arbitrary.[78] It is further not certain whether the average wage in the relevant company is appropriate itself and therefore whether it is a suitable aspect of reference for assessing directors' compensation. It would seem that considering the gap between the directors' compensation and that of the higher level management would be more rewarding than looking at the relation between directors' compensation and union rates, the average wages of skilled workers etc.[79]

The vertical component in assessing the appropriateness of directors' compensation is strongly reminiscent of the outdated[80] socialist-influenced theory of the company as a social organisation and, in part, also of the legislature's conceptions incorporated in the 1937 version of the Stock Corporation Act (also known as "social clause", i.e. "Sozialklausel" in German*)* in Para. 77 Sect. 3 of the 1937 SCA).[81]

If one had the desire to advocate the vertical perspective, it would – at least theoretically – also be possible to choose a completely different approach: by exceeding the thinking behind the so-called "tournament theory"[82] ("Turniertheorie" in German*)*

---

[77] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2535; see also *Adams,* Zeitschrift für Wirtschaftsrecht 2002, p. 1325, 1344 who suggests a remuneration limit being 150 times greater than an average payment for a skilled worker (= 4,785 € each year); see further *Lutter,* Zeitschrift für Wirtschaftsrecht 2003, p. 737, 739 stating the thesis that the efficient employee working with other people's money would be well paid if he earns five times as much as the Federal Chancellor.

[78] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2535; see already *Schwark*, Festschrift Raiser, 2005, p. 377, 389: The fixation of an absolute limit of appropriateness is "too coarse to be really considered". However, remarkable in this context is the reference made by *Krienke/Schnell,* Neue Zeitschrift für Gesellschaftsrecht 2010, p. 135, who state that the remuneration of high employees in stock corporations often tops the compensation of the board members. This applies for a long time in particular for brokers and investment banker.

[79] *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 2.

[80] *Rittner/Dreher,* Europäisches und deutsches Wirtschaftsrecht, 3rd edition 2007, § 8 no. 23.

[81] *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 25: »Although the idea of a collective of the enterprise may still have been a basis in para. 78 SCA 1937, this conception does not satisfy any more the current market realities and the competition among the positions of the business management.«

[82] The tournament theory is the theory in personnel economics used to describe certain situations where wage differences are based not on marginal productivity but instead based upon relative differences between the individuals. This theory was invented by economists *Edward Lazear* and *Sherwin Rosen.*

borrowed from economics, one could attempt to raise managers' motivation by drastically overpaying them deliberately, while arguing that the increased motivation this brings about in the company's employees downstream will surely yield an adequate equivalent value.[83] To cite one example: a company in the financial services sector recently used an internal event at the Cologne Arena to reward each of its most deserving employees with a suitcase filled with 250,000 Euros and a villa in an attractive location. Now that certainly increased the assembled employees' motivation to work harder!

However, one decisive counterargument to the “tournament theory” is the fact that employees will normally not be in a position where they might be promoted to management position within their companies. This means that huge gaps between directors' remuneration and their own are more likely to discourage than being motivated by them. As a result, the increased performance that is desired by companies can, at best, be expected from other directors or even potential directors that are not yet being remunerated to the same extent. It seems doubtful whether the desired positive effects on the directors can offset the negative effects on the employees. The "tournament theory" is therefore not very persuasive in the context of this question.[84]

The legislature's primary concern – i.e., avoiding excessive directors' compensation – is a valid one.[85] However, the question as to what method is the right one for reaching this legitimate goal in a more or less safe way still remains unanswered. If in doubt, the horizontal perspective of appropriateness must be preferred.[86]

---

[83] The argumentation – driven to the peak – by *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2535; with reference to the *prize of the tournament*-approach in the U.S. corporate law see *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 480.

[84] *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, 457, 480.

[85] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2535.

[86] *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 2 with further citations; *Bauer/Arnold,* Die Aktiengesellschaft 2009, p. 717, 720; *Fleischer,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 801, 802.

5. Miscellaneous criteria

It should be mentioned in passing that scholars are discussing further criteria to be observed in relation to the previous version of Para. 87 SCA.[87] For example, a “lasting positive effect on the company's share price caused by the director's appointment” is surprisingly said to justify a higher level of compensation.[88] However, a further opinion that must be rejected is that purely personal circumstances like, for example, a director's family background should be taken into account.[89] Furthermore other aspects such as “unusual personality traits like strong leadership, teamwork, charisma”, his “skills in public relations” (i.e. so-called “soft skills”) and “the manager's age”[90] are considered to be relevant.[91]

Following the “substantiation” of the appropriateness criteria under the new version of Para. 87 SCA, characteristics not related to performance, like a director's family background, should at any rate not be taken into consideration in future assessments of the appropriateness of directors' compensation.[92] Otherwise one would arrive at the remarkable and strange conclusion that a director's merely average performance could be compensated for in respect of his compensation by the fact that he has a swarm of offspring. Well, that cannot be right. After all, the performance-orientated

[87] For a more detailed argumentation see *Schwark*, Festschrift Raiser, 2005, p. 377, 384 f.

[88] *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 469 f.; accordingly *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 28.

[89] *Spindler*, in: Münchner Kommentar zum Aktiengesetz, 3rd edition 2008, para. 87 no. 28 with citations; *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 469; *Lingemann,* Betriebs-Berater 2009, p. 1918; *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 2.

[90] For a different – and correct – view see *Schwark*, Festschrift Raiser, 2005, p. 377, 385, who considers the jurisdiction of the German Federal Supreme Court on the appropriateness of manager salaries in the field of the legislation on limited companies as non-transferable for the interpretation of para. 87 sect. 1 SCA. Further, *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 8 states that such a search practice can only be transferred cautiously on the law of stock companies, because the patterns of conflict and the incentives that could lead to litigation in both constellations are not identical.

[91] *Goette,* loc. cit. (fn. 26), p. 3.

[92] See *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 7: A consideration of the familiy backround of a board member can not be justified »in difference to traditional legal opinions«; different view *Thüsing,* Stellungnahme, loc. cit. (fn. 63), p. 3.

compensation of a director is not maintenance similar to that received by a civil servant.

One counter-example that has been offered is the permissible criterion of "the qualification- and experience-based market value of the director where it is in relation to the type of tasks that he has been assigned"[93]. Ultimately, the market value[94] of a (potential) director is a reflection of how he is valued on the demand side, in particular where his performance-related traits like qualifications and experience are concerned. While personal traits will naturally also be taken into account when forming opinions about possible candidates, no respectable supervisory board will appoint a business personality as a director simply because of his excellent non-performance-related “soft skills”. In light of the recent lamentations over the general shortage of capable managerial staff,[95] it seems somewhat strange that the criterion of the market value of a director is only a small part of the discussion surrounding the appropriateness criteria under Para. 87 Sect. 1 SCA, especially in an economic order dominated by supply and demand.[96]

---

[93] *Schwark*, Festschrift Raiser, 2005, p. 377, 385.

[94] On the significance of the market value of a board member see also *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 7, 11 *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 2.

[95] *Peltzer,* Festschrift Lutter, 2000, p. 571, 574 speaks so opportunely of a »short resources management«.

[96] The market value of a potential board member and its connection with the assessment of the level of fixed payment is an aspect that has been mentioned in the discussion (7 April 2010) by the Marburg Economist Prof. Dr. *Ulrich Fehl*, whom the author would like to express his gratitude for the reference. There are of course voices within the literature that consider the trust in the competition and its effects »only within tight limits as reliable«. The competition is inadequate to control the deep impulses for the big money, see *Martens,* Festschrift Hüffer, 2010, p. 647. However, the same author also realizes explicitly that »the remuneration of the board members is a main parameter in the competition for the best managerial staff« (loc. cit, p. 649).

II. Sustainability and longevity as elements of the compensation structure

Para. 87 Sect. 1 sentence 2 SCA reads that (only) listed stock companies' compensation structures for directors must be aimed at "sustainable company development".

1. Definition of "sustainability"

The aim of letting directors' compensation be guided by sustainable company development is primarily to prevent them from profiting from short-term effects (so-called "flashes in the pan") or from measures and transactions that are harmful to the long-term development of the company.[97] Directors are only supposed to be rewarded for individual achievements and not for the coincidental effects of some generally beneficial development in the market.[98]

The definition of "sustainability" is derived from European environmental law (i.e. "sustainable development"), though its meaning differs from it. In the context of company law it is related to the interests of the company (the most important keywords here are the corporate goals of long-term profitability and the preservation of the company).[99]

The sustainability criterion is viewed from the perspective of the concept of "incentive compatibility" by economic scholars.[100] This concept stipulates that directors should not exclusively pursue short-term desirable outcomes – which may come at the expense of the company's future – but that they should focus on long-term pros-

---

[97] *Hohenstatt/Kuhnke,* Zeitschrift für Wirtschaftsrecht 2009, p. 1981, 1984.

[98] *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 478.

[99] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2537; *Hohaus/Weber,* Der Betrieb 2009, p. 1515, 1516. To the connection between the German company's interests, the US prohibition on a *waste of corporate property* and the determination of the appropriateness see *Schwark*, Festschrift Raiser, 2005, p. 377, 382, who points out that »a company's interest is an even more inexact legal concept than the appropriateness of the remuneration«, which is why »it might be as well in German law difficult to derive from it operational main standards for an acceptable level of the board remuneration«.

[100] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2536.

perity. Since supervisory boards don't simply take past performance but also future expectations into account when deciding on directors' compensation, sustainability doesn't necessarily have to be visible *ex ante* prosperity but may also be expected or planned future sustainability.[101] This is supported by the wording of Para. 87 Sect. 1 sentence 2 SCA ("is to be orientated towards").

The alternative interpretation of the term "sustainability" that is being discussed by scholars, which stipulates that sustainability can only be assessed once the result has occurred,[102] is arguably more theoretical in nature.[103] It seems unrealistic to expect the supervisory boards of listed public companies to adopt a practice of retroactively determining substantial parts of directors' compensation many years after they have taken up their posts.[104]

The sustainability requirement must be applied to both the fixed and the variable elements of directors' compensation.[105] In the opinions of German scholars, it is doubtlessly suited to preventing the "windfall profits" the legislature so dislikes.[106]

---

[101] Cf. also *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2536.

[102] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2536.

[103] This is also not disregarded by *Suchan* and *Winter*, because according to their opinion the determination of sustainability from an individual perspective viewed ends at the latest where the effects on the income by decisions of other managers starts to dominate. A general accepted amount of years can barely be specified, and in sectors with high rates of innovation and short product cycles »it is also necessary to define the sustainability rather in the short-term.« The coupling of remuneration to perennial bases for assessment could cause a »fundamental problem«. (*Suchan/Winter,* Der Betrieb 2009, p. 2531, 2536).

[104] Different view *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2536, who focus »stronger on the income«. By the alternative interpretation the sustainability becomes rather a correcting factor of the performance assessment than being a specification of it.

[105] *Hohenstatt/Kuhnke,* Zeitschrift für Wirtschaftsrecht 2009, p. 1981, 1989.

[106] The problem of the indexation of stock options is discussed as an example by *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 477 f., 493 ff.

2. Variable compensatory elements versus rigid deadline-dependant compensation

a) Summary

Para. 87 Sect. 1 sentence 2 SCA must be interpreted in light of the fact that variable compensatory elements are both particularly practically relevant and potentially very risky. The reforming legislature was consciously trying to distance itself from using rigid deadlines[107] (for example: the share price on a particular date) for determining directors' compensation and was leaning towards a “multi-year basis of assessment”.[108] A mixture of short- and long-term incentives is also a future possibility “as long as it results in the creation of a long-term incentive”.[109] Unfortunately, the Act does not explain how these long-term incentives are supposed to be contractually implemented in practice. It is clear from the explanatory materials that there are “many conceivable contractual implementations”[110], such as a bonus/malus system or performance evaluation over the lifetime of the contract.[111] According to the draft law, the “performance-dependent, variable elements” in particular are intended to provide long-term incentives.[112] Bonuses and gratuities are not to be designed in such a way that their parameters can only be fulfilled on a particular deadline (for example: by the end of the year) if the beneficiaries attempt to “inflate the quantity of orders”[113], without the subsequent deterioration of the parameters having any effect on the assessment of the directors’ compensation.[114] The same is true for success-related parameters that are determined by specific balance sheet parameters, in re-

---

[107] BT-Drs. 16/12278, p. 5.

[108] Para. 87 sect. 1 sentence 3 SCA and BT-Drs. 16/13433, p. 10; this means a perennial time period of assessment, like this convincing *Hohenstatt/Kuhnke,* Zeitschrift für Wirtschaftsrecht 2009, p. 1981, 1984.

[109] BT-Drs. 16/13433, p. 10.

[110] BT-Drs. 16/13433, p. 10.

[111] BT-Drs. 16/13433, p. 10.

[112] BT-Drs. 16/12278, p.5.

[113] BT-Drs. 16/12278, p. 5.

[114] BT-Drs. 16/12278, p. 5.

spect of which the supervisory board has to take care that the directors' compensation is not inflated by extraordinary gains (such as the selling of shareholdings (divestments)) or volatile accounting profits.[115] In addition, stocks, stock options, phantom stocks and similar contractual remunerations will be subject to longer holding periods in the future.[116]

b) Extended holding periods for stock options

The holding period for stock options has been increased from two to four years under Para. 193 Sect. 2 SCA.[117] The legislature considers this four-year period an "interpretive aid for formulating long-term incentives within the meaning of Para. 87 Sect. 1"[118]. While this rule may provide some orientation,[119] it will be impossible in respect of remuneration measures other than stock options[120] to rigidly depend on four-year periods.[121] According to the wording, anything over two years is a "multi-

[115] BT-Drs. 16/12278, p. 5.

[116] BT-Drs. 16/12278, p. 5.

[117] To the inconsistency in the evaluation of the question if stock option programs are useful from the shareholder's view and if the have bad effects, see *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2537. The consensus of the different studies is supposed to be in the assessment that stock option programs »are at least no wonder weapon for motivation, but also do not contribute systematically to the termination of the assets«. Non of the studies was able to ascribe the effect of stock option programs to single design parameters such as a waiting period which is why any empirical ensured knowledge is missing about what sort of waiting period should be regulated. (see *Suchan/Winter,* ebd.).

[118] BT-Drs. 16/12278, p. 5.

[119] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2537; *Hohaus/Weber,* Der Betrieb 2009, p. 1515, 1517.

[120] For example *phantom stocks, share appreciation rights* and share-based contractual-based payment instruments.

[121] Also *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2537; *Hohenstatt/Kuhnke,* Zeitschrift für Wirtschaftsrecht 2009, p. 1981, 1985; *Annuß/Theusinger,* Betriebs-Berater 2009, p. 2434, 2436. Payment systems with a runtime of two or three years have satisfied in general the requirement of a perennial time period of assessment.

year basis of assessment”.[122] Therefore, compensatory systems which run for two or three years always fulfil the requirement of a multi-year assessment period.[123]

III. Retroactive reduction of directors’ compensation under Para. 87 Sect. 2 SCA

1. Summary of the changes

The legislature made considerable changes to Para. 87 Sect. 2 SCA, which regulates the retroactive reduction of directors’ compensation, by abandoning forthwith restrictive criteria like the *significant* deterioration[124] of the company’s condition and the *serious* inequity of continuing to remunerate a director[125]. As of now, the result of this is that the requirements for retroactively reducing directors’ compensation – and for the infringement of existing contracts – are easier to meet,[126] although this can still only be done within three years of the director’s resignation.

The purpose of removing these restrictions is to fulfil the legislature’s desire of making the wording of the requirements in Para. 87 Sect. 2 SCA “clearer and tighter”[127]. This explanation has been rightly criticised by scholars, as removing these restrictions does not solve the problem – it merely shifts it from one location to an-

---

[122] *Suchan/Winter,* Der Betrieb 2009, p. 2531, 2537.

[123] See citation in fn. 122.

[124] The law maker waived on purpose the requirement for a substantial deterioration and justified this with the blurring of the characteristic; see BT-Drs. 16/12278, p. 6. So far, the interpretation of para. 87 Sect. 2 SCA has been very restrictive and a »substantial deterioration in the conditions of the company« has been only affirmed in case of an existential crisis in the company, see LG Essen, Neue Zeitschrift für Gesellschaftsrecht 2006, p. 356; *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1352.

[125] View rejected by *Diller,* Neue Zeitschrift für Gesellschaftsrecht 2009, 1006 f.

[126] Critical *Goette,* loc. cit. (fn. 26), p.5 f.

[127] BT-Drs. 16/12278, p. 6.

other (primarily to the weighing of interests). It certainly does not help to achieve the specification that the legislature wanted.[128]

Removing the previous restrictive criteria of Para. 87 Sect. 2 SCA causes constitutional concerns as well: unilaterally renouncing valid contracts made on the basis of private autonomy is only possible in extremely exceptional cases due to the effect of the fundamental rights enshrined in Art. 2 Para. 1 and Art. 14 Para. 1 of the German Constitution *("Grundgesetz der Bundesrepublik Deutschland")*, as well as the principle of legitimate expectations.[129] The critics have mainly been voicing their considerable concerns[130] over the retroactive reduction of pensions, pension entitlements, survivors' pensions and similar benefits that have already been earned.[131]

2. Factual requirements for reduction

As of now, the requirement for the reduction of a director's compensation by the supervisory board under the new version of Para. 87 Sect. 2 SCA is *inequitable* to continue paying him that compensation due to the *deterioration* of the company's condition. According to the legislature, a company's condition is considered to have *deteriorated* where, for example, the company is forced to make redundancies or re-

---

[128] Further details by *Diller,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 1006; *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1352; see also *Lunk/Stolz,* Neue Zeitschrift für Gesellschaftsrecht 2010, p. 121, 122 with fn. 7.

[129] *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1352; *Gerven,* Betriebs-Berater 2009, p. 2154, 2159.

[130] Different view *Annuß/Theusinger,* Betriebs-Berater 2009, p. 2434, 2437; *Weller,* Neue Zeitschrift für Gesellschaftsrecht 2010, p. 7, 8 ff.

[131] *Hüffer*, Aktiengesetz, 9th edition 2010, § 87 no. 9: »Including the pension would be »also during the first three years more than problematic«. Although there is no need to touch Art. 14 of the German Basic Law, the interception in the pensions is »already a problem of equity«; see also *Martens,* Festschrift Hüffer, 2010, p. 647, 653: »The top of legal arbitrariness reaches the provision with its interception in pensions of former board members.«

duce wages and can no longer distribute profits.[132] However, it is not necessary for the company to face "insolvency or an immediate crisis"[133]. The wording of the paragraph suggests that it is merely a "directory provision", although this gives rise to the question as to whether it actually only gives the supervisory board discretion in exceptional cases.[134] This would mean that where the factual requirements are met, the reduction of a director's compensation to a reasonable amount requires no further justification, but is rather in the interests of the company. The explanatory materials pertaining to the Act state – without further dogmatic definition of the directory provision – that the supervisory board can only abstain from reducing directors' compensation where there are exceptional circumstances.[135] The legislature consciously rejected making this a mandatory provision, thus deviating from the initial draft, due to the fact that it wanted to make the rule "more flexible".[136] However, some critics are worried that supervisory boards will now rashly unilaterally reduce their directors' remuneration in order to avoid being held personally liable under Para. 116 sentence 3 SCA.[137]

Where directors' compensation is reduced it will be lowered to a level which would be appropriate in the given situation according to Para. 87 Sect. 1 sentence 1 SCA, i.e. not just to the company's equitable limit. Reductions do not only affect the remuneration of active directors but also entitlements to have the remainder of a director's

---

[132] BT-Drs. 16/12278, p. 6. Rightly criticised *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1352: »However, these statements are highly problematic. A necessarily connection between the remuneration of the board members and any dismissals or wage cuts does not exist. It is often the (unpopular) official duty of the board to reduce the staff for an ongoing cost optimization or even to avoid a crisis. It would be contra productive to connect to such professional duties any compensation disadvantages.«

[133] BT-Drs. 16/12278, p. 7.

[134] Cf. also *Kling,* Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht 2005, p. 45, 47.

[135] BT-Drs. 16/13433, p. 10.

[136] BT-Drs. 16/12278, p. 6.

[137] *Lingemann,* Betriebs-Berater 2009, p. 1918, 1921 with further citation.

contract paid out after his dismissal, as well as the pensions[138], survivors' pensions and similar benefits[139] mentioned in Para. 87 Sect. 1 sentence 2 SCA.

Where their compensation is reduced under Para. 87 Sect. 2 SCA, sentence 4 of the same section grants the affected directors a special right to give notice to the end of the next quarter within six weeks. If the directors believe that the supervisory board exceeded the limits set by Para. 87 Sect. 2 SCA, they can initiate legal proceedings under Para. 315 Sect. 3 sentence 3 of the German Civil Code. This means that they can have the courts review the board's decision and, if necessary, determine a new level of compensation.[140]

3. Outlook

Given the fact that the previous incarnation of Para. 87 Sect. 2 SCA hardly had any practical importance and that the legislature failed to specify the new version, it is not expected that this provision will awaken from its hibernation,[141] but instead will continue to be doomed a "shadowy existence"[142] within the law.[143]

---

[138] Detailed criticism by *Diller,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 1006, 1008 f. with reference to the jurisdiction of the German Federal Labour Court and the German Federal Supreme Court that rightly reduce ex post interventions in pension commitments. According to the new para. 87 sect. 2 SCA – like this *Diller,* loc. cit., p. 2008 (see also *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1354; different view *Thüsing,* Die Aktiengesellschaft 2009, p. 517, 523; *Fleischer,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 801, 804) – the reduced part of the employment arrangements would be dropped without replacement, viz. it would not be taken over by the pension reserve fund („Pensionssicherungsfonds", abbreviated as PSV).

[139] BT-Drs. 16/12278, p. 6.

[140] *Diller,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 1006, 1009 with reference to OLG Düsseldorf, Neue Zeitschrift für Gesellschaftsrecht 2004, p. 141, 145 = Die Aktiengesellschaft 2004, p. 321, 324 (10% reduction of the remuneration by the court instead of 50% as decided by the Supervisory Board); see also *Lunk/Stolz,* Neue Zeitschrift für Arbeitsrecht 2010, p. 121, 124 with fn. 45.

[141] *Diller,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 1006, 1009: There has not been a single case known in which the board has opposed possible external help, because he did not to want to touch its own compensation.

[142] *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1357.

IV. Competence and legal consequences of a breach

1. Competence

a) Summary

Generally, the supervisory board will remain responsible for setting the level of compensation that directors receive. They – not the shareholders in the "annual general meeting"[144] ("Hauptversammlung" in German) – therefore decide on how much of the company's assets is distributed to the directors (this is a so-called "entrepreneurial decision" that the supervisory board can make).[145] Under the previous provision, the internal responsibility for this task fell to the personnel committee of the supervisory board. In contrast, the new version of Para. 107 Sect. 3 sentence 3 SCA now requires a decision of the full supervisory board.[146] This means the ruling is now more transparent than before. However, this does not mean that the personnel committee cannot do the necessary preparatory work.[147] In fact, the increasing complexity of pension schemes will often necessitate the committee's prior involvement.

A new option is the possibility for the shareholders to make a voluntary decision on the matter in general meeting under Para. 120 Sect. 4 SCA. This provision allows the

---

[143] *K -P. Müller,* loc. cit. (fn. 53), p. 3: which is why a change of the law will not lead to a significant change in the legal position; different view see *Lingemann,* Betriebs-Berater 2009, p. 1918, 1924: para. 87 SCA will no longer endure a wallflower existence.

[144] The demand for the »involvement of the board« in the composition and assessment of its own compensation (like this the »core thesis« of *Dauner-Lieb/von Preen/Simon,* Der Betrieb 2010, p. 377, 382) is to be rejected, because this might boost supposedly the »self-service mentality« of negligent board members instead of preventing compensation excesses. So far it should be remembered that board members are qualified as trustees of the shareholders who shall no enrich themselves on their assets, see *Schwark*, Festschrift Raiser, 2005, p. 377, 387.

[145] To the classification of the determination of compensation as a »business decision« and to the – affirmative – judicial review see *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 15; *Schwark,* Festschrift Raiser, 2005, p. 377, 391 f.; *Peltzer,* Festschrift Lutter, 2000, p. 571, 577 with fn. 24; cf. also *Kling,* Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht 2005, p. 45, 46.

[146] *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1355; *Beuthien,* Neue Zeitschrift für Gesellschaftsrecht 2010, p. 333, 334; critical *Diller,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 1006, 1009; view rejected by *K.-P. Müller,* loc. cit (fn. 51), p. 5.

[147] *Lingemann,* Betriebs-Berater 2009, p. 1918, 1922 pointing out that the proposal for a decision for the whole Supervisory Board has to be justified more than in the past.

shareholders of a listed public company to decide whether or not to ratify the compensatory system for their directors (sentence 1). However, this decision does not confer any rights or duties and, more importantly, it does not affect the supervisory board's duties under Para. 87 sentence 2 SCA. This regulatory solution was patterned after the "exoneration decision" under Para. 120 Sect. 2 sentence 2 SCA. It should also be noted that the shareholders' decision cannot be challenged under Para. 243 sentence 3 SCA. This was clearly done intentionally so as to prevent the general meeting's decision from being exposed to disruption and delay by a small and vocal group of shareholders.[148]

b) Evaluation of the new provision

The legislature has been overcautious in respect of Para. 120 Sect. 4 SCA.[149] Why only provide for a mere voluntary decision which is not binding for the supervisory board, cannot be challenged by the shareholders and, on top of that, is restricted to listed public companies[150]? If you consider the shareholders in the general meeting to be generally unfit to decide on directors' compensation – and it seems that the vast majority of company law scholars do[151] – then this decision should be completely left to the supervisory board ("Aufsichtsrat" in German).[152] If, on the other hand, you be-

---

[148] Like this *Goette,* loc. cit. (fn. 26), p. 9.

[149] See also *P. Hanau,* Neue Juristische Schulung 2009, p. 1652, 1653: »Particularly soft is the new para. 120 sect. 4 SCA...«; different view *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1356 criticising that an orientation on the English conception and therefore on a regulation of the monistic system is problematic.

[150] Critical as well *Hirte,* Stellungnahme zum Fraktionsentwurf eines Gesetzes zur Angemessenheit der Vorstandvergütung (VorstAG) für den Deutschen Bundestag – Sitzung des Rechtsausschusses am 25.5.2009 – p. 10 f.

[151] Detailed explanation by *Martens,* Festschrift Hüffer, 2010, p. 647, 657 f.; see also *Semler,* repeated by *Notz,* loc. cit. (fn. 23), p. 247, 250.

[152] Like this e.g. the German Federation of Trade Unions (abbreviated as "DGB" in German) in its 'Stellungnahme zum VorstAG' (Stand: 22.5.2009), p. 12: »The composition of the remuneration of the board members is one of the core tasks of the Supervisory Board.«; cf. also *Annuß/Theusinger,* Betriebs-Berater 2009, p. 2434, 2440 pointing point that the Supervisory Board is strictly responsible for the decision about the conclusion of the employment contract and its content according to para. 84

lieve that the shareholders as the “masters of the company”[153] should decide themselves on this issue in the annual general meeting (“*Hauptversammlung*”)[154], then their decision should bind the supervisory board, especially as it is the organ that has to prepare and implement the shareholders’ decision. Even though the management is not bound to put the issue of director’s compensation on the agenda for a general meeting if the shareholders call for it under Para. 120 Sect. 4 SCA, the legislature is of the opinion that this explicit shareholders’ power will give them an instrument to control the existing compensatory system for their companies’ directors. It also expects positive repercussions on the realisation of the requirements of Para. 87 SCA.[155] The reason why such an instrument is restricted to listed public companies is that, apparently, private companies have no need for such differentiated regulations. Further, the legislature believes that the “considerable publicity” generated by the condemnation of directors’ compensation by shareholders in general meeting justifies its lack of binding legal force.[156] In the eyes of the legislature, these purely practical effects seem appropriate and sufficient to allow shareholders in general meeting to control their directors’ existing compensatory systems and no further legally binding effect is deemed necessary.[157]

---

sect. 1 sentence 5 SCA. They also hold the thesis that question about compensation are inseparably connected whit this which is why the general meeting has no right to incorporate any guidelines about the remuneration of the board members in the statues; different view *Lutter,* Zeitschrift für Wirtschaftsrecht 2003, p. 740, 741; *Thüsing,* Der Betrieb 2003, p. 1612, 1613.

[153] Cf. *Goette,* loc. Cit. (fn. 26), p. 1.

[154] *Dreher*, RWS-Form 25 Company Law 2003, 2004, p. 203 (243 sub VI.1.e); also *Spindler*, in: Münchner Kommentar zum Aktengesetz, 3rd edition 2008, para. 87 no. 26; *Goette,* loc. cit. (fn. 26), p. 9 speaks of a »natural right of the shareholders« to be informed about the remuneration of the members of the board and to make a decision; yet, he holds the view that it is in line with the allocation of rights and duties within the stock corporation that the decision has no binding effect; see also *Thüsing,* Zeitschrift für Unternehmens- und Gesellschaftsrecht 2003, p. 457, 491 who supports abstract guidelines for the assessment of remuneration by the shareholders.

[155] BT-Drs. 16/13433, p. 12.

[156] BT-Drs. 16/13433, p. 12.

[157] BT-Drs. 16/13433, p. 12.

The arguments that the reforming legislature has advanced are not very convincing. They foster the suspicion that this is merely a “placebo regulation”.[158] However, a different argument that was also voiced by the legislature may be more acceptable: Para. 120 Sect. 4 sentence 2 SCA is also meant to prevent the supervisory board being indirectly exempted from its duties under Para. 87 SCA as a result of a “well-meaning” decision of the shareholders in the general meeting, which would result in their exemption from liability for inappropriate remuneration of directors under Para. 116 sentence 3 SCA.[159] Not freeing the supervisory board from its duties is certainly a weighty argument in favour of this regulation and, at the end of the day, the only convincing one.[160]

2. The supervisory board’s liability under Paras. 116, 93 SCA

a) Principles of liability

The new regulation in Para. 116 sentence 3 SCA explicitly makes the members of the supervisory board liable for damages in respect of inappropriate directors’ compensation (but not for the breach of the duty to reduce it under Para. 87 Sect. 2).[161] Thus, it is a specification of their liability for culpably breaching their duties under Para. 116 sentence 1 and Para. 93 Sect. 2 SCA. Thereby, the reforming legislature wants to make clear “that setting appropriate directors’ compensation is one of the supervisory boards most important tasks and that it is personally liable for any breach of this duty.”[162] It claims that this “currently seems to be unclear to those con-

---

[158] *P. Hanau,* Neue Juristische Schulung 2009, p. 1652, 1653.
[159] BT-Drs. 16/13433, p. 12.
[160] *Goette,* loc. cit. (fn. 26), p. 9.
[161] Indeed, this is »striking«, as *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1354 point out.
[162] BT-Drs. 16/12278, p. 6.

cerned".[163] That is the reason why the legislature once again put particular emphasis on the supervisory board's duty of care (alongside its duty of confidentiality) when agreeing directors' compensation. However, it seems doubtful that this declaratory emphasis on their liability in case of breach of duty will be enough to satisfy the urgent need for professionalism among German supervisory boards.[164]

A provision for consolidation of damages[165] that was originally contained in sentence 4 was dropped.[166] As a result, the general rules of Para. 249 et seq. of the German Civil Code apply instead. The rule that was previously envisaged was unnecessary, as damage always amounts to the difference between the appropriate amount of directors' compensation and the amount that the supervisory board actually agreed to. It should also be noted in this context that the Act's explanatory materials state that an adjustment of profits is not possible in this case.[167] This deserves approval.

b) D&O insurance

The personal liability of directors and members of supervisory boards can be mitigated by D&O insurance, which companies regularly conclude for their management staff. Under Para. 93 Sect. 2 sentence 3 SCA, directors are to have a deductible of at least 10% of the damage, up to a maximum of one and half times the director's fixed

---

[163] BT-Drs. 16/12278, p. 6.

[164] This is rightly claimed by *K.-P. Müller,* loc. cit. (fn. 51), p. 1; *Kling,* Deutsche Zeitschrift für Wirtschafts- und Insolvenzrecht, 2005, p. 45, 56; to the necessity of training measures *Lutter,* Der Betrieb 2009, p. 775, 779.

[165] It said: »In this case, the surplus to an adequate compensation is to be refunded as minimum damages.«, see BT-Drs. 16/12278, p. 3.

[166] The law maker sought to refuse the impression of punitive damages modelled after US fashion and in addition meant to prevent the misunderstanding that damages even then have to be paid if according to the general rules no damage has been caused, see *Nikolay,* Neue Juristische Schulung 2009, p. 2640, 2645.

[167] BT-Drs. 16/12278, p. 6.

annual remuneration. This does not apply to members of the supervisory board, which can be seen from the explicit wording of Para. 116 SCA.[168] In addition, it should be noted that the directors are able and allowed to insure the deductible.[169] This means that in practice, it is not unusual for their premiums to be “factored into” their remuneration.[170]

V. Does Para. 87 SCA apply to other types of companies?

1. Cooperatives

German scholars have no reservations about applying Para. 87 SCA to cooperatives.[171] In truth, the similarity between the organisational structures of cooperatives and public companies makes this an obvious parallel. The fact that cooperatives have a fourth organ in addition to the board of directors, the supervisory board and the shareholders, namely the audit committee (which advises the supervisory board), does not justify any differential treatment. Any possible differentiations can be justified by the variety in the real-life compositions of cooperatives.

---

[168] In the legislative materials it is said that the new regulation is limited to „regulate the most important case in relation to liability aspects, which means the insurance in favour of the board members «, see BT-Drs. 16/13433, p. 11.

[169] *Annuß/Theusinger,* Betriebs-Berater 2009, p. 2434, 2441; *Bosse,* Betriebs-Berater 2009, p. 1650, 1652; *Fleischer,* Neue Zeitschrift für Gesellschaftsrecht 2009, p. 801, 806; *Hirte,* loc. cit. (fn. 151), p. 4.

[170] *Hohenstatt,* Zeitschrift für Wirtschaftsrecht 2009, p. 1349, 1354 considers this as unacceptable.

[171] *Beuthien,* Genossenschaftsgesetz, 14th edition 2004, § 24 no. 14; *Fandrich,* in: Pöhlmann/Fandrich/Bloehs, Genossenschaftsgesetz, 3rd edition 2007, § 24 no. 37; *Gräser,* in: Hettrich/Pöhlmann/Gräser/Röhrich, Genossenschaftsgesetz, 2nd edition 2001, § 24 no. 9.

2. Private limited companies (GmbH)

The explanatory materials[172] accompanying the Stock Corporation Act have made it clear that Para. 87 SCA is not to be analogously applied to private limited companies ("Gesellschaft mit beschränkter Haftung", abbreviated as GmbH in German). Therefore, it appears that the principles laid down in a judgment of the German Federal Supreme Court (BGH) on May 14, 1990[173] in regard to the specification of the appropriateness of managing directors' compensation are still in force.[174] It was held that the following criteria were to be taken into account: the type, the size and the capacity of the business, as well as the age, training, experience and abilities of the director. In its ruling of June 15, 1992[175], the German Federal Supreme Court also held Para. 87 Sec. 3 SCA to be applicable.[176] However, this does not mean that existing contracts can be infringed without the existence of a statutory provision similar to Para. 87 Sect. 2 SCA. Nonetheless, in case of an extreme economic emergency a duty to reduce managing directors' salaries may, as an exception, arise from fiduciary duties.[177] The Higher Regional Courts ("Oberlandesgerichte") have held a temporary reduction by half of a managing director's salary (more specifically: from € 5,700 to € 2,800) to be permissible in times of crisis[178], though they have rejected more draconian pay cuts[179].

---

[172] BT-Drs. 16/13433, p. 10.

[173] BGHZ 111, p. 224, 228 = Neue Juristische Schulung 1990, p. 2625.

[174] *Hohaus/Weber,* Der Betrieb 2009, p. 1515.

[175] BGH, Neue Juristische Schulung 1992, p. 2894.

[176] *Goette,* loc. cit. (fn. 26), p. 2 f.

[177] *Greven,* Betriebs-Berater 2009, p. 2154, 2157; *Lunk/Stolz,* Neue Zeitschrift für Gesellschaftsrecht 2010, p. 121, 123.

[178] OLG Köln, Neue Zeitschrift für Gesellschaftsrecht 2008, p. 637 = Zeitschrift für Wirtschaftsrecht 2009, p. 36.

[179] OLG Naumburg, GmbH-Rundschau 2004, p. 423 no. 21 f.: The reduction of the annual remuneration of the managing director of approximately 62.000 € to 24.000 € (gross) (= 2.000 € monthly) was inadequate despite an economic crisis. The bad economic situation is only one factor in the whole context. The contractually agreed remuneration also does not seem to be inadequately high considering the economic crisis of the company. The bad economic situation alone could not justify the right to reduce the remuneration.

It can safely be assumed that the new version of Para. 87 SCA will not have any direct effect on the remuneration of managing directors of private limited companies, just as the legislature desired.[180] However, it should not come as a surprise if courts considering matters pertaining to the law of private companies continue to look to the implementation of Para. 87 SCA for orientation on the extent of fiduciary duties.

C. Conclusion

In sum, the 2009 version of Para. 87 SCA is not a "great leap" – but it is, at least, a step in the right direction that can be expanded on in the future:

1. Preventing the excessive remuneration of directors is a legitimate goal and the legislature's demand for setting long-term incentives ("sustainability") is most welcome.

2. The undefined term "appropriateness" needs a considerable amount of specification. Therefore, it is fundamentally right for the legislature to limit the appropriateness test under Para. 87 SCA by prescribing certain criteria.[181] However, even the addition of the "new" appropriateness criteria (the performance of the director and the customariness of his compensation) to the existing criteria (the functions of the director and the condition of the company) does not answer all of the numerous fundamental theoretical and practical questions that were previously left unanswered. In

---

[180] BGH, Neue Juristische Schulung 1992, p. 2894, 3. guiding principle: »In case of a substantial deterioration of the economic realities of the company the managing director can be obliged to agree to a reduction of its own remuneration.«; OLG Naumburg, GmbH-Rundschau 2004, p. 423, 2. guiding principle: »An obligation of the managing director to agree to a reduction of its own remuneration can be considered if the economic realities of the company have been substantially deteriorated, as long as that this has not been already considered during the last assessment of the remuneration (...). Maintaining the remuneration at its current level must be a heavy inequity for the company. (...). This is the case when the company loses resources by paying out salaries although these are urgently needed to survive (...). The burden of producing evidence and the burden of substantive proof lies with the company.«; see also *Greven,* Betriebs-Berater 2009, p. 2154, 2159.

[181] Cf. *Fleischer*, in: Spindler/Stilz, Aktiengesetz, 2007, para. 87 no. 9.

respect of the former it suffices to point out that there is still no “correct” interpretation of the term “performance”. However, since the performance of directors has been an unwritten criterion for the appropriateness test since the Stock Corporation Act of 1937 and thus there are decades of experience with this criterion to fall back on, there is no need to fear that there will be particularly great difficulties regarding future interpretation of Para. 87 SCA in practice.

3. In contrast, the changes made to Para. 87 Sect. 2 SCA are legally binding but unfortunately a complete failure in practice.[182] The deletion of the prior restrictive criteria (*significant* deterioration and *serious* inequity) in favour of simplifying the reduction of directors’ compensation in times of crisis does not lead – contrary to what the legislature intended – to a clearer and tighter wording of the provision. Regardless of these changes, it is unlikely that Para. 87 Sect. 2 SCA will become more important in the future than it has been until today.

4. The regulation contained in the new version of Para. 107 Sect. 3 sentence 3 SCA, namely that the full supervisory board has to decide on directors’ compensation, is one that is most welcome. However, it can be assumed that this new rule does not make the preparatory work of the personnel committee superfluous, though this is not an argument against transparency and in favour of the supervisory board deciding on directors’ compensation. The principle of collective responsibility demands that the members of the supervisory board must concern themselves with the important questions that fall within the ambit of the board, of which the compensation of, or rather the compensatory system for directors is most certainly one. Having two classes of members on the supervisory board, i.e. those who are informed and those who are not, cannot be justified by aspects of labour economics and confidentiality

[182] Therefore, the resigned conclusion of *Martens,* Festschrift Hüffer, 2010, p. 647, 652 is also right; it includes that para. 87 sect. 2 SCA (new version) is »a dictum of the law maker that is free of dogmatic aspects and which can be related to outer obedience but no inner acceptance«.

considerations.[183] The same can be said about the argument that the calculation of directors' compensation may be very complicated. This may be true, but this is also a perfect example of an important job for the personnel committee, which is or at least should be capable of informing the other members of the board of and explaining to them even the most complicated of questions. Furthermore, the question as to the qualifications and on-going training of the members of supervisory boards, in particular of the employees' representatives in supervisory boards with codetermination, remains unanswered. Unfortunately, the AADC does not provide the answer to this question.

5. Para. 120 Sect. 4 SCA offers "neither fish nor fowl". According to the argument that this provision represents, shareholders as the "masters of the company" are supposed to have the option of giving their supervisory boards binding instructions in relation to directors' compensatory structures. However, one must agree with the legislature on the fact that it is necessary to prevent "well-meaning" – i.e. liability-excluding – decisions of the shareholders in the annual general meeting due to the effect they would have on the liability of the members of the supervisory board under Para. 116 sentence 3 SCA where they previously agreed an inappropriate level of compensation with a director.

– – – –

[183] Best described by *Beuthien,* Neue Zeitschrift für Gesellschaftsrecht 2010, p. 333, 335: »So far there is no more secrecy within the Supervisory Board.« (emphazised in the original).

Materials (in German):

Aktiengesetz (Stock Corporation Act)

§ 87 Grundsätze für die Bezüge der Vorstandsmitglieder [31. 7. 2009]

(1) Der Aufsichtsrat hat bei der Festsetzung der Gesamtbezüge des einzelnen Vorstandsmitglieds (Gehalt, Gewinnbeteiligungen, Aufwandsentschädigungen, Versicherungsentgelte, Provisionen, anreizorientierte Vergütungszusagen wie zum Beispiel Aktienbezugsrechte und Nebenleistungen jeder Art) dafür zu sorgen, dass diese in einem angemessenen Verhältnis zu den Aufgaben und Leistungen des Vorstandsmitglieds sowie zur Lage der Gesellschaft stehen und die übliche Vergütung nicht ohne besondere Gründe übersteigen. Die Vergütungsstruktur ist bei börsennotierten Gesellschaften auf eine nachhaltige Unternehmensentwicklung auszurichten. Variable Vergütungsbestandteile sollen daher eine mehrjährige Bemessungsgrundlage haben; für außerordentliche Entwicklungen soll der Aufsichtsrat eine Begrenzungsmöglichkeit vereinbaren. Satz 1 gilt sinngemäß für Ruhegehalt, Hinterbliebenenbezüge und Leistungen verwandter Art.

(2) Verschlechtert sich die Lage der Gesellschaft nach der Festsetzung so, dass die Weitergewährung der Bezüge nach Absatz 1 unbillig für die Gesellschaft wäre, so soll der Aufsichtsrat oder im Falle des § 85 Absatz 3 das Gericht auf Antrag des Aufsichtsrats die Bezüge auf die angemessene Höhe herabsetzen. Ruhegehalt, Hinterbliebenenbezüge und Leistungen verwandter Art können nur in den ersten drei Jahren nach Ausscheiden aus der Gesellschaft nach Satz 1 herabgesetzt werden. Durch eine Herabsetzung wird der Anstellungsvertrag im übrigen nicht berührt. Das Vorstandsmitglied kann jedoch seinen Anstellungsvertrag für den Schluß des nächsten Kalendervierteljahrs mit einer Kündigungsfrist von sechs Wochen kündigen.

(3) Wird über das Vermögen der Gesellschaft das Insolvenzverfahren eröffnet und kündigt der Insolvenzverwalter den Anstellungsvertrag eines Vorstandsmitglieds, so kann es Ersatz für den Schaden, der ihm durch die Aufhebung des Dienstverhältnisses entsteht, nur für zwei Jahre seit dem Ablauf des Dienstverhältnisses verlangen.

----

§ 93 Sorgfaltspflicht und Verantwortlichkeit der Vorstandsmitglieder [9. 12. 2010]

(1) Die Vorstandsmitglieder haben bei ihrer Geschäftsführung die Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters anzuwenden. Eine Pflichtverletzung liegt nicht vor, wenn das Vorstandsmitglied bei einer unternehmerischen Entscheidung vernünftigerweise annehmen durfte, auf der Grundlage angemessener Information zum Wohle der Gesellschaft zu handeln. Über vertrauliche Angaben und Geheimnisse der Gesellschaft, namentlich Betriebs- oder Geschäftsgeheimnisse, die

den Vorstandsmitgliedern durch ihre Tätigkeit im Vorstand bekanntgeworden sind, haben sie Stillschweigen zu bewahren. Die Pflicht des Satzes 3 gilt nicht gegenüber einer nach § 342b des Handelsgesetzbuchs anerkannten Prüfstelle im Rahmen einer von dieser durchgeführten Prüfung.

(2) Vorstandsmitglieder, die ihre Pflichten verletzen, sind der Gesellschaft zum Ersatz des daraus entstehenden Schadens als Gesamtschuldner verpflichtet. Ist streitig, ob sie die Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters angewandt haben, so trifft sie die Beweislast. Schließt die Gesellschaft eine Versicherung zur Absicherung eines Vorstandsmitglieds gegen Risiken aus dessen beruflicher Tätigkeit für die Gesellschaft ab, ist ein Selbstbehalt von mindestens 10 Prozent des Schadens bis mindestens zur Höhe des Eineinhalbfachen der festen jährlichen Vergütung des Vorstandsmitglieds vorzusehen.

(3) Die Vorstandsmitglieder sind namentlich zum Ersatz verpflichtet, wenn entgegen diesem Gesetz

1. Einlagen an die Aktionäre zurückgewährt werden,

2. den Aktionären Zinsen oder Gewinnanteile gezahlt werden,

3. eigene Aktien der Gesellschaft oder einer anderen Gesellschaft gezeichnet, erworben, als Pfand genommen oder eingezogen werden,

4. Aktien vor der vollen Leistung des Ausgabebetrags ausgegeben werden,

5. Gesellschaftsvermögen verteilt wird,

6. Zahlungen entgegen § 92 Abs. 2 geleistet werden,

7. Vergütungen an Aufsichtsratsmitglieder gewährt werden,

8. Kredit gewährt wird,

9. bei der bedingten Kapitalerhöhung außerhalb des festgesetzten Zwecks oder vor der vollen Leistung des Gegenwerts Bezugsaktien ausgegeben werden.

(4) Der Gesellschaft gegenüber tritt die Ersatzpflicht nicht ein, wenn die Handlung auf einem gesetzmäßigen Beschluß der Hauptversammlung beruht. Dadurch, daß der Aufsichtsrat die Handlung gebilligt hat, wird die Ersatzpflicht nicht ausgeschlossen. Die Gesellschaft kann erst drei Jahre nach der Entstehung des Anspruchs und nur dann auf Ersatzansprüche verzichten oder sich über sie vergleichen, wenn die Hauptversammlung zustimmt und nicht eine Minderheit, deren Anteile zusammen den zehnten Teil des Grundkapitals erreichen, zur Niederschrift Widerspruch erhebt. Die zeitliche Beschränkung gilt nicht, wenn der Ersatzpflichtige zahlungsunfähig ist und sich zur Abwendung des Insolvenzverfahrens mit seinen Gläubigern vergleicht oder wenn die Ersatzpflicht in einem Insolvenzplan geregelt wird.

(5) Der Ersatzanspruch der Gesellschaft kann auch von den Gläubigern der Gesellschaft geltend gemacht werden, soweit sie von dieser keine Befriedigung erlangen können. Dies gilt jedoch in anderen Fällen als denen des Absatzes 3 nur dann, wenn die Vorstandsmitglieder die Sorgfalt eines ordentlichen und gewissenhaften Geschäftsleiters gröblich verletzt haben; Absatz 2 Satz 2 gilt sinngemäß. Den Gläubigern gegenüber wird die Ersatzpflicht weder durch einen Verzicht oder Vergleich der Gesellschaft noch dadurch aufgehoben, daß die Handlung auf einem Beschluß der Hauptversammlung beruht. Ist über das Vermögen der Gesellschaft das Insolvenzverfahren eröffnet, so übt während dessen Dauer der Insolvenzverwalter oder der Sachwalter das Recht der Gläubiger gegen die Vorstandsmitglieder aus.

(6) Die Ansprüche aus diesen Vorschriften verjähren bei Gesellschaften, die zum Zeitpunkt der Pflichtverletzung börsennotiert sind, in zehn Jahren, bei anderen Gesellschaften in fünf Jahren.