

Legal Update

Corporate and Tax, Mergers & Acquisitions

Premature Reappointment of Executive Officers of German Public Limited Companies

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Introduction

The executive officers of a German public limited company (*Aktiengesellschaft*) are appointed by the company's supervisory board, which may appoint such officers for a term of up to a maximum of five years (first sentence of section 84(1) of the Stock Corporation Act (*Aktiengesetz – AktG*)). Supervisory boards may, however, also reappoint officers or extend their term of office (second sentence of section 84(1) of the Stock Corporation Act) by adopting a resolution to that effect no earlier than one year prior to the end of a term of office (third sentence of section 84(1) of the Stock Corporation Act).

Before the Federal Court of Justice (*Bundesgerichtshof*) ruled on the issue, it was not clear whether an officer could resign from his position voluntarily in agreement with the supervisory board earlier than one year prior to the end of a term and be reappointed for a subsequent term of five years. Some were of the opinion that the above procedure would constitute illegal circumvention of the provision of law contained in the third sentence of

section 84(1) of the Stock Corporation Act and that such appointments would therefore have to be considered to be of no validity or effect.

Decision of the Federal Court of Justice

The Federal Court of Justice had an opportunity to address this issue in its recent judgment of 17th July 2012 (NZG 2012, 1027).

According to that judgment, executive officers may, as a rule, be reappointed for a (maximum) term of five years if they resign more than one year prior to the end of an original term of office, and this also applies if there is no particular reason for such reappointment.

In the case before the Federal Court of Justice, a supervisory board decided unanimously to accept the voluntary resignation of an executive officer more than two years prior to the end of that officer's term of office and immediately reappointed the latter for a further term of five

years. The officer in question then submitted his resignation the same day.

According to the Federal Court of Justice, the fact that the officer resigned only afterwards was no reason for misgiving since the latter indicated retrospectively his agreement with the termination of the initial term of officership and did this within a short time. It is, however, necessary to take into account in this context that unilateral termination of the appointment of the executive officer by the supervisory board would otherwise have been possible only for good cause (first sentence of section 84(3) of the Stock Corporation Act).

The Federal Court of Justice also saw no improper circumvention of the provision against premature reappointment of an executive officer within the meaning of the provision contained in the third sentence of section 84(1) of the Stock Corporation Act. Paragraph 5.1.2 of the German Corporate Governance Codex (DCGK), according to which this option may be exercised only under special circumstances, is also occasionally cited in this context. According to the Federal Court of Justice, the purpose of the above provision is not, however, defeated if the resignation of the officer is mutually agreed, the reason being that the purpose of the third sentence of section 84(1) of the Stock Corporation Act is to ensure that a supervisory board decides anew at least every five years whether to reappoint officers or extend their term of office. The court ruled that this condition is fulfilled in the case of resignation upon mutual agreement followed by reappointment and that the five-year limit pursuant to the third sentence of section 84(1) of the Stock Corporation Act is respected such that the company is adequately protected against unreasonable financial burdens. In fact, the Court reasoned that the period of commitment by the company is even shorter in the case of premature termination than the maximum period prescribed by law.

Finally, the Federal Court of Justice found that the supervisory board's decision was not made with abusive intent in this case, mentioning by way of argument in particular that the members of the supervisory board had made their decision unanimously despite the fact that half the members represented one branch of an alienated family and half the other branch. The elected procedure was therefore not intended to create a *fait accompli* prior to an impending annual shareholders' meeting at which a new supervisory board would be elected.

Practical Implications

The decision of the Federal Court of Justice clearly shows that the reappointment of officers following resignation by common agreement earlier than one year prior to the end of an original term of office is also permissible in the absence of any objective reason for such reappointment. However, the end of the term of office must be mutually agreed by the respective officer and the supervisory board since a supervisory board can otherwise terminate an officership only for good reason.

In such cases, it is therefore recommended that the respective officer attend the corresponding meeting of the supervisory board and that a record be kept of the agreement to terminate the appointment by mutual consent. In the case of publicly traded companies, it is also necessary to take into account that the current German Corporate Governance Code stipulates that this possibility normally exists only under special circumstances. In the event that this should not be the case, this must be mentioned in the statement of compliance with the German Corporate Governance Code required pursuant to the first sentence of section 161(1) of the Stock Corporation Act along with the reason for failure to comply with paragraph 5.1.2 of the German Corporate Governance Code.

Note

This overview is solely intended for general information purposes and may not replace legal advice on individual cases. Please contact the respective person in charge with GÖRG or respectively the authors themselves: Clemens Scholz-Remes on +49 30 884503-151 or by email to cscholz-remes@goerg.de or Dr. Martin Nentwig on +49 30 884503-312 or by email to mnentwig@goerg.de. For further information about the authors visit our website www.goerg.com.

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