

07.11.2018

CORPORATE

MINISTERIAL DRAFT BILL OF THE ACT IMPLEMENTING THE SECOND SHAREHOLDER RIGHTS DIRECTIVE (ARUG II) – WHAT LISTED COMPANIES SHOULD EXPECT

The draft bill of an act implementing the Second Shareholder Rights Directive (ARUG II) was published on 11 October 2018. The act primarily targets listed companies and introduces numerous changes concerning, among other issues, board remuneration (“say on pay”), related party transactions and shareholder identification and information (“know your shareholder”). It also aims to improve the transparency of institutional investors, asset managers and proxy advisors, something which will not, however, be discussed in detail here. The Second Shareholder Rights Directive must be transposed into German law by 10 June 2019.

Say on pay

In future, the supervisory board of a listed company must adopt an “easily understandable system” for the remuneration of management board members. Section 87a(1) Stock Corporation Act (Draft Bill) (AktG-E) contains detailed provisions on such a **management board remuneration policy**. Whereas section 120(4) Stock Corporation Act (AktG) currently stipulates a voluntary vote on the management board remuneration system by the general meeting of a listed company, shareholders will in future have to vote on all significant changes, but at least every four years on the management board remuneration policy (section 120a(1) AktG-E). The shareholders’ vote will still be incontestable and non-binding for the supervisory board (which remains responsible for determining management board remuneration). But if the following (ordinary?) general meeting rejects the supervisory board’s proposal, the latter must submit a reviewed remuneration policy to a vote. The supervisory board is not, however, obligated to make changes to the remuneration policy should it be rejected by the annual general meeting. If, following its review, the supervisory board concludes that it wishes to retain the policy, this decision cannot be legally contested. Based on previous experience, however, remuneration policies rejected by the annual general meeting require adjustment.

The Second Shareholder Rights Directive also requires the annual general meeting of a listed company to vote on the **supervisory board remuneration policy**. Since German law actually assigns to the general meeting the right to specifically determine the remuneration of the supervisory board (section 113(1) AktG), the requirement of the Directive is taken into account by the fact that in future the general meeting will vote on the supervisory board remuneration at least every four years (possibly only to confirm it). The resolution must contain all the relevant information concerning the remuneration policy, according to section 87a(1) AktG-E. The above statements on incontestability and the obligation to present a reviewed remuneration policy apply correspondingly.

According to section 120a(4) AktG-E, the agenda of every ordinary general meeting of a listed company will in future include a resolution on the **remuneration report** to be prepared by the management board and supervisory board and examined by the auditor each year (section 162 AktG-E). The remuneration details are to be provided for each management member individually, stating their name; it is no longer possible to opt out (as is currently still the case in section 286(5) German Commercial Code (HGB)). Unlike the votes on the remuneration policy, the resolution on the remuneration report is contestable; however, the legal consequences of a successful contestation are likely to be limited to an obligation to account for the resolution in the following year’s report (cf. section 162(1), sentence 2, no. 6 AktG-E). In the case of small and medium-sized companies (within the meaning of section 267(1) and (2) HGB), it is sufficient to explain the remuneration report instead of having to adopt a resolution; however, a separate agenda item is required for this as well.

In contrast to the remuneration report being introduced under stock corporation law, the **commercial law provisions** on special remuneration reporting of listed companies are **largely being deleted** in the appendix or management report.

Both remuneration policies and remuneration reports are to be kept available on the company's **website** for at least ten years.

Related party transactions

Before the draft bill was published, there was much discussion of the required approval by the general meeting or supervisory board – called for by the Second Shareholders' Rights Directive – for **material transactions of the company with related parties** and the integration thereof into German corporate group law.

For the **definition of related persons**, the draft of the ARUG II refers to the international accounting standards **IAS/IFRS** (IAS 24.9 primarily applies) and, moreover, makes full use of the leeway given by the Directive in sections 111a et seq. AktG-E. This can be seen in particular

- › in a relatively high (and, thankfully, easy to calculate) **materiality threshold** (section 111b(2) and (4) AktG-E; more than 2.5% of the sum of the current and fixed assets according to the most recently adopted annual financial statements or, in the case of parent companies, the approved consolidated financial statements of the company/group; in this connection, all of the transactions carried out with the same related parties within the past twelve months must be added up),
- › in the numerous **exceptions** (section 111a(2) and (3) AktG-E; including transactions in the ordinary course of business and at standard market terms and conditions, transactions with direct or indirect wholly-owned subsidiaries and with direct or indirect subsidiaries without other related shareholders) and, in this connection, in particular
- › in the **exemption of contract-based groups**, since transactions that require the approval or authorisation of the general meeting or are carried out based on such approval or authorisation – these include, in particular, affiliation agreements and transactions based on such agreements (section 111a(3), no. 3 a) AktG-E) – are excluded, as well as
- › in the allocation of the **approval responsibility to the supervisory board** (section 111b(1) AktG-E).

The supervisory board's approval must be obtained **before** the transaction is carried out (section 111b(1), at the end, AktG-E); according to the explanatory memorandum, the **contractual obligation** is decisive. The supervisory board can set up a **committee** in preparation of the approval decision; according to the draft bill (which, however, is in need of editorial improvement with respect to this issue), it is not possible to delegate the approval itself. In order to ensure impartial decision-making within the supervisory board, the draft provides for voting bans and, when a committee is set up, a graduated process that seems somewhat complicated in parts (sections 107(3), sentence 4, 111b (2), 111c AktG-E). If the supervisory board refuses its approval, the management board is at liberty to bring the matter to the general meeting (section 111b(4) AktG-E). A transaction completed **without approval** is **legally valid** but can result in liability on the part of the management board.

The rules for the **public announcement** of transactions with related parties required by the Second Shareholder Rights Directive are laid down outside of the Stock Corporation Act, namely in section 48a draft of the Securities Trading Act (WpHG-E). The publication must take place "without undue delay", which – according to the explanatory memorandum on the basis of section 33(1) Securities Trading Act – is "generally" (and subject to the stricter provisions on ad hoc disclosure) still considered to be the case if an announcement has been made within four trading days.

Know your shareholder

A further key issue in the Second Shareholder Rights Directive is improved shareholder identification and information. The draft bill of the ARUG II addresses this issue due to its thematic link with the share register in sections 67a et seq. AktG-E. The central norm is section 67d AktG-E, which stipulates a **claim** – for the listed company against all intermediaries that hold shares of the company in custody – to be **informed about the identity of the shareholders** whose shares are being held in custody. If the intermediary used by the company is, for its part, holding the shares for another intermediary, the request for information is to be passed on "along the chain" to the intermediary that is holding shares for a shareholder. This "final intermediary" must generally transmit the requested information directly (thus, not back "through the chain" again) to the company.

This provision is flanked by **information transmission duties** of the company and the intermediaries that are

intended to facilitate the exercise of shareholder rights (sections 67a to 67c AktG-E). These duties **also apply to unlisted companies**. They will affect how general meetings are organised.

For practical purposes, it must be noted that, on 3 September 2018, the European Commission issued an **Implementing Regulation (EU) 2018/1212** that stipulates in detail the formal requirements for future requests for information and the fulfilment thereof by means of detailed tables.

Further timetable and first-time application of the new rules

A **draft bill** is not expected before the beginning of next year. Whether ARUG II will be able to take effect on time as of 10 June 2019 remains to be seen. At any rate, the legislator is planning to additionally cushion the effects of the first-time application of the new rules by means of **transitional provisions** in the Introductory Act to the Stock Corporation Act. This applies in particular to aspects related to general meetings. For example, sections 67a et seq. Stock Corporation Act will not apply before the beginning of 2020. On the other hand, the new "say on pay" rules might – assuming ARUG II takes effect in a timely manner – already require attention as of November 2019.

EXPERTISE

Corporate

LAWYERS

Peter Steffen Carl

Dr. Cornelius Götze

Martin Hitzer

Dr. Vera Rothenburg

Christian Steinke

Dr. Dirk Wasmann

Dr. Fred Wendt