

## Employment & Labour - Netherlands

New termination rules for listed company managing directors

Contributed by [CMS Derks Star Busmann](#)

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[Background](#)  
[First case](#)  
[Second case](#)

### Background

New legislation has recently been adopted in the Netherlands that changes the position of board members of (the approximately 70) listed companies. From January 1 2012, a managing director who is appointed based on the articles of association of the company is no longer also an employee under Dutch law (for further details please see "[The dismissal of managing directors - key issues](#)"). This change is part of new legislation which, among other things, allows companies to opt for a one-tier board and limits the number of supervisory board positions awarded to individuals.

The main reason behind the change for managing directors is to provide that as a result of termination of the position, a managing director is no longer automatically entitled to a severance payment based on the Cantonal Court Formula. Although this formula does not have legislative status, it is a starting point for the courts when calculating severance. In the Netherlands, the employer usually pays severance to the employee based on this formula when the employment agreement is terminated either through a court procedure or by mutual consent. The formula allows the employee to receive (on average) one gross month's salary (including fixed emoluments) for each year of service. This calculation is referred to as the neutral outcome, and can be decreased or increased depending on the culpability of the employee or the employer.

This legislative change is unlikely to lead to a reduction in termination costs. This update looks at two common situations and the employment and contractual issues that may arise in each case:

- appointment of an employee who becomes managing director after years of employment; and
- appointment as managing director of a person from outside the company.

### First case

As a result of the new legislation, once an employee has been appointed managing director, he or she is no longer regarded as an employee. However, the appointment does not lead to the automatic termination of his or her employment agreement as there are a limited number of ways in which an employment agreement can end in the Netherlands. Either the parties must first agree on the terms of the termination of the agreement, or the (employment) agreement must be made dormant. Should the parties opt for an official termination, it is more than likely that the employee will cooperate with the termination only if the company is willing to reimburse the lost years of service and pay a severance based on the formula. The calculation of the severance usually results in an amount higher than the neutral outcome of the formula because:

- the company wishes to express its commitment to the new managing director; and
- the managing director may not automatically be entitled to severance when that new appointment ends.

Another option is to make the employment agreement dormant and to agree in writing that after termination of the appointment as managing director, the employment agreement will be officially terminated unless the managing director returns to the company as a regular employee which, in practice, is unlikely. The parties also agree that during the period of appointment neither is obliged to act in accordance with the employment agreement. Sometimes the agreement to make the employment

Author

[Katja Van Kranenburg-Hanspi](#)



agreement dormant also states that the parties contractually agree on a minimum severance amount depending on the manner in which the appointment ends. Although this is legal, it is clearly contrary to the intentions behind the legislative change. The same conclusion applies should parties opt for an employment agreement with one of the subsidiaries and a(n unpaid) appointment as managing director at a higher group level.

From a contractual point of view, the new legislation will result in new situations. Since the managing director is no longer regarded as an employee, it is likely that the parties will enter into a service agreement rather than an employment agreement (also known as a consultancy agreement or management agreement). Of course, they are not obligated to do so. The parties still have the liberty to agree on common Dutch employment terms, the most significant of which is the payment of full wages for 104 weeks of illness. However, it is expected that the parties will opt for a service agreement. One important consequence for the company to bear in mind is the payment of the fee to the managing director. The fact that the managing director is no longer an employee under Dutch law does not automatically release the company from its obligation to withhold wage taxes and to pay social security premiums. Dutch tax law may still lead to the conclusion that an agreement between parties is a fictitious employment agreement.

## Second case

Where a managing director is appointed from outside the company, in relation to contractual issues the same generally applies as set out above. The managing director will most likely render his or her services under a service agreement. Usually, under such an agreement the manager sends an monthly invoice to the company (which is subject to value added tax) based on an agreed daily fee which is payable only in case of actual services rendered. In principle, there is no obligation to make payments if the manager is unable to render services due to, for example, illness or holidays. Again, parties can contractually agree to the payment of damages or a golden parachute should the cooperation end prematurely.

The Corporate Governance Code recommends that a managing director receives one year's salary at the end of his or her appointment. It is arguable whether this recommendation still applies to new appointments since the new managing director will not receive a salary, but a remuneration. The code also allows for higher severance should the appointment end prematurely. However, the code does not have legislative effect and works on the basis of the principle either to comply or to explain. It is likely that, after some time, practice will show that the change in legislation has not led to the lowering of costs for the hiring and firing of managing directors.

*For further information on this topic please contact [Katja Van Kranenburg-Hanspians](mailto:katja.vankranenburg@cms-dsb.com) at CMS Derks Star Busmann by telephone (+31 20 301 6301), fax (+31 20 301 6333) or email ([katja.vankranenburg@cms-dsb.com](mailto:katja.vankranenburg@cms-dsb.com)).*

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