

Polish Sejm has adopted a new state sector salary cap act

On 9 June 2016, the Polish Sejm adopted the Act on the Principles of Determining the Salaries of Persons Managing Certain Companies (the "New Salary Cap Act" (Polish: ustawa kominowa)). This results in an important change to the existing regulations regarding the salaries of members of corporate bodies in companies controlled by the State Treasury and local government entities. The Act has already been sent by the Senate for signing by the President (without any amendment), and is to come into force within 30 days of publication. This is expected to take place within two months.

The Salary Cap Act currently in force (the "**Old Salary Cap Act**") applies to a wide range of legal entities, including companies in which more than half of the share capital is held by the State Treasury or a local government body, and the subsidiaries of those companies.

Pursuant to the New Salary Cap Act, the Old Salary Cap Act is to remain in force, but the restrictions it provides for are to apply only to entities other than commercial companies. On the other hand, the New Salary Cap Act is to regulate in a comprehensive way the remuneration of members of the management and supervisory boards of limited liability companies and joint stock companies in which the State Treasury or local government holds any shares (rather than over 50% of the shares, as has been the case up until now), and of the subsidiaries of those companies.

The main objectives of the New Salary Cap Act is to: (1) depart from the current fixed maximum level of salaries for corporate bodies members by adjusting the salary limits according to the company's scale of business; and (2) replace the current controversial mechanism that allows non-application of restrictions regarding remuneration and fringe benefits for management board members with a more reasonable and transparent mechanism.

Procedure for implementing the principles in companies

The New Salary Cap Act does not provide for an absolute requirement to apply the principle of determining salaries in

all the companies in which the State Treasury has a stake. It merely imposes an obligation on those persons exercising, at a shareholders' meeting / general meeting, the voting rights vested in the State Treasury or local government entities, and on the members of supervisory boards appointed by those entities, to take certain actions in order to establish the remuneration principles in the company in a certain way. In particular, to participate in voting and to vote for a resolution to determine the principles of remunerating the management board and supervisory board members in accordance with the requirements set out in the Act (the "**Remuneration Resolution**"). This means that the remuneration principles arising from the New Salary Cap Act could be successfully forced through in companies in which the State Treasury or local government entities do not hold a controlling interest.

Members of the management board of a holding company in which the State Treasury or local government bodies have an interest and in which the Remuneration Resolution is successfully adopted, are to be responsible for the adoption and application of the new remuneration principles in its subsidiaries. Otherwise, they will not gain the right to receive any annual bonus.

The new regulations also amend the Commercial Companies Code by granting to the shareholders' meetings in limited liability companies (and by modifying, in the case of the general meetings of shareholders of joint stock companies) the right to adopt resolutions setting out the levels and principles of remuneration for members of their

corporate bodies. This applies to all such companies, even those in which the State Treasury or local government entities do not hold any shares.

Fixed salary limits

The remuneration of management board members in respect of which a Remuneration Resolution is passed must be composed of two parts: a fixed part and a variable part (a bonus). As before, the fixed salary limits are to be based on the average monthly salary in the enterprise sector, without taking into account any awards paid out of profits in the fourth quarter of the previous year, as announced by the President of the Polish Central Statistical Office (GUS) (the "**Assessment Basis**"). The Assessment Basis applicable in 2016 is PLN 4,280.39.

Five different bands have been adopted for the minimum and maximum fixed salary levels, expressed as multiples of the Assessment Basis, within which the competent bodies can set the salaries of management board members. The application of a particular band in relation to the management board members of a company should, as a rule, depend on the fulfilment by that company (or the entire group, in the case of holding companies preparing consolidated financial statements) of at least two out of three conditions during the last two financial years, based on the following criteria:

- average annual employment level;
- annual net turnover; and
- total assets.

For example, the highest band providing for a minimum level of seven times and a maximum level of fifteen times the Assessment Basis (with the current maximum limit of six times the Assessment Basis under the Old Salary Cap Act) can be used in companies that have satisfied at least two out of the three following conditions: they employed on average at least 1,251 employees per annum; they achieved annual turnover exceeding EUR 250 million or had total assets of at least EUR 215 million.

Principles of awarding bonuses

The variable salary component (the bonus) may not exceed 50% (or, in the largest companies and public companies, 100%) of the basic salary of the management board member in the previous financial year. The Remuneration Resolution will specify quantifiable and objective criteria as regards the implementation and evaluation of management objectives, the achievement of which is a condition to the award of a bonus. A sample list of such objectives is set out

in the Act. However, in the case of companies carrying out a public service mission (i.e. companies whose field of activity or business objective has been fixed by law) or performing public tasks (i.e. companies for which any legislation or its constitutional documents impose(s) additional obligations as regards the fulfilment of those public service objectives referred to in Article 6 of the Real Estate Management Act), one of the objectives must be the extent to which such mission or such tasks have been accomplished. The contract with a management board member may also set out the terms on which some of the bonus may be deferred for up to 36 months, with the deferred parts to be awarded subject to the occurrence (or non-occurrence) of specific events related to the management tasks.

Limitations on other benefits

The Remuneration Resolution may also approve other benefits, in particular severance pay (to which a person may become entitled only after holding his/her position for at least 12 months and which may not be higher than three times the fixed part of the salary) and compensation for agreeing to a non-compete undertaking (not higher than 100% of the salary, and for a period of up to 6 months).

The New Salary Cap Act does not, however, contain a closed list of additional benefits that may be granted to members of corporate bodies, which is a very welcome change compared to the current rigid and unreasonable limitations.

Uniform employment model for management board members

Pursuant to the draft New Salary Cap Act, the Remuneration Resolution must also specify that management board members can be employed only on the basis of a management contract governed by civil law and concluded for their term of office, with an early termination option (subject to up to three months' notice), rather than, for example, an employment contract. This Resolution is also to exclude the possibility of management board members in companies in which the State Treasury or the local government holds shares collecting any additional remuneration for holding any posts in the subsidiaries of those companies.

Remuneration of supervisory board members

The Remuneration Resolution should also set out the level of remuneration for supervisory board members. The remuneration level may not exceed a limit being the product of the Assessment Basis and various multipliers adopted for companies with a specific scale of business activity. For example, the multiples for the smallest and the largest companies are to amount to 0.5 and 2.75, respectively.

Option not to apply the limits to remuneration levels

Currently, in order not to apply the limitations arising from the Old Salary Cap Act, it is sufficient to conclude a management services contract with the management board member as part of his/her business activity, provided that such manager has a D&O policy (the reasoning behind this mechanism was unclear). This option will no longer be available.

However, the draft New Salary Cap Act does provide for an option to derogate, in the Remuneration Resolution, from the restrictions set out in the Act, if this is justified due to exceptional circumstances affecting the company or the market on which it operates, provided that the justification of this decision is published in the Public Information Bulletin. The draft Act contains a sample (open) list of such circumstances, which include, for example, implementation of investment programmes significantly exceeding the value of the company's fixed assets, as well as the fact that the company has been operating for less than a year. In the case of public companies, any derogation from these restrictions would require prior comparison of the remuneration being contemplated against the remuneration of management board members in companies with a similar scale or field of activity.

However, for entities mainly involved in managing the assets of other entities, only the total balance sheet assets are to be taken into account, including any assets placed under their management. Consequently, such companies will be able to remunerate their management board members at a relatively high level, if this is justified by the scale of their asset management operations, even if, according to their own total assets, turnover and average employment level, such companies would have been placed in a much lower band.

Transitional provisions

The Act provides for a transitional period to enable companies to adjust to the requirements arising from the Act. The new principles must be implemented no later than when the companies hold shareholders' meetings / general meetings to approve their financial statements for 2016. At the same time, the existing provisions will apply to those management contracts concluded with management board members as part of their business activity concluded before the New Salary Cap Act enters into force. In practice, this means that the managers engaged based on the latter type of contracts will still not be subject to any restrictions (at present, the restrictions of the Old Salary Cap Act do not apply to those contracts). The contracts (in particular employment contract) of other managers will have to be replaced by management contracts that comply with the new rules.

Comments

The proposed amendments incorporate most of the recommendations submitted over the years by experts and business groups. Making the principles according to which the remuneration of the members of corporate bodies is determined more flexible by adjusting the salary limits to the scale and type of the company's business will make it possible to set those salaries in companies larger than SMEs at a level closer to market standards than is the case under the current regulations, without applying any additional controversial mechanisms similar to those currently in operation. At the same time, the adoption of new, transparent and reasonable principles that allow for those limits not to be applied (such as referring to the benchmark in other similar public companies) may potentially make it possible for salaries of management board members in companies of strategic importance to the country to be established at market levels. Some business groups have raised concerns regarding the fact that bonuses have been made dependent on the degree of implementation of public tasks also in those companies whose shareholders, along with the State Treasury and local government entities, also include private entities (e.g. listed energy companies). The inclusion in the new regulation of companies in which the State Treasury holds only a token stake is also quite controversial. However, if the Remuneration Resolution is not passed in such companies then the regulation will not apply.

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