

THE CORPORATE
GOVERNANCE
REVIEW

SEVENTH EDITION

Editor
Willem J L Calkoen

THE LAWREVIEWS

THE CORPORATE GOVERNANCE REVIEW

The Corporate Governance Review

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PREFACE

I am proud to present this new edition of *The Corporate Governance Review* to you.

In this seventh edition, we can see that corporate governance is becoming a more vital and all-encompassing topic with each year that passes. We all realise that the modern corporation is one of the most ingenious concepts ever devised. Our lives are dominated by corporations. We eat and breathe through them, we travel with them, we are entertained by them, most of us work for them. Most corporations aim to add value to society and they very often do. Some, however, are exploiting, polluting, poisoning and impoverishing us. A lot depends on the commitment, direction and aims of a corporation's founders, shareholders, boards and management and employees. Do they show commitment to all stakeholders and to long-term shareholders, or mainly to short-term shareholders? There are many variations on the structure of corporations and boards within each country and between countries. All will agree that much depends on the personalities and commitment of the persons of influence in the corporation.

We see that everyone wants to be involved in 'better corporate governance': parliaments, governments, the European Commission, the US Securities and Exchange Commission (SEC), the Organisation for Economic Co-operation and Development (OECD), the UN's Ruggie reports, the media, supervising national banks, more and more shareholder activists and other stakeholders. The business world is getting more complex and overregulated, and there are more black swans, while good strategies can quite quickly become outdated. Most directors are working diligently, many with even more diligence. Nevertheless, there have been failures in some sectors, so trust has to be regained. How can directors do all their increasingly complex work and communicate with all the parties mentioned above?

What should executive directors know? What should non-executive directors know? What systems should they set up for better enterprise risk management? How can chairs create a balance against imperial CEOs? Can lead or senior directors create sufficient balance? Should most non-executive directors understand the business? How much time should they spend on their function? How independent must they be? What about diversity? Should their pay be lower? What are the stewardship responsibilities of shareholders? What are the pros and cons of shareholder rights plans?

Governments, the European Commission and the SEC are all pressing for more formal inflexible legislative acts, especially in the area of remuneration. Acts set minimum standards, while codes of best practice set aspirational standards. We see a large influence on 'norms' by codes and influential investor groups.

More international investors, voting advisory associations and shareholder activists want to be involved in dialogue with boards about strategy, succession and income. Indeed, far-sighted boards have 'selected engagements' with stewardship shareholders to create trust.

What more can they do to show all stakeholders that they are improving their enterprises other than through setting a better ‘tone from the top’? Should they put big signs on their buildings emphasising integrity, stewardship and respect?

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at General Motors and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code and many countries produced national versions along the lines of the Cadbury ‘comply or explain’ model. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been instances where CEOs gradually amassed too much power or companies have not developed new strategies and have produced bad results – and sometimes even failure. More are failing since the global financial crisis than previously, hence the increased outside interest in legislation, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists. The European Commission is developing a regulation for this area as well.

This all implies that executive and non-executive directors should work harder and more as a team on policy, strategy and entrepreneurship. More money is lost through lax or poor directorship than through mistakes. On the other hand, corporate risk management is an essential part of directors’ responsibilities, and sets the tone from the top. How can directors do their important work well without being petrified of attacks from shareholders’ regulations and the press?

Each country has its own measures; however, the chapters of this book also show a convergence. The concept underlying the book is of a one-volume text containing a series of reasonably short, but sufficiently detailed, jurisdictional overviews that permit convenient comparisons, where a quick ‘first look’ at key issues would be helpful to general counsel and their clients.

My aim as editor has been to achieve a high quality of content so that *The Corporate Governance Review* will be seen, in time, as an essential reference work in our field. To meet the all-important content quality objective, it was a condition *sine qua non* to attract as contributors colleagues who are among the recognised leaders in the field of corporate governance law from each jurisdiction.

I thank all the contributors who helped with this project. I hope that this book will give the reader food for thought; you always learn about your own law and best practice by reading about the laws and practices of others. Further editions of this work will obviously benefit from the thoughts and suggestions of our readers. We will be extremely grateful to receive comments and proposals on how we might improve the next edition.

Willem J L Calkoen

NautaDutilh
Rotterdam
March 2017

AUSTRALIA

*John Williamson-Noble and Tim Gordon*¹

I OVERVIEW OF GOVERNANCE REGIME

i Sources of law, regulation and best practice relating to the governance of listed companies

Listed companies in Australia are subject to common law and statutory corporate governance obligations and the Australian Securities Exchange (ASX) Corporate Governance Council (the Council) Corporate Governance Principles and Recommendations. The statutory obligations are set out in the Corporations Act 2001 (the Corporations Act) and the Australian Securities Exchange Listing Rules (the Listing Rules).

Corporations Act

The Corporations Act imposes specific duties on directors and officers of companies. These duties include:

- a* the duty to exercise their powers and duties with the care and diligence that a reasonable person would have; and
- b* the duty to exercise their powers and duties in good faith in the best interests of the company and for a proper purpose.

Decisions made by directors must be made for proper purposes and in the best interests of the company as a whole. When the company is in an ‘insolvency context’, this will require that the interests of the company’s creditors be taken into account.

ASX Listing Rules

The Listing Rules govern disclosure and other aspects of a listed entity’s conduct. Compliance with the Listing Rules is a requirement for admission to the ASX’s official list. The Listing Rules are enforceable against listed entities and their associates under the Corporations Act.

Under the Corporations Act and Listing Rules, public companies must immediately disclose all material price-sensitive information unless there is a relevant exemption (such as where the information is confidential and forms part of an ‘incomplete proposal’).

Corporate Governance Principles and Recommendations

The ASX provides guidance on corporate governance practices that should be adopted by listed entities. The guidelines are encapsulated in eight principles and 29 recommendations

¹ John Williamson-Noble and Tim Gordon are partners at Gilbert + Tobin.

under the Council's Corporate Governance Principles and Recommendations (the Principles and Recommendations). The third edition of the Principles and Recommendations took effect from 1 July 2014, and was drafted following a comprehensive review of the previous edition.

The extent to which a listed company has followed the Principles and Recommendations in a given year must be disclosed in a 'corporate governance statement', which may either be included in its annual report or made available online. If it has not followed a recommendation, it must identify the reasons for not doing so. This is referred to as the 'if not, why not' rule. Compliance with this rule is required under both the Principles and Recommendations and the Listing Rules, ensuring the market receives an appropriate level of information about a particular company's arrangements.

ii Enforcement

The Australian Securities and Investments Commission (ASIC) is Australia's corporate, markets and financial services regulator. ASIC is an independent Commonwealth government body established to administer the Australian Securities and Investments Commission Act 2001 and the Corporations Act.

ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit. ASIC also has responsibility for the supervision of trading on Australia's domestic licensed equity, derivatives and futures markets.

The ASX is the primary body charged with administering the Listing Rules. However, the courts have the power to enforce the Listing Rules as a result of the contract between the listed entity and the ASX and from the recognition given to the Listing Rules under the Corporations Act. Additionally, ASIC is able to issue infringement notices and fine an entity for a breach of its continuous disclosure obligations without initiating court proceedings.

II CORPORATE LEADERSHIP

i Board structure and practices

Australia has a one-tier board structure. As discussed below, there are requirements on certain companies to establish an audit committee, while the Principles and Recommendations also recommend the establishment of separate board nomination and remuneration committees.

Management of Australian companies is left to the executives. The board's role is to supervise, oversee and offer guidance, and the board will generally only be involved through meetings that are held up to 11 times a year in a large company. The chairperson is generally non-executive and mentors the CEO and chairs board meetings. The management team reports to the CEO, who may also be a board member. The CFO is sometimes also a board member.

To reduce the risk of a board becoming entrenched, the Listing Rules require that a director of an entity must not hold office (without re-election) past the third annual general meeting following the director's appointment or three years, whichever is longer. Additionally, a director appointed to fill a casual vacancy or as an addition to the board must not hold office (without re-election) past the next annual general meeting of the entity. This rule does not apply to the managing director (but if there is more than one managing director, only one is entitled not to be subject to re-election).

Legal responsibilities of the board

Australian corporate law does not impose any minimum business functions upon directors. To conduct the business, the board operates through the company's executives. However, the functions of directors do go beyond general oversight because the Corporations Act and other statutes impose specific duties on directors, such as a statutory responsibility for the company's financial statements.

Involvement of directors in takeovers

Directors of a public target must be careful to ensure that management and the directors do not breach their duties during a takeover process. The Corporations Act, Listing Rules, Takeovers Panel decisions and policy as well as the common law all limit the extent to which defensive tactics developed to deal with unwelcome takeover offers can be utilised by directors.

While there is no express duty on directors in Australia to actively conduct an auction process or otherwise seek the best price for a company in a change of control context, the directors must act in accordance with their general duties to act in the best interests of the company and avoid conflicts of interest. Furthermore, the Takeovers Panel has jurisdiction to ensure that actions taken during control transactions do not constitute 'unacceptable circumstances' (which may occur when a transaction is not conducted in an efficient, competitive and informed market) and has issued guidance on insider participation in control transactions. Some of the key considerations for the target's management and directors are:

- a* when to notify the board of an approach from a potential bidder;
- b* when to disclose confidential due diligence information to a potential bidder;
- c* whether to provide equal access to information to a rival bidder;
- d* when executive directors should stand aside from negotiations; and
- e* when information concerning an approach should be disclosed to shareholders and how much information should be disclosed.

Where there is potential participation from management or directors, the target board commonly adopts conflict protocols and establishes an independent committee to oversee the consideration of the transaction and will generally appoint an independent financial adviser to assist in determining recommendations.

Where a transaction involves a bidder that has a 30 per cent (or greater) stake in the target or where the target and bidder have common directors, the target board is required to obtain an independent expert's report. Many target boards are reluctant to make a recommendation without such a report in all cases.

Target boards are not obliged to provide equal access to information to rival bidders. Accordingly, in a takeover context the target board may choose what information it discloses and to whom, provided that it acts in accordance with its fiduciary duties and in the best interests of the company.

ii Directors

Liability of directors

There are over 700 Commonwealth and state laws that impose liabilities upon directors. The Corporations Act provides, however, that a director or other officer of a corporation, who properly makes a valid 'business judgement', will be considered to have met the requirements

of the statutory duty of care and diligence and its equivalent at common law. In applying the business judgement rule, Australian courts have expressed a reluctance to interfere with directors' judgements in questions of business management.

A director must inform himself or herself to the extent he or she reasonably believes to be appropriate. This leaves it open to a director to take into account the time that is realistically available in deciding the extent to which he or she should be informed in relation to a particular decision. For example, a director could reasonably act on incomplete information if time constraints required an urgent decision and the risks of delaying that decision outweighed the risks of acting on incomplete information. Nevertheless, care and attention needs to be taken at all times. The *Centro* case,² for example, considered the circumstances in which a director may rely on external advisers and an internal compliance function. In that case, non-executive directors, who did not necessarily have accounting backgrounds, were found to have breached their duties to take reasonable care and diligence in the exercise of their duties by failing to identify accounting errors missed by external auditors and the company's internal compliance function. In another high-profile decision, *James Hardie*,³ it was found that the CEO (also a director) and the company secretary and general counsel had breached their duties of care and diligence as a result of the board approving the release of an inaccurate market announcement. The statement in question was found to be false and misleading, and the relevant officers were unsuccessful in arguing that they had reasonably relied on advice from external advisers.

To have the protection of the business judgement rule, the director must show that he or she rationally believed the judgement to be in the best interests of the corporation. The director's belief that the judgement is in the best interests of the corporation is taken to be a rational one, unless the belief is one that no reasonable person in that position could hold. A belief will be rational if 'it is supported by an arguable chain of reasoning'.

A proposed development of the scope of directors' liabilities in Australia concerns the requisite duties of a director when a company is in an 'insolvency context'. Under the Corporations Act, a director currently has a positive duty to prevent insolvent trading or be subject to serious penalties, ranging from orders to pay the company's creditors for the debts involved to full civil and criminal fines. Insolvent trading is said to occur if a company incurs a debt while it is unable to pay its debts as and when they fall due. In December 2015, one of the proposals announced by the Australian government as part of its National Science and Innovation Agenda was a 'safe-harbour' provision for company directors, protecting directors from possible breaches of the duty to prevent insolvent trading where they are seeking to restructure a business. Two possible safe harbour provisions have been proposed. The first option affords directors protection against insolvent trading claims where professional restructuring advisers were appointed during periods of financial difficulty to develop a turnaround plan for the company. The second option is a broader carveout from the insolvent trading provisions, protecting directors where the following three tests are satisfied:

- a the debt was incurred as part of reasonable steps to maintain (or return the company to) solvency;
- b the director held the honest and reasonable belief that incurring the debt was in the best interests of the company and its creditors as a whole; and
- c incurring the debt does not materially increase the risk of serious loss to creditors.

2 *ASIC v. Healey & Ors* [2011] FCA 717.

3 *ASIC v. Hellicar* [2012] HCA 17.

During 2016, the Australian government conducted a consultation process in respect of the two options. A preferred approach is expected to be confirmed and introduced in proposed legislation in early 2017.

The development of insolvent trading protections marks a shift in Australia's current insolvency regime that would enable boards and directors to work towards better integration of strategy and risk rather than, for fear of personal liability, adopting the propensity to quickly put companies in financial distress into voluntary administration or liquidation.

Appointment, nomination, knowledge and diversity

The Principles and Recommendations provide that companies should have a board of an effective composition, size and commitment to adequately discharge the responsibilities and duties imposed by law on the directors, and that to this end the majority of the board should be independent directors.

An independent director is defined as a non-executive director who is free of any business or other relationship that could materially interfere with – or could reasonably be perceived to materially interfere with – the independent exercise of his or her judgement.

The Council identifies particular relationships that the board should consider when determining the independent status of a director, including whether that director is employed in an executive capacity.

In addition, the Principles and Recommendations state that the chairperson should be an independent director and that the roles of chairperson and CEO should not be exercised by the same individual.

The Listing Rules and the Principles and Recommendations contain additional requirements in relation to the appointment of directors, the composition of the board and diversity. Listed companies should, among other requirements:

- a* use and disclose a 'skills matrix' that identifies the mixture of skills and diversity on the current board, and the mix that the board wishes to achieve in the future;
- b* have and disclose a process for evaluating the performance of the board, its committees and the directors, in addition to reporting on whether a performance evaluation was undertaken during a reporting period;
- c* establish a nomination committee of at least three members, the majority of whom are independent, to manage the appointment and re-appointment of directors, and a committee charter that is disclosed publicly; and
- d* establish a diversity policy and disclose the policy or a summary of that policy, which should include requirements for the board to establish measurable objectives for achieving gender diversity. The measurable objectives, and the company's progress in achieving them, should be assessed annually and disclosed in the annual report.

Listed companies should also establish a remuneration committee to bring transparency, focus and independent judgement to remuneration decisions. The remuneration committee should be structured so that it consists of a majority of independent directors, is chaired by an independent director and has at least three members. The Listing Rules require an S&P/ASX 300 company to have such a committee composed solely of non-executive directors.

Conflicts of interest of directors

A conflict exists where a director, in any matter falling within the scope of his or her office, has a duty or an interest that conflicts or may possibly conflict with his or her duty to the

company. The courts will take a pragmatic, common-sense approach to the conflict of interest rule by requiring a real, sensible possibility of conflict before finding that a conflict of interest exists. The test for ascertaining a possible conflict is objective. It is not necessary to establish fraud, dishonesty or bad faith.

The law does not, other than in exceptional circumstances, regard it as objectionable for a director to accept or continue in a position creating duties to a third party, even if there is a real possibility that those duties may come into conflict with the director's duty to the company. However, once there is an actual conflict between the duties owed in each relationship, the fiduciary principle is attracted. The High Court in *R v. Byrnes* (1995) 17 ACSR 551 at 562, stated:

A director of a company who is also a director of another company may owe conflicting duties. Being a fiduciary, the director of the first company must not exercise his or her powers for the benefit or gain of the second company without clearly disclosing the second company's interest to the first company and obtaining the first company's consent.

In some cases, disclosure may not be enough, and the common director may be obliged to abstain from taking part in the negotiations or voting on the transaction. Conversely, abstention without disclosure may be insufficient.

III DISCLOSURE

ASIC advises companies to nominate a senior officer to have responsibility for ensuring compliance with continuous disclosure requirements, overseeing disclosure of information to the ASX, analysts, brokers, shareholders, media and the public, and for educating directors and staff on the company's disclosure policies and procedures and the principles underlying continuous disclosure. In practice, this person is often the company secretary, although most large companies engage a 'chief risk officer'.

The ASX has provided clear guidance that compliance with periodic financial disclosure requirements does not extinguish an entity's continuous disclosure obligations. Where structured disclosure of financial information – for example, the quarterly, half-year or preliminary final reports – is required by the Listing Rules, information that emerges in the preparation may be relevant to the achievement of forecasts or indications of profit or revenue previously released to the market. Companies must then consider whether this is information that should be immediately disclosed.

An entity may have obligations to immediately disclose information if it becomes aware that its earnings for the current period will materially differ from market expectations. The relevant ASX Listing Rules guidance note clarifies that while 'immediately' does not mean 'instantaneously', such information must be disclosed 'as quickly as it can be done in the circumstances and not deferring, postponing or putting it off to a later time'. ASX's guidance on continuous disclosure, which was updated again in July 2015, provides greater clarification to the issues surrounding analyst and investor briefings, analyst forecasts and consensus estimates. It also seeks to draw a distinction between 'earnings surprises' and 'market sensitive earnings surprises'. Although following shortly off the back of amendments made in 2014, the 2015 update does not fundamentally change ASX's existing position on continuous disclosure, but provides useful guidance in light of recent developments in this area. Recently, ASIC released a paper setting out its policy on selective briefing and the handling of confidential information, making clear that if price-sensitive information is provided to one party, it must be provided to all. The strict nature of a company's disclosure

obligations has been illustrated by a number of recent high-profile incidents where listed entities allegedly made disclosures to analysts through briefings that were not also released to the market generally. Of particular significance was the A\$1.2 million penalty imposed by the Federal Court on Newcrest Mining for contravening its continuous disclosure obligations (being more than double Australia's previous largest disclosure rules penalty).⁴

i Financial reporting and accountability

The Corporations Act requires all companies to keep written financial records, which record the transactions and financial position of the company and would enable financial statements to be prepared and audited. These financial records must be retained for seven years.

The Corporations Act requires most entities, other than Australian-controlled 'small' entities, to prepare a financial report and a directors' report for each financial year and to lodge them with ASIC.

The content requirements of the annual financial report essentially include three elements; financial statements, notes to the financial statements and the directors' declaration regarding the statements and notes. The annual directors' report must include general information about operations and activities, and specific information on numerous aspects of the business. Reports must be lodged with ASIC within four months after the end of the financial year.

Annual financial reports of each financial year must be made available to shareholders either in hard copy, electronic copy (if a shareholder has elected to receive them in this form) or by making the reports readily accessible on a website. A breach of this requirement is a strict liability offence. Shareholders are also to be given the directors' and auditor's report or a concise report for the year.

Recent amendments to the Corporations Act have also sought to improve the system of remuneration reporting imposed on companies.⁵ Since March 2015, companies that are 'disclosing entities' for the purpose of the Corporations Act, but whose securities are not listed on a securities exchange, have not been required to prepare a remuneration report.

ii Auditors' role and authority, and independence

There is a general requirement in the Corporations Act that an auditor be independent. It is a requirement that auditors make an annual declaration that the auditors have complied with the auditor independence requirements in the Corporations Act and any applicable code of professional conduct. There are also restrictions on specific employment and financial relationships between auditors and their clients and the imposition of mandatory waiting periods before partners of audit firms, directors of audit companies and audit personnel may join an audit client as a director or in a senior management position. Along with the other independence requirements, listed companies are required to disclose in the annual directors' report the fees paid to auditors for each non-audit service as well as a description of each service. In addition, the annual directors' report of each listed company must include a statement by directors whether they are satisfied that the provision of non-audit services does not compromise independence.

⁴ *ASIC v. Newcrest Mining Limited* [2014] FCA 698.

⁵ Corporations Legislation Amendment (Deregulatory and Other Measures) Act 2015 (Cth).

The Listing Rules require that the top 500 companies at the beginning of the financial year have an audit committee during that year. If the company is in the top 300 of that index, the company must comply with the recommendation relating to the composition of the audit committee.

Auditor appointment requirements for companies limited by guarantee have also been streamlined under the recent Corporations Act amendments. Under the amendments, small companies limited by guarantee, and most other companies limited by guarantee that have their financial reports reviewed, are no longer required to appoint or retain an auditor.

IV CORPORATE RESPONSIBILITY

In relation to corporate social responsibility (CSR), a director's legal duty is to the 'company as a whole', which includes shareholders and, under certain circumstances, creditors, but not customers, employees, the environment or society as a whole. Despite this, the Principles and Recommendations encourage companies to act ethically and responsibly. This involves companies not only complying with their legal obligations, but also considering the 'reasonable expectations' of investors and the broader community, and acting as 'good corporate citizens'.

The Principles and Recommendations state that listed companies should establish a code of conduct, with Council commentary that the code should ideally go further than merely ensuring compliance with legal obligations. The Principles and Recommendations provide suggestions as to how a listed company can use its code of conduct to encourage ethical and responsible corporate behaviour beyond the basic requirement of legal compliance. The code of conduct should be made publicly available, and should be a statement of the company's core values. According to the most recent Annual Report released by the Australian Centre for Corporate Social Responsibility (ACCSR), stakeholder engagement remains the biggest priority for achieving strong CSR performance measures.⁶ According to ACCSR, building stronger and productive relationships with stakeholders remains the highest priority for organisations across all stages of a company's CSR development.

Listed companies are also subject to express requirements relating to the company's social and environmental impact. A listed company should disclose whether it has material exposure to economic, environmental and social sustainability risks, and how it manages or intends to manage those risks. Disclosure of these risks, in particular environmental and social sustainability risks, requires a company to consider factors that may often run counter to economic imperatives.

As a result of this enhanced focus on CSR, an increasing number of Australian companies impose CSR obligations in their commercial contracts. CSR clauses may state that the relevant goods or service supplier acknowledges that the engaging company has a commitment to corporate social responsibility, and that this commitment extends to its suppliers and that the company expects all of its suppliers to conduct their operations in an environmentally and socially responsible manner. Such clauses may require the supplier to consider ways of minimising the social and environmental impacts of its operations, including by identifying social and environmental effects and risks, and implementing appropriate controls to manage them.

⁶ 'The State of CSR in Australia and New Zealand' (Annual Review 2015, Australian Centre for Corporate Social Responsibility, May 2015), http://accsr.com.au/wp-content/uploads/2015/03/ACCSR_StateOfCSR_20151.pdf.

V SHAREHOLDERS

i Shareholder rights and powers

Shadow directors

Under the Corporations Act, a person will be considered a ‘shadow director’ of a company, and liable as a director, if the directors of the company ‘are accustomed to act in accordance with the person’s instructions or wishes’.

In exchanging information and views between the directors of the company and the significant shareholders, those shareholders may run the risk of inadvertently becoming a ‘shadow director’ of the company. For that reason, while obtaining the advice of the significant shareholders may often be of significant benefit to directors, it remains incumbent on those directors to bring an independent mind to any matter on which the significant shareholders’ views have been sought.

Decisions reserved to shareholders

The Corporations Act prescribes that certain matters must be decided by shareholder meetings. These include:

- a* altering the constitution;
- b* consolidating or subdividing share capital;
- c* reducing the company’s issued share capital;
- d* altering rights attached to shares;
- e* altering the company’s status;
- f* selective buy-backs of shares or a buy-back exceeding the prescribed ‘10 in 12’ limit; and
- g* in the case of a public company, removing a director.

Additionally, there are other corporate activities that require member consent – for example, the giving of financial benefits to directors. In the case of listed companies, the Listing Rules require certain transactions be approved by shareholders in general meetings; for example:

- a* a disposal of the company’s main undertaking;
- b* the company changing its activities in a significant way;
- c* the issue of new share capital in excess of 15 per cent of its capital within 12 months (if the new issue is not *pro rata* to members); and
- d* entry into a related-party transaction valued in excess of 5 per cent of shareholder funds.

Rights of dissenting shareholders

The Corporations Act allows relatively small shareholder groups to call meetings and to propose resolutions. However, recent amendments to the Corporations Act have seen a restriction on the rights of dissenting shareholders, protecting companies from unrepresentative activism. As a result of these changes, a group of 100 shareholders is no longer able to compel a company to convene a general meeting. The main consideration behind this repeal was that 100 members in large corporations may hold a very small percentage of voting shares. In light of the rising presence of shareholder activism in Australia, the 100 member rule was seen as allowing an unrepresentative stakeholder group force a company to incur the costs of holding a meeting in circumstances where it is unlikely any resolution proposed by those 100 members will be passed (as most resolutions require over 50 per cent). Accordingly, under the Corporations Act, the directors of a company must now only call a general meeting at the request of members with at least 5 per cent of the votes that may be cast at the general meeting.

Over the course of 2016, 29 ASX-listed companies received shareholder requisition notices to convene extraordinary general meetings. Of these, at least 11 notices were withdrawn, as the shareholder groups were successful in motivating the relevant directors to resign ahead of the extraordinary general meeting.

Groups of 100 shareholders are still able to place matters on the agendas of general meetings, and a resolution may be proposed to be moved at a general meeting by:

- a* members with at least 5 per cent of the votes that may be cast on the resolution, or
- b* at least 100 members who are entitled to vote at a general meeting.

The Full Federal Court in the *Commonwealth Bank of Australia* (CBA) case⁷ confirmed the circumstances where shareholders may propose resolutions to be moved at general meetings, effectively drawing a line between the powers of shareholders and the powers of directors in the management of companies. Broadly, the case involved a shareholder group that represented over 100 CBA shareholders, seeking to move advisory resolutions relating to the environmental impact of CBA's lending at a CBA annual general meeting. The Full Federal Court held that shareholders may not control, usurp or exercise the powers of the directors (subject to provisions to the contrary in a company's constitution) and that shareholders may only propose resolutions that have some constitutional or statutory basis. As a result, it was found that the CBA shareholder group had no power to propose advisory resolutions.

To protect minority interests, the Corporations Act gives the courts a discretionary power to grant relief on the basis of oppression or unfair conduct (among other powers).

A court may make an order if conduct is either:

- a* contrary to the interests of the members as a whole; or
- b* oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members, whether in that capacity or in any other capacity.

The courts have interpreted this power broadly and in a flexible manner to afford shareholders the maximum protection against commercially unfair conduct. If directors conduct a company's affairs so as to advance their own interests or the interests of others of their choice to the detriment of the company or of the other shareholders, this conduct can be caught. For example, oppression would likely be found where shares are issued for the sole purpose of devaluing minority shareholders' shares and diluting their voting power.

ii Shareholders' duties and responsibilities

Controlling shareholders' duties may at times be extended, but there are no superior duties. There are no facilities for long-term shareholders to receive special benefits, such as extra votes or extra dividends.

Executive pay

In 2011, the Australian federal government introduced legislation to implement a 'two-strikes' rule, which gives shareholders the opportunity to vote out a company's directors if the company's remuneration report is subject to a 'no' vote by 25 per cent or more of its shareholders at two consecutive annual general meetings. After these 'two strikes', a resolution approved by a simple majority of shareholders can force a 'spill meeting' to be held within

⁷ *Australasian Centre for Corporate Responsibility v. Commonwealth Bank of Australia* [2016] FCAFC 80.

90 days, at which all current board members automatically cease to hold office immediately before the spill meeting closes. Shareholders must vote at the spill meeting to appoint persons to the board, and the applicants may or may not be directors affected by the spill resolution. If the shareholders re-elect a director who would otherwise have been required to vacate their position, that director's term continues as if no spill meeting had taken place.

This came relatively shortly after the introduction of stricter limitations on 'golden handshakes' to corporate executives.

The Corporations Act was also amended in 2011 to prohibit directors, senior executives and related parties from hedging their remuneration packages voting on their own remuneration packages, including through the use of undirected proxies. This was implemented in an attempt to ensure that executive remuneration remains linked to company performance.

In 2016, over 100 ASX-listed companies received a first strike in relation to the company's remuneration report, including AGL Energy, Woodside Petroleum and CBA.

iii Shareholder activism

Australia has seen an increase in shareholder activism in recent years, including through the emergence of specialist activist funds that are beginning to target Australian companies.

As noted above, recent amendments to the Corporations Act seek to protect companies from unrepresentative activism, now only enabling shareholders collectively holding 5 per cent of votes to call meetings, but Australian shareholders remain empowered however to appoint or remove directors at a general meeting with a simple majority vote. The growing trend in shareholder activism is encouraging a shift in Australia from director-centric governance to more shareholder-centric governance, with shareholders having a much more active say on a company's strategic issues (such as asset sales and takeover bids). Shareholder activism in the past few years has involved such motions for director removal and appointment, as well as shareholders agitating for the sale of certain company assets, applying pressure on boards to permit a suitor to conduct due diligence, and voting against the remuneration reports, which has become a particular focal point of shareholder activism and an outlet for shareholder dissatisfaction with board performance.

Commentators expect the level of activism to only increase in the coming years, although there is some wariness as to the mixed benefits shareholder activism can bring to the corporate governance regime in Australia. While an important mechanism in encouraging directors to discharge their duties efficiently and effectively as well as ensuring better compliance with the company's CSR obligations, there is a risk that short-term activists can undermine a company's long-term strategic planning.

iv Takeover defences

In Australia there are strong limits placed on the defensive tactics that can be employed by directors who have the intention of thwarting a hostile takeover on a listed entity. By virtue of being a public company, there is an accepted risk of the company being open to takeover bids. Accordingly, takeover defences focus on maximising shareholder value and ensuring control does not pass at an inadequate price.

Pro-active defences

A company and its shareholders may decide to adopt a form of proactive defence, which operate as a pre-emptive deterrent to make a target company unattractive from the outset to prospective bidders. Such defences include the following measures:

- a* ensuring placement of shares with those likely to support the company;
- b* use of inter-company shareholdings between associated companies;
- c* amendment of the company's constitution to introduce provisions making takeovers more difficult or less attractive (provisions of this kind include the requirement of shareholder approval for partial bids or, in very limited cases, maximum levels of shareholding); and
- d* use of share buy-back provisions under the Corporations Act to enable the company to repurchase some blocks of shares.

However, the Listing Rules effectively preclude a number of the above defensive strategies being employed. A target is prevented from issuing shares without shareholder approval for a period of three months after it is notified a person is making, or proposes to make, a takeover for securities in the target company. Even prior to the announcement of a bid, the issue of new securities by the target is subject to a general prohibition that prevents a listed company issuing new securities exceeding 15 per cent of that class within a period of 12 months. As a result of Listing Rules provisions that prescribe a one-vote one-share rule, defensive voting right restrictions are also not permissible in Australian listed companies. A company is further restricted in its ability to pay termination benefits to directors or employees that would be actioned on a change of control.

The Corporations Act does not facilitate the use of staggered or 'classified' board structures as an anti-takeover mechanism. Shareholders of a public company in Australia can at any time vote to remove a director from office, the effect being that a new owner can use this provision to remove all incumbent directors and replace them with directors of his or her choosing.

Reactive defences

In an alternative scenario, a company and its shareholders may only choose to undertake defensive strategies once a takeover offer has actually been made, or has been proposed. Such reactive defences include:

- a* criticism of the bidder and the bid, to dissuade shareholders from accepting it;
- b* seeking a white knight to make a rival bid or to acquire a large shareholding; and
- c* asset redeployment or corporate restructuring.

Takeovers Panel policy operates as a significant restriction on the actions target directors may take in direct response to an unwelcome takeover bid. As noted above, the Takeovers Panel has jurisdiction to ensure that actions taken during control transactions do not constitute 'unacceptable circumstances'. The Takeover Panel's guidance on frustrating actions is extremely broad in scope, prohibiting any action by a target (taken or proposed) by reason of which a bid may be withdrawn or lapse, or where a genuine potential bid is not proceeded with. Undertaking a frustrating action may give rise to unacceptable circumstances regardless of whether it is consistent with, or a breach of, already existing directors' duties.

Prior independent shareholder approval is also required if a listed company or its associates propose to acquire or dispose of assets valued at more than 5 per cent of the

company's paid up capital, reserves and accumulated profits and losses where the vendor or purchaser is associated with the company. Asset redeployment may also be constrained, with the Corporations Act requiring shareholder approval for disposal of the company's main undertaking.

Ultimately the key weapon at a target's disposal is the directors' recommendation (which is particularly critical if the bidder needs to acquire 100 per cent of the target). It is important for the directors not to wait too long to issue their recommendation, as it may be of limited use if the bidder is already approaching a controlling stake.

v Contact with shareholders

Continuous disclosure obligations

ASIC advises that the chief risk officer be aware of information disclosures in advance of investor briefings, including information to be presented at private briefings to minimise the risk of a company breaching its continuous disclosure requirements. ASIC's policy is that information used in such briefings should be given to the ASX for immediate release to the market and also be posted on the company's website.

Companies must not make a disclosure to a significant shareholder of any of its price-sensitive information that has not otherwise been released to the ASX. If such a disclosure was made, it would trigger an obligation under the Listing Rules for the company to disclose that information to the market generally. Differential disclosure of such information between shareholders is not permitted.

Notice of meetings and proxy solicitation

Shareholders of listed companies must receive notices of meetings, containing the technical information requirements prescribed by the Corporations Act, at least 28 days before the relevant meeting.

In contentious matters, proxy solicitation is practised, with companies engaging proxy solicitation and public relations firms to mobilise shareholders. Shareholders may also provide their views on a proposed resolution in advance.

VI OUTLOOK

The recent changes in the Australian corporate governance framework have focused on driving Australian businesses to be more innovative, dynamic and competitive on the global stage. Australian businesses would welcome the continued implementation of changes designed to allow boards to embrace sensible risk-taking and innovation, such as the expected protections from insolvent trading offences (discussed above).

However, 2016 has seen a building mood across Western economies, with questions being asked of corporate governance. Communities are wanting evidence that companies exist for more than simply generating short-term profits for current shareholders. Increased shareholder activism in the Australian market echoes this discontent.

As noted above, the fiduciary duty to act in the best interests of the company arguably constrains the actions available to Australian boards in respect of these broader issues. With that being said, Australian boards are open to adopting the position that taking into consideration long-term, non-financial issues is in the best interest of the company.

Unlike other Western governments, Australia's has not yet pursued regulatory action to address this rising temper. Given the absence of regulatory action, Australian boards have an opportunity to autonomously ensure their remuneration and disclosure practices reflect the views of shareholders and the broader community. In doing so, they will need to navigate the requirements of their fiduciary duties.

AUSTRIA

*Martin Abram and Clemens Ph Schindler*¹

I OVERVIEW OF GOVERNANCE REGIME

Austrian listed companies are incorporated in the form of a joint-stock corporation (JSC) or – less frequently – a European company (SE).² The most relevant sources of law for listed companies are:

- a* the Stock Corporation Act or the Societas Europaea Act and the SE Regulation, which set forth the organisational framework for the company;
- b* the Stock Exchange Act, which regulates disclosure obligations, as well as the rules on insider trading, market manipulation and directors' dealings;
- c* the Takeover Act, which sets forth the framework for public takeover bids;
- d* the Commercial Code, which contains the applicable Austrian accounting rules;
- e* the Accounting Control Act, which is aimed at ensuring that financial and other information published by listed companies complies with national and international accounting standards;
- f* the (non-binding) Corporate Governance Code, which contains best practice rules and recommendations for listed companies; and
- g* regulations and circulars by the Austrian Financial Market Authority.

As regards the Corporate Governance Code, it is principally non-binding and only applies to listed JSCs or SEs that have committed themselves to complying with the Corporate Governance Code; however, such a commitment is a prerequisite for entry to the prime market of the Vienna Stock Exchange.

Listed companies are subject to the supervision of the Financial Market Authority (in particular regarding insider trading, market manipulation and directors' dealings), the Takeover Commission (regarding takeover bids) and the Austrian Financial Reporting Audit Panel (for audits pursuant to the Accounting Control Act, unless the audits are made by the Financial Market Authority).

II CORPORATE LEADERSHIP

Most Austrian-based listed companies have a two-tier board structure (consisting of a management board and a supervisory board), even though the two-tier structure is only

1 Martin Abram and Clemens Ph Schindler are partners at Schindler Rechtsanwälte GmbH.

2 Societas Europaea.

mandatory for JSCs – SEs may choose between a one- or two-tier structure. As there are only a few companies that have opted for a one-tier structure, the following overview will focus only on the two-tier structure.

i Board structure and practices

Management board

Role

The management board is responsible for managing the operations of the company, taking into account (as the Stock Corporation Act provides) the interests of the shareholders, the employees and the public good. In performing its function, the management board is not subject to instructions by the supervisory board or the shareholders; however, certain decisions (such as the determination of business principles and the establishment or closure of business lines or production branches) and transactions (such as the sale or acquisition of shares or real estate, the granting and taking up of loans exceeding certain thresholds, investment above certain thresholds) are subject to the consent of the supervisory board. These consent requirements are based on the Stock Corporation Act, but can (and typically are) made more specific or be expanded in the rules of procedure for the management board or – less frequently for listed companies – in the articles of association. Certain transactions and decisions (e.g., acquisition of treasury stock, issuance of new shares or bonds, mergers, spin-offs or dissolution) require the prior consent of the shareholders' meeting. Further, the management board may decide, or be required (see Section V.i, *infra*), to ask the shareholders' meeting for instructions on or approval of certain transactions.

Composition

According to the law, the management board can have one or more members. For certain regulated businesses (such as financial institutions or insurance companies), at least two members need to be appointed. In practice, listed JSCs have more than two members.

As a general rule, any two management board members together can represent the company, except if the articles of association allow for single signing authority and the appointment resolution bestows such single signing authority on a board member.

The signing authority of each board member is published in the Companies Register; in business dealings, third parties can rely on this information in the Companies Register (if acting in good faith), even if the management board members fail to comply with internal restrictions on their representation powers.

Chairperson

If two or more management board members are appointed, the supervisory board typically also appoints the CEO of the company as the chairperson of the management board. In the event of a tied vote, the chairperson has the deciding vote, except if the articles of association provide for otherwise. In addition to the specific tasks delegated to him or her by (typically) the by-laws, the chairperson of the management board also is responsible for the preparation, convocation and documentation of the meetings of the management board. However, the chairperson is not entitled to give instructions to the other board members.

Delegation of tasks and committees

Even though the Stock Corporation Act provides that the operations of a JSC are managed by the members of the management board collectively, it is customary (and recommended by the Corporate Governance Code) that the various members of the management board have specific areas of responsibility (i.e., they would each be responsible for certain departments). This allocation is established either in the articles of association or the by-laws of the management board (which are adopted by the supervisory board) or by the management board itself. Even when certain management tasks are allocated exclusively to certain management board members, the other management board members are still responsible for proper supervision of the due performance of these tasks. Certain tasks cannot be delegated to individual board members (such as decisions on the fundamental business policy of the company or the convocation of general meetings where the company's equity is equal to or lower than its stated capital). It is not customary for the management board to establish committees. It has to be noted that the allocation of tasks among the members of the management board does not dispense the management board members from keeping themselves informed of (and obtaining information about) developments and activities in areas allocated to other management board members or from acting if they perceive any deficits.

Supervisory board

Role

The supervisory board is tasked with the control and monitoring of the management board. In performing its functions, the supervisory board is not bound to instructions by the management board or the shareholders. The supervisory board can request reports of the management board and can inspect the books and records of the company. The supervisory board needs to hold a meeting at least every calendar quarter.

Composition

According to law, the supervisory board must have at least three and no more than 20 members elected or nominated by the shareholders. For listed companies, the Corporate Governance Code recommends a maximum of 10 supervisory board members elected or nominated by the shareholders.

Representation of the company

Neither the supervisory board nor any of its members are entitled to represent the company, except in connection with the conclusion, amendment or termination of a director's agreement and legal proceedings of the company against the members of the management board. In such cases, the supervisory board is represented by its chairperson.

Chairperson

The supervisory board is required to elect from its midst a chairperson and (at least one) vice chairperson. Even though this means that a representative delegated by the employees' council could also be so elected, in practice these positions are predominately taken up by supervisory board members elected or nominated by the shareholders. Besides certain administrative duties (such as the convocation of the supervisory board meetings, the preparation of the agenda), the chairperson of the supervisory board also takes the chair of the (annual or

extraordinary) general meeting, is entitled to demand a report from the management board even without the support of other supervisory board members and is required to sign certain applications of the company with the Companies Register.

Delegation of tasks and committees

The Stock Corporation Act allows for (and in one case mandates), and the Corporate Governance Code recommends, the establishment of committees of the supervisory board. Each committee established must have at least three members. For listed companies, the establishment of an audit committee is mandatory; in addition, the Corporate Governance Code recommends the creation of a nomination and compensation committee. The mandatory audit committee is basically responsible for the monitoring of the company's accounting process, the internal control systems and the audit of the financial statements (and related documents), including the preparation for their approval. The audit committee is also tasked with proposing the auditor of the company to the general meeting and with monitoring the independence of the appointed auditor. One member of the audit committee must be a person with special knowledge and practical experience in finance and accounting and reporting. If established, a remuneration and nomination committee is responsible for negotiating and approving directors' agreements, determining general policies for the remuneration of the management board, preparing nominations for the appointment of new management board members (including successor planning) as well as for the appointment of new supervisory board members.

Remuneration of the management board

As mentioned above, the remuneration of the members of the management board is decided by the supervisory board (or the compensation committee, if any).

In determining the compensation for a management board member (which includes payments, bonuses, stock options or benefits in kind), several aspects have to be taken into account. The compensation should be appropriate both for the tasks allocated to the board member and the overall economic situation of the company. The compensation should include a fixed and variable component; as regards the criteria for the variable component, they should be chosen so as not to incentivise inappropriate risks and should not exclusively be based on financial figures. If management board members receive stock options, the vesting period must not be less than three years and vesting should be based on long-term, measurable and sustainable criteria. There should be contractual safeguards implemented in the directors' agreements to clawback variable payments in the event the pay-out decision was based on obviously false data. Finally, the management board members should not be entitled to redundancy payments if their director's agreement is terminated on important grounds; also redundancy payments should in any case be no more than two years' salary. The same principles also apply to senior management.

The remuneration of the management board has to be published both in the annual financial statements (on an aggregate basis) as well as the annual corporate governance report (on an individual basis, including the split between fixed and variable remuneration). The annual financial statements also have to disclose the number of stock options granted to the management board members.

Remuneration of the supervisory board

The remuneration of the members of the supervisory board is either determined in the articles of association of the company or (more frequently) by a decision of the general meeting. Remuneration for supervisory board members in Austria is relatively low compared with other countries (although a certain trend to raise the remuneration can be reported for the recent past), and usually comprises of a base remuneration (which is typically higher for the chairperson, vice chairperson and committee members) and a meeting fee (which will only be paid to members attending the meeting). The remuneration of each supervisory board member is published annually in the corporate governance report of listed companies. While it is possible for supervisory board members to participate in stock option programmes, the Corporate Governance Code does not recommend such participation.

Board and company practice in takeovers

When faced with a takeover offer, the boards of the target company are bound by the objectivity principle set forth in the Takeover Act. This means that they are barred from taking any measures that would prevent the shareholders from taking a free and duly informed decision about the offer.

Both boards of a JSC are required to publish a reasoned statement regarding the offer, which is subject to a mandatory review by an independent expert. The statement has to contain, *inter alia*, an assessment of (1) the consideration offered by the bidder; (2) the expected consequences of a successful takeover for the company, its employees (in particular the terms and conditions of employment and working conditions) and creditors; (3) the strategic goals pursued by the bidder; and (4) information on whether the members of the management board and the supervisory board recommend shareholders to accept the offer. If such a recommendation is deemed by the boards to be inappropriate, they are obliged to state arguments both for and against the acceptance of the offer.

ii Directors

Management board

Appointment

Members of the management board are appointed by the supervisory board for a period of up to five years. It is possible (and customary) to renew an appointment, with the renewed term again being subject to the five-year limit. According to the Corporate Governance Code, the supervisory board is required to define profiles for the respective management board members and an appointment procedure as a basis for the appointment decision. There are currently no special rules aiming at promoting diversity or appropriate representation of women in Austria (unlike, for example, in Germany), although the Austrian government has published its intention to introduce such rules (mainly for listed companies) in 2018. Supervisory board members may not be appointed management board members of the same company; for certain regulated industries, candidates for the management board need to fulfil additional criteria or pass a ‘fit and proper’ test before they can be appointed.

Dismissal

Members of the management board can be dismissed by the supervisory board before the end of term only on important grounds, in particular if the board member has materially

breached his or her duties, the board member is unable to properly carry out his or her duties (both for health reasons or lack of required skills or knowledge) or the shareholders adopted a vote of no-confidence (except if the vote was adopted for obviously inappropriate reasons).

Duties

As a general matter, the members of the management board of an Austrian company owe to the company (not the shareholders or any other constituents) the following duties: (1) the duty of care, requiring members to exercise the level of care of a proper and diligent person in similar circumstances (which includes an obligation to be reasonably informed about areas allocated to other board members and articulate any concerns they may have); (2) the duty of loyalty, requiring members to act in the best interest of the corporation (taking into account the interest of its shareholders, employees and the public good) and not in their own interest; (3) the duty of confidentiality; and (4) a duty not to compete.

Liability

Wilful or negligent failure to comply with these duties results in the personal liability of the responsible board members, unless the general meeting has lawfully approved the measure resulting in the damage. As regards the duty of care, not every decision or transaction that results in a loss for the company is automatically deemed a breach. Based on the business judgement rule, which was recently included in statutory law, management board members are allowed to assume risks provided that the risks are not outside normal business practice or inappropriate given the economic situation of the company. A JSC may waive or settle its damage claims with an affirmative shareholder vote of 80 per cent after five years, or even before that with an affirmative vote of all shareholders.

Conflicts of interest

As a general rule, management board members shall take their decisions without being influenced by their own interests or the interests of controlling shareholders. If a management board member has a material personal interest in transactions of the company (or its subsidiaries) or other conflicts of interest, he or she has to inform the supervisory board and the other management board members without delay. Any transactions of the company with a management board member (or its related persons or entities) need to be on arm's-length terms, have to meet industry standards and have to be approved by the supervisory board. For other conflicts of interest not involving such transactions, the management board member should not participate in any discussions of the management board concerning the topic and be excluded from any information flow in this respect. There are also statutory provisions and recommendations in place aimed at preventing (or limiting) potential conflicts of interest: The aforementioned non-compete duty prohibits management board members from operating other businesses, becoming supervisory board members in non-affiliated companies, becoming general partners of (entrepreneurial) partnerships or engage in business transactions in the company's field of business, except – in each case – with the consent of the supervisory board. The Corporate Governance Code also recommends that management board members should not sit on more than four (or chair more than two) supervisory boards of non-affiliated companies, even with the supervisory board's approval. The Corporate Governance Code also recommends implementing similar restrictions for senior management. Finally, management board members are prohibited from becoming

supervisory board members of the same company for a period of two years following the end of their term on the management board, unless they were nominated by shareholders holding more than 25 per cent of the total voting rights of the company.

Conflicts of interest may also arise in connection with any dealings by a management board member (or its related persons or entities) in the stock of the company (director's dealings). In this respect, management board members are required to report such trades to the Financial Market Authority within five banking days; the Financial Market Authority maintains a publicly accessible database for the reported trades. Additionally, listed companies are required to issue internal compliance guidelines that deal with the handling of, and the monitoring of access to, potential insider information. These internal compliance guidelines and their implementation are monitored by the Financial Market Authority.

Supervisory board

Appointment

Members of the supervisory board are elected by the shareholders meeting, usually at an annual general meeting; the articles of association can also bestow nomination rights to shareholders (for up to one-third of the total number of supervisory board members). Supervisory board members are elected for a limited term, which has to expire – by law – at the latest with the completion of the fifth annual general meeting after their election. Re-elections are permissible. No term limitations are mandated for nominated supervisory board members. The Stock Corporation Act provides that shareholders should consider the following aspects when electing supervisory board members: (1) the professional and personal qualifications of the candidates, (2) that the composition of the supervisory board (and the respective professional qualifications of its members) adequately accounts for the structure and business of the company and (3) diversity, appropriate age structure and internationality as well as appropriate representation of women on the supervisory board. Persons already holding multiple supervisory board positions (i.e., 10 positions in non-listed companies or eight positions in listed companies (with positions as chairman counting double) – or a combination thereof) may not run for further supervisory board positions in listed companies. Also, persons holding managerial functions in the JSC or any of its affiliated companies may not be elected to the supervisory board.

The employees' council (if established) of a listed JSC is entitled to delegate employee representatives to the supervisory board. For every two supervisory board members elected or nominated by the shareholders, the employees' council can delegate one representative. If the number of supervisory board members elected or nominated by the shareholders, is uneven, the number of representatives to be delegated by the employees' council is calculated based on the next highest even number (e.g., if there are seven supervisory board members elected or nominated by the shareholders, the employees' council can delegate four representatives).

Dismissal

Members of the supervisory board can be removed from office during their term of appointment by a shareholders' resolution that requires a 75 per cent majority of the votes cast, unless the articles of association provide for otherwise. Members of the supervisory board delegated by the employees' council can be recalled at any time by the employees' council.

Duties

Members of the supervisory board are in principle subject to the same duties as the members of the management board, which are scaled down to reflect that fact that the supervisory board members are mainly tasked with the monitoring and review of the conduct of the management board. One exception is that supervisory board members are not explicitly prohibited from competing with the company. Any actual competition will, however, always be under scrutiny under the duty of loyalty to the company.

Liability

The liability standards applicable to management board members also apply to supervisory board members.

Conflicts of interest

In principle, the provisions regarding conflicts of interest of management board members also apply to supervisory board members, except that supervisory board members are not subject to a statutory non-compete obligation. In this respect, the Corporate Governance Code recommends supervisory board members not to assume functions on the boards of competing companies. As a precautionary measure, candidates running for a position on the supervisory board have to present to the general meeting information on all positions they hold and all other circumstances that could give rise to potential conflicts of interest. Supervisory board members are also subject to the same director's dealing requirements as members of the management board and are typically also covered by the internal compliance guidelines of the company.

III DISCLOSURE

Listed companies are required to prepare (consolidated) annual financial statements and half-yearly financial report. In most cases, listed companies also prepare quarterly reports. The financial statements and reports have to be prepared in accordance with IFRS. In addition, listed companies also have to prepare stand-alone annual reports in accordance with Austrian GAAP.

The annual financial statements need to be audited by an independent auditor or auditing firm appointed by the general meeting based on a recommendation of the audit committee. Any auditor or auditing firm proposed as the annual auditor has to provide a statement to the general meeting confirming that neither of the statutory exclusion reasons apply, and disclosing its business dealings with the company during the past business year.

Listed companies also have to publish a corporate governance report together with the annual financial statements. Besides certain information on the organisation, composition and remuneration of the boards of the company, and on the measures to promote appropriate representation of women on the management board, the supervisory board and in executive positions, the report in particular has to include a corporate governance statement. This statement has to include information whether – and if so in what form – the company deviates from any 'comply or explain' rules of the Corporate Governance Code.

Additionally, listed companies and their directors are subject to various disclosure requirements under the Stock Exchange Act, such as publication of directors' dealings and *ad hoc* disclosure. *Ad hoc* disclosure is aimed at preventing insider trading and requires listed companies to publish without undue delay any non-public information relating to the issuer

that could have a material impact on the market price of the securities of the company. Finally, shareholders of listed companies are faced with a statutory obligation to notify the company and the Financial Market Authority, if their shareholdings (whether direct or indirect) exceed certain thresholds (starting at 4 per cent, unless the articles of association lower the threshold to 3 per cent).

IV CORPORATE RESPONSIBILITY

Corporate responsibility and compliance have become important topics in recent years, in particular in connection with corruption scandals and highly publicised criminal proceedings against management board members regarding anticompetitive practices. As a consequence, listed companies have introduced compliance codes and installed compliance officers. These compliance codes materially influence the daily corporate life and usually emphasise the ‘tone from the top’ principle. Many companies have also established whistle-blowing hotlines. The establishment of such hotlines, however, is only possible after the company has received the consent of the Austrian Data Protection Authority. This permission is no mere formality, and usually requires the listed company to adhere to certain impositions by the Data Protection Authority; additionally the Data Protection Authority also demands that the company conclude a shop agreement with the employee’s council regarding the hotline before granting its permission.

V SHAREHOLDERS

i Shareholder rights and powers

Shares in JSCs have – except for limited exceptions provided by law – equal rights (i.e., equal voting, dividend and information rights). The Stock Corporation Act expressly prohibits ‘golden shares’ (i.e., shares with multiple or disproportionately higher voting rights). However, it is permissible for the articles of association to introduce maximum voting rights or staggered voting rights. Also, a JSC may issue non-voting preferred shares based on a shareholder resolution, whereas the nominal amount of such non-voting shares may not exceed one-third of the aggregate stated capital of the JSC.

Shareholders in listed companies have no direct influence on the management board and are not permitted to issue instructions or otherwise direct the management board. Their influence is limited to certain reserved decisions, which fall into the following three categories. First, certain decisions (such as changes of the articles of association, the appointment of supervisory board members, the appropriation of distributable profit, acquisition of treasury stock, issuance of new shares or bonds, mergers, spin-offs or dissolution) require a shareholder resolution by operation of law. Second, the management board or the supervisory board may put certain decisions to the shareholders, if no agreement can be reached among the boards. Third, there is an obligation to put certain fundamental business decisions to a vote by the shareholders; this requirement is not based on a statutory obligation, but on a doctrine developed by the German Supreme Court, which was also followed by the Austrian Supreme Court.

Other rights of the shareholders include the right to demand a convocation of a shareholder meeting and the right to put certain matters on the agenda of a general meeting convened shareholder meeting (which requires the requesting shareholders to hold at least 5 per cent of the stated capital, unless the articles of association provide for a lower

threshold) and the right to demand a special audit of the company (which requires the requesting shareholders to hold at least 10 per cent of the stated capital). All shareholders are entitled to request information on all items on the agenda in a shareholders' meeting, and are furthermore entitled to request that any of their statements (and the responses thereto) are recorded verbatim in the meeting minutes.

Dissenting shareholders are entitled to object to resolutions passed at a shareholders meeting and can (if an objection was made) file for annulment or rescission of a resolution with the competent court in limited circumstances.

ii Shareholders' duties and responsibilities

Shareholders of a JSC (both controlling and minority) are subject to a fiduciary duty requiring them not to directly causing harm to the company in the exercise of their shareholder right. Shareholders' resolutions breaching fiduciary duties may be contested and may give raise to damage claims against the JSC and its shareholders. Shareholders breaching this fiduciary duty may also be subject to damage claims by the company.

There are no specific duties for institutional investors above the general duties applicable to all shareholders. Also, there is no code of best practice for shareholders of Austrian listed companies.

iii Shareholder activism

Shareholder activism has traditionally not played an important role in Austria (unlike Germany). More recently, Austrian activist shareholders as well as the Austrian Shareholder Association have taken a more active role in representing free float shareholders.

Proxy battles do occur, but not very frequently. The most recent example was an (initially unsuccessful) proxy battle at the general meeting of Conwert SE, where minority shareholders tried to have two candidates elected to the board. This attempt was initially thwarted as the chairman of the meeting decided to suspend the voting rights of certain shareholders owing to alleged violations of the Takeover Act, which led to the election of two candidates proposed by the board. The minority shareholders then initiated legal proceedings aiming at the annulment of this election. Ultimately, the minority shareholders prevailed, as Conwert decided not to continue its objection against the legal proceedings.

As mentioned before, shareholders in Austrian listed companies have no direct say as regards the remuneration of the directors, with the exception of stock option or transfer schemes, the introduction of which requires a vote of the shareholders. This regime is, however, expected to change once the amendment of the EU Shareholder Directive is finally passed, following the political agreement announced in December 2016.

iv Contact with shareholders

Under Austrian law, listed companies are in general required to treat all shareholders in an equal manner. Therefore, as a matter of principle, any direct communication with shareholders is a sensitive matter and is only possible if an objective justification exists. Such an objective justification may exist, for example, if a listed company intends to acquire a business owned by one of its shareholders. In such cases, it is standard market practice to insist on a comprehensive secrecy agreement (which sometimes includes standstill covenants). In such cases, listed companies typically impose internal restrictions so that only a limited

number of persons (usually the management board, selected senior managers) have access to such information. If the transaction requires the consent of the supervisory board, the matter is sometime delegated to a committee of the supervisory board to ensure confidentiality.

Selective meetings with individual shareholders usually take place during corporate roadshows or capital market days. Additionally, several Austrian listed companies do schedule investor's calls, typically around the publication of financial information by the company. To avoid allegations of unequal treatment of shareholders, the presentations given during such events and recordings of investor calls are made publicly available on the website of the company.

VI OUTLOOK

On 1 January 2016, an amendment of the Criminal Code came into effect dealing with balance sheet fraud and misrepresentation. There is still a great deal of uncertainty as to the effect of these new provisions on listed companies and their auditors. In this regard, it has to be noted that business decisions of the management boards of listed companies seem to be scrutinised more and more under criminal law aspects. Recent judgments of the Austrian Supreme Court have resulted in a high degree of uncertainty whether certain business decisions could constitute fraud or embezzlement, and further clarifications by the courts would be welcome. On the other hand, the inclusion of the business judgement rule gives management boards more robust grounds for defence.

A recurring topic of discussion is the lack of 'say on pay' statutory provisions for listed companies in Austria. Current expectations are that Austria will not enact rules similar to the German system on its own, but rather wait for the adoption of the amendment of the EU Shareholder Directive.

BELGIUM

*Elke Janssens*¹

I OVERVIEW OF GOVERNANCE REGIME

Belgian corporate governance practices for listed companies have been partially codified in the Belgian Company Code (BCC). The BCC contains mandatory provisions on, for example, the establishment of an audit committee and a remuneration committee, requirements with respect to the determination and disclosure of executive remuneration, requirements for independent directors, and the issuance of a corporate governance statement. Compliance with these mandatory provisions is ensured, for the most part, by the listed company's auditor and the Financial Services and Markets Authority (FSMA).

In addition, other financial and *ad hoc* disclosure requirements for listed companies are laid down in the Royal Decree of 14 November 2007 on the obligations of issuers whose financial instruments are admitted for trading on a regulated market. Listed companies must also disclose the transparency notices they receive from their shareholders pursuant to the Act of 2 May 2007 and the Royal Decree of 14 February 2008.

The other main source of guidance with respect to corporate governance for Belgian listed companies is the Corporate Governance Code 2009 (the 2009 Code),² published on 12 March 2009 and also known as the Daems Code. The 2009 Code is an initiative of the non-governmental Corporate Governance Committee, composed of representatives from bodies such as the FSMA (formerly the CBFA), the Federation of Belgian Enterprises, Euronext Brussels, the Belgian Institute of Chartered Accountants and the Central Economic Council. The 2009 Code replaced the Corporate Governance Code 2004 (the Lippens Code). The FSMA monitors compliance by listed companies with the 'comply or explain' principle applicable to the 2009 Code. The 2009 Code is intended to apply to Belgian companies whose securities are listed on a regulated market.³

In 2010, the 2009 Code was named the mandatorily applicable corporate governance code for certain listed Belgian companies, more specifically those whose shares are listed on a regulated market (in Belgium or another Member State of the European Economic Area (EEA)) or whose shares are traded on a multilateral trading facility (MTF) (i.e., in Belgium,

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2 See www.corporategovernancecommittee.be.

3 There is an inconsistency between the Dutch version of the 2009 Code, on the one hand, and the French and English versions, on the other; the latter only refer to 'companies whose shares are listed on a regulated market'.

mainly the Vrije Markt/Marché Libre and Alternext),⁴ provided they have other securities listed on a regulated market (e.g., in Belgium, Euronext Brussels or the market for derivatives of Euronext Brussels). The BCC obliges such companies to adhere to the provisions of the 2009 Code or to explain in their corporate governance statement, which forms part of the annual report, why they have not done so, assuming of course that the provisions in question are not of mandatory application. This means that listed companies that fail to explain why they have not abided by certain provisions of the 2009 Code will be deemed to be in violation of Belgian law. In other words, listed companies are not required by law to comply with the 2009 Code, but they are required to explain why they have not done so. In addition, compliance is highly recommended since it gives credibility and authority to listed companies. Non-compliance can indeed adversely affect public opinion about a company.

The Belgian corporate governance rules have thus evolved over the past few years from soft law (the Lippens Code and the 2009 Code) to hard law (BCC), and the process is ongoing. The 2009 Code will be reviewed in 2017. The Corporate Governance Committee wishes to update the 2009 Code and incorporate the changes in the BCC.⁵ European legislation is often the driving force behind Belgian legislative proposals.

One of the most important recent legislative actions in the area of corporate governance is the adoption of rules that oblige listed companies to ensure that at least one-third of the members of their board of directors is of a different gender than the other members.⁶ This action is based on a January 2011 recommendation on gender diversity of the Corporate Governance Committee. Indeed, the means of increasing the number of women on management boards has been widely debated. The legislature finally decided to use hard law rather than soft law (such as a recommendation in the 2009 Code) to achieve this goal.

Specific, more stringent corporate governance rules are applicable to financial institutions.

In addition to the 2009 Code, which is applicable to listed companies, the Bourse Code II contains corporate governance recommendations for unlisted companies. The Bourse Code II was published in 2009 to update the Bourse Code 2005; compliance with this code is voluntary in nature.

This chapter, however, focuses only on the corporate governance rules applicable to listed companies.

4 Publieke Veilingen/Ventes Publiques, Trading Facility and Easynext, organised by Euronext Brussels, and MTS Belgium, MTS Denmark and MTS Finland, organised by MTS Associated Markets SA, are also MTFs but are rarely used.

5 An important reform of the BCC is scheduled to take place in the course of 2017. The Minister of Justice established a non-profit organisation composed of corporate law experts with an academic background two years ago and this non-profit organisation is working on the new draft of the BCC.

6 Act of 28 July 2011 amending the Act of 21 March 1991 on the reform of certain economic public undertakings, the Company Code, and the Act of 19 April 2002 on the functioning and management of the National Lottery, to guarantee that women are represented on the boards of directors of public undertakings, listed companies and the National Lottery, published on 14 September 2011 in the Belgian State Gazette.

II CORPORATE LEADERSHIP

i Board structure and practices

In Belgium, listed companies usually take the form of a limited company (NV/SA).⁷ Companies with other corporate forms can be listed if their shares are freely transferable.

The basic governance structure of an NV/SA is a one-tier model, whereby the board of directors holds all powers except those specifically reserved by law or the articles of association to the general meeting of shareholders. Limitations on the powers of the board of directors set out in the articles of association are not enforceable against third parties and have internal effect only. The board of directors should be composed of at least three directors (or two if there are only two shareholders in the company and the articles of association so provide).

The BCC allows the board of directors to delegate daily management of the company, and the external representation of the company in that respect, to another person, who may also be a director. Limitations on the powers of the daily manager, either set out in the articles of association or adopted by the board of directors, are not enforceable against third parties and have internal effect only. This person is generally known as the CEO, managing director or general manager. The board of directors still has authority to take decisions with respect to the delegated powers.

The BCC allows companies to adopt a two-tier governance model if their articles of association provide for this possibility. In this model, the board of directors delegates (some of) its powers to a management committee, except those reserved to it by law and general corporate policy. Limitations on the powers to be delegated can either be set out in the articles of association or adopted by the board of directors. Again, such limitations are not enforceable against third parties and have internal effect only. If the board of directors thus delegates all of its powers except those reserved to it by law and general policy, it becomes in fact a supervisory board and can no longer take management decisions. Very few listed companies have adopted a two-tier governance model.

The most common governance model in listed companies, and the basis for the 2009 Code, is the one-tier model, whereby the board of directors delegates daily management to the CEO, who is assisted by a number of executive managers (who may or may not be directors), for example, the chief operating officer, the chief financial officer or the chief legal officer. Together, they constitute the company's executive management. The powers of the executive managers, other than the CEO, to represent the company for the purposes of certain acts derive from a special authorisation granted by the board of directors or the CEO.

In addition to representation by the CEO (for matters of daily management) and other executive managers (within the limits of their specific powers), the company can also be represented externally by a majority of its directors, acting jointly, or by a person appointed to this end in the articles of association (often two directors acting jointly, the chair, the CEO, etc.). The company will be bound by any acts taken or obligations incurred by these individuals, even if the internal decision was not taken by the correct corporate organ (unless the counterparty acted in bad faith). Quantitative limitations (e.g., representation for transactions with a value of up to €100,000) on the external representation powers of the CEO or the persons appointed in the articles of association to represent the company are not enforceable against third parties and have internal effect only.

⁷ Since most listed companies in Belgium take the form of an NV/SA, the governance structures of other corporate forms are not discussed in this chapter.

In the above model, the board of directors still has all powers to manage the company, but daily management is mostly handled by executive management. The board of directors, in actuality, mainly supervises the management of the company. The 2009 Code indicates that the board of directors is responsible for determining the company's values and strategy, its risk appetite and key policies. As a guideline, the board of directors should ensure that the necessary leadership and human and financial resources are available for the company to meet its objectives. In translating values and strategies into key policies, the board should pay attention to corporate social responsibility, gender diversity and diversity in general. In addition to general corporate policy, the board of directors should at least, in the context of its supervisory role:

- a* review the performance of executive management and the realisation of the company's strategy;
- b* monitor and review the effectiveness of the board's committees;
- c* take all necessary measures to ensure the integrity and timely disclosure of the company's financial statements and other material financial and non-financial information disclosed to shareholders and potential shareholders;
- d* approve the internal control and risk management mechanisms proposed by executive management;
- e* review the implementation of these mechanisms, taking into account the review made by the audit committee;
- f* supervise the performance of the statutory auditor;
- g* supervise the internal audit function, taking into account the review made by the audit committee; and
- h* describe the main features of the company's internal control and risk management systems (disclosed in the corporate governance statement).

The 2009 Code states that the board of directors should take decisions in close consultation with the CEO regarding the structure of executive management and should determine the powers and duties of the executive managers. A mention to this effect should be included in the terms of reference of the board and of executive management. The board should ensure that executive management is able to perform its responsibilities and duties. In view of the company's values, risk appetite and key policies, executive management should have sufficient latitude to propose and implement corporate strategy. Executive management should at least:

- a* be entrusted with the running of the company;
- b* put internal controls in place (i.e., systems to identify, assess, manage and monitor financial and other risks) without prejudice to the board's supervisory role and based on a framework approved by the board;
- c* present to the board complete, timely, reliable and accurate financial statements, in accordance with the applicable accounting standards and company policies;
- d* prepare the company's disclosure of financial statements and other material financial and non-financial information;
- e* present the board with a balanced and comprehensible assessment of the company's financial situation;
- f* provide the board in due time with all information necessary for the latter to carry out its duties; and
- g* be responsible and accountable to the board for the discharge of its responsibilities.

The 2009 Code states that the board of directors should be composed of both non-executive directors, who do not participate in the company's daily activities, and executive directors, who belong to executive management and thus participate in the company's daily activities. At least half the board should be made up of non-executive directors, at least three of whom are independent based on the criteria set out in Article 526 *ter* BCC. The board's composition should ensure that decisions are taken in the company's interest and should reflect gender diversity and diversity in general, as well as complementary skills, experience and knowledge. No individual or group of directors should dominate the board's decision-making process, and no individual should wield excessive decision-making powers. In January 2011, the Corporate Governance Committee, which issued the 2009 Code, issued an additional recommendation providing that within seven years, at least 30 per cent of board members should be women.⁸

The Act of 28 July 2011 introduced Article 518 *bis* into the BCC, which stipulates that at least one-third (rounded to the nearest whole number) of the board of directors of companies whose securities are listed on a regulated market should be of a different gender than the other members. If the required number of directors of the less-represented gender is not met, the next appointed director should be of that gender. If not, the appointment shall be deemed null and void. The same holds true if an appointment would cause the number of directors of the other gender to drop below the required minimum. This requirement and sanction are applicable as from the first day of the sixth financial year that starts to run after 14 September 2011. For listed companies whose free float⁹ amounts to less than 50 per cent and for small listed companies,¹⁰ this requirement and sanction are applicable as from the first day of the eighth financial year beginning after 14 September 2011.

For companies whose securities are admitted to trading on a regulated market for the first time, the requirement should be met as from the first day of the sixth financial year after the admission.¹¹

If the required quota is not met, a board that meets the quota should be composed at the next general meeting. Otherwise, any financial or other benefit to which the directors are entitled by virtue of their office shall be suspended. These benefits will be reintroduced once the board meets the gender diversity requirement.¹²

The 2009 Code assigns a clear role to the chairperson of the board of directors. The chair and the CEO should not be the same person, and there should be a clear division between duties related to the running of the board (chair) and the management of the

8 This recommendation has not yet been incorporated into the 2009 Code, nor has the BCC made this recommendation part of the reference corporate governance code (the 2009 Code).

9 There is an inconsistency between the French and Dutch text of Article 518 *bis* BCC. The French version refers to the 'free float' while the Dutch version refers to 'the value of freely negotiable shares'. In our opinion, the French version is correct, since it appears that the Dutch text has not been fully updated following an amendment to extend the scope of the act from listed shares to listed securities.

10 Listed companies that meet at least two of the following three requirements on a consolidated basis: (1) fewer than 250 employees on average during the financial year, (2) a balance sheet total of less than €43 million, and (3) net annual turnover of no more than €50 million.

11 Applicable as from the first day of the first financial year starting after 14 September 2011.

12 This sanction is applicable as from the first day of the seventh financial year commencing after 14 September 2011. For listed companies whose free float amounts to less than 50 per cent and for small listed companies, this sanction is applicable as from the first day of the ninth financial year commencing after 14 September 2011.

company's business (CEO). This division of responsibilities should be clearly established, set out in writing and ratified by the board. The chair should cultivate a close relationship with the CEO, providing support and advice while fully respecting the CEO's executive responsibilities. As a guideline, the chair should stimulate effective interaction between the board and executive management. The chair is responsible for leading the board of directors and can be entrusted by the board with specific responsibilities. The chair should take the necessary measures to foster a climate of trust within the board, contribute to open discussion, allow constructive dissent and ensure support for the board's decisions. The chair determines the agenda for board meetings, after consultation with the CEO, and ensures that procedures relating to preparations for board meetings, deliberations, the adoption of resolutions, and the implementation of decisions are properly followed. The chair is responsible for ensuring that the directors receive accurate, timely and clear information before the meetings and, where necessary, between meetings. All directors should receive the same information.

The BCC obliges companies¹³ whose shares are listed on a regulated market to set up a remuneration committee composed of non-executive directors, a majority of whom should be independent.¹⁴ The members of the remuneration committee must possess the requisite level of expertise in the area of remuneration policy. The chair of the board of directors or another non-executive director should head the remuneration committee. The remuneration committee should meet at least twice a year and whenever it deems necessary to carry out its duties. The remuneration committee should report regularly to the board of directors on the exercise of its duties. The CEO should attend meetings of the remuneration committee when the committee is discussing the remuneration of executive management. The remuneration committee should submit proposals to the board of directors on the company's remuneration policy and on the individual remuneration of directors and executive managers and, where appropriate, on proposals to be submitted by the board of directors to the general meeting of shareholders (i.e., proposals on the remuneration of directors). The remuneration committee also prepares the remuneration report that forms part of the annual report and provides explanations on this report at the annual general meeting of shareholders.

The 2009 Code provides for practically the same requirements with respect to the remuneration committee. The 2009 Code further specifies, however, that the remuneration committee should have at least three members and should submit proposals to the general meeting of shareholders on the remuneration of directors and executive managers, including proposals on variable remuneration and long-term incentives, such as the grant of stock options or other financial instruments and arrangements for premature termination. The remuneration committee should review (at least every two to three years) its terms of reference and its own effectiveness and recommend necessary changes, if any, to the board.

13 There is an exception for small listed companies that meet the criteria set out in Article 526 *quater* Section 4 BCC. In that case, no remuneration committee need be set up. Rather, the board of directors will perform the duties of the remuneration committee and should have at least one independent member. If the chairperson of the board is an executive director, he or she cannot chair board meetings when the board is acting as the remuneration committee. There is also an exception for public undertakings for collective investment with variable capital, within the meaning of Article 10 of the Act of 20 July 2004 on certain forms of collective management of investment portfolios, and for companies whose business is the issuance of asset-backed securities, as defined in Article 2(5) of Commission Regulation (EC) No. 809/2004.

14 In accordance with the requirements set out in Article 526 *ter* BCC.

In addition to a remuneration committee, the BCC obliges companies whose securities are listed on a regulated market¹⁵ to set up an audit committee, composed of non-executive directors. At least one member should be independent¹⁶ and must possess the requisite level of expertise in the area of accountancy and audits. The audit committee should report regularly to the board of directors on the exercise of its duties and in any case when the board draws up the annual accounts, consolidated annual accounts and the short-form financial statement (intended for publication). The audit committee should monitor the financial reporting process, the effectiveness of the company's internal control and risk management systems, the internal audit – if any – and its effectiveness, the audit of the annual and consolidated accounts, including the follow-up of any questions and recommendations by the statutory auditor, and review and monitor the independence of the statutory auditor, in particular with respect to the provision of additional services to the company. The statutory auditor should report to the audit committee on key matters arising from the audit of the annual accounts, in particular on material deficiencies in internal control of the financial reporting process. The statutory auditor shall confirm to the audit committee annually, in writing, its independence from the company, inform the audit committee on an annual basis of any additional services provided to the company, and examine, together with the audit committee, the risks to its independence and the safeguards to be implemented to minimise these risks. The audit committee should make a proposal on the appointment or reappointment of the statutory auditor or external auditor, which should be placed on the agenda of the general meeting.

The requirements of the 2009 Code with respect to the tasks and duties of the audit committee are much more detailed and give further guidance as to what should be done to fulfil the mandatory tasks set out above. The 2009 Code also indicates, *inter alia*, that (1) the audit committee should have at least three members, (2) at least half of the audit committee's members (versus one in the BCC) should be independent, and (3) the chairperson of the board of directors cannot also chair the audit committee. The audit committee should meet at least four times a year and review (at least every two to three years) its terms of reference and its own effectiveness and recommend any necessary changes to the board. The committee should meet with the external and internal auditors at least twice a year to discuss the audit process. An independent internal audit function should be established, or at least once a year it should be considered whether this is necessary. In June 2012, the Corporate Governance Committee issued additional advice in relation to the audit committee's proposal regarding the (re)appointment of the statutory auditor or external auditor. The Committee advised that when appointing an auditor, the audit committee should solicit offers on the basis of predetermined selection criteria (e.g., technical skill, price, financial and economic expertise). The audit committee should also review the work of the statutory or external auditor every

15 There is an exception for small listed companies that meet the criteria set out in Article 526 *bis* Section 3 BCC. In that case, no audit committee need be set up. Rather, the board of directors will perform the tasks of the audit committee and should have at least one independent member. If the chairperson of the board is an executive director, he or she cannot chair board meetings at which the board is acting as the audit committee. There is also an exception for public undertakings for collective investment with variable capital, within the meaning of Article 10 of the Act of 20 July 2004 on certain forms of collective management of investment portfolios, and for companies whose business is the issuance of asset-backed securities, as defined in Article 2(5) of Commission Regulation (EC) No. 809/2004.

16 In accordance with the requirements set out in Article 526 *ter* BCC.

three years with a view to the submission of a proposal to the board of directors on the reappointment of the auditor. The board in turn will forward the proposal to shareholders and, if applicable, the works council.

The 2009 Code introduced a third committee, namely the nomination committee, whose duties may also be exercised by the remuneration committee, in which case it shall be known as the remuneration and nomination committee. The nomination committee should have at least three members, a majority of whom should be independent non-executive directors. The chair of the board of directors or another non-executive director shall chair the nomination committee. The chair cannot preside over meetings of the nomination committee when the committee is discussing the appointment of the chair's successor. The nomination committee should make recommendations to the board with regard to the appointment of directors, the CEO and other executive managers and should consider proposals made by relevant parties, including management and shareholders. It should meet at least twice a year and review (at least every two to three years) its terms of reference and its own effectiveness and recommend any necessary changes to the board.

The 2008 financial crisis led to an animated debate on the (at times excessive) remuneration of directors and executive managers of Belgian companies. In an attempt to rein in the remuneration of directors and executive managers, several new provisions were adopted in 2010 and codified in the BCC.

As a general rule, the general meeting of shareholders has exclusive power to determine the remuneration of directors. The board of directors, in turn, determines the remuneration of executive management, unless the company's articles of association provide otherwise. In listed companies, the articles of association sometimes provide that the shareholders' general meeting determines the overall remuneration for the board of directors as a whole, while the board itself decides how to distribute this total amount among its members.

The BCC stipulates that the remuneration of individual directors and executive managers shall be determined further to a proposal by the remuneration committee. The remuneration committee should also submit proposals on the company's remuneration policy, which must be explained in the remuneration report that forms part of the board's annual report. The general meeting of shareholders need not approve the remuneration policy *per se* but does have the power to vote on the remuneration report in which the remuneration policy is described. There are no consequences, however, if the general meeting rejects the remuneration report. The remuneration report should also be provided to the works council or, in the absence thereof, the employee representatives on the committee for prevention and protection at work or, if there is no such committee, the trade union representatives.

If an executive manager receives variable remuneration (i.e., remuneration linked to performance), the criteria used to determine the remuneration should be set out in the contractual or other provisions governing the company's relationship with the manager, and payment can only take place if these criteria have been met within the specified time period. If this is not the case, the executive's variable remuneration cannot be taken into account to determine his or her severance package.

If the variable remuneration of an executive manager of a listed company makes up more than one-quarter of his or her annual remuneration, at least 25 per cent of the variable remuneration should be based on previously established and objectively verifiable performance criteria measured over a period of at least two years, and at least another 25 per cent should

be based on previously established and objectively verifiable performance criteria measured over a period of at least three years, unless the articles of association provide otherwise or the general meeting of shareholders expressly consents to deviate from this rule.

Unless the articles of association provide otherwise or the general meeting of shareholders expressly agrees, shares shall only be finally acquired and share options or any other rights to acquire shares shall only be exercisable by a director or executive manager of a listed company after a holding period of at least three years is satisfied.

The general meeting of shareholders should also approve in advance¹⁷ any severance package agreed by the company with an executive manager if the severance pay amounts to more than 12 months' remuneration, as well as any variable remuneration granted to an independent or non-executive director.¹⁸ If the severance package represents more than 18 months' remuneration, a reasoned opinion from the remuneration committee is also required. Any such contractual provision that has not been approved by the general meeting shall be deemed null and void. The proposal should also be notified to the works council or, if there is none, the employee representatives on the committee for prevention and protection at work or, in the absence thereof, the union representatives.

The aforementioned provisions of the BCC are supplemented by the 2009 Code principles and best practices with regard to the level and structure of executive remuneration, including the following:

- a* the level of remuneration should be sufficient to attract, retain and motivate executive managers who meet the profile determined by the board;
- b* the level and structure of the remuneration of executive managers should be such that qualified and expert professionals can be recruited, retained and motivated, taking into account the nature and scope of their individual responsibilities;
- c* an appropriate percentage of an executive manager's remuneration should be linked to the company's and the individual's performance; and
- d* severance pay should not exceed 12 months' fixed and variable remuneration.

Further to a special recommendation of the remuneration committee, the severance package can amount to 18 months' fixed and variable remuneration. In any case, the severance package should not take into account variable remuneration or exceed 12 months' fixed remuneration if the departing CEO or executive manager did not meet the agreed performance criteria. The 2009 Code also adds that the prior approval of the general meeting of shareholders is required for schemes that provide for the remuneration of executive managers with shares, options or any other right to acquire shares.

The 2009 Code further provides that the remuneration of non-executive directors should take into account not only their role as ordinary board members but also any specific positions they may hold, such as chair of the board, or chair or member of a board committee, as well as their resulting responsibilities and commitments in terms of time, and that non-executive directors should not be entitled to performance-based remuneration such as bonuses, long-term stock-based incentive schemes, or fringe or pension benefits.

¹⁷ This rule applies to any agreements entered into or renewed as from 3 May 2010.

¹⁸ For non-executive dependent directors, this rule applies to any agreements entered into or renewed after 3 December 2011.

ii Directors

The 2009 Code indicates that both executive and non-executive directors, regardless of whether the latter are independent or not, should exercise independence of judgement in their decisions. Directors should make sure they receive detailed and accurate information and should study this information carefully so as to acquire and maintain a clear understanding of the key issues relevant to the company's business. They should seek clarification whenever they deem it necessary to do so.

While executive and non-executive directors are part of the same body (namely, the board of directors), they play complementary roles on the board. The 2009 Code stipulates, as a guideline, that executive directors should provide all relevant business and financial information needed for the board to function effectively. Non-executive directors should constructively challenge and help develop strategy and key policies proposed by executive management. They should also scrutinise the performance of executive management in meeting agreed goals.

Non-executive directors should be made aware of the extent of their duties at the time of their appointment, in particular the time commitment involved. They should not consider taking on more than five directorships in listed companies. Changes to commitments and the assumption of new commitments outside the company should be reported to the chairperson of the board, as they arise.

Pursuant to the BCC, a director can be either a natural person or a legal entity. In the latter case, a permanent representative should be appointed from among the entity's shareholders, directors, members of executive management or personnel, who is solely responsible for performing this office in the name and on behalf of the legal entity. The representative shall be liable for the performance of this office as if he or she had been appointed in his or her own name, notwithstanding the joint liability of the legal entity that is represented. The directors of autonomous governmental companies, public institutions and any legal entities over which the state exerts direct or indirect influence¹⁹ must be natural persons if they are remunerated for the directorship.²⁰ Any payment to a legal entity, acting as director, in this case will be deemed null and void. A listed company that falls into any of the aforementioned categories (e.g., Proximus Group NV) must ensure that its remunerated directors are natural persons.

Directors cannot use the information obtained in their capacity as directors for purposes other than the exercise of their functions. They have an obligation to treat confidential information received in their capacity as directors with care.

Each member of the board should arrange his or her personal and business affairs so as to avoid direct and indirect conflicts of interest with the company. Transactions between the company and its board members should take place at arm's length. The board should establish a policy for transactions or other contractual relationships between the company, including its related companies, and its board members, which are not covered by the statutory

19 Holding directly or indirectly a majority of the share capital or voting rights, having the power to appoint a majority of the members of the governing or executive body or to appoint a person entrusted with governmental supervision including by means of a contract.

20 Act of 19 December 2012 on the remuneration of employees and office holders in institutions of public utility, autonomous governmental companies and legal entities over which the state exerts, directly or indirectly, a preponderant influence, published in the Belgian State Gazette on 28 January 2013, entered into force on 1 August 2013.

provisions on conflicts of interest. This policy should be disclosed in the company's corporate governance charter. Comments on the application of this policy should be included in the corporate governance statement (which forms part of the annual report). The BCC indicates a specific procedure to be followed when directors have a pecuniary conflict of interest with the company. In listed companies, a director with a conflict of interest of a financial nature cannot participate in the deliberations or vote on the decision in question.

The board should also take all necessary and useful measures to ensure effective and efficient execution of the Belgian rules on market abuse. It should draw up a set of rules (the dealing code) regulating transactions (and the disclosure thereof) in shares of the company or in derivatives or other financial instruments linked to shares carried out for their own account by directors or other persons with managerial authority.

Directors can be held liable for shortcomings in the performance of their official duties in accordance with the applicable statutory provisions. For a violation of the law or the company's articles of association, directors can be held jointly and severally liable (unless they were not personally involved in the violation and brought it to the attention of the company's shareholders at the first general meeting after becoming aware of it). In addition, directors can be held liable in a number of specific circumstances (e.g., in the event of bankruptcy, a conflict of interest or tax liability).

Although the term of office of a director in an NV/SA cannot exceed six years by law, the 2009 Code advises setting the maximum term of directors at four years. The 2009 Code indicates that the board of directors should establish nomination procedures and selection criteria for its members, including specific rules for executive and non-executive directors where appropriate. The chair of the board (or another non-executive director) leads the procedure, while the nomination committee makes proposals regarding the candidates. For any new appointment to the board, the skills, knowledge and experience of existing board members and those needed on the board should be evaluated and, in the light of that assessment, a description of the role and skills, experience and knowledge should be prepared. For a director to qualify as independent, a number of criteria should be met.²¹

III DISCLOSURE

Companies whose securities are listed on a regulated market²² must publish annually and biannually²³ a financial report. These listed companies are also obliged to publish *ad hoc* information if the information in question can be considered inside information. The annual financial report must contain the annual accounts and consolidated annual accounts, the board's annual report (including the BCC requirements, such as the corporate governance statement and remuneration report), and a number of specific items that could have consequences in the event of a takeover²⁴ (e.g., shareholder agreements or limitations on the transferability of shares and securities), the statutory auditor's report and a declaration by the issuer on the faithful nature of the accounts and report. If the issuer decides to publish a communication between the end of the financial year and publication of the annual financial report, this communication should meet certain criteria. The biannual financial

21 Article 526 *ter* BCC.

22 Some of the provisions also apply to companies whose securities or shares are listed on certain MTFs.

23 The latter is applicable to companies whose shares or debt instruments are listed.

24 Act of 1 April 2007 on public takeover bids.

report should contain interim financial statements and an interim report, information on external control and a declaration by the issuer regarding the faithful nature of the statements and report.

Listed companies are subject to other disclosure requirements with respect to any changes in the conditions, rights and guarantees linked to their securities, special reports of the board of directors, and draft amendments to the articles of association. Listed companies should also disclose the transparency notices they receive from their shareholders in accordance with the Act of 2 May 2007 and the Royal Decree of 14 February 2008.

In addition to the disclosures set out above, the 2009 Code indicates that the company should draw up a corporate governance charter describing the main aspects of its corporate governance policy and containing the minimum information set out in the 2009 Code. The charter should be updated as often as necessary to reflect the company's corporate governance at all times. It should be made available on the company's website and should specify the date of its most recent update.

The corporate governance charter should include at least:

- a* a description of the company's governance structure and the terms of reference of its board of directors;
- b* the policy established by the board for transactions and other contractual relationships between the company, including related companies, and board members and executive managers, to the extent not covered by the statutory provisions on conflicts of interest;
- c* the measures taken by the company to comply with the Belgian rules on market abuse;
- d* the terms of reference of each board committee;
- e* the terms of reference of executive management;
- f* the identity of major shareholders, with a description of their voting rights and special control rights, and, if they act in concert, a description of the key elements of existing shareholders' agreements;
- g* any other direct and indirect relationships between the company and its major shareholders; and
- h* a statement that the company has adopted the 2009 Code as its reference code.

The board of directors should also include a corporate governance statement in its annual report, describing all relevant corporate governance events that have taken place in the past year. This statement should be included in a specific section of the annual report and should contain the minimum information set out in the 2009 Code. If the company has not complied fully with one or more provisions of the Code, it should explain its reasons for not doing so in its corporate governance statement (the 'comply-or-explain' principle). The BCC has made a corporate governance statement mandatory.

Pursuant to the BCC, the following items should be disclosed in the corporate governance statement in the company's annual report:²⁵

- a* a statement that the company has adopted the 2009 Code as its reference code and the place where the 2009 Code can be consulted, as well as relevant information on the corporate governance practices applicable in addition to the 2009 Code and the place where these can be consulted;
- b* if the company does not fully comply with the 2009 Code, an indication of the provisions of the 2009 Code that were not complied with during the year and an explanation for the non-compliance;
- c* a description of the main features of the company's internal control and risk management systems in relation to financial reporting;
- d* the shareholder structure on the closing date of the financial year as it appears from the notifications the company received;
- e* the holders of securities to whom special control rights have been granted and a description of these rights;
- f* any limitations on voting rights, provided for by law or the company's articles;
- g* the rules for the appointment of directors and amendments to the company's articles of association;
- h* the powers of the board of directors, specifically the possibility to issue or purchase own shares;
- i* a description of the composition and running of the board of directors and its committees; the 2009 Code adds that this description should include at least:
 - a list of all board members, indicating which are independent;
 - information on any directors who have ceased to meet the requirements for independence;
 - an activity report on board and board committee meetings, indicating the number of board committees;
 - information on meetings and the individual attendance records of directors;
 - a list of all members of board committees;
 - if applicable, an explanation as to why the appointment of the former CEO as chair is in the best interests of the company; and
 - a list of all members of executive management; and
- j* an overview of the efforts taken to ensure that at least one-third of the members of the board of directors are of a different gender than the other members.

The 2009 Code adds that the following should be set out in the corporate governance statement:

- a* comments on the application of the policy established by the board for transactions and other contractual relationships between the company, including related companies, and its board members and executive managers, to the extent not covered by the statutory provisions on conflicts of interest;
- b* information on the main features of the process for evaluating the board, its committees and individual directors;

25 These requirements are applicable to companies whose shares are listed on a regulated market. The requirements under (a), (b) and (i) are also applicable to companies whose securities, other than shares, are listed on a regulated market when their shares are listed on an MTF. The requirement set out under (c) is also applicable to companies whose securities are listed on a regulated market.

- c* key features of any incentives granted in the form of shares, options or any other right to acquire shares as approved by, or submitted to, the general meeting of shareholders; and
- d* a general description of the main features of the company's internal control and risk management systems.

As mentioned above, the BCC indicates that the corporate governance statement should also include a remuneration report, prepared by the board of directors further to a proposal of the remuneration committee.

The following information should be disclosed in the remuneration report pursuant to the BCC:

- a* a description of the company's internal procedure to develop a remuneration policy for directors and executive managers and set the level of individual remuneration for directors and executive managers;
- b* the remuneration policy for directors and executive managers, containing at least the following items of information:
 - the principles on which remuneration is based, including the relationship between remuneration and performance;
 - the importance of the various components of remuneration;
 - the characteristics of performance-based bonuses in the form of shares, share options or other rights to acquire shares; and
 - information on the remuneration policy for the next two years. Furthermore, any significant changes to the remuneration policy since the end of the financial year should be expressly mentioned.
- c* the individual remuneration and other benefits granted directly or indirectly by the company, or another company that falls within the same scope of consolidation, to non-executive directors;
- d* the remuneration granted to executive managers who are also directors, but in that case only the remuneration received in their capacity as directors. It is unclear whether this information should be disclosed on an individual or collective basis;
- e* if the executive managers receive variable remuneration linked to the performance of the company, a company that falls within the same scope of consolidation as the company or a business unit of the company or their own performance, the criteria used to evaluate the achievement of the specified goals, the evaluation period and a description of the methods applied to verify whether the performance criteria are met. This information should be disclosed in such a way as to prevent the disclosure of confidential information about the company's strategy;
- f* the remuneration and other benefits granted directly or indirectly to the CEO²⁶ by the company or a company that falls within the same scope of consolidation, indicating:
 - base remuneration;
 - variable remuneration – for all incentives, the form in which the variable remuneration is paid;

26 The term CEO can refer here to the main representative of the executive directors, the chairperson of the management committee, the main representative of 'other leaders' or the main representative of the persons entrusted with daily management of the company.

- pension benefits – the amounts paid or the value of services provided during the financial year, per pension scheme, with an explanation of the applicable pension schemes; and
- other components of remuneration, such as the cost or monetary value of insurance coverage and fringe benefits, with an explanation of the details of the main components.
- Moreover, any significant changes to the remuneration policy since the end of the financial year should be expressly mentioned;

g on a collective basis, the remuneration and other benefits granted directly or indirectly to other members of executive management (excluding the CEO) by the company or a company that falls within the same scope of consolidation, with a breakdown between:

- base remuneration;
- variable remuneration – for all incentives, the form in which the variable remuneration is paid;
- pension benefits – the amounts paid or the value of the services granted during the financial year, per pension scheme, with an explanation of the applicable pension schemes; and
- other components of remuneration, such as the cost or monetary value of insurance coverage and fringe benefits, with an explanation of the details of the main components.

In addition, any significant changes to the remuneration policy since the end of the financial year should be expressly mentioned;

b for each executive manager (including the CEO):

- the number and key features of shares, share options or any other rights to acquire shares granted, exercised or expired during the financial year;
- the provisions on severance pay; and
- whether the company has the right to recover any variable remuneration granted on the basis of incorrect financial data; and

i if an executive manager (including the CEO) leaves the company, the decision of the board of directors, further to a proposal of the remuneration committee, on whether the person is eligible to receive a severance package and the method used to calculate the severance pay.

The 2009 Code adds that the remuneration report should also explain whether, with respect to the disclosure of the remuneration of the CEO and other executive managers, the company has materially deviated from its remuneration policy during the financial year. If, on or after 1 July 2009, the contract of the CEO or any other executive manager provides for a severance package in excess of 12 months' (but less than 18 months') base and variable remuneration, the remuneration report should indicate the circumstances under which the severance package can be paid, and a justification for the payment, on an individual basis.

In 2012, the FSMA conducted its third annual study²⁷ on compliance with the 2009 Code and found that significant progress has been made over the past three years. The main improvements related to the remuneration report, in that no company found it necessary to 'explain' non-compliance in its 2011 annual report. Many of the recommendations set

27 'The first legal remuneration reports: second follow-up study of Study No. 38' – December 2012 (available at www.fsma.be).

out in the first two studies have been taken into consideration by Belgian listed companies. The FSMA points out, however, that its recommendation to specifically mention when a provision is not applicable, which would further increase transparency, is not yet followed by all companies. It also specifically points to the requirement to mention the following with respect to each executive manager (including the CEO) in the annual report (on the basis of the BCC): (1) provisions on severance pay and (2) whether the company has the right to recover any variable remuneration granted on the basis of incorrect financial data. These requirements are not set out in the 2009 Code, only in the BCC.

The FSMA makes some further recommendations to companies to improve the quality of their corporate governance disclosures.

One-on-one contacts between directors and majority or institutional shareholders are common in listed companies; such contacts should comply with the rules set out in Section V.iv, below.

In February 2015, the Belgian supervisory authority, the Financial Services and Markets Authority (FSMA), published a study on the disclosure by listed companies of relations and transactions with related parties. As a follow-up, the Corporate Governance Committee issued in February 2016 an additional explanatory note on how listed companies should report on their related-party transactions. The explanatory note is structured around three main lines: the legal framework, practical considerations and a number of explanatory annexes.

In 2016, the Corporate Governance Committee made a comparative study of the quality of the 'explain' principle applied in the different EU Member States. They came to the conclusion that in Belgium the quality of the application of the principle was insufficient (too formal and superficial explanations) compared with the United Kingdom and Sweden (because their governance codes contain stricter guidelines on high-quality explanations). In May 2016, the Corporate Governance Committee issued guidelines to increase the quality required of the explanations.

IV CORPORATE RESPONSIBILITY

The Belgian corporate governance rules do not specifically cover corporate responsibility, with the exception of Article 518 *bis*, which was inserted in the BCC in 2011 and provides that at least one-third (rounded to the nearest whole number) of the board members of companies whose securities are listed on a regulated market should be of a different gender. Most listed companies should meet this target as from 2017. The 2009 Code moreover mentions that 'in translating values and strategies into key policies, the board should pay attention to corporate social responsibility, gender diversity and diversity in general'. In January 2011, the Corporate Governance Committee, which issued the 2009 Code, issued an additional recommendation, stating that within seven years, at least 30 per cent of board members should be women.²⁸

The report on the main differences between the 2009 Code and the Lippens Code notes that corporate social responsibility and diversity have become increasingly relevant topics over the past few years. However, the objective of the 2009 Code is to issue broad recommendations on how companies should be directed, managed and controlled, without going into each and every aspect of corporate responsibility. In view of the importance of

28 This recommendation has not yet been incorporated into the 2009 Code, nor has the BCC made this recommendation part of the reference corporate governance code (i.e., the 2009 Code).

issues such as corporate social responsibility and diversity, however, it was deemed appropriate to insert a supplementary guideline in the 2009 Code and indicate that people governance is another area of concern raised during the public consultation on the 2009 Code.

Unlike financial institutions, which have specific rules on compliance policies and risk management, there are currently few specific rules on compliance and risk management for listed companies. The only provision in the 2009 Code is that an independent internal audit function should be established, with resources and skills adapted to the company's nature, size and complexity, and that if the company does not have such a position, the need for one should be reviewed at least annually. The effectiveness of the internal control and risk management systems set up by executive management should be monitored by the audit committee at least once a year, with a view to ensuring that the main risks (including those relating to fraud and compliance with existing legislation and regulations) are properly identified, managed and disclosed in accordance with the procedures approved by the board.

The 2009 Code further indicates that the audit committee should review the specific arrangements in place that staff may use to raise, in confidence, concerns about possible improprieties in financial reporting or other matters. If deemed necessary, arrangements should be made for the proportionate and independent investigation of such matters, appropriate follow-up actions and schemes whereby staff can inform the chairperson of the audit committee directly. It should be noted that the rules on personal data protection should of course be respected when establishing a whistle-blowing scheme.

On 18 December 2014, the Institute of Internal Auditors (IIA) Belgium and the Institute of Company Auditors, together with the Belgian Association of Listed Companies, issued further practical guidelines for an effective relationship between the audit committee, the internal auditor and the external auditor. These guidelines are supported by the Corporate Governance Committee.

V SHAREHOLDERS

i Shareholder rights and powers

The basic rule is that each share of the same value carries one vote. If the shares do not have the same value or if there is no value mentioned, the shares carry voting rights in proportion to the capital they represent, with the share with the lowest value carrying one vote. Fractions of votes are not taken into account.²⁹

Controlling shareholders often have the right to appoint a majority of the company's directors, so that they *de facto* influence the management of the company.

Any powers not granted by law or the company's articles of association to the general meeting of shareholders are reserved to the board of directors. A number of decisions are reserved by law to the general meeting and cannot be delegated³⁰ to the board of directors, such as approval of the annual accounts and discharge of the directors and statutory auditor, the final appointment of directors and the statutory auditor, the initiation of claims by the company against the directors, dissolution of the company, a merger, division, etc. In 2010, a number of decisions relating to the remuneration of executive managers and directors were also made subject to the approval of the general meeting (see above).

29 Except as mentioned in Article 560 BCC.

30 It is generally accepted that, in certain cases, some powers can be delegated.

In general, a validly adopted decision of the general meeting of shareholders is, by law, binding on dissenting shareholders or shareholders who did not attend the meeting. Any party that can prove standing, including a shareholder, may, however, seek to invalidate a decision of the general meeting on account of:

- a* a formal irregularity, provided this irregularity could have influenced the decision;
- b* a violation of the procedural rules of the general meeting or the passage of a resolution on an item that was not on the agenda, provided there is fraudulent intent;
- c* an *ultra vires* act or abuse of power;
- d* the exercise of suspended voting rights, if this influenced the adoption of the decision; or
- e* any other reason set out in the BCC.

In addition, dispute resolution procedures are available to shareholders pursuant to which they can be obliged to sell their shares or purchase the shares of other shareholders in the event of a serious conflict among them (Articles 635 to 644 BCC) or the involuntary dissolution of the company can be requested, as a last resort (Article 645 BCC).

One or more shareholders who, individually or collectively, hold one-fifth of the share capital can also request the board of directors and the statutory auditor to call a general meeting. It is generally accepted that these shareholders also have the possibility to determine the agenda for the meeting. In accordance with Article 533 *ter* of the BCC, shareholders holding at least 3 per cent of the share capital of a listed company have the right to submit proposals regarding items on the agenda and propose resolutions (this does not apply to meetings held on second call (i.e., meetings called because the required quorum was not met at the first meeting).

Shareholders also have the right to ask the directors (and the statutory auditor) questions during general meetings or in writing before the meeting (to be answered at the meeting). The directors or the statutory auditor, as the case may be, have a duty to answer these questions. There is, however, an exception to this rule: directors and the statutory auditor can refuse to answer a question if doing so would cause harm to the business of the company or violate their or the company's duty of confidentiality. The questions should relate to items on the agenda or to a report prepared by the board of directors or the statutory auditor. Questions on the same topic may be consolidated and answered together.

One or more shareholders owning at least 95 per cent of the securities to which voting rights are attached can initiate a squeeze-out to obtain 100 per cent of all voting securities or securities that allow their holders to acquire voting securities.

ii Shareholders' duties and responsibilities

The 2009 Code stipulates that, in companies with one or more controlling shareholders, the board should endeavour to have the controlling shareholders make considered use of their position and respect the rights and interests of minority shareholders. The board should encourage the controlling shareholders to respect the 2009 Code.

Aside from this reference, there are no specific duties or best practices in the corporate governance rules pertaining to controlling shareholders and institutional investors. The general rule of law that minority shareholders can seek to invalidate a resolution of the general meeting on the grounds of abuse of majority still applies, of course. Such a request must be made within six months from the time the resolution became enforceable against the shareholder or was notified to the shareholder. Pursuant to this principle, a resolution

can be invalidated if the voting rights were not exercised in the company's interest or the voter abused his or her rights, meaning the voting rights were exercised in an obviously unreasonable manner.

iii Shareholder activism

As indicated above, the general meeting of shareholders normally determines the remuneration of directors, but not of executive managers (except for the approval of severance pay in certain cases), so it does not have a complete 'say on pay'. The general meeting of shareholders has the power to vote separately on the remuneration report in which the remuneration policy is described, but there are no consequences if it rejects the report.

If one or more shareholders do not agree with the board's management of the company, there is judicial relief available to them.

The BCC does not contain express rules on the invalidation of resolutions by the governing body (i.e., the board of directors); however, based on general rules of law, the courts tend to accept that resolutions of the board of directors can be declared null and void at the request of any interested party (including a shareholder).

In general, the grounds for invalidating resolutions of the board of directors are the following:

- a* violation of the convocation formalities or procedural requirements for the meeting;
- b* violation of rules of law or the articles of association (e.g., an *ultra vires* act);
- c* resolutions that are obviously in violation of the company's interests; and
- d* resolutions adopted fraudulently.

Directors can be held liable, in accordance with the BCC, for shortcomings in their management of the company, breach of rules of law or the articles of association and, in certain cases, violation of their general duty of care (the relevant standard is how a reasonably prudent director would have acted under the same circumstances). The general meeting of shareholders has the power to initiate proceedings on behalf of the company against one or more directors on the above-mentioned grounds. Such a decision should be approved by a majority of votes cast. No action can be taken if the general meeting has already discharged the directors. There is also a possibility for minority shareholders to initiate the same proceedings on behalf of the company if they represent at least 1 per cent of the voting securities or hold at least €1.25 million of the company's capital on the day the general meeting voted to discharge the directors. Minority shareholders that validly approved the discharge cannot bring such proceedings.

At the request of one or more shareholders holding at least 1 per cent of the total voting rights or securities that represent at least €1.25 million of the company's capital, the court may also appoint, if there are indications that the interests of the company are seriously jeopardised or could be jeopardised, one or more experts to verify the company's books and accounts and the actions of its corporate bodies.

In certain cases, one or more shareholders can also request the appointment of a temporary administrator to manage the company in lieu of the board of directors.

The BCC provides for the possibility to solicit proxies for certain shareholder meetings. This solicitation should, however, comply with the requirements of the BCC.³¹ A public

31 Article 548 BCC.

solicitation of proxies (i.e., when advertisements or intermediaries are used or if more than 50 shareholders are targeted) should be approved by the FSMA and a number of requirements should be met.³² Proxy solicitation is mostly done by associations that defend (minority) shareholders' rights.

Several associations that defend (minority) shareholders have campaigned to involve as many shareholders as possible in certain proceedings (e.g., the *Fortis* case in 2008, the case against the National Bank of Belgium in 2010, the *Lernout & Hauspie* case, the *Madoff* case and the *Lehman Brothers* case).

Pursuant to the Act of 28 March 2014,³³ class actions are now possible in Belgium. However, certain limitations apply. A class action may only be brought: (1) against a company; (2) by a consumer; and (3) for breach of a contractual obligations or a specific law. Thus, shareholders who would like to introduce a claim against (current or former) directors cannot bring a class action under Belgian law. Therefore, only investors that take part in the proceedings against a company have the right to claim damages.

iv Takeover defences

In general, the following measures can be taken by the target company to frustrate a takeover bid:

- a Capital increase with the issuance of new shares: in principle, only the general meeting of shareholders is entitled to increase the company's share capital, unless the board of directors has been authorised to do so (pursuant to the Company Code). However, such an authorisation is not valid in the context of a takeover bid, during which the board, in principle, cannot increase the share capital by means of a contribution in kind or in cash with cancellation or restriction of the shareholders' pre-emptive right. The general meeting may, however, authorise the board of directors to increase the share capital during the offer period by means of a contribution in kind or in cash with cancellation or restriction of the shareholders' pre-emptive right, provided (1) the board has been specifically authorised to do so within the past three years, (2) the newly issued shares are fully paid up, (3) the number of new shares does not exceed 10 per cent of the number of existing shares, and (4) the subscription price is at least equal to the offer price.
- b Acquisition of own shares by the company: in principle, the general meeting of shareholders must authorise the acquisition of own shares by the company, unless the board of directors has been authorised to do so (pursuant to the Company Code). However, such an authorisation is not valid during a takeover bid, as from the time the company is notified of the bid by the FSMA. As an exception to this rule, the board may acquire own shares to avoid serious, imminent harm to the company, provided the articles of association so allow (for a maximum period of three years). In this case, other conditions governing the acquisition of own shares also apply (e.g., the acquisition may not exceed 20 per cent of the issued share capital).
- c 'Poison pill': in general, certain advance measures are available to protect companies against potential takeover bids. However, pursuant to Article 556 of the Company Code, only the general meeting of shareholders (thus not the board) can grant rights to third parties liable to affect the company's assets or give rise to a debt or obligation

32 Article 549 BCC.

33 Act of 28 March 2014 on class actions, Belgian State Gazette, 29 April 2014.

on behalf of the company, when the exercise of the rights depends on the launch of a takeover bid or a change in control. To be valid, the resolution to this effect should be filed with the clerk's office (of the competent court) prior to the FSMA's notification of the bid to the company. During the offer period, only the target company's (general meeting of) shareholders can take decisions or execute transactions that could have a significant impact on the composition of the company's assets or liabilities or enter into transactions without effective compensation. Such decisions and transactions cannot, in any case, be made subject to the outcome of the bid. Decisions that have been sufficiently implemented prior to receipt of the FSMA's notification can be further executed by the board; however, the FSMA and the bidder should be immediately notified of any such decisions, which should also be made public.

- d* Issuance of convertible bonds or subscription rights (warrants): these instruments may be issued by the general meeting of shareholders and may, for example, be convertible or exercisable upon the launch of a takeover bid. It is also possible to create a pyramidal ownership structure or issue share certificates.

As a general rule, in keeping with the Takeover Directive, the target company's board of directors must act in the company's interest. It may therefore seek out an alternative bidder (or white knight). Belgian law specifically provides that the target company need not inform the FSMA of the fact that it is searching for an alternative bidder (while it should inform the bidder and the FSMA of any decision in relation to the issuance of shares or that is liable to frustrate the bid).

Belgium has opted out of the provisions of the Takeover Directive aimed at restricting the use of defensive measures by the board of directors. Nevertheless, companies with their registered office in Belgium and whose shares are (at least partially) listed on a regulated market may voluntarily include such restrictions in their articles of association (i.e., opt in).

In this regard, the company may provide in its articles of association that:

- a* during the offer period, the board of directors (or the body to whom the relevant powers have been delegated) may not take any action (other than seeking alternative bids) liable to result in frustration of the bid without the prior consent of the general meeting of shareholders;
- b* any decisions taken prior to the offer period that are not yet fully implemented and that could frustrate the bid can only be further implemented with the prior consent of the general meeting of shareholders (except for those taken in the ordinary course of business);
- c* restrictions on share transfers expressed in the articles of association or a shareholders' agreement shall not apply to the bidder during the acceptance period or after the bid, if the bidder holds at least 75 per cent of the target's share capital;
- d* restrictions on voting rights expressed in either the articles of association or a shareholders' agreement shall not apply at a general meeting held during the offer period for the purpose of adopting measures to frustrate the bid or after the offer if, as a result of the offer, the bidder holds at least 75 per cent of the target's capital; and
- e* provisions of the articles allowing a shareholder to appoint or remove a director shall not apply at the first general meeting called by the bidder after the offer, provided the bidder holds at least 75 per cent of the target's capital as a result of its bid.

If the rights set out in (c) to (e) cannot be exercised, reasonable compensation should be paid to their holders.

The company may also stipulate in its articles of association that such provisions shall only apply to the extent the bidder or the company controlling the bidder is subject to the same restrictions on the application of defensive measures (the reciprocity rule).

The use of staggered boards as a takeover defence is not relevant in Belgium, as a director of a public limited company can always be removed at will by the general meeting of shareholders.

v Contact with shareholders

The basic rule is that the company should treat all similarly situated shareholders equally.

The Royal Decree of 24 November 2007³⁴ regulates periodic (annual and semi-annual) and occasional information (i.e., inside information) to be disclosed by listed companies, in addition to the mandatory disclosures set out in the BCC (e.g., annual accounts and annual reports). Periodic information should be disclosed quickly and on a non-discriminatory basis so that it can reach as many people as possible, and disclosure should take place, insofar as possible, simultaneously in Belgium and other Member States of the EEA. The company should use media that are expected to ensure disclosure in all Member States of the EEA. Any inside information should be disclosed as simultaneously as possible to all categories of investors in the Member States where the company has requested or agreed to trade its financial instruments on a regulated market.

The 2009 Code stipulates that the company should design a disclosure and communications policy that promotes effective dialogue with shareholders and potential shareholders. Individual meetings with institutional investors are also encouraged to receive explanations on their voting behaviour. It is indeed common practice for companies to hold individual meetings with their controlling shareholders, institutional shareholders, or both. However, the information disclosed in these meetings should be information that is already public or that is made public at the same time, to avoid the unequal treatment of shareholders.

Each director has a duty to keep information about the company confidential unless required to disclose it pursuant to a statutory or ethical duty. This duty also extends to the company's shareholders. Some scholars argue, however, that directors representing a controlling shareholder can consult with that shareholder on decisions to be taken by the board of directors and the position the director will adopt in future deliberations, unless the board of directors specifically decides otherwise. This does not mean that the directors can inform the person they represent of information he or she can then use for his or her own purposes (e.g., to determine whether to sell or purchase shares).

In addition to this general duty of confidentiality, it is also forbidden for anyone in possession of inside information (e.g., directors) to, *inter alia*, disclose such information to anyone else except in the normal course of business or in the performance of his or her professional duties.

The general rule is that inside information should be immediately disclosed. However, the company can decide, at its own risk, to postpone the disclosure of inside information if the disclosure could harm the company's legitimate interests, provided that the delay in disclosure does not mislead the public and confidentiality can be guaranteed. If inside

34 Royal Decree of 24 November 2007 on the obligations of issuers of financial instruments traded on a regulated market, Belgian State Gazette, 3 December 2007.

information is disclosed in the normal exercise of the discloser's profession, function or work, the information should simultaneously be made public unless the person to whom the inside information is disclosed is bound by a duty of confidentiality (e.g., the printer or the communications department). If the disclosure of inside information is postponed, the company should take the necessary measures to, *inter alia*, bar access to this information to all persons who do not need it to exercise their functions.

Based on the foregoing, in our opinion, directors cannot disclose inside information to a shareholder further to a confidentiality agreement. The only exception to this rule is if a third party or a shareholder requests information from the company to determine, for example, the appropriateness of making a public offer, in which case the board of directors can grant access to the information in question if it enters into a confidentiality agreement that includes a standstill clause (i.e., no transactions in the company's shares until the information has been made public) and provided disclosure is in the company's interest.

VI OUTLOOK

The Belgian legislature is currently investigating and discussing a thorough modernisation of the Company Code, including corporate governance-related areas such as the corporate organs (e.g., the one-tier two-tier principle) of a public limited company, the abolition of certain corporate forms (such as the partnership limited by shares), changes to the definition of listed company, etc., which could impact the corporate governance of listed companies and result in a need to update the Corporate Governance Code.

Moreover, some (minor) legislative proposals with respect to the remuneration of directors and management have been made. A proposal to provide that listed companies are obliged to disclose the difference between the median salary of executive directors and the median salary within the company as a whole, a proposal to ensure employee representation on the remuneration committee, and a proposal obliging listed companies to draw up a corporate responsibility report are all pending.

It is now possible to perceive the level of implementation of corporate governance legalisation and whether companies comply with the rules. Several studies are being carried out (e.g., by the FSMA, VBO and GUBERNA) and the Corporate Governance Committee continues to follow up on the progress of and compliance with the corporate governance rules, issuing advice where necessary. In 2013, the Corporate Governance Committee decided that it is not yet necessary to update the 2009 Code, based on an independent study conducted in September 2012 indicating that, overall, the 2009 Code and Belgian law are characterised by an above average implementation of EU corporate governance requirements and that, in future, the main changes to the 2009 Code and Belgian law are expected to result from changes at the EU level, at which many changes in the field of corporate governance are expected.

On 12 December 2012, the European Commission approved a new action plan outlining future initiatives in the areas of company law and corporate governance for the purpose of improving corporate competitiveness and sustainability. The action plan identifies three main areas for action: enhancing transparency, increasing shareholder engagement, and supporting corporate growth and competitiveness. These goals are to be achieved through the implementation into the national laws of the Member States of 16 different actions considered fundamental.

As regards enhancing transparency between companies and their shareholders, the Commission would like to introduce measures aimed at:

- a* encouraging companies to enhance board diversity (i.e., in terms of skills and views of the board members) and assign greater weight to the reporting of non-financial risks;
- b* improving corporate governance reporting on the reasons for derogating from particular recommendations of the applicable corporate governance codes;
- c* improving the visibility of shareholders and the identification of shareholders by issuers; and
- d* strengthening the transparency rules applicable to the voting and engagement policies of institutional investors.

Various initiatives will also be taken to encourage and facilitate long-term shareholder engagement to avoid the inability to take corrective action and the supervision of management exclusively by the board. These initiatives include:

- a* ensuring greater transparency with regard to remuneration policies and the individual remuneration of directors, as well as a right of shareholders to vote on and approve remuneration policies and the remuneration report;
- b* implementing adequate safeguards to protect the interests of shareholders in related-party transactions (i.e., transactions between the company and its directors or controlling shareholders (conflicts of interests, corporate opportunities, etc.));
- c* ensuring a coherent and effective operational framework for proxy advisers, especially as regards transparency and conflicts of interest;
- d* clarifying the concept of 'acting in concert' with a view to increasing legal certainty on the relationship between investor cooperation with corporate governance issues and the rules on acting in concert; and
- e* investigating whether employee share ownership can and should be encouraged.

In addition, the action plan foresees improvement of the statutory framework for cross-border transactions and the unification of all major company law directives into a single instrument. This would make European company law more accessible and comprehensible and reduce the risk of future inconsistencies.

Certain measures proposed by the European Commission have already been implemented in Belgium, such as the right of the shareholders of a Belgian listed company to vote on and approve the remuneration policies of the company's executive directors and the remuneration report. However, many of the proposed measures will require legislative initiatives that will apply either to only listed companies (e.g., voting policies of institutional investors) or to all companies, listed or unlisted (e.g., provisions on cross-border divisions).

Following this action plan, in 2014 the European Commission issued a proposal for a revision of the Shareholders' Rights Directive (Directive 2007/36/EC). The proposal contains provisions on:

- a* enhancing the transparency of institutional investors and asset managers with regard to their investment and engagement policies in the companies in which they invest;
- b* disclosure by listed companies of their remuneration policy and the remuneration of individual directors, including the right of shareholders to vote on and approve the remuneration policy and the remuneration report;
- c* the obligation for listed companies to submit related-party transactions representing more than 5 per cent of the company's assets, or which could have considerable

- consequences for the company's profits or turnover, to the general meeting for approval (and disclose smaller transactions representing more than 1 per cent of the company's assets);
- d* the transparency to be shown by proxy advisers on the methodologies for the preparation of their recommendations and how they manage possible conflicts of interests; and
 - e* the possibility for listed companies to request information on the identity of their shareholders from intermediaries and the facilitation of the exercise of shareholders' rights (e.g., voting rights), in particular in cross-border situations.

On 8 July 2015, a press release was issued indicating that the European Parliament, Council and Commission are expected to try to reach an agreement on the text of the proposal in informal meetings, so that the directive can be formally adopted at first reading.

The European Parliament also passed a resolution on a proposal for a directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures. The resolution strives to ensure equal access for both women and men to non-executive positions on boards of listed companies so that by 2020, at least 40 per cent of non-executive directors' positions are held by women. If the directive is adopted, the relevant provisions of Belgian law (Article 518 *bis* BCC) will need to be modified as they currently provide that only 30 per cent of the directors of a Belgian listed company should be women, as from 2017.

BOLIVIA

Jorge Inchauste and José Bernal¹

I OVERVIEW OF GOVERNANCE REGIME

Corporate governance in Bolivia is mainly regulated by Book 1 Title 3 of the Bolivian Commercial Code and by the articles of incorporation of each corporation. In addition, the Bolivian Comptroller of Corporations (AEMP), a regulator for enterprises in Bolivia, issued its Guidelines on Corporate Governance in 2011. Adopting and complying with these Guidelines is not mandatory for any corporation in Bolivia, and in practice they are not usually referenced or considered in corporate incorporation documents or by-laws.

There are two entities that are in charge of the enforcement of the corporate governance regime of corporations. On the one hand, the Registry of Commerce is in charge of issuing an annual certificate of good standing to the corporations that comply with the basic requirements and obligations imposed by the Commercial Code, such as having one annual shareholders' meeting to appoint or ratify the directors, registering the balance sheets of the corporation each year, and so forth.

On the other hand, AEMP is the comptroller of corporations in matters related to corporate governance, antitrust, corporate restructuring and overseeing the functioning of the Registry of Commerce. While one of AEMP's tasks is to issue the Guidelines on Corporate Governance, because adoption of the Guidelines is not mandatory, the enforcement powers of this entity with regard to corporate governance practices are minimal.

Besides the general rules applicable to all companies and industries, certain specific industries are under the supervision of specific regulatory entities that may determine and affect the corporate governance system of those companies. This is the case for financial institutions and banks under the supervision of the Bolivian Financial System Authority (ASFI), which monitors and enforces compliance with financial regulations, including regulations regarding the creation and composition of corporations engaged in financial services practices. ASFI issued its Rules on Corporate Governance in December 2012, which came into force a year later (and which were amended in September 2015), for all the entities under its authority. Compliance with the Rules is mandatory for all financial institutions in Bolivia, in contrast to the voluntary Guidelines on Corporate Governance issued by AEMP, applicable to all other industries and entities. Where appropriate, we will make specific reference to the ASFI Rules on Corporate Governance.

Notwithstanding the development of corporate governance rules and guides in the financial sector, the evolution of corporate governance legislation in the country has been slow. During the past few decades, the corporate governance regime in Bolivia has not

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been on the radar of legislators and the executive branch of the government. In 2002, Law No. 2427 established certain corporate governance requirements for directors of pension funds in Bolivia and, in addition, created an overseeing entity, then called the Superintendency of Businesses, charged with regulating and controlling the compliance of corporations in antitrust and corporate governance matters. Later, in 2009, its name was changed to the Authority of Fiscal and Social Control of Companies, which is now known as AEMP.

In recent years, AEMP has increased its level of engagement and become a more important player in the creation and management of corporations and their compliance with corporate regulations. The growing importance of this entity is most clearly noticed in the field of antitrust, but its importance is also expected to grow in the field of corporate governance.

The efforts of the region to unify and promote the regulation of corporate governance are also noteworthy. In 2005, CAF, the Development Bank of Latin America, created the Andean Code of Corporate Governance, with the help of representatives of stock markets in the Andean countries, including the Bolivian Stock Market. The aim is to provide corporations in the Andean region with a corporate governance regime that makes them more attractive to international investment and more competitive in the international arena.

One of the notable aspects of corporate governance in Bolivia is that the law does not specifically deal with regulations regarding fiduciary duties of directors and executive officers. A possible reason for this lack of interest on the part of legislators is the fact that the structure of most public corporations in Bolivia involves a major shareholder who owns a majority of the corporation's stock (unlike in other countries, where dispersed ownership is common). For the purposes of this analysis, we will refer to the Bolivian corporation structure as a 'concentrated ownership' structure. In this structure, the dominant shareholder usually owns a sufficient amount of shares to allow him or her to appoint all directors of the board, or at least a majority of them. As a result, the possibilities for 'entrenchment' by directors who reject, for example, a friendly acquisition offer, are minimal, whereas in other countries the more active M&A markets have been the main drivers of jurisprudential and regulatory development regarding the duties of directors.

II CORPORATE LEADERSHIP

Boards of directors in Bolivia commonly have a one-tier structure; however, pursuant to the Bolivian Commercial Code, the board of directors may designate a special executive committee, composed of a smaller number of board members for the management of specific affairs. The organisation of such a committee does not diminish the obligations and responsibilities of the board of directors as a whole.

Traditionally, the representation and administration of the corporation – which lies with the board of directors – is delegated to executive officers with broad powers to act on behalf of the corporation. Although managers and executives may represent the corporation (by means of power of attorney) in the executive and administrative duties of the corporation, the delegation of power to them does not diminish the responsibilities and oversight duties of the board of directors.

i Composition of the board

Under the Commercial Code, boards of directors must be composed of no less than three and no more than 12 directors. The members of the board are appointed by decision of the shareholders during the shareholders' ordinary meeting, which must be held at least once

a year (a more thorough description of the characteristics and powers of an 'ordinary' meeting are described below). The shareholders can remove directors and can also re-elect directors for indefinite periods, unless the articles of incorporation of the particular corporation establish a maximum number of possible re-elections. In general terms, the Bolivian Commercial Code allows for many of the internal rules governing corporations to be simply decided by shareholders or specified in the by-laws of the corporation.

ii Company representation

The representation of the company is vested in the chairperson of the board of directors who, pursuant to Article 314 of the Commercial Code, is the official representative of the company, but the representation of the board may also be delegated to other directors and executive managers, if the by-laws of the corporation contemplate the possibility. As mentioned above, these faculties are commonly delegated to a general manager or CEO of the corporation, by means of a general power of attorney for administration purposes, granted by the totality of the board in representation of the corporation, which can enable the company to have a shared representation (by the board and by the CEO). In practice, the representation of the corporation is usually delegated to a CEO in medium-sized and large corporations, but it remains with the chairperson of the board of directors in the case of smaller businesses in which, frequently, the shareholders of the corporation also play the role of directors of the board.

There are exceptions to this general rule. Under Article 325 of the Commercial Code, the chairperson of the board may only represent the corporation in matters of urgency regarding the day-to-day management of the business of the corporation, but decisions of the chairperson are subject to ratification by the board of directors in its next meeting.

The chairperson of the board can also represent the company without the need of a board decision, but he or she is only allowed to represent the company in the daily management of the business of the company, not in any extraordinary actions, and even the daily management of the corporation is subject to the ratification of the entire board of directors.

Although the representation of the corporation is vested in the board of directors, there are certain decisions that cannot be taken by the board, but need to be taken by the shareholders in a duly convened shareholders' meeting, as further explained below.

iii Delegation of board responsibilities

Legislation has not provided separate roles for the CEO and the chairperson of the board, but instead establishes that the administrative power of the board can be delegated to managers, meaning that both may have basically the same faculties regarding managerial functions. However, the overseeing functions remain only with the board and, ultimately, with the shareholders. Thus, there is no true delegation of the overseeing responsibilities of the board, only a delegation of its administrative powers.

iv Direct communication with shareholders

There are no provisions in the Commercial Code that prohibit direct communication between shareholders and the chairperson of the board or any other members of the board of directors. In practice, it is common for shareholders and directors to have a very fluent line of communication, at least in small and medium-sized corporations. One of the possible

reasons for this is the concentrated ownership structure of corporations in Bolivia, because the pool of shareholders of a corporation is not as numerous as the pool of shareholders in jurisdictions with dispersed ownership.

v Remuneration of directors and senior management

Article 320 of the Bolivian Commercial Code states that the remuneration of the board needs to be contemplated in the by-laws of the corporation. This Article has two important implications: (1) remuneration not being mentioned in the by-laws implies that the service of the board is unremunerated – this provision is particularly designed bearing in mind the cases of small corporations where sometimes all the shareholders act as both shareholders and directors of the corporation; and (2) remuneration of directors is established by the shareholders in the by-laws and can thus only be modified by amending the by-laws.

In the case of medium-sized and large corporations, it would be unusual for directors not to be paid for their services. Normally, by-laws do not establish an exact amount but instead provide a mechanism that determines the remuneration of directors in relation to a measurable factor, such as the annual earnings of the corporation. In such cases, Article 320 of the Bolivian Commercial Code provides that the maximum amount of remuneration that the board of directors may receive is 20 per cent of the net profit of the corporation in any particular year. If the company suffers losses during the year, the shareholders' meeting needs to expressly authorise the amount of remuneration that will be paid.

On the other hand, remuneration of senior management is mandatory under the Commercial Code, but there are no specific regulations determining limits or minimum amounts that may be paid for the services of the CEO. In the case of financial institutions, remuneration of directors and the management team cannot exceed 20 per cent of the administrative expenses of the entity, under the ASFI Rules on Corporate Governance.

vi Committees

Board committees are also not extensively regulated by the Bolivian Commercial Code, but they are, nevertheless, permitted and even recommended by the Guidelines on Corporate Governance. However, committees are not common in the Bolivian corporate governance regime. Article 330 of the Commercial Code allows the appointment of an executive committee (if the by-laws also provide for it) for the purpose of completing determined activities of the corporation. As with the Guidelines on Corporate Governance, the appointment of an executive committee or any other committee is not mandatory but merely recommended.

Although there are other regulations that do mandate appointment of committees, these are only applicable to specific industries. The boards of directors of financial institutions subject to ASFI regulations must have several committees to comply with the norms, such as a risk management committee. The specific regulations for financial entities vary depending on their level of complexity and their involvement in the market.

Notably, all financial institutions, with the exception of exchange houses, are subject to the regulations on corporate governance issued by ASFI in 2012 and amended in 2015, and these regulations mandate the creation of a specific committee on corporate governance within the board of directors of all these entities. The committee on corporate governance must be composed by at least one director of the corporation and the general manager, and this committee is in charge of preparing and filing an annual report on corporate governance with ASFI.

vii Takeovers

Because of the concentrated ownership structure of corporations in Bolivia (where a dominant shareholder owns more than half or, at least, a large percentage of the shares of the corporation), takeover attempts are very scarce in our jurisdiction. This is because control of the corporation cannot be effectively acquired unless the shares of the dominant shareholder are purchased, because even the purchase of all the shares of the remaining shareholders would not be sufficient to allow the new owner to take important decisions regarding the corporation. Defensive mechanisms against takeover attempts, such as ‘poison pills’, are not used in our jurisdiction.

Notwithstanding the power that a controlling shareholder has over the business of a corporation and the effect that this has on takeovers in Bolivia, there are cases where buyers have acquired significant amounts of shares of corporations to launch takeover attempts. In these scenarios, the controlling shareholders keep sufficient voting power to maintain a favourable board of directors and defend the corporation against the takeover attempt. However, pressure from the buyers may create disruption in the handling of the business. The goal of the buyers in doing so is not to take over the corporation as such, but to create discomfort and struggles inside the corporation, to create more leverage for negotiations with the controlling shareholder. In a way, this is comparable to the practice of ‘greenmailing’, with the difference that buyers are not interested in forcing the firm to buy back their shares at a premium, but instead are interested in forcing the controlling shareholder to sell the remaining shares to the acquirer.

viii Directors

There is little regulation in Bolivia regarding outside directors and, specifically, there is no requirement specifying a minimum percentage of outside directors on boards. Therefore, not all public corporations have outside directors serving on their boards. In practice, it is common for shareholders in small corporations to act as directors of the board, and it is also common to find the senior management personnel of the firm acting as directors, although this clearly defeats the controlling purpose of the board.

Even in the case of corporations that do have outside directors on their boards (usually banks, financial institutions and large corporations), these directors play only a moderate role in the corporate governance system. This is probably another consequence of the concentrated ownership structure of Bolivia; most corporations have a controlling shareholder who owns at least 51 per cent of the shares of the corporation and who has almost complete control over the appointment of the majority of the board members and management team, and hence there is no true incentive for the appointment of outside directors by the controlling shareholder.

However, corporations that have a minority of at least 20 per cent of the issued shares are entitled to designate up to one-third of the board of directors. As a result, in many cases where the minority shareholders themselves are not appointed to the board, they may appoint outside directors, typically prominent professionals such as financial advisers, partners of accounting firms and lawyers, based on their ability to provide the board with advice on how to better conduct business and review the coherence of managerial decisions.

Legal duties and best practice for inside and outside directors

Because of the lack of legislation regarding outside directors, both inside and outside directors are subject to the same standards and duties. Bolivian legislation sets out the responsibilities of the board of directors in a very broad way, stating that the board of directors is responsible

for the administration of the company and its representation. On the other hand, boards of financial institutions are subject to the guidelines provided in the ASFI Rules on Corporate Governance, which include principles of independence and ethical conduct for directors.

Liability of directors

Directors may be held accountable and jointly liable for their actions if they break their duties of ‘diligence, prudence and loyalty’ towards the corporation. In some cases it is disputed whether the duty to the corporation also means a duty towards the shareholders of the corporation, in particular to the shareholder group that appointed the board members. However, the definition and scope of the obligations of diligence, prudence and loyalty have not been developed by specific regulation or by a clear jurisprudential line. Thus, it is generally hard to argue that there has been a breach of the duties of the directors, particularly if their diligence and prudence is being questioned. Breach of loyalty, on the other hand, is often linked to undisclosed conflicts of interest, and is thus easier to demonstrate in court.

Appointment requirements

The Bolivian Commercial Code does not establish requirements that must be met by potential directors to be eligible, but instead sets out in Article 310 a list of characteristics that impede the appointment of a person as director of a corporation, including:

- a* the fact that a person is judicially banned from performing commercial acts as a result of bankruptcy proceeding;
- b* persons that might face conflicts of interest;
- c* persons related by blood or family; and
- d* public officers who performed duties in fields related to the field of business of the corporation, for two years after having left office (e.g., a former minister of the Vice Ministry of Electricity and Alternative Energy cannot be part of a board of directors of a corporation involved in the business of providing electricity).

Conflicts of interest

The above-mentioned article of the Bolivian Commercial Code applies the criterion of ‘conflict of interest’ in a broad manner and there is no specific case law that discusses or analyses the actions or situations that may create conflicts of interest. The wording is very peculiar because it establishes that ‘conflicts of interest, judicial claims or debts with the corporation’ are elements that impede persons from serving as directors, meaning that a conflict of interest is not defined as having a judicial claim or a debt with the corporation, but instead that having a conflict of interest may encompass other things as well. However, it is not common, in practice, for appointments of directors to be challenged on any of these bases, and when they are, conflicts of interest are mostly linked to economic ties (creditor–debtor relationship) or family ties.

III DISCLOSURE

The Commercial Code establishes that faithful keeping of accounting books is one of the duties of corporations. Under Article 39 of the Code, accounting of the corporation must be kept by legally authorised accountants. Additionally, Article 64 expressly prohibits the practice of ‘double accounting’, levying criminal sanctions against persons who breach this rule.

As explained above, the concentrated ownership structure of corporations in Bolivia is a very important element that allows us to better understand the reasons behind some of the rules (or lack thereof) in the corporate governance regime. For example, regulations restricting one-on-one meetings of directors and shareholders do not exist in our jurisdiction, and in fact these kinds of meetings are fairly common. There are no restrictions that forbid these kinds of meetings, and there is usually a very strong line of communication between the board and, in particular, the dominant shareholder of the corporation.

IV CORPORATE RESPONSIBILITY

Bolivia is a very atypical country with respect to corporate social responsibility and stakeholders.

As a first consideration, it has to be taken into account that there is wide-ranging regulation that protects the rights and social benefits of employees in the country. Bolivian legislation is considered to be employee-friendly, because it prohibits, for example, the at-will termination of employment agreements without a cause. In addition, the freedom of employees to create syndicates to represent workers' rights is strongly protected by labour laws.

Despite the fact that labour law in the country provides many advantages for employees over employers, there are no specific regulations protecting the interests of stakeholders inside the decision-taking bodies of corporations, or allowing, for example, the participation of syndicates in the decisions of the board of directors. Even though labour law and corporate governance rules do not complement each other, the importance of labour unions in Bolivian companies is unquestionable.

Although it is not very common and the law does not mandate it, some of the larger corporations in Bolivia have implemented projects to allow the participation of employees and stakeholders in decision-making processes, in an effort to reinforce the well-being of their employees and the community.

V SHAREHOLDERS

Pursuant to Article 231 of the Bolivian Commercial Code, each share of the corporation grants its owner the right to cast one vote. However, holders of preferred stock have limited voting rights. This means that holders of ordinary stock are empowered to cast their votes in both the ordinary and extraordinary shareholders' meetings held by the corporation, while holders of preferred stock may only cast their votes on extraordinary meetings (although they are allowed to participate in ordinary meetings, but without voting powers).

i Powers of shareholders to influence the board

In practice, shareholders in Bolivia have undisputed power to influence the board of directors. There are two reasons for this. First, and most importantly, the influence of the shareholders (and in particular of dominant shareholders) is a result of the concentrated ownership structure of corporations in Bolivia. On the other hand, the lack of a developed M&A market highlights the fact that there are generally no disputes over the control of the corporation as a result of conflict between the power of the board and the power of the shareholders, because friendly mergers are the norm rather than the exception.

ii Decisions reserved to shareholders

The decisions taken by shareholders' meetings are the most important governing actions in the functioning of corporations, as shareholders have the ultimate power to take decisions regarding key aspects of the corporate governance of corporations, such as electing directors and defining their responsibilities. Under Articles 285 and 286 of the Commercial Code, these corporate decisions are strictly reserved to the vote of shareholders and cannot be taken by the board of directors.

It is important to differentiate two kinds of meetings that may be held by the shareholders. The first is the ordinary meeting, commonly referred as the annual meeting, because it must be held at least once a year to comply with the requirements of the Registry of Commerce (but can be held more frequently). The ordinary meeting has exclusive competence to approve the balance sheet and accounting books of the corporation, the payment of dividends to the shareholders, and the appointment of directors.

The second kind of meeting that can be held by shareholders is an extraordinary meeting, which has exclusive competence to determine the amendment of the by-laws, the issuing of stock, bonds and debentures, or the dissolution of the corporation. Extraordinary meetings are not mandatory, and may take place as many times in a year as necessary.

iii Rights of dissenting shareholders

Dissenting shareholders who decide to object any measure taken by the shareholders' meeting as a whole are excluded from potential liability that may arise as a result of the illegality or judicially declared nullity of the measure taken. Therefore, although dissenting shareholders are bound by the determinations of the other majority of the shareholders and do not acquire any particular right as a result of their dissent, they do acquire the right of immunity in the case of an overcoming nullity of the action taken by the other shareholders, pursuant to Article 304 of the Bolivian Commercial Code.

iv Facilities for long-term shareholders

Pursuant to Article 279 of the Bolivian Commercial Code, 'founding' shareholders are entitled to receive special bonds, which are not convertible to shares and do not empower the founding shareholders to participate in the administration of the corporation. The amounts to be paid by the corporation to the bond-holding 'founders' of the corporation depend on each specific corporation. In practice, it is uncommon for corporations to issue these kinds of bonds.

v Board decisions subject to shareholder approval

Certain board decisions require the approval of the shareholders. One example is approving the resignation of directors, which can be accepted by the board of directors of the corporation, but is subject to the later ratification of the shareholders. In addition, shareholders may impose other restrictions in the by-laws of the corporation on board decisions.

vi Controlling shareholders' duties and liability

As mentioned above, it is very common to find that Bolivian corporations are controlled by a dominant shareholder who owns a large amount of the shares of the corporation. Although there are no specific obligations imposed on controlling shareholders (or a definition of what constitutes a controlling shareholder), there is a specific provision stating that minority

shareholders who represent at least 20 per cent of the voting shares of the corporation may appoint one-third of the board of directors. Minority shareholders may also convene general meetings, even if the board of directors disapproves or objects.

vii Institutional investors' duties and best practice

Institutional investors are subject to the ASFI Rules on Corporate Governance for the management of their internal corporate functioning, and their management bodies are thus subject to the obligations imposed on this norm.

viii Codes of best practice for shareholders

The AEMP Guidelines on Corporate Governance act as a code of best practice for shareholders, as they recommend certain measures that might be considered as intended to aid minority shareholders. One of the more relevant parts of these Guidelines is based on the importance of providing reliable information to all shareholders and the importance of establishing, in advance, the specific topics that are going to be discussed in the shareholders' meetings.

ix Shareholder activism

The concentrated ownership structure of corporations in Bolivia makes shareholder activism an unusual topic for the Bolivian jurisdiction. Because the ultimate power of decision is vested in the shareholders, and it is common to find a controlling shareholder in the corporation, there is rarely conflict between directors and shareholders over the power to take decisions regarding the corporation (the power lies with the dominant shareholder).

There are also no specific provisions governing the use of derivative actions by shareholders, nor the use of proxy battles to take control of the corporation, as control normally lies with the dominant shareholder.

There are some particular requirements for calling a shareholders' meeting under Article 288 of the Bolivian Commercial Code:

- a* the meeting has to be advertised in a national newspaper;
- b* notice has to be given of the topics that will be discussed during the meeting;
- c* notice has to be given of the place and the time; and
- d* the meeting has to be advertised for three non-consecutive periods, with the final advertisement being made at least five days before the meeting is held.

x Takeover defences

Another consequence of the concentrated ownership structure of corporations in Bolivia is that takeover attempts are extremely rare, and the use of takeover defences unnecessary. The reason for this is that successful takeovers require obtaining a majority of the shares of a corporation, to have effective control of the corporation and influence the board of directors in favour of the merger of the company with the acquirer. A controlling shareholder, however, disrupts the scheme, because it is not possible for the potential buyer to obtain more than 50 per cent of the shares of the corporation without acquiring some of those shares directly from the controlling shareholder. Hence, bidding parties are forced to negotiate with the board of directors of the corporation and through them, with the controlling shareholder itself.

As mentioned above, there are cases where buyers have acquired significant amounts of shares of corporations in an effort to force the controlling shareholder to sell the remaining shares to the acquirer. However, no clear takeover defences have been developed in Bolivia to counter this strategy.

VI OUTLOOK

The development of corporate governance in Bolivia is just beginning. It is expected that the AEMP will become a more active participant and enforcer of corporate governance regulation in the future (in the same way that it has become a more active participant in the field of antitrust law during the past five years). In addition, the Commercial Code of 1977 is expected to be modified in the next few years – a new Commercial Code is under review by the Bolivian National Assembly and many changes to the regulation of the creation of corporations and companies are anticipated. Also, a law on merger control is expected to be discussed by the Bolivian National Assembly in 2017. If this law is approved, it may have an impact on fiduciary duties and corporate obligations.

BRAZIL

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I OVERVIEW OF GOVERNANCE REGIME

The corporate governance regime applicable to Brazilian listed companies is basically established by the Brazilian Corporation Law (Federal Law No. 6,404, of 15 December 1976, as amended), the rulings issued by the Brazilian Securities Commission (CVM), and the listing rules issued by the São Paulo Stock Exchange (BM&FBOVESPA) to each of its listing segments.²

In addition to the Law and rules mentioned above, listed companies are encouraged to follow the best practice recommendations provided in the Brazilian Corporate Governance Code for listed companies elaborated by GT Interagentes (the Interagents Working Group, which comprises 11 of the most important agencies concerned with the Brazilian capital markets) and issued on 16 November 2016. The Brazilian Corporate Governance Code adopts the ‘comply or explain’ approach. In addition, there are also codes issued by the Brazilian Institute of Corporate Governance and by the Brazilian Association of Listed Companies, which are among the entities that make up the Interagents Working Group. While these codes were previously important references for Brazilian listed companies, with the publication of the Brazilian Corporate Governance Code it is expected that they will become secondary references.

Of the BM&FBOVESPA listing segments, the Novo Mercado has the highest standards of corporate governance rules, followed by Level 2 and Level 1. There is also the BOVESPA MAIS, an organised over-the-counter market managed by BM&FBOVESPA and created as a way for small and medium-sized companies to access the capital markets. It falls under the authority of CVM, a federal independent agency reporting to the Ministry of Finance that supervises and enforces listed companies’ compliance with the Brazilian Corporation Law and the rules issued by CVM. This enforcement can result in the imposition of fines and restrictions on companies and their administrators.

BM&FBOVESPA is responsible for supervising compliance with its listing rules and has the authority to impose on companies and their administrators contractual fines and other sanctions, such as suspension and exclusion from trading in shares in the BM&FBOVESPA environment.

Most Brazilian listed companies do not have widely held stock, but in recent years there has been a trend for CVM to stimulate the participation of minority shareholders

1 Marcelo Viveiros de Moura is a partner and Marcos Saldanha Proença is a senior associate at Pinheiro Neto Advogados.

2 Note that BM&FBOVESPA and the companies listed in the Novo Mercado segment are currently discussing changes to the Novo Mercado’s listing rules.

in the governance of companies, through the creation of a mechanism that enables all the shareholders to send their votes electronically prior to any shareholders' meeting. Until 2016, implementation of this mechanism was not mandatory, but it will become mandatory for the main companies listed on BM&FBOVESPA in 2017, and for all companies in 2018.

CVM has also enacted rules in recent years to improve the quality and amount of information that a listed company must disclose to its investors, including Ruling No. 480, published at the end of 2009, which created the 'reference form', a document containing very detailed information about the company that must be updated at least once a year; and Ruling No. 481 (published simultaneously with Ruling No. 480), which sets forth the mandatory information that must be disclosed by listed companies on an ordinary basis and prior to each shareholders' meeting. Both these rules have already been adjusted to incorporate improvements that CVM considered necessary and it is currently discussing additional changes to Ruling No. 480, including the means for companies to disclose their corporate governance practices pursuant to the comply or explain approach adopted in the Brazilian Corporate Governance Code.

Furthermore, BM&FBOVESPA launched the State-Owned Enterprise Governance Programme in September 2015 in response to the recent scandals and political use of state-owned companies by the government. The Programme aims to restore investor confidence in state-owned companies (which are significant elements of the Brazilian capital markets) by enhancing the corporate governance rules of these companies in the following ways: (1) through more clear disclosure of the company's objectives, (2) through the creation of mechanisms to remove administrators who divert company activities from the stated objective, (3) through the establishment of detailed nomination criteria encompassing the qualifications and expertise of the administrators, and (4) through the commitment of the public controlling shareholder to comply with corporate governance best practice.

It should be interesting, during 2017, to observe (1) how the Brazilian capital markets react to the adoption of mandatory electronic voting for the main companies listed on BM&FBOVESPA; (2) whether listed companies will follow the rules provided in the Brazilian Corporate Governance Code elaborated by the Interagents Working Group; and (3) the changes that will be implemented by CVM in Ruling No. 480.

II CORPORATE LEADERSHIP

i Board structure and practices

Brazilian listed companies are managed by a board of directors³ and by an executive office. Brazilian companies can also install a fiscal board, which does not have the nature of a managerial body but rather of a supervisory body.

Board of directors

The board of directors is a decision-making body with authority to establish the company's business policy in general; to elect and dismiss officers; to set the duties and monitor the day-to-day managerial actions of the officers; to express an opinion on any matters to be

3 Closely held companies are not required to have a board of directors.

submitted to the shareholders; and to approve the implementation by the executive office of specific matters prescribed by law or under the company by-laws. The authority of the board of directors established by the Brazilian Corporation Law cannot be delegated to other bodies.

The board of directors shall be composed of at least three members, but in the case of the companies listed in the Novo Mercado and Level 2 segments, the board must be composed of at least five members and at least 20 per cent of the members must be considered to be 'independent'.⁴ The members of the board of directors are not required to be Brazilian residents.

The requirements for the appointment to occupy a position on the board of directors are established in the Brazilian Corporation Law. Generally speaking, the director must be someone with an unblemished reputation who has not been convicted in an administrative or judicial procedure in relation to corporate crimes or irregularities.

The board of directors can create specific committees (e.g., compensation, related-party transactions, and audit) to assist it in the management of the company. In this regard, listed companies must rotate their independent auditor every five years and must wait at least three years before rehiring the same auditor. However, if the listed company has installed a statutory audit committee, rotation can occur every 10 years instead of five.

In the event of a tender offer for the acquisition of the control of a listed company (Takeover TO), in principle, the board of directors of the listed companies is not under an obligation to make a statement as to whether or not it agrees with the terms and conditions of the Takeover TO.

If, however, the board of directors decides to make a statement on the Takeover TO, the statement must be disclosed to the market and must address such issues as: provision of information on all aspects necessary to allow an informed decision by the investor, especially with regard to the price being offered; and any material changes in the company's financial condition since the date of the most recent financial statements or quarterly reports disclosed to the market.

In the case of companies listed on the Novo Mercado and Level 2 listing segments, the board of directors is required to prepare and disclose a reasoned opinion on the Takeover TO – in favour or against it – and to address the following topics:

- a* the suitability of and opportunities presented by the Takeover TO;
- b* the impact of the Takeover TO on the interests of the company;
- c* the offeror's stated strategic plans for the company; and
- d* any other point of consideration the board may deem relevant.

Executive board

The executive board shall be composed of at least two officers. The officers of Brazilian listed companies can be elected and removed at any time by the board of directors.

Up to one-third of the board members may be elected for executive board positions held concurrently. Pursuant to the rules of the Novo Mercado, Level 2 and Level 1 listing segments, the offices of chairman of the board of directors and CEO cannot be held by the

⁴ This specific rule regarding independent board members is currently under discussion by BM&FBOVESPA and the companies listed in the Novo Mercado segment, as part of the proposed changes to the listing rules of the Novo Mercado.

same individual. However, the holding of these positions concurrently is allowed, on an exceptional basis, for a maximum period of three years from the date that the company's shares start to be traded on the special listing segment.

Among other duties, the executive board represents the company in dealings with third parties. The by-laws may establish that certain managerial decisions should be taken in executive board meetings only.

The by-laws will establish the number of officers permitted, the manner of their replacement, their term of office, and the assignments and powers of each officer. Officers will perform their duties separately, according to their assignments and powers, but in keeping with the other officers, and will not be held liable for any obligations assumed on behalf of the company as regards routine acts necessary for the company's management.

If the by-laws are silent or there is no resolution adopted by the board of directors prescribing the officers' duties, any officer may represent the company and take the actions necessary for its routine operations.

Compensation of the members of the board of directors and executive board

The shareholders' meeting shall prescribe the aggregate or individual compensation of the members of the board of directors and executive board, including benefits of any kind and representation allowances, taking into consideration their responsibilities, the time devoted to their duties, their skills and professional standing, and the market value of their services. If the shareholders' meeting approves the aggregate compensation to be paid to the company's directors and officers, it will fall under the authority of the board of directors to approve the allocation of the compensation between the company's directors and officers.

If the company's by-laws sets forth a compulsory dividend equal to or above 25 per cent of the net profits, it may establish a share in the company's profits to the benefit of the company's directors and officers, provided that the total amount thereof does not exceed the annual compensation of the directors and officers, nor one-tenth of the profits, whichever is the lower. Nevertheless, directors and officers shall only be entitled to a share in the profits in a financial year for which the compulsory dividend is paid to the shareholders.

Detailed information on the compensation paid to the company's directors and officers, including, but not limited to, the breakdown of the compensation (e.g., fixed and variable compensation), the minimum, lowest and average compensation paid, must be disclosed in the company's reference form.

Fiscal board

The fiscal board is a supervisory body responsible for supervising the company's directors and officers and providing information in this respect to the shareholders.

The fiscal board is a compulsory body, but need not operate on a standing basis. A non-permanent fiscal board must be instated upon the request of shareholders representing at least 10 per cent of the voting stock or 5 per cent of the non-voting stock.

The fiscal board is composed of three to five members and a like number of alternates. The conditions for election and impairment of fiscal board members (who must be Brazilian residents) are prescribed by law.

The fiscal board has the authority to, among other things:

- a monitor the actions of the company's officers and directors and verify their compliance with their legal and statutory duties;
- b review and give an opinion on the board of directors' annual report;

- c* review and give an opinion on proposals of the management to the shareholders' meeting relating to changes in capital, issuance of debentures or warrants, investment plans or capital budgets, dividend distribution and certain corporate reorganisations;
- d* report any error, fraud or criminal act and suggest measures useful to the company to any officer or member of another administrative body and, if these fail to take any necessary steps, to act to protect the corporation's interest and report to the shareholders' meeting;
- e* review the balance sheet and other financial statements periodically prepared by the company; and
- f* examine the financial statements for the fiscal year and give an opinion about them.

The fiscal board's authorities can be neither delegated nor attributed to any other body of the company.

ii Directors

As mentioned above, the board of directors is a decision-making body of the company, but the daily routine of administration of the company shall fall to the executive board. All the members of the board of directors, including the outside or independent members, must receive in advance of the meetings of the board of directors information about the matters that will be discussed and put to the vote.

Brazilian legislation does not expressly state that the directors have the right to visit the company's facilities and its subsidiaries, or that the directors should have free access to the lower management of the company. However, considering that among the duties provided for the board of directors in the Brazilian Corporation Law it is established that the board of directors shall 'supervise the performance of the officers, examine the books and records of the company at any time, request information on contracts signed or about to be signed, and take all other necessary action', it is expected that the directors shall have free access to the company, its subsidiaries and its lower management.

Pursuant to the Brazilian Corporation Law, the directors have the following duties and obligations:

- a* a duty of diligence, employing the same care and diligence that every diligent and honest person employs in its own business;
- b* to act within the scope of their duties without misuse of power, refraining from the performance of gratuitous or non-authorized acts and from the receipt of personal advantage by reason of the performance of their duties;
- c* even if elected by a certain group or class of shareholders, they have the same duty to the company as everyone else, and must not, even in the defence of the interests of those who elected them, fail to fulfil these duties;
- d* a duty of loyalty;
- e* to act without conflict of interest, not intervening in any transaction where they have an interest conflicting with that of the company; and
- f* a duty of information.

As regards the liability of the directors, the directors shall not be held personally liable for the obligations assumed on behalf of the company as a result of a regular act of management. However, the directors shall be held liable in civil lawsuits for the losses that they cause owing to acts of negligence or fraudulent intent and in violation of the law or the company's by-laws.

Note that the directors shall not be liable for unlawful acts performed by other directors, unless they are involved with these directors, or they neglect to perceive them or if, having knowledge of them, fail to act to prevent their performance. However, directors are held jointly liable in the case of decisions taken by the board of directors.

In this particular, we note that each of its members is personally liable for any act of omission or negligence of the board of directors, and a dissident director shall express his or her disagreement regarding the resolutions taken through the clear and written register in the minutes of the meeting of the competent administration body, to release him or herself from any eventual civil liability. The director who agrees with the performance of acts that violate the law or the company's by-laws shall be held jointly liable for the losses resulting from said act.

The members of the board of directors are elected by the shareholders, who can dismiss them at any time. The shareholders representing at least one-tenth of the voting capital may request that a multiple voting procedure be adopted to entitle each share to as many votes as there are board members and to give each shareholder the right to vote cumulatively for only one candidate or to distribute his or her votes among several candidates.

The term of office of the directors must be defined in the by-laws, but it cannot exceed three years, although re-election is permitted. In the case of companies listed in the Novo Mercado, Level 2, Level 1 and BOVESPA MAIS listing segments, the term of office cannot exceed two years, although again re-election is permitted.

The requirements for the appointment to occupy a position on the board of directors are established in the Brazilian Corporation Law. Generally speaking, the director must be someone with unblemished reputation, who has not been convicted in an administrative or judicial procedure in relation to corporate crimes or irregularities. Furthermore, unless waived in a shareholders' meeting, individuals who hold positions in companies that may be regarded as market competitors of the company, or who have any interests that conflict with those of the company, cannot be elected as board member.

As regards conflicts of interest, a director shall not take part in any corporate transaction in which he or she has an interest that conflicts with an interest of the company, nor take part in the decisions made by the other directors on the matter. He or she shall disclose his or her disqualification to the other directors and shall cause the nature and extent of his or her interest to be recorded in the minutes of the meeting of the board of directors.

Notwithstanding compliance with the conflict of interest provision, the director may only contract with the company at arm's length. Any business contracted other than on an arm's-length basis is voidable, and the director concerned shall be compelled to transfer to the company all benefits that he or she obtains through such business.

III DISCLOSURE

The Brazilian Corporation Law has adopted the principle of full disclosure when it comes to acts or facts related to the company that may be considered relevant. The disclosure of material events is a duty of the company's investor relations officer, who may be held personally liable for damages arising as a result of non-disclosure.

CVM Ruling No. 358/2002, which sets forth the general disclosure rules for listed companies, defines 'material event' broadly, as any decision arising from a controlling shareholder, a general shareholders' meeting or a management body of a publicly held corporation, or any other act or event of a policy, management, technical, business, economic

or financial nature in connection with its business that could considerably influence the trading price of the securities issued by or related to the company; the decision by investors to buy, sell or keep those securities; and the decision by investors to exercise any rights they have as holders of securities issued by or related to the company.

At the end of 2009, CVM enacted CVM Rulings Nos. 480/2009 and 481/2009, modifying, respectively, the rules regarding the disclosure of information by publicly held companies and the presentation of documents and information before meetings are held. The main change in disclosure issues was the introduction of the reference form, which basically compiles corporate, contractual, financial or economic, governance, and human resources information about the company. The reference form must be updated at least once a year, or in a shorter period upon the occurrence of certain events that demand an update of the information provided in the reference form.

Of the changes to Ruling No. 480 currently under consideration by CVM, one proposal is the introduction of a requirement for a disclosure document for listed companies – the ‘Brazilian Corporate Governance Code: Listed Companies Information’ (the Listed Companies Information). According to the latest draft of the ruling, this information would be disclosed by listed companies on an annual basis, within the first six months after the end of each fiscal year, and would be updated on the date of the filing for a request for the registration of any public offer. The Listed Companies Information would indicate, in relation to each recommendation of the Brazilian Corporate Governance Code, whether the company was compliant, and if not, would provide an explanation for the non-compliance.

As to financial reporting, listed companies must disclose their financial statements, together with the management report, the independent auditors’ report and the opinion of the fiscal board, if installed, at least one month in advance of the ordinary shareholders’ meeting.⁵

Listed companies must also disclose the standard form of financial statements (DFP), within the first three months after the end of each fiscal year. The DFP is an electronic form created in CVM’s electronic system that must be completed using information obtained from the annual financial statement.

Listed companies shall also disclose, on a quarterly basis, the quarterly information form, which is also an electronic form, and which must be completed using the company’s quarterly financial information; it must contain the report of the special review issued by the independent auditor.

In addition to disclosing their financial statements in Portuguese, companies listed in the Novo Mercado and Level 2 listing segments must also disclose them in English.

Regarding one-on-one meetings, companies listed in the Novo Mercado, Level 2 and Level 1 listing segments are required to hold, at least once a year, a public meeting with analysts and other third parties, to disclose information about their financial and economic situation, projects and expectations.

IV CORPORATE RESPONSIBILITY

Pursuant to the Brazilian Corporation Law, all publicly held companies must prepare on an annual basis, within their financial statement, a value-added statement, which could be considered as the balance statement of the company’s ‘social account’. This statement provides

⁵ The ordinary shareholders’ meeting must be held within the first four months after the end of each fiscal year.

information on the overall wealth produced by the company, on the allocation of resources to those areas of the company that contributed to the generation of that wealth (such as employees, financiers, shareholders, the government and others) and on the unallocated portion of that wealth. In addition, some companies seek certification from institutes such as the Ethos Institute, the Brazilian Institute of Social and Economic Analysis and the Global Reporting Initiative, but such certification is not mandatory for listed companies.

Another aspect of this ‘social accounting’ is evidenced in the code published by the Brazilian Financial and Capital Markets Association (ANBIMA) regarding public offerings, which sets forth that companies must include in their reference form information on social responsibility and cultural incentives, and on any projects in those areas implemented by the company. Thus, although the ANBIMA code does not require their existence, if the company has any social responsibility policies in place, these should be disclosed in the reference form.

Furthermore, a new anti-corruption law has been in place since 29 January 2014, and this introduced administrative and civil liability of legal entities for illicit acts committed in relation to local and foreign public officials. However, there is as yet no whistle-blowing legislation in force in Brazil.

V SHAREHOLDERS

i Shareholder rights and powers

Each common share shall have the right to one vote in shareholders’ meetings and it is not possible to have shares with multiple voting rights. Brazilian companies can, however, issue preferred shares, which can be issued without voting rights (although companies listed in the Novo Mercado are required to issue only common shares).

In addition, the Brazilian Corporation Law sets forth that it is possible to include in the company’s by-laws a provision restricting the number of votes by each shareholder. Nevertheless, the companies listed in the Novo Mercado and Level 2 listing segments are not permitted to include in their by-laws any provision restricting the number of votes of shareholders to a percentage below 5 per cent of the stock capital, except in a few cases provided in the listing rules.

In theory, shareholders should not have the ability to influence the directors’ decision-making. In this regard, a specific article of the Brazilian Corporation Law sets forth that a director shall use his or her powers to achieve the company objectives and to support its best interests, even if these interests are contrary to those of the shareholder, or group of shareholders, who have elected or indicated him or her.

Nevertheless, the Brazilian Corporation Law also contain a provision stating that the votes of directors can be bound by a shareholders’ agreement. Therefore, the Brazilian Corporation Law recognises that the directors can receive instructions from the shareholders on how to vote in board meetings.

The shareholders’ meeting has exclusive authority to:

- a* amend the by-laws;
- b* elect or discharge the company’s senior management and fiscal board members;
- c* receive the annual accounts of the senior management and resolve on the financial statements presented by them;
- d* suspend the exercise of rights by a shareholder;
- e* resolve on the appraisal of assets contributed by any shareholder to the company’s capital;
- f* authorise the issuance of participation certificates;

- g* resolve on the transformation, merger, consolidation, spin-off, winding-up and liquidation of the company; elect and dismiss liquidators; and examine the liquidators' accounts; and
- b* authorise the senior managers to admit bankruptcy of the company and to file for debt rehabilitation.

As for the rights of dissenting shareholders, certain fundamental changes in the company entitle the shareholders who have not voted in favour of the resolution to withdraw, by refund of their shares, under the circumstances below:

- a* in the case of the creation of preferred shares or increase of an existing class without maintaining its ratio in relation to the other classes, and change of a preference, a privilege or a condition of redemption or amortisation conferred upon one or more classes of preferred shares, or creation of a new and more favoured class;
- b* the spin-off of the company only triggers the right to withdraw if it results in a change in the corporate purposes – except when the spun-off company is transferred to a corporation with a main line of business that coincides with the line of business of the spun-off company – a reduction in the mandatory dividend or participation in a group of corporations;
- c* the reduction of the compulsory dividend in any specific fiscal year, change of corporate purpose and insertion of an arbitration clause in the by-laws;
- d* the approval of the 'merger of shares' entitles shareholders of both companies involved to withdraw; and
- e* a shareholder who has not voted in favour of the acquisition by the listed company of which he or she is a shareholder of the control of a business corporation is entitled to withdraw if the purchase price exceeds 1.5 times the greatest of: the average quotation of the shares on the stock exchange during the 90 days prior to the contracting date; the net value of each share or quota, the assets and liabilities having been valued at market prices (liquidation value); and the net profit of each share or quota, which may not exceed 15 times the annual net profit per share during the past two fiscal years, monetarily adjusted.

ii Shareholders' duties and responsibilities

The controlling shareholder has the duty to use its controlling power to make the company accomplish its purpose and perform its social role, and shall have duties and responsibilities towards the other shareholders of the company, those who work for the company and the community in which it operates, the rights and interests of which the controlling shareholder must loyally respect and heed.

The controlling shareholder shall be liable for any damage caused by acts performed in abuse of its power. The Brazilian Corporation Law list some examples of what would be considered an abuse of power, which include, among others, the following:

- a* to guide a company towards an objective other than in accordance with its stated objects, or harmful to national interests, or to induce it to favour another Brazilian or foreign concern to the detriment of the minority shareholders' interests in the profits or assets of the company or of the Brazilian economy; and

- b* to arrange for liquidation of a viable company or for the transformation, merger or division of a company to obtain, for itself or for a third party, any undue advantage to the detriment of the other shareholders, of those working for the company or of investors in the company.

There are no specific duties provided in Brazilian legislation for institutional investors and there is no code of best practice for shareholders.

iii Shareholder activism

Shareholder activism is not well developed in Brazil. Recent years, however, have seen a growing amount of shareholder activism, especially by some fund managers, but shareholder activism is still not part of the culture of the Brazilian capital markets.

The Brazilian companies most exposed to shareholder activism are those that have issued American depository receipts in the US market. A good example would be Petrobras, the Brazilian oil and gas company, which recently faced several lawsuits filed with the New York courts by mutual funds, owing to losses stemming from the money-laundering and corruption schemes that have recently become public.

iv Takeover defences

Shareholder and voting rights plans, and similar measures

Brazilian Corporation Law and CVM Ruling No. 361 requires as a condition for effectiveness of the direct or indirect disposal of a controlling interest in a listed company that the acquirer make a mandatory public tender offer (tag-along TO) for the acquisition of all the voting shares that are not part of the controlling block.

The tag-along TO must ensure minority shareholders the receipt of at least 80 per cent of the value paid per voting share included in the controlling block. For companies listed on the Novo Mercado listing segment, the amount to be paid in the tag-along TO shall correspond to 100 per cent of the value paid per voting share included in the controlling block.

Another defence to be considered is the use of 'poison pills', which Brazilian legislation does not prevent companies from putting in place, and they are common in listed companies. The typical Brazilian poison pill requires the acquirer of an equity interest above a given threshold to make a tender offer to all shareholders for a punitive price. The use of poison pills must, however, be established in the by-laws of the company. As a consequence, only the shareholders' meeting, which has exclusive authority to amend the by-laws, is empowered to put poison pills in place.

CVM has already pronounced against provisions that penalise or prevent shareholders from voting against the exclusion of poison pills on a case-by-case basis in a definitive manner. Furthermore, the rules of the Novo Mercado listing do not allow companies that want to trade their shares on the Novo Mercado to have poison pills in their by-laws.

v Contact with shareholders

Mandatory and best practice reporting to all shareholders

The company must disclose to all of its shareholders, through its website, as well as on the CVM and BM&FBOVESPA websites, certain ordinary and extraordinary reports or

information, such as the reference form, financial statements, minutes of the shareholders' meetings and documents necessary for review by shareholders to be able to exercise their voting right in shareholders' meetings.

It is a common practice in listed companies to hold a conference call with investors right after the release of the annual or quarterly financial statement to discuss the company's results. It is also usual for the companies to hold meetings or calls with analysts to discuss the company, to enable the analysts to issue their reports on the company.

Whenever the company holds a meeting with a specific shareholder to discuss a material fact that has not been disclosed, it is usual to have this shareholder sign a non-disclosure agreement and the shareholder would be subject to a blackout period, during which it would be unable to trade in the company's shares, until the material information is disclosed to the market.

The call notices for the shareholders' meetings of publicly held companies must be published at least three times, with the first call notice being published, as a general rule, at least 15 days in advance.⁶

Publicly held companies are required to disclose on the same day as the first publication of the call notice the manual of the shareholders' meeting, which contains detailed information about the matters to be discussed and the management proposal for each of the matters that will be voted on.

The supporting documentation for the ordinary shareholders' meeting (e.g., financial statements, management report, independent auditors report and opinion of the fiscal board) must be disclosed to the shareholders 30 days in advance of the date of the meeting.

In 2015, CVM enacted a ruling on attendance and distance voting at shareholders' meetings of publicly held companies, whereby shareholders would be able to present proposals of deliberations to be voted on, and to vote on the deliberations of the shareholders' meeting, subject to certain requirements. Implementation of this proxy voting system was not mandatory for companies up until 2016, but as from 2017 it will be mandatory for the major companies listed on BM&FBOVESPA and, as from 2018, for all listed companies.

VI OUTLOOK

We expect that the biggest trends in the next few years in Brazil will be the escalation of proxy voting and the battle over the implementation by listed companies of the practices provided in the Brazilian Corporate Governance Code, since CVM Ruling No. 480, currently under discussion, will, if enacted, require companies to publish justification for any non-compliance with the Code in their Listed Companies Information.

⁶ For some specific matters the call notice must be published 30 days in advance.

CANADA

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I OVERVIEW OF GOVERNANCE REGIME

Canada's system of corporate governance is derived from the British common law model and strongly influenced by developments in the United States. While corporate governance practices in the United Kingdom and the United States are similar in many respects, where there are differences Canadian practice usually falls somewhere in between. For example, a Canadian corporation is more likely than a US corporation to have a chair who is not the CEO, and typically has fewer executives on the board than a UK corporation.²

Under Canada's Constitution, provincial governments have exclusive power over property and civil rights within the province. As a result, corporations may choose to incorporate under federal corporate law or under the corporate laws of any of the 10 provinces in Canada. In addition, securities law in Canada is regulated by securities administrators in Canada's 10 provinces and three territories. However, the federal governments and five provincial governments are collaborating on a cooperative capital markets regulatory system.³ Regulation of Canada's national stock exchange is divided between the Province of Ontario for the senior exchange, the Provinces of British Columbia and Alberta for the venture exchange and the Province of Quebec for the derivatives exchange.

Corporate governance practices in Canada are shaped by legal rules and best practices promoted by institutional shareholder groups, the media and professional director associations such as the Institute of Corporate Directors. Sources of legal rules include provincial corporate statutes, securities laws and rules, stock exchange requirements and the common law, as well as a wide variety of other regulatory statutes, regulations and policies. The 10 provincial securities commissions are very active in corporate governance matters, which often overlap

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- 1 Andrew MacDougall, Robert Yalden and John Valley are partners at Osler, Hoskin & Harcourt LLP.
 - 2 According to reports by Spencer Stuart, in Canada 86 per cent of corporations have a chair who is not the CEO and 80 per cent of directors are independent; in the United Kingdom the CEO rarely serves as chair but only 72.2 per cent of the directors (excluding the chair) are non-executives (of whom 94.2 per cent, or 61.1 per cent of all directors, are independent); and in the United States only 48 per cent of corporations have a chair who is not the CEO, but 85 per cent of directors are independent. See the 2016 Spencer Stuart Board Index, the 2016 Canadian Spencer Stuart Board Index and the Spencer Stuart 2016 UK Board Index.
 - 3 The cooperative capital markets regulatory system would involve uniform provincial capital markets legislation of participating provinces and complementary federal legislation. Jurisdictions participating in this initiative are working towards implementation of the relevant legislation by 30 June 2018 and having the system operational in 2018. The participating provinces and territories are Ontario, British Columbia, Saskatchewan, New Brunswick, Prince Edward Island and Yukon.

corporate law areas of concern. Canadian corporate governance has also been influenced by the high proportion of public corporations in Canada that have a dominant or controlling shareholder, either through equity ownership or the ownership of multiple voting rights.

Canadian institutional investors have a profound influence on Canadian corporate governance practices, including through a national institutional investor organisation formed to promote good governance practices in corporations whose shares members own. This organisation, the Canadian Coalition for Good Governance (CCGG) comprises 52 members, including many of Canada's largest institutional investors, collectively managing approximately C\$3 trillion in assets, and has pursued an organised programme of articulating its views and encouraging best practices generally without resorting to proxy battles.

i Recent developments

In May 2016, fundamental amendments to the takeover bid regime in Canada came into force. Among other things, the amendments provide a corporation that is the subject of a hostile takeover bid with up to 105 days to respond to the hostile bid (instead of the 35 days that previously governed). Market practice is expected to evolve in response to these changes, including in connection with shareholder rights plans (which should play a more limited role going forward), the structure of white-knight transactions and the ways in which boards of directors in Canada respond to hostile bids.

In July 2016, the Ontario Securities Commission (OSC) established the Office of the Whistleblower. The Office of the Whistleblower oversees a programme for the payment of financial incentives of up to C\$5 million to individuals who provide the OSC with information that meaningfully assists the OSC in a securities law enforcement investigation that results in monetary sanctions or settlement amounts. The programme is modelled on the Securities and Exchange Commission's programme in the United States, although it seeks to avoid some of the more egregious aspects of that programme by imposing a proportionally smaller reward scale and establishing a maximum award cap. At the same time, the Securities Act (Ontario) was amended to prohibit reprisals against whistle-blowers and to invalidate contractual restrictions on making whistle-blower reports to regulators. The securities regulator in Quebec, the *Autorité des marchés financiers*, launched its own whistle-blower programme in June 2016, although this programme does not offer any financial incentives to whistle-blowers.

Despite the implementation of diversity disclosure requirements in certain jurisdictions of Canada as far back as 31 December 2014, little progress was made year-on-year in 2016 in improving the representation of women on boards and in executive officer positions at Toronto Stock Exchange (TSX) listed companies. However, Canadian governments continued in 2016 to demonstrate clear ongoing interest in board diversity in Canada. The province of Ontario announced a target that women should make up at least 40 per cent of all provincial board and agency appointments by 2019, and encouraged corporations to adopt in 2017 a target of appointing 30 per cent women directors to their boards with a view to achieving that target within five years. The Canadian federal government introduced proposed amendments to the Canada Business Corporations Act (CBCA) and the regulations under the CBCA to require CBCA publicly traded corporations to send annual diversity disclosure to shareholders. The proposed regulations would expand on existing securities-law gender-diversity disclosure requirements by requiring disclosure of whether

or not the corporation has a written policy for diversity other than gender for its board and senior management, and would also increase the number of corporations subject to diversity disclosure requirements, as existing requirements apply only to TSX-listed companies.

The proposed CBCA amendments have important implications for director elections. The proposals would not only eliminate the ability of CBCA corporations to provide for staggered board elections and slate voting for directors by requiring all directors to be elected annually and each director to be elected individually, but would also introduce a new majority voting standard for director elections in uncontested meetings. This standard would require shareholders to be given the option to vote ‘against’ director nominees, and each nominee would be elected only if the number of votes cast ‘for’ the nominee exceed the number of votes cast ‘against’ that nominee. Currently, shareholders may only vote ‘for’ or ‘withhold’ in respect of a particular nominee. This standard, if implemented, would mark a significant departure from the existing majority voting requirements applicable to TSX-listed companies in Canada, which permit the board of directors to make a determination as to whether or not to accept the resignation of a director who failed to receive majority support in his or her election.

In February 2017, the Canadian Securities Administrators (CSA), a group composed of the 10 provincial regulators, published new proxy voting protocols. These voluntary protocols were developed in response to perceived gaps in the existing vote reconciliation process identified by the CSA in a previous review of the proxy voting infrastructure in Canada. The protocols set out CSA staff’s expectations on the role and responsibilities of the key entities that implement shareholder meeting voting reconciliation and they are intended to ‘lay the foundation’ for the key entities in this process to work collectively to improve the system, including developing an ‘end-to-end’ vote confirmation system to allow beneficial owners to confirm that their proxy votes have been accepted. The CSA has indicated that it will monitor implementation of the protocols for the 2017 and 2018 proxy seasons to determine whether further regulatory action is required.

II CORPORATE LEADERSHIP

i Board structure and practices

Responsibility for the governance of a corporation is vested in the corporation’s board of directors (the board). The board is a single-tier body elected by the shareholders that supervises the management of the corporation. If shareholders are not satisfied with the performance of the board, they may remove the directors or refuse to re-elect them.

The role of directors is one of stewardship and oversight. Directors have complete discretion to exercise their powers as they deem appropriate, subject to the constraints imposed by law. The board discharges its responsibilities through majority approval of the directors at board meetings.

Directors are neither required nor expected to devote their full time and attention to the corporation’s affairs. Instead, responsibility for the day-to-day management of a corporation’s affairs is delegated to the CEO and other senior executives who are responsible to, and report back to, the board. Appointing these senior executives and evaluating their performance are among the most important functions of the board. Notwithstanding such delegation, the board retains the ability to intervene in management’s decisions and must exercise final

judgement on matters that are material to the corporation. National Policy 58-201 Corporate Governance Guidelines (NP 58-201), issued by the CSA, recommends that a board adopt a written mandate in which it acknowledges responsibility for stewardship of the corporation.

Committees

The board may delegate certain of its responsibilities to committees of directors. Certain responsibilities may not be delegated to a committee of the board, including (under the Canada Business Corporations Act):

- a* making changes to the by-laws;
- b* approving the annual financial statements, a management proxy circular, a takeover bid circular or directors' circular;
- c* issuing securities (except on terms already approved by the board);
- d* declaring dividends; and
- e* purchasing or redeeming shares of the corporation.

In practice, the committees of many boards do not formally approve the matters before them but return the matter to the full board with their recommendation.

All public corporations are required by statute to have an audit committee. Private corporations frequently choose to have an audit committee as a matter of good practice. Most public corporations also have separate committees to deal with compensation matters and director nominations and corporate governance. Corporations with larger boards may also have an executive committee. Boards also strike *ad hoc* or special committees from time to time to address specific issues or transactions.

Under the corporate statutes, the audit committee of a public corporation must be composed of at least three directors, a majority of whom must not be employees of the corporation or any of its affiliates. However, National Instrument 52-110: Audit Committees (NI 52-110) of the CSA requires that public corporation audit committees be composed of at least three members, all of whom must be 'independent' directors, as defined in that instrument. NI 52-110 also requires that all members of the audit committee be 'financially literate' – that is, that they have the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the corporation's financial statements. Furthermore, corporations must disclose the education and experience of each audit committee member that is relevant to the performance of his or her responsibilities as an audit committee member.

Public corporations are required to disclose publicly on an annual basis the processes by which a board determines compensation for the corporation's directors and officers, including the responsibilities, powers, experience and operation of the compensation committee of the board, if any, and the identity, mandate and compensation paid to any advisers retained by the committee in the past financial year. The overwhelming majority of Canadian public corporations establish a board committee that has responsibility for overseeing compensation matters. NP 58-201 recommends that a board appoint a compensation committee composed entirely of independent directors with responsibilities for oversight of the compensation payable to senior executives. The members of the compensation committee are not required to be independent or to have any particular expertise. However, if the compensation committee

is not comprised solely of ‘independent’ directors as defined in Section 1.4 of NI 52-110, the corporation must disclose what steps the board takes to ensure an objective process for determining executive compensation.

Most Canadian public corporations also have a board committee that has responsibility for overseeing the process for nominating directors for election by shareholders. NP 58-201 recommends that, before an individual is nominated as a director, the board, with advice and input from the nominating committee, should consider the competencies and skills that the board, as a whole, should possess; the competencies and skills of each existing director and of each new nominee; and whether the new nominee can devote sufficient time and resources to serving as a director. Public corporations are required to disclose publicly on an annual basis the process by which the board identifies new candidates for nomination and the responsibilities, powers and operation of the nominating committee. The members of the nominating committee are not required to be independent or to have any particular expertise. However, if the nomination committee is not comprised solely of ‘independent’ directors as defined in Section 1.4 of NI 52-110, the corporation must disclose what steps the board takes to ensure an objective nominating process.

Board chair

Boards appoint a chair from among the directors with responsibility to provide leadership to the board to enhance board effectiveness. The chair is responsible for, among other things, managing the board, setting the agenda, ensuring that directors are kept informed, presiding at director and shareholder meetings, and acting as a key liaison between the board and senior management.

Canadian boards typically do not appoint the CEO as board chair. Concerns about board accountability and process and the desire to provide independent leadership to the board have led most larger public corporation boards in Canada to appoint an independent director as board chair. NP 58-201 recommends that the chair of the board should be an independent director and, where this is not appropriate, an independent director be appointed as lead director. Public corporations are required to disclose whether or not the chair is an independent director and, if not, to disclose whether the board has a lead director. If there is no independent chair or independent lead director, a corporation must then disclose what the board does to provide leadership for its independent directors.

ii Directors

Directors are fiduciaries of the corporation they serve. This obligation and duty arises under common law and is codified in the corporate statutes in the requirement that directors act honestly and in good faith with a view to the best interests of the corporation, and must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. This fiduciary relationship requires a strict standard of conduct that includes loyalty and good faith and requires directors to avoid putting themselves in a position where their duty to act in the best interests of the corporation conflicts with their other obligations.

Directors are required by corporate statutes to discharge their fiduciary duty ‘with a view to the best interests of the corporation’. The Supreme Court of Canada has stated that directors owe their fiduciary duty to the corporation and that the best interests of the corporation must not be confused with the interests of the corporation’s shareholders or any other stakeholders of the corporation.

Director qualifications

Canadian corporate statutes impose minimal qualifications for directors. Any individual who is 18 or over and of sound mind and who is not bankrupt may serve as a director. Some Canadian corporate statutes also require that a certain percentage of directors of the board and committees be resident Canadians.

The ability of the board to exercise independent judgement is of fundamental importance to the governance of public corporations. As a result, most public corporation boards have a number of ‘independent’ directors. Independent directors and the role they play in ensuring the board is able to exercise independent judgement have been a focus for those concerned with accountability in corporate governance. Rules for the determination of who may be considered to be an independent director are set out in both corporate and securities legislation in Canada. In addition, some Canadian institutional shareholders set their own standards for assessing director independence.

The corporate statutes define an independent director as any director who is not employed by the corporation or one of its affiliates. Under this definition, recently retired employees of the corporation and representatives of a controlling shareholder of the corporation would qualify as ‘independent’. Further, as the term ‘affiliates’ involves the concept of control, directors or employees of a major, but not controlling, shareholder are technically independent under the corporate statutes.

The TSX requires a listed corporation to have at least two independent directors. For this purpose, an independent director is a person who:

- a* is not a member of management and is free from any interest and any business or other relationship that could reasonably be perceived to materially interfere with the director’s ability to act in the best interest of the corporation; and
- b* is a beneficial holder, directly or indirectly, or is a nominee or associate of a beneficial holder, collectively of 10 per cent or less of the votes attaching to all issued and outstanding securities of the corporation.

However, the TSX does not consider a person to be independent if within the past three years they have served as an employee or service provider to the listed corporation or its affiliates or they currently serve as an employee or controlling shareholder of a corporation that has a material business relationship with the listed corporation.

For publicly traded corporations, there is yet another definition of ‘independent director’. The definition is set out in Section 1.4 of NI 52-110 of the CSA and requires the board to consider whether there is a material relationship between the director and the corporation that could, in the board’s view, be reasonably expected to interfere with the exercise of that director’s independent judgement. In making its determination, the board must consider all direct and indirect relationships between a director and the corporation – past, present and anticipated – both individually and collectively. The board’s determination is subject to certain ‘bright-line’ tests that are similar to the director independence tests under the New York Stock Exchange’s corporate governance listing requirements. Under these tests, recently retired employees and employees of a parent of the corporation are not independent. Public corporations are required to disclose annually which of the directors on the board are independent and which are not, and describe the basis for determining that a director was not independent. For audit committee purposes, there are additional bright-line director independence tests set out in Section 1.5 of NI 52-110 that correspond to requirements under the Securities Exchange Act of 1934 in the United States.

Election and term

Directors are usually elected by shareholders at the corporation's annual meeting. Most Canadian corporations provide shareholders with the opportunity to vote on each director individually, instead of en bloc for a slate of directors. Slate voting for directors is rare in Canada since the TSX senior exchange requires all its listed companies to provide for individual voting for directors. Shareholders may vote for directors or withhold their vote but cannot vote 'against' a director. A corporation's articles may provide for cumulative voting for directors, whereby each shareholder may cast one vote for each share held multiplied by the number of directors to be elected. However, this is very rare. The articles of a corporation may also permit a particular class of security holders, such as preferred shareholders, to elect one or more directors, or may permit a particular class of security holders to hold multiple voting rights, such as 10 votes per share.

Since 30 June 2014, companies listed on the TSX, other than those that are majority controlled, have been required to have adopted majority voting for the election of directors, either as a board policy or as an amendment to their constating documents. Under majority voting, if in an uncontested election more votes are withheld from the election of a director than are voted in favour of the director's election, the director must immediately tender a resignation for consideration by the board. The board must accept the resignation absent exceptional circumstances and it must make its determination as to whether to accept the resignation within 90 days and announce via press release promptly thereafter. A copy of this press release must also be provided to the TSX.

Directors are generally elected annually. Although corporate statutes permit directors to be elected for terms of up to three years and on a staggered basis, such practices are rare since most Canadian corporate statutes permit shareholders to remove one or more directors from office mid-term and elect their replacements. In addition, the TSX senior exchange requires all its listed companies to elect directors annually.

Board diversity requirements

Virtually all Canadian issuers subject to public reporting requirements in Canada, other than 'venture issuers' and investment funds, are subject to disclosure requirements respecting the representation of women on the board and in senior management and respecting board renewal mechanisms. All provinces and territories other than British Columbia, Yukon and Prince Edward Island have implemented amendments to a national instrument on disclosure of corporate governance practices that require issuers to disclose annually in the proxy circular for the annual meeting (or the annual information form if the issuer does not send a proxy circular to its investors) the number and percentage of women directors and women who are executive officers. Such issuers must disclose whether:

- a* the issuer has adopted term limits for board service or other mechanisms for board renewal, and if so to describe them and, if not, to explain why;
- b* the issuer has a written policy for the identification and nomination of women directors and, if not, to explain why;
- c* the board considers the level of representation of women on the board in identifying and nominating candidates for director and how it does so, and if it does not, to explain why;
- d* the issuer considers the level of representation of women in executive officer positions when making executive officer appointments and how it does so, and if it does not, to explain why; and

- e* the issuer has adopted targets respecting the number or percentage of women on the board and in executive officer positions, and if not, to explain why.

If an issuer has adopted a written policy for the identification and nomination of women directors, the issuer must summarise the policy and its objectives, the measures taken to implement it, the annual and cumulative progress made on achieving the objectives and whether, and if so how, the board or nominating committee measures the policy's effectiveness. If targets regarding women on the board or in executive officer positions have been adopted, the issuer must disclose the annual and cumulative progress made on achieving the targets.

III DISCLOSURE

All Canadian corporations are subject to periodic reporting to shareholders. In the case of a private corporation, periodic reporting may consist solely of the delivery of annual financial statements and a notice of an annual shareholder meeting. Public corporations are also subject to continuous disclosure reporting requirements under Canadian securities laws.

Periodic disclosure requirements require public corporations to file publicly certain documents on the System for Electronic Document Analysis and Retrieval (SEDAR) including:

- a* annual and quarterly financial statements, and related management's discussion and analysis;
- b* an annual information form describing the corporation and its business; and
- c* information circulars in respect of shareholder meetings, including disclosure respecting compensation paid or payable to the directors and certain named executive officers.

Canadian public corporations are also subject to timely disclosure obligations. Under Canadian securities laws, public corporations must issue and file on SEDAR a press release as soon as there has been a material change in the business, operations or capital of the corporation that would reasonably be expected to have a significant effect on the market price or value of any of the corporation's securities. They must also file a material-change report on SEDAR within 10 days of the date of the material change. TSX rules also require listed corporations to promptly disclose by press release any fact that would reasonably be expected to have a significant effect on the market price or value of any of the corporation's securities.

Failure to comply with periodic filing requirements and timely disclosure obligations may lead to enforcement proceedings by securities administrators. In addition, investors in most jurisdictions in Canada may have a statutory right of action against the corporation and its directors and officers for damages in the event that written or oral disclosure by the corporation is misleading or untimely. Although there are statutory limits on such liability, class action proceedings alleging misleading or untimely disclosure are becoming increasingly prevalent in Canada.

Directors, certain officers, 10 per cent shareholders and certain others are required to file on the System for Electronic Disclosure by Insiders insider reports detailing their holdings of securities and related financial instruments, including equity-based compensation holdings, and other arrangements involving, directly or indirectly, a security of the public corporation or related financial instrument. Persons acquiring more than 10 per cent of any class of securities of the public corporation are required to issue a press release and file a report disclosing their holdings.

Many Canadian corporations also provide a range of supplemental voluntary disclosures that they publish on their corporate websites. Public corporation websites typically include links to documents filed on SEDAR and press releases issued by the corporation, as well as supplemental information provided to analysts, recordings or transcripts of analyst or investor calls, and key corporate governance documents (such as the board and committee charters and code of conduct).

IV CORPORATE RESPONSIBILITY

Directors are permitted to consider various stakeholder interests in determining whether they are acting in the best interests of the corporation. In the Supreme Court of Canada's decision in *BCE Inc v. 1976 Debentureholders*, the Court stated that where there are conflicting stakeholder interests, it falls to the directors to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation, viewed as a 'good corporate citizen'. By this reference, together with the Court's focus on what is in the corporation's best interests, the Supreme Court of Canada has rejected a purely shareholder-centric understanding of the duties of a board. Rather, there is recognition that corporations have a responsibility to consider the community in which they operate and boards have to balance many competing factors and interests when making decisions.

Many Canadian corporations seek to enhance stakeholder trust including through voluntary participation in initiatives such as the Global Reporting Initiative's Sustainability Reporting Guidelines.

Boards are responsible for setting the tone at the top by approving codes of conduct for employees and directors that set out the board's expectations regarding compliance with laws, handling of conflicts of interest and use of resources and stakeholder relations. NP 58-201 states that the board is responsible for satisfying itself as to the integrity of the CEO and other executive officers of the corporation and that the CEO and other executive officers create a culture of integrity throughout the organisation. The audit committee is required under NI 52-110 to establish procedures for the receipt, retention and treatment of complaints received by the corporation regarding accounting, internal accounting controls or auditing matters and the confidential, anonymous submission by employees of the corporation of concerns regarding questionable accounting or auditing matters. Most corporations satisfy this requirement by adopting a whistle-blowing policy that addresses not only reporting of such matters, but also reporting of potential violations of the corporation's code of conduct.

V SHAREHOLDERS

Although directors owe a duty to the corporation and not its individual shareholders, shareholders are accorded a special role in the governance of Canadian corporations. Increasingly, shareholders in Canada are taking steps to make their views known to the board and are exercising their rights when the board's response or corporate performance is not satisfactory.

i Shareholder rights and powers

Under Canadian corporate statutes, shareholders elect the directors and appoint the external auditors of the corporation. Certain matters of fundamental importance are also required to

be approved by shareholders, including changes to the articles and by-laws, amalgamations, reorganisations, the sale of all or substantially all of the corporation's assets and the continuance of the corporation to the laws of another jurisdiction. In addition, TSX rules require listed corporations to obtain shareholder approval of certain dilutive transactions and for share-based compensation arrangements involving new issuances of shares.

If a shareholder believes that the actions of the corporation have been unfairly prejudicial to its interests, the corporate statutes provide several ways for the shareholder to take action against directors. First, a shareholder may apply to the court for an order compelling the directors to comply with the corporation's articles, by-laws or governing statute. Second, a shareholder can pursue a derivative action, which allows the shareholder to require the corporation to take action against the directors in the name and on behalf of the corporation. Third, a shareholder may take advantage of the oppression remedy. The oppression remedy is a very broad remedy available to a complainant where the corporation, the board or the corporation's affiliate has acted in a manner that was oppressive or unfairly prejudicial to or that, under certain statutes, unfairly disregarded the complainant's interests. The remedy gives a court 'broad, equitable jurisdiction to enforce not just what is legal but what is fair' to protect the reasonable expectations of the shareholders.

In addition, shareholders have available to them a range of tools in Canada to exert pressure on corporations they feel are underperforming, all of which are intended to force a reluctant management or board to engage in a dialogue.

Canadian corporate statutes allow shareholders holding at least 5 per cent of the issued shares of a corporation to require directors to convene a shareholder meeting for a broad range of purposes relating to the business of the corporation so long as they respect certain prescribed criteria.

The corporate statutes also permit a shareholder to circulate a proposal to shareholders with a supporting paragraph containing not more than 500 words describing the topic the shareholder wishes to raise at an upcoming shareholder meeting. If the proposal meets time parameters and certain other limited criteria, it must be included in the management information circular sent to shareholders of the corporation. A shareholder proposal submitted by shareholders representing more than 5 per cent of the outstanding shares may include proposed director nominees. Although there continues to be considerable debate regarding 'proxy access' in the United States, the ability of shareholders to submit a shareholder proposal including director nominees has been a long-standing provision of Canadian corporate law.

Once a shareholder meeting has been called, any shareholder can solicit proxies either for or against any matter properly before the meeting, including the election of one or more directors, by providing a dissident proxy circular containing prescribed information to the person solicited prior to or contemporaneously with the solicitation. However, certain activities are expressly excluded from the definition of 'solicitation' and shareholders are entitled to certain exemptions from the proxy solicitation rules. For example, Canadian securities laws now allow a shareholder to solicit proxies by way of public broadcast or speech, or by way of publication, without having to incur the costs associated with preparing and mailing a dissident proxy circular, provided certain conditions are met.

ii Shareholder activism

Shareholders of Canadian corporations are prepared to exercise voting rights and submit shareholder proposals as a means of encouraging change at corporations. In part, this reflects the influence of well-capitalised US-based funds that have traditionally been active in trying

to influence the governance of US corporations and have come to realise that the Canadian environment is comparatively favourable to shareholder activist activity. For example, some Canadian corporations have engaged in contests with Carl Icahn (Fairmont Hotels, Lions Gate Entertainment, Talisman Energy), Crescendo Partners (Cott Corporation), Jana Partners (Agrium), Mason Capital Management (TELUS Corp) and Pershing Capital (CP Rail). In addition, although Canadian fund managers have historically been more than comfortable making their views known to corporate boards and the public, they have periodically demonstrated an increased appetite for formally opposing corporate activity. In 2010, the Canada Pension Plan Investment Board and the Ontario Teachers' Pension Plan Board were highly vocal opponents of the terms on which Magna International proposed to eliminate its dual-class share structure (and launched an ultimately unsuccessful court challenge).

Some of the reasons the Canadian environment is more favourable to shareholder activists are:

- a* the use of staggered boards is ineffective as most Canadian corporations' directors may be removed at any time by a simple majority vote of shareholders;
- b* there are clear rights to requisition meetings with a 5 per cent ownership interest and a clear entitlement to a shareholder list;
- c* it is easier for shareholders to include proposals on the election of directors in management proxy circulars;
- d* the threshold for giving notice that a shareholder has accumulated a significant ownership position is higher at 10 per cent and the reporting regime after hitting that threshold is less onerous; and
- e* the TSX requires any listed issuer adopting a shareholder rights plan (i.e., 'poison pill') to obtain shareholder approval of the plan within six months of its adoption, which gives institutional shareholders the ability to influence the terms of these plans. Moreover, unlike the Delaware courts in the United States, prior to the amendments to the Canadian takeover-bid regime that came into force in May 2016, Canadian securities regulators had historically been prepared to terminate rights plans once they have given a board time to pursue alternatives to a hostile bid (typically 50–70 days). These amendments to the takeover-bid regime now afford a target company up to 105 days to respond to a hostile bid, and are discussed in more detail at Section V.iv, on takeover defences, below.

Shareholder activism has prompted a large number of Canadian corporations in recent years to amend their by-laws to require advance notice in respect of nominations for director. Corporations have also looked at adopting shareholder rights plans that may be triggered by shareholders entering into voting agreements or conducting a proxy solicitation, although such provisions are controversial.

iii Contact with shareholders

Shareholder communication is a fundamental and long-standing aspect of the board's fiduciary oversight responsibility. Boards must take shareholder interests into consideration, and so they have an interest in understanding shareholder views about the corporation, its governance and its operations. Accordingly, Canadian corporations have a long-standing practice of consulting with their principal shareholders on matters that may be of interest to them. The importance of shareholder communications is recognised in NP 58-201, which states that the board is responsible for adopting a communication policy for the corporation.

All Canadian corporations have some form of shareholder communications programme through which the corporation communicates material information to shareholders. Typically, the corporation's disclosure practices are summarised in a disclosure policy and a management disclosure committee is tasked with responsibility for ensuring compliance with the disclosure policy and the corporation's disclosure controls and procedures.

However, traditional shareholder communication and investor relations practices no longer satisfy shareholder demands for increased transparency, more frequent communications and more opportunities to express their views on how the corporation should be run, as evidenced by shareholder-led initiatives on majority voting for directors and say on pay. Some investors have actively sought the opportunity to meet with directors in addition to, or in lieu of, management. The CCGG has a regular annual programme through which its representatives meet with directors of almost 50 Canadian corporations each year to share perspectives on the corporation, its strategies, performance and management. Generally, management is not present for these meetings.

iv Takeover defences

In May 2016, fundamental amendments to the takeover-bid regime in Canada came into force. These amendments afford a target company up to 105 days to respond to a hostile bid. Although shorter periods may apply in the event the target company's board of directors agrees or in the event an 'alternative transaction' is entered into by the target company, the amendments afford a target company significantly more time to respond to the bid than is typically provided under the current regime.

The amendments do not specifically address how shareholder rights plans will be treated, nor have there been any court or securities regulatory decisions considering this point to date, but the existing takeover-bid defence regime continues to apply. Therefore, given the increased time afforded to a target company to respond to a hostile bid under the amendments, in the absence of unusual circumstances, it is expected that shareholder rights plans will not be permitted to remain in effect after the 105-day period expires.

This new 105-day mandatory minimum bid period may also decrease the incentive for issuers to adopt shareholder rights plans either 'strategically' at their annual general meetings or 'tactically' in the face of a hostile bid. However, because the amendments do not apply to exempt takeover bids, there will likely continue to be a role for shareholder rights plans in protecting a target company from a 'creeping bid' made through normal course purchases and private agreement exemptions and to prevent hard 'lock-up' agreements, and for tactical 'voting pills' in the context of proxy contests (to stop a dissident group from representing more than a given percentage (e.g., 20 per cent) of the outstanding shares).

Although market practice is evolving, the amendments may also affect the structure of white-knight transactions in Canada. The amendments require the initial hostile bid to remain open for at least 105 days, but this period may be shortened if the target company enters into a white-knight transaction. If the white-knight transaction is structured as a takeover bid, the hostile bid will be entitled to the same bid period as the white knight. However, if the white-knight transaction is structured in another fashion, such as an arrangement or amalgamation transaction, the hostile bid may be shortened to a minimum of 35 days from the original commencement date of the hostile bid. As this would leave the white knight at a timing disadvantage, the new regime creates an incentive for white-knight transactions to be structured as bids rather than 'alternative transactions'.

The amendments also mandate a minimum tender requirement of more than 50 per cent of the outstanding securities that are the subject of the takeover bid (other than those owned, or over which control or direction is exercised, by the bidder and any joint actors). Among other things, this will eliminate the ability to make ‘any-or-all’ takeover bids in Canada and will make takeover bids for target companies with significant minority shareholders more difficult to complete.

VI OUTLOOK

Corporate governance in Canada continues to evolve and the stage has been set for a number of the issues that emerged or remained as key issues in 2016 – including diversity on boards and in executive officer positions, potential changes in director elections and developments in shareholder engagement – to come to a head in 2017.

CHILE

Jorge Ugarte, Luciano Aguilera and Héctor Hernández¹

I OVERVIEW OF GOVERNANCE REGIME

i Sources of law and regulations

The primary sources of corporate governance rules applicable to listed corporations in Chile are contained in the Corporations Act (Law No. 18,046), the Corporations Regulation (Supreme Decree 702/2011 of the Ministry of Finance), the Securities Market Act (Law No. 18,045) and the rules issued by the Securities and Insurance Superintendency (SVS). Moreover, there are three active stock exchanges – Santiago Stock Exchange, Valparaíso Stock Exchange and the Chilean Electronic Stock Exchange – that have implemented a series of rule books for issuers and other market participants.

For the past 20 years, the corporate governance model in Chile has increasingly become a central concern among academics and lawmakers, and has been subject to various new laws and regulations. With a view to strengthening minority shareholder rights, in 2000, Congress passed Law No. 19,705, which introduced new corporate governance rules and measures (e.g., independent directors, internal committees and the regulation of related-party transactions) and provided for the first time a legal framework for tender offers. In the following years, in an effort to build a more robust corporate governance regime, Congress enacted a series of legal reforms, introduced by Law No. 19,768 and No. 19,769 of 2001 (also known as the MK I Law), Law No. 20,190 of 2007 (the MK II Law) and Law No. 20,382 of 2009 (the Corporate Governance Law).

ii Enforcement

The listed company regime is generally enforced by the SVS and, when disputes arise, by competent courts. The SVS is a regulatory agency that has primary responsibility for enforcing securities laws and regulations by monitoring and sanctioning listed companies and management team members who fail to discharge certain duties and responsibilities. The SVS sanctions may consist of fines, censorship, suspension or delisting. Local courts, on the other hand, generally settle disputes between the SVS and supervised individuals or entities, among shareholders, and between shareholders and the company's management.

iii Recent developments and future trends

Chile has certainly improved and strengthened corporate governance standards, becoming an investor-friendly jurisdiction within the Latin American region, according to international

¹ Jorge Ugarte is a partner, Luciano Aguilera is a senior associate, and Héctor Hernández is an associate at Carey. The authors would like to thank Joaquín Plaza, a legal intern, for his contribution to this chapter.

surveys.² Nevertheless, the most recent major reform of corporate governance was the Corporate Governance Law, enacted almost eight years ago. The Corporate Governance Law strengthened minority shareholder rights in listed companies by tightening rules for insider trading, enhancing the roles of independent directors and further regulating related-party transactions in listed corporations.

Although legal reforms of corporate governance have become stagnant, the SVS has been active in providing rules with a view to bolstering the corporate governance regime in Chile. In 2015, the SVS issued General Rule Nos 385 and 386 to enhance transparency standards and introduce corporate social responsibility practices by promoting, among other things, management diversity (e.g., in relation to gender, nationality, age and length of tenure for board members and high-level executives).

In a recent development, a bill currently under discussion proposes replacing the SVS and other market regulators with a centralised governmental body called the Financial Market Commission (FMC). Key aspects of this bill include the creation of an investigative unit for securities violations, an increase in corporate fines and penalties (including, as the most severe punishment, the dissolution of the company) and a leniency policy for whistle-blowers.

II CORPORATE LEADERSHIP

i Board structure and practices

Corporate boards in Chile are one-tier boards, and two-tier structures are not contemplated under Chilean law. The business of a listed company is managed by the board of directors, whose members are elected by the shareholders in shareholders' meetings.

The number of board seats, the term of appointments, and the existence of alternate directors are detailed in the company by-laws. Listed companies must have at least five members, whose term of office may not exceed three years. However, under certain circumstances, as explained below, listed companies are required to have at least a seven-member board, which must include one independent director and a board committee.

The board has managerial and representative responsibilities and must always act collectively at board meetings. Directors may participate in a meeting by physically attending the meeting or participating by technological means (e.g., telephone or similar device) that allows all persons participating in the meeting at least to hear each other at the same time. The board represents the company judicially and extrajudicially and is invested with all the managerial powers that the law or the by-laws do not otherwise reserve to the shareholders' meeting. The board has the duty to set short and long-term business objectives and make all the necessary decisions to reach those objectives, which may be made directly through board resolutions, or indirectly by delegating authority to managers and other company officers. The board of directors must appoint one or more managers whose attributions, duties, rights and obligations will be set by the board, and may delegate part of its authority to managers, assistant managers or lawyers, or a member of the board or a directors' committee and, for specific purposes, other individuals. However, the board's managerial functions

2 Chile has been praised for many years by international surveys for its solid institutions and low perceived corruption. See <https://lavca.org/wp-content/uploads/2015/11/UPDATED-FINAL-Scorecard-15-16.pdf>; and www.transparency.org/cpi2016.

may not be delegated; thus, although the board may delegate part of its authority to one or more individuals, the board members will remain ultimately liable for the management of the company.

Unless otherwise provided in the company's by-laws, all board resolutions must be passed with the approval of the absolute majority of the directors present with voting rights. The board meetings must be chaired by the chairman of the board, who has a casting vote, unless otherwise provided in the by-laws. The Corporations Act forbids the CEO or managers from being the chairman of the company. Board compensation is determined in the company by-laws and is annually approved at the regular shareholders' meeting. The annual report that listed corporations provide to the regular shareholders' meeting must detail payments made to the board members during the relevant fiscal year, including payments that do not relate to their functions as members of the board of directors.

When listed companies reach a market capitalisation of 1.5 million Unidades de Fomento³ and at least 12.5 per cent of the company's voting shares are held by shareholders that control or possess less than 10 per cent of all of the company's shares, an independent director must be appointed and a board committee must be established.⁴ The members of the board committee must be compensated, the majority of them must qualify as independent directors and all of them are simultaneously liable for their duties as directors and members of the board committee. Listed companies are free to have other committees as well (e.g., executive, internal-audit, risk, ethics, investment and human resources committees).⁵

ii Directors

The Corporations Act provides certain fiduciary duties for board members to discharge to adequately fulfil their managerial duties. These fiduciary duties are commonly classified as duties of care, loyalty, confidentiality, information and account rendering. The directors must always act with ordinary diligence and they are jointly and severally liable for any damage caused to the company, the shareholders or third parties. The managers have the same liability as the directors.

The director's liability can be civil, criminal or administrative. If a director does not wish to assume any responsibility for an act or agreement of the board of directors, he or she must record his or her dissent in the minutes of the meeting and it must be duly reported by the chairman in the following regular shareholders' meeting. Any provision in the corporate by-laws and any agreement adopted by the shareholders that tends to release or limit the directors' liability is void.

The board members are elected by the shareholders in a regular shareholders' meeting and their term of appointment, which is provided in the by-laws, cannot exceed a three-year term. Directors may also be re-elected indefinitely. However, if the by-laws are silent as to the directors' term of office, the board must be renewed annually. The board members must be elected and revoked as a whole and, therefore, partial replacements are forbidden. Vacancies on the board require a complete revocation and re-election of the board members; however, the board may fill the vacancy by appointing an interim director until the next regular

3 As of 29 January 2017 approximately US\$59,720,249.

4 Currently, all listed companies whose shares are traded in the Santiago Stock Exchange have a board committee. See Amrop MV Consulting, 'Directors in Chile' (2016 edition), p. 37.

5 Only a 23 per cent of all the companies listed with the Santiago Stock Exchange have one of these additional committees. *Id.*, p. 39.

shareholders' meeting takes place. The Corporations Act does not contemplate diversity requirements for boards' composition; however, it stipulates incompatible roles for directors, including senators, representatives, mayors, state secretaries and other senior government officers, employees of public entities (e.g., the SVS) that oversee the relevant company, and broker dealers, among others. The same individual is able to hold the position of director simultaneously in more than one listed company, and in fact this is a quite common practice.

In recent years, directors' fiduciary duties have become increasingly important. Directors and managers must discharge their duties with the degree of diligence, care and skill that an ordinary person would exercise in his or her own business (i.e., an ordinary standard of care). This fiduciary duty implies that a director must take all appropriate and timely measures to keep her or himself informed of the company's affairs, actively participate in board and board committee meetings, require the inclusion in board-meeting agendas of certain matters that may benefit the 'corporate interest', and oppose illegal resolutions or resolutions that diverge from benefiting the corporate interest.

The Corporations Act provides that directors have the right to be duly informed on the company's business affairs, and the Corporations Regulation and Chilean courts have made clear that they also have a duty to keep themselves reasonably informed to adequately comply with their administrative role.

Directors must also act loyally, which implies that they must abstain from acting in the event of a conflict of interest, and must not usurp corporate business opportunities for their own benefit or for any shareholder or group of shareholders, including those who elected them. In this context, the Corporations Act provides that directors elected by a shareholder or group of shareholders have the same duties towards the company and the other remaining shareholders as they do to the shareholder or group of shareholders that elected them, and they cannot approve by-law amendments, issue securities, approve policies or make decisions that move away from benefiting the company in its entirety. Also, the directors cannot borrow money or other assets from the company or use the company's assets for their own benefit or for the benefit of persons related to them, unless previously authorised by the board of directors. In general, the duty of loyalty entails that directors must always pursue the corporate interest.

If a director violates the aforementioned duty of loyalty rules, he or she will be forced to disgorge to the company any profits received thereby, and will remain liable for any other damage caused to the company, in addition to any other sanction that may be imposed by the SVS.

In the year 2009, the Corporate Governance Law introduced a new chapter to the Corporation Act on listed company related-party transactions. Related-party transactions are defined as transactions between the company and one or more individuals or entities related to the company (e.g., directors, managers or senior executives of the company or their relatives, legal entities in which any of the foregoing individuals own, directly or indirectly, at least 10 per cent of the shares or equity rights of the legal entity, among others). Listed companies, however, may enter into related-party transactions provided that they are intended to contribute to the corporate interest, the transaction is at arms' length as to the market price, terms and conditions, and the transaction complies with the related-party transaction procedure detailed in the Corporations Act.

Pursuant to the related-party transaction procedure, individuals who have a personal interest in the transaction must immediately report the situation to the board of directors. Before the company enters into the corresponding transaction, it must be approved by the

absolute majority of the board of directors, without counting the votes of the interested directors; and if the majority of the board members must be excluded from voting, the transaction must be either approved by unanimous vote of the disinterested directors or approved by the shareholders, in a special shareholders' meeting, by two-thirds of the issued voting shares. If the transaction is deferred for the shareholders' approval, the board must appoint at least one independent appraiser to prepare and provide the shareholders with a report on the terms and conditions of the proposed transaction and its potential impact on the company. The board committee or, if there is no such committee, the disinterested directors may appoint an additional independent appraiser. Once the final appraisal report is received, the directors must explain their interest in the transaction and provide the shareholders with their opinion on the same, taking into account the corporate interest. In any case, a violation of the related-party transaction procedure does not void the transaction, but gives the company and the shareholders the right to procure a court judgment in their favour and make the breaching individual or entity disgorge any profits obtained from the transaction, and indemnify the company for any applicable damages, regardless of any further sanctions imposed by any authority.

The approval of merger and capital contributions in kind are subject to specific procedures provided under the Corporations Act; however, Chilean courts and the SVS have recently held that when these transactions involve related parties, their approval must be subject to the related-party transaction procedure, which may be considered a stricter standard than the aforementioned specific procedures. Notably, the court and SVS resolutions were issued in relation to a dispute between a controlling shareholder and certain institutional investors, whereby the institutional investors sought better terms and conditions for themselves and other minority shareholders.

Companies that are required to have a special board committee must also appoint at least one independent director. Independent directors are subject to the same rights and obligations as regular directors. However, being part of the board committee allows them to be closely involved in the company's internal activities (e.g., examination of the company's financial matters, review of related-party transactions, reporting on related-party transactions to the shareholders, review of the company's executive compensation plans, and review of the annual reports, among other things). Independent directors, like regular directors, may arrange individual meetings with one or more shareholders, as well as with lower management officers, and they can also attend the board meetings of the company's subsidiaries; nonetheless, they are subject to the same confidentiality duties as regular directors and may not disclose information that the company has not officially disclosed to the market.

III DISCLOSURE

i Financial reporting and accountability

Listed companies must comply with reporting obligations provided in the Securities Market Act and rules issued by the SVS and the individual stock exchanges. These reporting obligations may be classified into reporting material events and periodic information.

A listed company has the legal obligation to truthfully, sufficiently and promptly report any material information about itself and its business. 'Material information' is defined as information that a prudent person would consider important in his or her investment decision-making, and includes events that are capable of having a significant impact on the company's assets and liabilities, business or financial condition. The company must report to

the SVS any material information as soon as it becomes aware of it; however, the board of directors, with a three-quarters majority vote, may report certain information on a reserved basis when it refers to pending negotiations whose knowledge may harm the corporate interest of the company.

Also, listed companies must periodically report to the market certain information that is generally determined by the SVS and the stock exchanges where their shares are traded. The SVS requires listed companies to report their financial statements annually and quarterly (consolidated or otherwise). The annual reports must be disclosed within 60 days after the close of the fiscal year and in any event at least 20 days before the shareholders' meeting that will approve the annual financial statements.

ii Auditors' role and authority, and independence

In recent years, lawmakers have strengthened reporting standards for listed companies and reinforced the role of external auditors.

External auditors review and audit the listed company's accounting and financial statements, and determine whether the accounting principles used by the company comply with applicable accounting standards. External auditors are monitored by the SVS and may provide audit services as long as the external audit company and its members are deemed to be independent from the audited company. The law has provided a standard of independence required for the external audit company and its members, pursuant to which it lacks independence if it, directly or indirectly, either: (1) maintains a significant contractual or credit relationship with the audited company (or any of the companies of its business group), (2) owns securities issued by the audited company (or any of the companies of its business group) or (3) simultaneously provides services that are banned by the Securities Market Act (e.g., internal audit services, record-keeping or representation services). The external auditor's members are presumed to lack independence when they: (1) qualify as a person related to the audited company, (2) are or have been within the past 12 months an employee of the audited company (or any of the companies of its business group), (3) own securities issued by the audited company or its business group, or (4) audit the company for more than five years, among other cases.

iii The 'comply or explain' model and mandatory disclosure

Recent SVS rules have adopted the European comply or explain model. In 2015, SVS enacted General Rule No. 385 on disclosure of information regarding corporate governance standards.⁶ This Rule's primary goal is to provide the market with better and more reliable information as to whether the listed companies are complying with certain corporate governance practices. All listed companies are required to provide the SVS, on an annual basis, with answers to a survey that relate to the board's functions and composition; relationships between the company, shareholders and public in general; third-party assessments; and internal control and risk management.

⁶ This rule repealed General Rule No. 341, which was the first comply or explain rule issued by the SVS, in 2012.

IV CORPORATE RESPONSIBILITY

i Compliance policies and whistle-blowing

There are no comprehensive laws on whistle-blower procedures or protection programmes in Chile. However, Chile has taken important steps to improve corporate internal control policies. To adopt the Organisation for Economic Co-operation and Development's anti-bribery guidelines, Chile enacted on 2 December 2009 the Corporate Criminal Liability Law (Law No. 20,393). The Corporate Criminal Liability Law encourages companies to create internal compliance programmes to prevent money laundering, terrorism financing, bribery of public officials and receipt of stolen property. These compliance programmes must offer whistle-blower reporting channels; however, they usually lack adequate measures to prevent retaliation against whistle-blowers.

ii Corporate social responsibility

There is no legal definition of 'corporate interest'. The Supreme Court, however, has held that corporate interest is the common interest between stockholders, as opposed to their individual interest. Also, the Court stated that corporate interest must always relate to the purpose of the company, the primary goal of which is obtaining and distributing profit among the shareholders.⁷

Corporate social responsibility is a developing concept in Chile. Although there are multinational firms that have voluntarily adopted and comply with international standards,⁸ there are no laws regarding corporate social responsibility towards society and stakeholders in general. However, General Rule No. 385 encourages listed companies to take into account corporate social responsibility. This rule compels listed companies to provide information on the existence of internal audit committees, corporate social responsibility programmes and whistle-blower reporting channels. This information is subsequently uploaded and published on the SVS website.⁹

⁷ See *Cuneo Solari et al. v. Superintendencia de Valores y Seguros*, Supreme Court, Case No. 3,389 (2015).

⁸ See 'Corporate Social Responsibility in Latin America: A collection of research papers from the Virtual Institute Network', United Nations (2010), p. 16 available at http://unctad.org/en/docs/dtlktcd20102_en.pdf.

⁹ A recent study has shown that as of 7 April 2016, of 206 listed companies, 37 per cent responded as having a risk management unit, 50 per cent responded as having an internal audit committee, 69 per cent responded as having anonymous whistle-blower reporting systems in place, and 37 per cent responded that they maintain internal policies that consider economic, social and environmental risks. See 'Gobiernos Corporativos en Chile: Una mirada a la implementación de la Norma de Carácter General No. 385', PwC, April 2016, available at www.pwc.com/cl/es/publicaciones/assets/2016/Estudio-NCG-385-2-VF.pdf.

V SHAREHOLDERS

i Shareholders rights and powers

Listed companies in Chile have high ownership concentration levels¹⁰ and are generally controlled by a controlling shareholder or a group of shareholders.¹¹ The Chilean corporate structure does not separate ownership and control, creating different minority shareholder concerns; these typically include concerns that conflicts between controlling shareholders and minority shareholders will, in practice, be settled favouring controlling shareholders' interests, and that controlling shareholders will benefit from asymmetry of information, among other things.

Recent legal reforms have strengthened minority shareholder rights, and the power of institutional investors in listed companies has become more significant than in previous decades. These investors are usually institutions that manage large pools of assets and invest their clients' money in listed company shares (e.g., pension fund managers, private equity firms and banks). Institutional investors have played a huge role in improving and promoting good corporate governance, becoming an influential counterweight to the controlling shareholders of Chile's concentrated capital market.

The Corporations Act contains the one-share-one-vote rule, recognising the proportionality principle for voting rights. The equal voting right, however, is subject to certain exceptions, as the by-laws may contemplate one or more preferred series of shares, without or with limited voting rights. Preferred shares must have fixed-term duration and may not grant dividend rights over distributions that do not derive from net income, retained earnings and their individual appreciation in value.

Because of the high ownership concentration of Chilean listed companies, shareholders (and specially controlling shareholders) usually have a strong influence on the board. Many business groups that control Chilean listed companies are family-owned, and in some cases family members are involved in top management positions.¹² Nevertheless, the Corporations Act clearly provides that directors elected by a group or class of shareholders may not represent their own interest to the detriment of the company and other shareholders.

The Corporations Act expressly provides for certain matters that are reserved to shareholders, which are to be decided in either regular or special shareholders' meetings. Regular meetings are held once a year, as provided in the by-laws of the company, and decide on matters that expressly relate to approving the company's financial statements, dividend distributions, election or revocation of the board members and appointment of auditors, among other things. In turn, special shareholders' meetings are held at any point where it is necessary to decide on material matters, including by-law amendments, corporate conversions, mergers and spin-offs, bond issuances, the transfer of all or substantially all of

10 A recent study concluded that although there has been a reduction of the frequency of increases in ownership concentration since 2000, it has not led to a quick ownership dilution. See M Donelli et al., 'Ownership Dynamics with Large Shareholders: An Empirical Analysis', *Journal of Financial and Quantitative Analysis*, 48(2) (2013), 582.

11 A study made in the year 2000 showed 70 per cent of non-financial listed companies in Chile belonged to a business group. See Fernando Lefort and Eduardo Walker, 'Ownership and Capital Structure of Chilean Conglomerates: Facts and Hypotheses for Governance', *Abante* 3(1) (2000), at 15–16.

12 See Fernando Lefort, 'Ownership Structure and Market Valuation of Family Groups in Chile', Pontifical Catholic University of Chile (2005).

the company assets, the furnishing of collateral or personal guarantees to secure third-party obligations (except in the case of subsidiaries, in which case the board's approval will suffice), the dissolution of the company and other similarly relevant matters.

Dissenting shareholders enjoy appraisal rights to demand from the company a buyout for their shares at market value if they vote against certain fundamental matters, including conversion or merger of the company, the transfer of all or substantially all of the company's assets, the furnishing of collateral or personal guarantees to secure third-party obligations, defects in the company's organisational documents making it subject to actions of annulment, and the creation of preferred shares, among other things. Appraisal rights must be exercised within 30 days after the shareholders' meeting that gave rise to the dissenting shareholders' appraisal right. The market value for shares that are traded on stock exchanges will be the weighted average of the stock market transactions of the shares during a period of 60 trading days between the ninetieth and thirtieth day prior to the shareholders' meeting that gave rise to the dissenting shareholders' appraisal right.

ii Shareholders' duties and responsibilities

Chilean law does not expressly contemplate fiduciary duties and liabilities applicable to controlling shareholders; therefore, they are subject to the general liability rules applicable under Chilean civil law. In any case, the Corporations Act provides that all shareholders must always act respecting the rights of the company and of the other shareholders, which may be construed as an express prohibition for all shareholders against exercising their rights abusively.

iii Shareholder activism

Given the concentration of corporate control in Chile, the only kinds of investors that conduct a certain kind of activism are institutional investors.

Institutional investors (such as pension fund managers, private equity firms and financial entities acting for their clients) usually play an important role in negotiating with controlling shareholders the structure, terms and conditions of certain transactions in which listed companies participate. Pension fund managers are subject to their own rules and regulations, and may only invest up to 7 per cent of an issuer's equity. In many cases, this ownership percentage allows them, acting either individually or jointly, to secure a board seat and, therefore, to closely monitor the management's performance.

The Chilean legislator has to some extent promoted shareholder activism by including in the Corporations Act, in the year 2000, a derivative action that any shareholder or group of shareholders representing at least 5 per cent of the voting shares, or any board member, may bring on behalf of the company against anyone who may prove to be liable for damages arising from, or losses incurred by the company as a result of, a breach of applicable laws and regulations, or of the company's by-laws. The shareholder or board member must be pursuing a corporate right (as opposed to an individual right) to procure a court judgment in the company's favour. However, this option to bring an action is rarely exercised in practice.¹³

13 See David Núñez And Diego Pardow, '¿Por qué no demandan los accionistas? El problema de las costas en la acción derivativa', *Estudios Públicos* No. 118 (2010).

VI OUTLOOK

A bill to reform the Chilean capital market institutions has been just approved by Congress and is expected to be enacted shortly. Although this bill could still undergo amendments before its definitive enactment, it will have a significant impact on the corporate governance regime in Chile. This legal reform includes the creation of the FMC, a new supervisory body that will replace the SVS. The FMC will be led by a commission rather than a single individual (as is the case with the SVS), which will probably guarantee a more technical approach in line with that of the Central Bank of Chile, which is also led by a commission. In addition, the FMC's responsibilities will be apportioned to different internal divisions, a new legal procedure for the investigation and sanctioning of legal infractions will be implemented, and a whistle-blower mechanism will be established.

We foresee that corporate governance will continue evolving in Chile in the coming years. We expect institutional investors to continue being the most relevant counterbalance to controlling shareholders in our highly concentrated market, as only they have the required negotiation power and sophistication for that purpose. Authorities such as the National Consumer Service and private consumer associations, helped by mass media, are gaining influence by claiming and recovering damages arising from corporate misconduct such as board liability and anticompetitive practices, and their influence and power will probably strengthen in the near future. Finally, the recent successful launch of an IPO by a retail corporation confirms that capital markets activity will probably be strengthened in the next few years, as other companies have also expressed their intention to list themselves on one or more Chilean stock exchanges.

CHINA

*Sherry Gong*¹

I OVERVIEW OF GOVERNANCE REGIME

In accordance with the People's Republic of China (PRC) Company Law (hereinafter Company Law), companies in China are classified as limited liability companies (which are analogous to LLCs under some common law jurisdictions) or stock limited companies (SLCs) (which are similar to incorporations under some common law jurisdictions). A listed company, pursuant to the Company Law, refers to an SLC whose stocks are listed and traded on a securities exchange. The State Administration for the Industry and Commerce (SAIC) in charge of company registration is the major government authority supervising the corporate governance of LLCs and unlisted SLCs by reviewing the non-listed companies' incorporation documents and mandatory filings for the change of registration in accordance with the Company Law and various regulations in relation to company registration. The China Securities Regulatory Commission (CSRC) is authorised to supervise the corporate governance of listed companies in accordance with the Company Law, the Securities Law of the People's Republic of China and various listing rules. Each of the Shanghai Securities Exchange and the Shenzhen Securities Exchange has also issued non-binding guidelines for the corporate governance of companies listed on the corresponding securities exchange. In general, listed companies are subject to more stringent corporate governance requirements than non-listed companies in China.

Companies in China can also, by reference to the place of incorporation of the shareholders, be divided into foreign-invested enterprises (where the shareholders include foreign economic entities or individuals) or domestic companies (where all shareholders are Chinese entities or individuals). Foreign-invested enterprises can be set up in the form of wholly foreign-owned enterprises (WFOEs), where all shareholders are foreign economic entities or individuals; Sino-foreign equity joint venture companies (EJVs), which must get a legal personality, or Sino-foreign cooperation joint venture companies (CJVs), which is more flexible with corporate structure. Though each of WFOE, EJV and CJV is actually an LLC, a special corporate governance regime has been set up for EJVs and CJVs respectively in accordance with the Sino-Foreign Equity Joint Venture Enterprise Law and the Sino-Foreign Cooperative Joint Venture Enterprise Law.

On 3 September 2016, the Standing Committee of the National People's Congress issued a new Decision on Revising the WFOE Law, EJV Law and CJV Law, effective as of 1 October 2016. Before this new Decision, the establishment of, and changes to, a foreign-invested enterprise were subject to examination and approval by the Ministry of

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Commerce (MOFCOM) or its local branch. Following this new Decision, if a foreign-invested enterprise is not engaged in any area subject to special market access administration measures, its establishment and changes only need to do a record filing with the MOFCOM. In other words, the foreign-invested enterprises approval system was simplified into a record-filing procedure. In addition, previously, changes to a foreign-invested enterprise, such as equity transfer and amendment to the articles of association, took effect upon the approval of the MOFCOM. Now, these changes will take effect upon the decision of the company's highest authority. There is a trend to harmonise the special corporate governance regime for foreign-invested enterprises with the general regime for all LLCs.

There are very strict listing rules in China and SLCs are normally transferred from the LLCs with the aim to get listed soon and thus majority companies in China, especially foreign-invested companies, are LLCs. Therefore in this chapter, we focus mainly on the corporate governance of LLCs with reference to non-listed SLCs where necessary.

II CORPORATE LEADERSHIP

i Board structure and practices

For LLCs and SLCs, the shareholders' meeting is the highest business-decision-making body of the company and the board of directors is the enforcement organisation of the shareholders' meetings. As for LLCs with relatively few shareholders or of a relatively small size may have one executive director as an alternative of the board of directors. The executive director may concurrently hold the post of the manager of the company. A special rule for EJV and CJV is that they are not required to hold shareholders' meetings, in which case, the board of directors is the highest authority in lieu of shareholders' meetings.

Composition, appointment and dismissal

Number of board members

LLCs shall have a board of directors that is to be composed of three to 13 members unless the executive director structure is adopted in lieu of a board of directors. SLCs shall have a board of directors that is to be composed of five to 19 members. EJV and CJV typically have boards of directors consisting of no less than three directors.

Elections

Directors who are not the representatives of the staff members are elected and appointed by the shareholders by a simple majority unless the articles of association provide otherwise. For EJV and CJV, the shareholders will agree on the number of directors appointed by each shareholder in the joint venture contract and the directors will be appointed by a shareholder without going through the election process.

Representatives of the staff members

The Company Law has special requirements for appointing the representatives of the staff members as directors. In the case of an LLC established with investment from two or more state-owned enterprises or two or more other types of state-owned investing parties, the members of its board of directors must include the representatives of the staff members of the company; in the case of any other LLC and SLC, the members of its board of directors may include representatives of the staff members of the company. The representatives of the

staff members in the board of directors shall be elected democratically through a general meeting of the representatives of the staff members, general meeting of staff members, or in other forms.

Chairman

The board of directors must have a chairman. For LLCs, the methods for election of chairman shall be specified in the articles of association. For SLCs, the chairman shall be elected by more than half of all the directors. Chinese laws do not make a distinction between executive directors and non-executive directors. The chairman has no additional cast voting at board meetings unless the articles of association provides otherwise.

Legal responsibilities

Statutory powers

The Company Law grants certain statutory powers to the board of directors or executive director (the statutory powers) in both LLCs and SLCs as below, to:

- a* be responsible for convening shareholders' meetings and presenting reports to the shareholders' meeting;
- b* implement resolutions adopted by the shareholders' meeting;
- c* determine the company's business plans and investment plans;
- d* prepare annual financial budget plans and final accounting plans in relation to the company;
- e* prepare profit distribution plans for the company and plans for making up any losses suffered by the company;
- f* prepare plans for increasing or reducing the company's registered capital and for issuance of corporate bonds;
- g* formulate plans for mergers, divisions, changes of corporate form or the dissolution of the company;
- h* determine the company's internal management structure;
- i* determine the appointment or removal of the company's manager and determining matters relating to his remuneration, appointment or removal, and upon the manager's recommendation, the appointment or removal of deputy managers of the company, the officer in charge of finance, and matters relating to determining their remuneration; and
- j* formulate the basic management system for the company.

The board of directors can be granted such other powers as are prescribed in the company's articles of association. There is no rule prohibiting any restriction of non-statutory powers.

The resolutions of the board of directors can be overridden by a resolution of a shareholders' meeting, in which case, the matter will be returned to the board of directors for reconsideration.

Right to sue

As in the case of derivative actions by shareholders, where supervisors acting in breach of their duties cause losses to the company, the board of directors or the executive director may file an action with court upon the written request of the aforesaid shareholders.

Power of convening interim shareholders' meetings

For LLCs, an interim shareholders' meeting must be held if so proposed by the shareholders representing more than one-tenth of the voting rights, or more than one-third of the directors or board of supervisors or supervisors in lieu of the board of supervisors. For SLCs, an extraordinary general meeting shall be held within two months where the board of directors deems it necessary to hold the extraordinary general meeting.

Special committees

The board of directors of a listed company shall, according to the relevant resolution of the general meeting of shareholders, establish special committees for strategies, auditing, nomination, remuneration and assessment, etc. Members of the special committees shall be composed of directors. Each special committee shall be responsible to the board of directors, and the proposals of each special committee shall be submitted to the board of directors for examination and decision. Chinese financial regulators require certain financial institutions to have special committees in the board of directors.

Board meetings

The meetings of the board of directors shall be convened and presided over by the chairman of the board of directors. One person shall be entitled to only one vote in voting on a resolution of the board of directors.

For LLCs, the rules of procedure and voting procedures of the board of directors shall be set forth in the company's articles of association. For SLCs, the board of directors shall convene at least two meetings annually. Shareholders representing more than one-tenth of the voting rights, more than one-third of all directors, or the board of supervisors may propose to convene an interim meeting of the board of directors. A meeting may be held only when more than half of all the directors are present. A resolution of the board of directors shall be passed by more than half of all the directors.

ii Directors

Term, qualification and remuneration

For LLCs and SLCs, the term of office of a director of a company shall be specified in the company's articles of association, subject to a maximum of three years. The term of office of a director may be renewed upon expiry thereof in the case of successful re-election.

Under the Company Law, the following circumstances will disqualify a candidate (disqualified person) from serving as a director of a company:

- a* the person does not have legal capacity;
- b* the person was criminally penalised for economic offences in the past five years;
- c* the person was a director or the person in charge of an enterprise that was declared bankrupt in the past three years and that person was responsible for the bankruptcy;
- d* the person was the legal representative of an enterprise, with respect to which the competent authority revoked its business licence or issued a closure order against that company in the past three years; or
- e* the person is in significant indebtedness that has become overdue.

The appointment of a disqualified person to serve as the director is void. A director who has become a disqualified person during the term of his or her appointment must be removed from the office.

For LLCs and SLCs, the shareholders' meeting has the right to decide the remunerations of the directors and supervisors. SLCs shall regularly disclose to its shareholders information on the remunerations received by the directors, supervisors and senior management personnel from the company.

Liability

Fiduciary duty and duty of care

A director owes a fiduciary duty to the company and is prohibited from engaging in the following activities under the Company Law:

- a* misusing company funds;
- b* depositing funds owned by the company in an account in his or her own name or in another person's name;
- c* lending company funds to others, or using company funds to provide security to others in breach of the provisions of the company's articles of association, and without the consent of the shareholders' general meeting, the shareholders' meeting or the board of directors;
- d* entering into a contract with the company, or entering into a transaction in breach of the provisions of the company's articles of association, or without obtaining the consent of the shareholders' general meeting or the shareholders' meeting;
- e* taking advantage of his position to appropriate for himself or herself or a third party a commercial opportunity that should belong to the company, or himself or herself or for the benefit of third party operating a similar business as that of the company in which he holds office, without obtaining shareholders' general meeting or shareholders' meeting consent;
- f* appropriating the commission for a third party's transaction with the company for himself or herself; or
- g* revealing company secrets without authorisation.

Gains made in breach of the aforementioned fiduciary duties can be claimed by the company.

A director owes a duty of care to the company under the Company Law and the General Provisions of the Chinese Civil Code. A director must exercise due care in the course of exercising his or her statutory powers as well as other powers provided in the articles of association. The director also has a duty to comply with the requirements stipulated in the relevant laws, regulations, and the articles of association of the company.

Conflicts of interest

As noted above, the director is prohibited from engaging in competing with the company for business without the consent of the shareholders or the board of directors.

Liability for compensation

The director who makes use of his or her affiliation to prejudice the interests of the company shall be liable for compensation if he or she causes any loss to the company.

For SLCs, the directors shall be liable for the resolutions of the board of directors. If a resolution of the board of directors is in violation of laws, administrative regulations, the company's articles of association or a resolution of its general meeting, and causes heavy losses to the company, the directors who participated in adopting the resolution shall be liable for compensation, with the proviso that a director may be exempted from liabilities if it is proved that he or she expressed objections at the time of voting and the objections were recorded in the meeting minutes.

Where any director violates laws, administrative regulations or the company's articles of association during the performance of duties, he or she shall be liable for compensation if any loss is caused to the company.

For SLCs, directors are obliged by statute to establish a liquidation committee in the event of dissolution, as well as fulfil other obligations in relation to the preservation of assets of the companies. Failure to discharge these duties will make the directors jointly and severally liable to creditors to the extent of the losses so caused. These obligations are not applicable to directors of LLCs, with respect to which, these obligations are imposed upon shareholders.

Other duties

Duties owed to the company

The directors owe a fiduciary duty and a duty of care to the company. The company can sue the directors who have breached these duties. The board of supervisors is also entitled to sue the directors in the name of the company.

Duties owed to shareholders

The directors owe a duty of care to shareholders. The directors shall attend a shareholders' meeting or a general meeting and accept the inquiries from shareholders upon the requirement of the meeting. The directors who acted in breach of laws, regulations, or the articles of association of a company, thus causing losses to a shareholder, can be sued by the shareholder.

Duties owed to creditors

As noted above, in the case of liquidation, directors of SLCs can be sued by creditors when they fail to fulfil some certain obligations by statute.

The directors registered on the official registrar of the relevant company can be sued. The concept of shadow director or *de facto* director is not recognised under Chinese laws.

Outside director

In China, only listed companies and some state-owned companies are required to have outside directors who are normally professionals such as lawyers and accountants.

iii Special governing bodies in China

Supervisory board

Elections

Supervisors who are not the representatives of the staff members are elected and appointed by the shareholders by a simple majority unless the articles of association provide otherwise. The directors or senior management personnel shall not concurrently hold the posts of supervisors.

Number of members of the supervisory board

LLCs and SLCs shall have a board of supervisors that is to be composed of at least three members. LLCs with relatively few shareholders or of a relatively small size may have one or two supervisors instead of a board of supervisors.

Representatives of the staff members

For LLCs and SLCs, the board of supervisors shall include representatives of the shareholders and an appropriate proportion of representatives of the staff members of the company. The specific proportion of the latter shall be specified in the company's articles of association, subject to a minimum of one-third. The election method of representatives of the staff members as supervisors is the same as that of the directors.

The term of office of a supervisor shall be three years. The term of office of a supervisor may be renewed upon expiry thereof in the case of successful re-election. The circumstances that will disqualify a candidate from serving as a supervisor are as same as those conditions specified above in the qualification of directors. The board of supervisors shall have one chairman. For LLCs and SLCs, the Chairman shall be elected by more than half of all the supervisors.

Legal responsibilities

Statutory powers

The board of supervisors or, in the absence thereof in a company, the supervisors shall exercise the following powers:

- a* conducting inspection of the financial issues of the company;
- b* supervising the performance of duties by the directors and senior management personnel, and submitting a proposal on the removal of any director or senior management person who violates laws or administrative regulations, the company's articles of association, or any resolution of the shareholders' meeting;
- c* requiring the directors or senior management personnel to correct their conducts that prejudice the interests of the company;
- d* proposing to convene interim shareholders' meetings, and convening and presiding over shareholders' meetings when the board of directors fails to perform the duties of convening and presiding over shareholders' meetings as specified in this Law;
- e* putting forward proposals to the shareholders' meeting; and
- f* filing actions against the directors or senior management personnel in accordance with the Company Law.

For most LLCs, the board of supervisors or the supervisors usually take passive roles in practice without much involvement in the operation of the company.

Power of questioning

The supervisors may attend the meetings of the board of directors as non-voting participants, and may raise questions or suggestions on the matters decided by the board of directors. The board of supervisors or, in the absence thereof in a company, the supervisors may conduct investigation when discovering any abnormality in the operating conditions of the company.

Right to sue

As in the case of derivative actions by shareholders, where a director or senior management person acting in breach of their duties causes losses to the company, the board of supervisors may file an action with court upon the written request of the aforesaid shareholders.

Liability

Fiduciary duty and duty of care

A supervisor shall abide by laws, administrative regulations and the company's articles of association. They shall be faithful and diligent to the company. No supervisor may, by abusing their powers, take any bribe or other illegal gains, or encroach on the property of the company.

Liability for compensation

The supervisor who makes use of their affiliation to prejudice the interests of the company shall be liable for compensation if he or she causes any loss to the company.

Where any supervisor violates laws, administrative regulations or the company's articles of association during the performance of duties, he or she shall be liable for compensation if any loss is caused to the company.

Other duty

Where a supervisor is required to attend a shareholders' meeting or a general meeting as a non-voting participant, the supervisor shall do so and accept the inquiries from shareholders.

Legal representative

In China the legal representative has a statutory power and apparent attorney to represent the company in commercial transactions and before the government authorities, arbitration tribunals or a court. The legal representative may only be served by the chairman and the general manager of the company. The legal representative can be held responsible for the harmful acts or omissions of the company even where he or she has no actual knowledge of the actions or omissions, such as when the company causes environmental damage or there is non-compliance with health and safety standards of the company.

Because of the significance of the position, the legal representative is also normally the chairman of the board of a purely domestic company, or sometimes a general manager or a factory head for state-owned enterprises. He or she has the authority to represent the company to enter into commercial transactions, to conduct litigation in the name of the company, and to transact business with the government authorities in relation to administrative matters.

The company may restrict the authority of the legal representative in the articles of association or shareholders' agreement. In the event that the legal representative acts outside his or her scope of authority, the company will be entitled to claim damages suffered as a result of the *ultra vires* of the legal representative. However, this restriction will not be binding on any relevant third party unless the third party is acting in bad faith in the sense that it has actual or attributed knowledge on the restricted authority of the legal representative.

III DISCLOSURE

As mentioned above, the focus of this chapter is LLCs instead of listed companies. For private companies, disclosure is more of an issue for protecting the interests of minority shareholders. In accordance with the Company Law, shareholders of an LLC are entitled to inspect and take copies of the articles of association, the minutes of shareholder meetings, the minutes of board meetings, the minutes of supervisory board meetings, and financial accounting reports relating to the company.

Shareholders of an LLC are also entitled to inspect the accounting books of the company. To inspect the accounting books, a shareholder must submit a written application to the company stating the purpose of the inspection. In the event that the company has reasonable grounds for thinking that the purpose of the shareholder in inspecting the accounting books is inappropriate, and is likely to prejudice the legitimate rights and interests of the company, the company may refuse to allow inspection, and shall, within 15 days of the date on which the shareholder submits its written application, give a written reply to the shareholder stating the reasons for refusal to grant access. In the event that the company refuses to allow inspection, the shareholder may apply to the People's Court to compel the company to allow inspection.

IV CORPORATE RESPONSIBILITY

There are no specific legal requirements in China regulating corporate social responsibility of non-listed or listed companies. However, more and more major companies are aware of the issues and are taking corporate social responsibilities in certain forms, such as establishing charity funds and breaking the glass ceiling for women.

V SHAREHOLDERS AND SHAREHOLDERS' MEETING

Companies are established based on the capital contribution of shareholders. In accordance with the Company Law, a LLC shall have no more than 50 shareholders while an SLC shall not exceed 200, and by deciding clause of articles of association and choosing directors and managers, shareholders control the company.

i Shareholders' rights and liabilities

After registering in the shareholder register book, shareholders can start to enjoy their various rights:

- a* right to know (inspect the accounting books; inspect and duplicate the company's articles of association, the minutes of the shareholders' meetings, the resolutions of the board of directors, the resolutions of the board of supervisors, and the financial and accounting reports of the company);
- b* rights to vote (in proportion to their respective capital contributions with each share having equal voting power);²
- c* rights to receive dividends (in proportion to the actual capital contributions paid up by them);

² China does not recognise different classes of shares in general.

- d* rights to get remaining property after liquidation of the company; and
- e* right to sue (for damaging interests or unlawful procedure of meetings; directly or indirectly).

As for liabilities, any shareholder of a company that has caused any loss to the company or to other shareholders by abusing shareholder's rights shall be liable for compensation in accordance with the Company Law. If any shareholder of a company evades debts by abusing the independent legal person status of the company or by abusing the shareholder's limited liabilities, thereby gravely prejudicing the interests of the creditors of the company, the shareholder shall be jointly and severally liable for the debts of the company.

ii Dissenting shareholders' rights

Although a general redemption right is not available to shareholders in China, under any of the following stipulated circumstances, a shareholder of a company who votes against a resolution of the shareholders' meeting may request the company to redeem their equity in the company at a reasonable price:

- a* where the company fails to distribute any profit to its shareholders for five consecutive years, while being profitable during those five consecutive years and satisfying the conditions on profit distribution specified in this Law;
- b* where the company is merged or divided, or it transfers its primary property; or
- c* where upon the expiration of the term of operation specified in the company's articles of association or the occurrence of any other cause of dissolution specified therein, a resolution is adopted at a shareholders' meeting to modify the articles of association to the effect that the company continues to exist.

If the shareholder fails to reach an agreement with the company on equity redemption within 60 days after the resolution of the shareholders' meeting is adopted, the shareholder may file an action with a competent people's court within 90 days after the resolution of the shareholders' meeting is adopted.

And where a company faces difficulty in operations and management such that the interests of its shareholders will suffer heavy losses if the company continues to exist, and there is no other way to resolve the problem, the shareholders representing more than 10 per cent of the voting rights of all the shareholders of the company may file a request with the competent people's court to dissolve the company.

According to a judicial interpretation of Supreme People's Court, difficulty in operation and management refers to situations as:

- a* the company fails to hold a shareholders' meeting or a general meeting of shareholders for at least two consecutive years, and the operation and management of the company encounters severe difficulties;
- b* the proportion required for adopting a resolution during a vote does not reach the statutory proportion or the proportion specified by the articles of association of the company, and no valid resolution of the shareholders' meetings or the general meetings of shareholders have been reached for at least two consecutive years, and the operation and management of the company encounters severe difficulties;
- c* conflict exists among the directors of the company for a long time, which cannot be settled through the shareholders' meetings or the general meetings of shareholders, and the operation and management of the company encounters severe difficulties; or

- d* other circumstances where the operation and management of the company encounters other severe difficulties and the continuance of the company's existence may cause major losses to the interests of the shareholders.

iii Derivative action

Derivative Action also applies under the Company Law. Where a director, supervisor or senior management person violates laws, administrative regulations or the company's articles of association during the performance of duties, the shareholders of an LLC, or one shareholder of an SLC who holds, or several shareholders thereof who jointly hold, at least 1 per cent stake in the company for at least 180 consecutive days, may submit a written request to the board of supervisors (if to sue a director or senior management person) or board of directors (if to sue a supervisor) to file an action with the competent people's court. Where the board of supervisors or board of directors refuse to or fail to file an action within 30 days or where the failure to immediately file an action in an emergency case will cause irreparable damage to the interests of the company, the shareholders specified in the preceding paragraph may, in their own name, directly file an action to the competent people's court for the interest of the company.

Where any other person infringes upon the legitimate rights and interests of the company and causes losses thereto the shareholders specified in previous paragraph may also file an action with the competent people's court pursuant to the procedure above.

iv Shareholders' meeting

The shareholders are the highest authority of a company and exercise their authority at shareholders' meetings, except that wholly state-owned companies, EJVs and CJVs are not required to hold shareholders' meetings, and in that case, the board of directors ascends.

As the company's governing body, the shareholders' meeting shall exercise the following powers:

- a* making decisions on the company's operation guidelines and investment plans;
- b* electing and replacing the directors and supervisors who are not the representatives of the staff members, and making decisions on the matters concerning the remunerations of the directors and supervisors;
- c* approving the reports of the board of directors through deliberation;
- d* approving the reports of the board of supervisors or those of the supervisors through deliberation;
- e* approving the annual financial budget plans and final accounts of the company through deliberation;
- f* approving the profit distribution plans and loss recovery plans of the company through deliberation;
- g* making resolutions on the increase or decrease of the company's registered capital;
- h* making resolutions on the issuance of corporate bonds;
- i* making resolutions on the merger, division, dissolution or liquidation of the company or on the conversion of the corporate form;
- j* modifying the company's articles of association; and
- k* exercising other powers specified in the articles of association.

VI OUTLOOK

The Company Law was amended significantly for the purpose of improving the corporate governance in 2006 (2006 Company Law Amendments). These amendments reduced the power of the chairman of the board of directors, emphasised the role of the board of supervisors, and clarified the duties of the directors. They also provided protections to minority shareholders.

However, there are areas for further improvement in relation to corporate governance under the Company Law. It is often argued that some of those provisions in the Company Law are drafted in a manner that is too abstract and that has rendered their enforcement difficult. Sometimes, these have given the courts considerable discretion in the application of the relevant provisions in the Company Law, which has created some uncertainties in the enforcement and observation of good corporate governance practice.

As China continues with its rapid economic development, the National People's Congress and the State Council will address these areas for improvement. In addition, the Supreme People's Court has often taken the step of issuing interpretations of laws for application by first instance and intermediate people's courts to resolve unclear topics. Given the size of the national economy and the complexity of China's bureaucracy, these improvements are not likely to come about rapidly.

There is also a trend to harmonise the special corporate governance rules for foreign-invested companies with the general rules provided in the Company Law. For example, there is no clear stipulation on a WFOE's highest authority in law. Before the 2006 Company Law Amendments, the government approval and registration authorities in China were of the view that WFOEs should follow the rules for EJVs and CJVs and thus the articles of association of a WFOE are required to provide that its board of directors is the highest authority. After the 2006 Company Law Amendments, however, as a demonstration of the trend to harmonise the rules governing foreign investment companies and the general rules in the Company Law, the shareholders' meeting is required to be set out as the highest authority of the WFOE in its articles of association. This trend can be seen in the proliferation of legislation initiatives, such as the issuance of the draft Foreign Investment Law by the MOFCOM on 19 January 2015 (Draft Foreign Investment Law) with the purpose of reforming the whole foreign investment administration regime. According to the Draft Foreign Investment Law, there should be no exceptional rules for the corporate governance of foreign investment companies after it becomes effective. The Law is still in draft form at present. Another example is the Interim Administrative Measures for Record-Filing of Establishment and Alteration of Foreign-Invested Enterprises issued by the MOFCOM on 8 October 2016, which sets forth provisions regarding the applicability of record filing, record-filing procedures, supervision and inspection, legal liability, etc., to implement the new record-filing reform introduced in October 2016, as mentioned above.

CYPRUS

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I OVERVIEW OF GOVERNANCE REGIME

i Legislation and supervision

Corporate governance is relevant to both private and public companies. Nevertheless, this chapter will focus on corporate governance rules, applicable to public limited companies listed on the Cyprus Stock Exchange (CSE).

In Cyprus, the Department of the Registrar of Companies and Official Receiver (DRCOR) is responsible for the registration, compliance and winding up of companies, while the approvals for listing on the CSE are granted by the Cyprus Securities and Exchange Commission (CySEC).

CySEC is the independent public supervisory authority responsible for the supervision of the investment services market and transactions in transferable securities; its mission is to exercise effective supervision to ensure investor protection and the healthy market development.

The core legislative provisions are included in the Cyprus Companies Law, Cap 113 (Companies Law). This law initially mirrored the provisions of the UK Companies Act 1948, but it has not followed the subsequent amendments of the UK legislation. Cyprus courts, however, seem to follow to a great extent the UK-developed case law. The Companies Law governs the provisions of a Cyprus company's memorandum and articles of association. Public and private companies may also adopt in whole or in part the model regulations contained in Table A of the Companies Law.

Common law principles also apply, such as those concerning the fiduciary duties of directors, or, for example, the duty to act in good faith and for the benefit of the company.

The relevant legislative framework, applicable to Cyprus-listed companies, also consists of:

- a* the Cyprus Securities and Stock Exchange Laws of 1993–2007, as amended (and relevant regulations);
- b* the Cyprus Securities and Exchange Commission Law 73(I)/2009, as amended;
- c* the Transparency Requirements Law 190(I)/2007, as amended (the Transparency Law);
- d* the Investment Services and Activities and Regulated Markets Law, 144(I)/2007;
- e* the Takeover Bids law of 2007, Law 41(I) of 2007 as amended (the Takeover Bids Law);

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- f* the Market Abuse Law 102(I)/2016 (the Market Abuse Law), which repealed the Inside Information and Manipulation of the Market (Abuse of the Market) Law 116(I)/2005; and
- g* the Corporate Governance Code (4th edition), April 2014 (the Code).

The Transparency Law, the Takeover Bids Law and the Market Abuse Law have implemented the relevant EU Directives.

CySEC issues directives and circulars regularly, supplementing the relevant regulatory framework. Its main responsibilities include the supervision of the CSE and of issuers of listed securities, the licensing of investment firms and the imposition of administrative sanctions and penalties for infringement of the stock market laws and regulations.

Following the recession that hit the Cyprus stock market in 2000, the CSE issued in 2002 the first corporate governance code purporting to introduce a set of corporate governance principles, offering additional protection to the shareholders of listed companies. Currently, the fourth revised version of the code applies, issued in April 2014.

The Code contains a set of legal principles, rather than inflexible legal rules. It is only obligatory for companies listed on the Main Market and, in part, it is also mandatory for companies listed on the Parallel Market. Its aims include strengthening the monitoring role of the board in listed companies, protecting small shareholders, adopting greater transparency and providing timely information as well as sufficiently safeguarding the independence of the board in its decision-making. Private companies are not bound by its provisions but are encouraged to consider it as guidance and utilise it as a best-practice model.

Moreover, Cyprus, as an EU member state, implements and complies in full with all relevant European directives and regulations.

ii Recent developments and trends

Recent studies indicate a positive tendency in adopting the Code, with almost 50 per cent of public companies complying at least partially with it.

The increase in the proportion of women on boards constitutes one of the main challenges in corporate governance. Currently, the percentage of female representation on the boards of public listed companies is significantly lower than the EU average. According to recent European Commission studies regarding the 20 largest listed companies in Cyprus, and based on data collected in April 2016, only 5 per cent of chairpersons are female, and 11 per cent of board members are female. In any case there is a higher level of female representation among non-executive directors. There has been an improvement in the proportion of female board members in recent years; however, the European Commission considers the rate of change to be too slow. The target is for 40 per cent of the members of non-executive boards of publicly listed companies to be women by 2020.

Relevant challenges have also arisen out of the banking crisis of 2013. It has been identified that the weaknesses in corporate governance practices in Cypriot banks were an essential cause of the banking crisis. This has led to the widespread view that a stricter framework and higher standards of corporate governance are required to promote correct behaviour in the interests of all stakeholders. To this extent, in April 2015 legislation was passed to amend the provisions of the Companies Law relating to insolvency.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure and composition of the board of directors

The Companies Law provides for a standard one-tier board structure for all companies.

The Code provides that every listed company should be headed by an effective board of directors, leading and controlling the company. It should function on the basis of the principle of collective responsibility and none of its members should absolve themselves from responsibility.

Pursuant to Section A.2 of the Code the board should include a balance of independent non-executive directors and remaining directors, such that no individual director or small group thereof can dominate the decision-making process. The board should contain a sufficient number of non-executive directors, with adequate abilities, knowledge and experience, so their opinion carries significant weight in the decision making.

The board exercises its power as a whole; in principle, its powers are not delegated to individual directors, except for the establishment of specific committees (analysed below). In any case, an individual director can represent and act on behalf of the company if so authorised by a board resolution, and an attorney can be appointed to represent the company pursuant to a power of attorney granted by the company, again following a relevant board resolution, and provided that the articles of association of the company allow it.

According to the Code, the roles of the chairman of the board and the chief executive officer should not be exercised by the same individual. The division of responsibilities between them should be clearly established, set out in writing and agreed by the board.

Legal responsibilities

The board of directors should meet regularly, at least six times per year, and these meetings should have a formal schedule of matters. The chairman is responsible for the proper running of the meetings and should ensure that the items on the agenda are sufficiently supported by all available information. Moreover, the minutes should include all details regarding the resolutions taken and should be at the disposal of the directors as soon as possible, and in any case before the next meeting.

According to the Code, directors should decide on a number of matters especially reserved for them. These matters include, *inter alia*, the objectives and strategic policy of the company; its annual budget and business plan; significant capital expenditures; mergers, acquisitions and allocations of part of the company's assets; the adoption and any changes in the application of accounting principles; and the material transactions of the company and its subsidiaries.

Directors who have a personal interest in a matter should declare their interest and, depending on the articles, they may be excluded from voting or may not be counted for quorum purposes.

The board has a duty to issue the annual report on corporate governance, which includes, *inter alia*, an assessment of internal control and other financial operational and compliance systems, a verification that the company has not violated any relevant laws and regulations, and a reference to any loans granted, any guarantees provided and to the company's accounts.

Communication with shareholders

As regards the relationship between directors and shareholders, the Code includes the principle that the board should use the annual general meetings (AGMs) to communicate with investors and encourage their participation. The chairman should ensure that the president of each committee is available to answer the shareholders' questions posed at the AGMs. Also, the agenda and the organisation thereof should allow for substantial dialogue.

Section D.2 of the Code provides that corporate governance practices should stem from the principle of equitable treatment of all shareholders, including minority shareholders, and the procedures at the general meetings should guarantee the equitable treatment of all shareholders. All information pertaining to the company should be distributed fairly, in a timely and costless manner to all shareholders, who should also be given timely and precise reports on all material changes concerning the company.

ii Remuneration

Cyprus companies should establish a formal and transparent procedure for developing a policy on executive directors' remuneration and for fixing the remuneration packages of individual directors. Directors should not be involved in deciding their remuneration.

The Code provides that a remuneration committee should be established, consisting exclusively of non-executive directors so as to avoid potential conflicts of interest, to make recommendations to the board on the context and level of remuneration and to determine specific remuneration packages. At least one member with knowledge and experience of remuneration policy should be included in the committee.

The remuneration of directors is in any case approved by the shareholders at a general meeting. The level of remuneration should be sufficient to attract, retain and motivate the directors necessary to run the company successfully, but a company should not pay more than is necessary for this purpose. The remuneration of executive or managing directors should be in proportion to the remuneration of other executive or managing directors or other staff members of the company.

The Code recommends that a proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.

If part of the remuneration is related to performance, this part should be designed to align the directors' interests with those of shareholders and to provide them with keen incentives to perform at the highest levels. Performance criteria should be based on the long-term viability of the company and include non-financial criteria relating to creating long-term value at the company.

In any case, Regulation 76 of Table A of the Companies Law provides that the general meeting is able to determine the directors' remuneration. Also pursuant to Section 188 of the Companies Law, the relevant details must be included in the financial statements presented before the general meeting for approval.

iii Committees

The Code suggests the establishment of three different board committees; nevertheless, it encourages the board to form additional committees if necessary. Pursuant to Section A.4.1 of the Code, a nomination committee should be established, responsible for leading the process for board appointments and making relevant recommendations to the board. Moreover, Section B.1.1 of the Code provides for the formation of the remuneration committee, which makes recommendations on the remuneration policy, while Section C.3.1 of the Code

provides for the establishment of the audit committee. This committee, *inter alia*, submits proposals for the appointment, termination and remuneration of the auditors and keeps under continuous review the scope and results of the audit, its cost-effectiveness and the independence and objectivity of the auditors.

iv Directors

Appointment and term of office

The principle is that there should be a formal and transparent procedure for the appointment of new directors, who should be competent and suitable. Section A.4.2 of the Code provides that the appointment of suitable and competent persons should also take into consideration their honesty and integrity as well as their knowledge and experience.

As outlined above, the procedure for appointments is led by the nomination committee. Non-executive directors should be appointed for a specific term and their re-election should not be automatic. All directors should be subject to election by the shareholders at the first AGM after their appointment, and to re-election thereafter at intervals of no more than three years.

The first directors are appointed either by being named in the articles of association or pursuant to a regulation that provides subscribers with the relevant power to appoint them. Subsequent directors are elected by the shareholders as prescribed in the articles. It is also customary that the board is entitled to appoint a director for the purposes of filling a casual vacancy or as an addition to the existing directors, provided that the maximum number of directors specified in the articles is not affected.

Section 178 of the Companies Law provides that a company can, by ordinary resolution, remove directors before the expiration of their period in office. However, the director concerned has the right to submit written representations. A recent amendment of the Companies Law has stipulated that the articles cannot provide for a greater majority for the removal of directors than that required by Section 178.

Role of non-executive directors

The involvement of non-executive directors in the management of the company is essential since it ensures board balance, and so avoids situations where a single director dominates the decision-making process.

The independence of non-executive directors is safeguarded by the Code itself, since it sets certain minimum requirements for their appointment. For example, non-executive directors should not have any business or close family ties with other members of the board or shareholders, or any other material relationship with the company that by its nature may affect their independent and unbiased judgement. Also, a non-executive director should not have been an employee of the company during the past five years.

Also, the participation of non-executive directors in the various board committees is important since it safeguards transparency, especially with regard to the appointment and remuneration process, and contributes to the avoidance of possible conflicts of interests.

Legal duties and liability of directors

In general, directors must act in good faith, in the best interests of the company and for the benefit of its shareholders as a whole, and in doing so they should consider the long-term consequences of their decisions and the impact on the company's reputation in the market.

Directors owe a fiduciary duty to the company to manage it pursuant to the Cypriot and European laws and regulations, and to its memorandum and articles of association. When in breach of this duty, they are liable for any loss and damage caused by illegal or *ultra vires* acts.

Furthermore, a duty of care in common law exists, which includes a duty not to act negligently in managing the affairs of the company. Nevertheless, pursuant to Section 383(1) of the Companies Law, if directors act honestly and reasonably according to the specific circumstances of the case, they cannot be held liable.

The directors are also responsible for the monitoring and settlement of any matters of conflicts of interest between executive directors and shareholders, including cases of mismanagement of assets or transactions with associated parties.

Furthermore, a number of statutory provisions impose various notification, disclosure and reporting duties on the directors, especially regarding the acquisition and disposals of shares in the company. A breach of statutory duties may result in sanctions and penalties.

III DISCLOSURE

The primary sources of the corporate governance disclosure requirements, other than the Companies Law, include the Code, the Transparency Law and the Market Abuse Law.

In any case, all Cyprus companies are subject to certain disclosure and notification requirements set out in the Companies Law, such as the maintenance of corporate registers, including the registers of shareholders, directors and charges; and the submission of annual returns to the DRCOR, including the audited financial statements for the previous year.

i The Code

The Code imposes an obligation on listed companies to include in the annual report a report on corporate governance by the board. In the first part of the report the company should specify whether it complies with the Code and the extent to which it implements its principles. The second part of the report should include a confirmation that the company has complied with the Code's provisions and, in the event that it has not done so, it should provide adequate explanation for its non-compliance.

Moreover, the company's report on corporate governance should contain a statement of the remuneration policy and related criteria as well as details of the remuneration of the executive and non-executive directors. It should be submitted to the shareholders each year and it is considered as the main vehicle through which the company reports to its shareholders in relation to the directors' remuneration.

It is also the board's responsibility to submit a balanced, detailed and understandable assessment of its position and prospects. This extends to all public reports, reports to regulators and information required to be presented by statutory requirements.

ii The Transparency Law

The Transparency Law applies to legal entities whose transferable securities have been admitted to trading on a regulated market, and it imposes a number of disclosure requirements. A number of amendments were introduced during 2016 in relation to the Transparency Law.

Financial disclosures

At the latest within four months after the end of each financial year, every company must disclose its annual financial report, including its annual financial statements, the directors' report, and a statement by the board and the general and financial directors confirming that the financial statements have been prepared according to the applicable accounting standards, that they provide a true and fair view of the financial position of the company, and that the directors' report provides a fair view of the development and performance of the business of the company. This report should remain available to the public for at least 10 years.

Moreover, at the latest within three months after the end of the first half of the financial year, every issuer of shares or debt securities must disclose half-yearly financial reports containing interim financial statements; an interim management report that contains, *inter alia*, a detailed and extensive economic analysis, a declaration of income deriving from extraordinary activities, comparative economic analysis with the previous year, and the principal risks and uncertainties for the year to come; and a relevant statement by the board. The half-yearly report must remain available to the public for at least 10 years.

Companies that operate in the mining industry or timber harvesting are subject to separate financial reporting requirements.

Entities that exclusively issue debt securities that are traded on a regulated market whose nominal value per unit is at least €100,000, or the equivalent in another currency, are exempt from the above requirements.

Ongoing obligations

A company acquiring or disposing of its own shares must disclose, at the latest within the next business day, the total amount of shares being acquired or disposed of, provided they amount to or exceed 5 per cent or 10 per cent of the total voting rights in the case of an acquisition, or amount to or fall below these thresholds in the case of a disposal. Furthermore, any change to the rights attached to a class of shares must be disclosed immediately. The company must also disclose, at the end of the relevant calendar month, an increase or decrease in its total capital and voting rights.

Upon receipt of any notification, the company must disclose all the information contained therein as soon as possible and in any event before the close of the next business day following receipt of the notification.

Where a proposal for the amendment of the company's memorandum and articles is made, the company must, as soon as possible, notify CySEC and the regulated market upon which the securities are traded and in any case before the general meeting for the examination of the relevant amendment is called.

Disclosures relating to the acquisition or disposal of shares with voting rights attached

Where a shareholder acquires or disposes of shares with voting rights attached, the company and CySEC must be notified of the percentage of rights held by that shareholder if, in the case of an acquisition, the percentage of voting rights reaches or exceeds specific thresholds or, in the case of a disposal, the voting rights reach or fall below the relevant thresholds. Similar obligations arise where an equivalent event occurs that alters the breakdown of the voting rights and where the voting rights are, *inter alia*, held by a third party. Similar provisions apply where financial instruments held in the company entitle the holder to acquire shares

with voting rights attached. In such cases the obligation to notify arises when, at the date of maturity, the holder has an unconditional right to acquire the underlying shares or the discretion to acquire the shares.

iii The Market Abuse Law

Further disclosure obligations are imposed by the Market Abuse Law, which has been implemented for the purposes of the effective application of Regulation (EU) No. 596/2014 of the European Parliament and of the Council on market abuse (the Market Abuse Regulation). The aim of the Market Abuse Regulation and the Market Abuse Law is effectively to enhance market integrity and investor protection, and at the same time eliminate insider dealing and market manipulation. Companies that deal in financial instruments traded on a regulated market are under an obligation to detect and report market abuse and insider dealing according to the provisions of the Market Abuse Regulation. The competent authority responsible for supervising and applying the provisions of the Market Abuse Regulation and the Market Abuse Law is CySEC.

iv Information on websites

The Companies Law provides that the name, registration number, registered office and nature of a company (i.e., whether public or private) must be published on its website.

Moreover, a company whose shares are admitted on a regulated market should publish on its website all information that it is obliged to disclose under the Transparency Law, together with any other information as specified in circulars issued by CySEC. The company should also communicate this information to CySEC, which may publish the information on its website.

Also, as described in Section IV.iii, *supra*, issuers of transferable securities should publish, as soon as possible, inside information on their website and keep it there for at least five years.

v Role of the auditors

Pursuant to the Companies Law, every company must appoint its auditors at the AGM, while every company required by the Companies Law to prepare consolidated financial statements and every public company and private company (except small companies) must have its financial statements audited. In practice, and since the tax authorities require tax computations to be supported by audited financial statements, all Cyprus companies should have their financial statements audited.

Pursuant to the Transparency Law the auditors must review and report on the periodic financial statements that must be disclosed, as outlined above.

The auditors must be properly licensed to perform the audit and, while doing so, they must be independent from the company, not be involved in the decision-making body and not have a direct or indirect economic, professional or other relationship with the company.

IV CORPORATE RESPONSIBILITY

It is evident that awareness of corporate social responsibility (CSR) in Cyprus is constantly increasing and attempts are being made to integrate the principles of CSR into the internal

policies of Cypriot entities. Therefore, Cypriot entities are moving towards a more active role in achieving responsible business practices and ensuring that their financial goals are not detrimental to social improvement.

The move towards more CSR-friendly practices is being promoted by the government of Cyprus, which is taking active steps to create awareness of CSR.

More specifically, the government has appointed the Directorate General for European Programmes, Coordination and Development (DG EPCD) as the national coordinator for the promotion of CSR in Cyprus. Steps taken by the DG EPCD include issuing a National Action Plan for 2013–2015, which was approved by the Council of Ministers for the purpose of evaluating and promoting CSR, and aiming to introduce a suitable framework for the systematic development and promotion of CSR practices in both the private and public sectors. Revision of the National Action Plan may arise as a result of the new CSR strategy currently in preparation by the EU.

As the responsible public authority, the DG EPCD is expected to carry out a supporting role through an intelligent combination of policy measures and, where necessary, complementary regulations. The measures include the dissemination of CSR guides, the establishment and enhancement of the Cyprus CSR Network website in collaboration with the Cyprus Chamber of Commerce and Industry, the Technological University of Cyprus and the Planning Office, the organisation of seminars, promoting CSR in the academic environment and giving awards for best practices.

In addition, the DG EPCD in cooperation with the DRCOR is in the process of coordinating the transposition into national law of Directive 2014/95/EU, whereby the EU establishes a minimum legal requirement for certain large undertakings or groups and public-interest entities as regards the disclosure of non-financial information relating to social and environmental matters.

Furthermore, the Cyprus Organisation for Standardisation has issued the Cyprus standard CYS ISO 26000:2014 – Guidance on Social Responsibility, providing information on CSR and how this can become part of everyday business practice. Interested firms may acquire the specific standard.

V SHAREHOLDERS

A shareholder of a company is a natural or legal person that has legal title to the shares of a company and is able to enjoy and exercise the rights attached to those shares.

i Shareholder rights and powers

The powers that shareholders have under Cypriot law are considerably less extensive than those of the board of directors. The board of directors, unlike the shareholders, is legally bestowed with the power to manage and control a company, in support of the fundamental principle that a company is a separate legal entity that operates independently from its shareholders. The rights and powers of shareholders are, nevertheless, substantial.

While some of the powers of a shareholder are statutory deriving directly from the Companies Law, certain others vary depending on the regulations set out in the articles of association of a company (the articles).

The rights and powers of shareholders are exercised through their right to attend and vote at general meetings of a company. This entails the passing of resolutions in one of the following manners, depending on the matter to be addressed and based on the provisions of the Companies Law as well as the regulations adopted in the articles:

- a* ordinary resolutions, which require a simple majority;
- b* extraordinary resolutions passed by a majority of not less than three-quarters of the members;
- c* special resolutions, which also require a majority of not less than three-quarters of the members, provided 21 days' notice is given specifying the intention to propose the resolution as a special resolution; and
- d* such other voting mechanics as may be set out in the articles (only applicable with respect to non-statutory powers).

In all the above cases, the percentages are calculated based on the members entitled to vote and who are present and voting at the relevant meetings, either in person or by proxy.

The statutory powers that pertain to the shareholders include, *inter alia*, the following:

- a* removing directors before the expiration of their period of office;
- b* increasing or reducing the authorised share capital of the company;
- c* altering the memorandum of association and the objects contained therein;
- d* changing a company's name;
- e* varying rights attached to classes of shares;
- f* cross-border mergers;
- g* amalgamations and schemes of reconstruction;
- h* voluntary liquidation of the company; and
- i* holding the AGM for consideration of, *inter alia*, the financial statements, dividend payments (provided the dividend payments are proposed by the directors), appointment and remuneration of auditors, and appointment or removal of directors who have been appointed to fill a vacancy.

A recent amendment to the Companies Law allows the articles to provide that resolutions with respect to specific matters passed at general meetings that require a certain majority by virtue of the Companies Law are to be passed by a greater majority than that set out in the Companies Law, with the exception of the removal of directors, which, pursuant to the Companies Law, must at all times be passed by way of an ordinary resolution.

Aside from the above statutory powers, shareholders are entitled to have further rights reserved to their competence. These rights must, however, be included in the articles to be binding on the company, otherwise they merely remain contractual rights as agreed between the shareholders. The purpose of the articles is to regulate the relationship among the members and between the members and the company. Any such non-statutory rights must not interfere with the statutory rights that pertain to the directors, otherwise the rights risk being considered unenforceable.

The rights of shareholders are directly linked to the shares held by them. Specifically, the voting rights each shareholder has are dependent on the rights attached to those shares (i.e., voting or non-voting rights, rights to dividends, etc.); these rights are specified in the articles. Furthermore, the percentage of shares held by the shareholder determines the controlling power of that shareholder in the decision-making process, unless the articles provide for weighted voting rights with respect to specified matters.

Notwithstanding the above, both the Code and the Companies Law embody the general principle that shareholders who hold shares of the same class shall be treated equally, and provisions in the articles to the contrary shall be void. The articles and the law contain a number of provisions to ensure that this principle is respected, including rights of pre-emption, sufficient notices for general meetings, etc. The Code specifically provides that all shareholders of the same category should be treated equally and have the same voting rights.

ii Shareholders' duties and responsibilities

The duties and responsibilities of shareholders towards the company, as opposed to those of the directors towards the company, are limited. As mentioned above, Cypriot companies are separate legal entities that have a separate personality from their shareholders. Shareholders are, therefore, generally not involved in the day-to-day management of a company and thus do not owe any duties and responsibilities to the company or to the other shareholders. In fact, with limited liability companies, the liability of shareholders is limited by the memorandum to the amount, if any, that is unpaid on the shares held by them individually. Shareholders can be held liable only in exceptional circumstances, such as in cases of fraud. In such cases the corporate veil can be pierced.

A primary duty of the shareholders is to ensure that the company has a management body. On the incorporation of the company the directors are either named in the articles by the shareholders or a clause is inserted in the articles giving the shareholders a right to appoint them. Thereafter, the shareholders should ensure that the number of directors does not fall below the minimum requirement set out in the articles, otherwise this will automatically result in the company ceasing to be operational and thus being struck off the register by the DRCOR.

Furthermore, the shareholders have a duty to pay the subscription price for the shares allotted to them. If a shareholder fails to pay the subscription price, the articles may prohibit the shareholder from exercising its voting rights and the directors may forfeit the shares, in which case the shareholder ceases to be a member of the company. This, however, does not affect the continuity of a company (provided, of course, that the company has other shareholders or, if not, the shares are transferred to a new shareholder), since the company as a separate legal entity can take steps through its management board to resolve the issue.

Although shareholders are not necessarily obligated to attend and vote at general meetings, this constitutes their main task. This ultimately ensures that the shareholders retain a certain level of control over the company through exercising their voting rights. In particular, the shareholders are required to hold AGMs. The first AGM must be convened within 18 months from the date of incorporation of the company; thereafter, the AGM must be convened within 15 months of the previous AGM. The issues discussed at the AGM include the consideration of the financial statements, the auditors' and directors' reports, the composition of the board of directors, and the appointment and remuneration of auditors.

With respect to public companies, the Companies Law⁷ provides that, within a period of not less than one month, nor more than three months, from the date at which the company is entitled to commence business, it is required by law to hold a general meeting of the members of the company – the 'statutory meeting'.

iii Shareholder activism

Although the management and control of a company is vested in the board of directors, the shareholders nevertheless have the power to put pressure on the company's management body.

The most substantial power vested in shareholders is that they have direct control over the composition of the board of directors and, although they do not have control over what decision or action is taken by the directors, this can nevertheless affect the decisions taken by the directors in an indirect manner.

In addition, both the Companies Law and the Code promote the giving of information to shareholders. The Companies Law specifically provides that shareholders have the right to inspect the following documents without payment of a fee, or to be provided with copies thereof upon payment of a fee, as applicable:

- a* the register of the holders of debentures of the company pursuant to Section 84 of the Companies Law;
- b* the register and index of the members of the company pursuant to Section 108 of the Companies Law;
- c* the minutes of proceedings of all general meetings of the company to date, pursuant to Section 140 of the Companies Law;
- d* a certified true copy of all audited financial statements, directors' reports and auditors' reports to date, pursuant to Section 152(2) of the Companies Law;
- e* the register of charges, book of mortgages and copies of all instruments creating a charge, and the particulars of all mortgages requiring recording (including with the Registrar of Companies by virtue of Section 90 of the Companies Law, as well as in the internal register of charges and book of mortgages pursuant to Section 99 of the Companies Law), pursuant to Section 100(1) of the Companies Law;
- f* the register of directors' shareholdings, pursuant to Section 187(5) of the Companies Law; and
- g* the register of the directors and secretaries of the company, in accordance with Section 192(6) of the Companies Law.

Generally, under the Companies Law, all extraordinary general meetings (EGMs) are convened by the board of directors, therefore an EGM cannot normally take place unless convened by the board. As an exception to this rule, the Companies Law provides that, notwithstanding anything in its articles, upon the request of shareholders holding not less than one-tenth of the paid-up capital that carries the right of voting at general meetings or, in the case of a company not having share capital, members of the company representing not less than one-tenth of the total voting rights of all the members with a right to vote at general meetings, the directors of a company shall proceed to convene the EGM.

Despite the fact that Cypriot courts are reluctant to interfere with the internal management of a company, the shareholders have the power to bring the following actions:

- a* a personal action against the company in relation to a breach of the company's duties towards the shareholders; or
- b* a derivative action – available only where there is an alleged fraud and the wrongdoers are in control of the company. In this case, the shareholder brings an action on behalf of the company.

In addition to the above, the Companies Law provides statutory protection to a shareholder. In accordance with Section 202 of the Companies Law, any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some of the members (including him or herself) may apply by petition to the court for an order. In such cases, the court, if it considers that the company's affairs are being conducted

in an oppressive manner and that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding-up order on the grounds that it was just and equitable that the company should be wound up, it may issue an order as it thinks fit, including an order (1) regulating the conduct of the company's affairs in the future; (2) for the purchase of the shares of any members of the company by other members of the company; (3) for the purchase of the shares of any members by the company and the reduction accordingly of the company's capital; or (4) otherwise.

iv Takeover defences

Generally certain takeover defence tactics exist under Cyprus law; however, these have been limited by Directive 2004/25/EC on takeover bids (the Takeover Directive), which was implemented in Law 41(I)/2007 and which seeks to safeguard efficient takeover mechanisms by introducing two key concepts, namely the breakthrough principle and the board neutrality principle, allowing the bidder to render some pre-existing restrictions inoperable, to remove the board and to change the articles to override frustrating actions.

Shareholder and voting rights plans, and similar measures

Defensive measures under Cyprus law include restrictions on the transfer of securities (either in the articles of the target or contractually agreed between the target company and the shareholders), restrictions on voting rights or weighted voting rights.

Cyprus has taken a more shareholder-friendly approach when implementing the provisions of the Takeover Directive by giving shareholders the option to resolve on disapplying pre-existing restrictions that can make an offer inoperable (such as removing the board and changing the articles to override frustrating actions against a potential bid). Instead of making the disapplication of these provisions mandatory under statute, the Takeover Law simply allows the target to elect to disapply the provisions by passing a shareholders' resolution. This ultimately gives the shareholders a level of control over the bid depending on whether the offer is hostile or not. The shareholders may specifically resolve the following (breakthrough principle):

- a* Any restrictions on the transfer of securities, provided for in the articles of the target company shall not apply vis-à-vis the offeror during the time allowed for acceptance of the bid.
- b* Any restrictions on the transfer of securities provided for in contractual agreements between the target company and holders of its securities or between holders of its securities, entered into after 21 April 2004, shall not apply in relation to the offeror during the time allowed for acceptance of the bid.
- c* Restrictions on voting rights provided for in the articles of the target company shall not have effect at the general meeting of shareholders that decides on any defensive measures. In these general meetings, every security gives to its holder the right of one vote. Restrictions on voting rights provided for in contractual agreements between the target company and holders of its securities entered into after 21 April 2004, shall not have effect at the general meeting that decides on any defensive measures. Multiple voting securities shall carry only one vote at the general meeting deciding on any defensive measures.

This does not apply to securities where restrictions on voting rights are compensated for by specific pecuniary advantages:

- a Where, following the bid, the offeror holds 75 per cent or more of the capital carrying voting rights, no restrictions on the transfer of securities or on voting rights nor any extraordinary rights of shareholders concerning the appointment or removal of board members provided for in the articles of the target company shall apply. Multiple vote securities shall carry only one vote each at the first shareholders' meeting following the closure of the bid called by the target company to amend the articles or remove or appoint board members. To that end, the offeror shall have the right to convene a general meeting at short notice, provided that the meeting does not take place within two weeks of notification. This does not apply to securities where restrictions on voting rights are compensated for by specific pecuniary advantages.
- b Where rights are removed on the basis of the above provisions of Section 35, equitable compensation must be provided for any loss suffered by the holder of those rights. The terms of the compensation and payment shall be determined between the bidder and the shareholder whose rights are affected.

Therefore on the basis of the above, the shareholders have control as to whether they will allow defensive measures to frustrate the bid or whether they will resolve to dissapply such measures.

White-knight defence

Competing takeover bids are possible provided the competing offeror announces its firm decision any time before the beginning of the fourteenth day before the expiration of the time allowed for acceptance of the original takeover bid and its revision. In such cases, if the original offeror does not exercise its right to recall its own bid, the time allowed for acceptance of the original bid is automatically extended until the expiration of the time allowed for the acceptance of the competing bid. The recipients may withdraw the acceptance of the original bid if a competing bid is made provided the offeror of the original bid is notified in writing of the withdrawal and the competing bid is validly accepted, in which the letter informing the original offeror of the withdrawal is included as an attachment to the acceptance of the competing bid.

Furthermore, the board is allowed to seek alternative bids; however, as soon as the board of the offeree company becomes aware that a bid is imminent and until the expiration of the time allowed for acceptance or the revocation or cancellation of the bid, it may not, without the prior authorisation of the general meeting of the shareholders, take any action that may result in the frustration of the bid.

Staggered boards

Pursuant to Section 178 of the Companies Law, a company may by ordinary resolution remove a director before the expiration of his or her period of office, notwithstanding anything in the company articles or in any agreement between the company and the director. Therefore, if the new shareholder has 50 per cent plus one vote in the company or if his or her shares can be combined with the votes of another shareholder he or she may remove a director in accordance with the provisions set out in Section 178.

Furthermore, the shareholders may resolve that where following the bid, the offeror holds 75 per cent or more of the capital carrying voting rights, no restrictions on voting rights nor any extraordinary rights of shareholders concerning the appointment or removal of board members provided for in the articles of the target company shall apply. Multiple vote

securities shall carry only one vote each at the first shareholders' general meeting following the closure of the bid called by the target company to amend the articles or remove or appoint board members. To that end, the offeror shall have the right to convene a shareholders' general meeting at short notice, provided that the meeting does not take place within two weeks of notification.

v Contact with shareholders

The Code generally promotes contact with shareholders through the drawing up of reports. The Code specifically provides that shareholders should be given timely and precise reports on all material changes concerning the company, including its financial condition, performance, ownership and corporate governance. The report should contain, *inter alia*, the following material information:

- a* the financial statement of the company;
- b* the targets and activities of the company, if diversified;
- c* the major shareholders and voting rights;
- d* material foreseeable risks;
- e* material issues concerning employees and shareholders;
- f* the structure of governance and policies; and
- g* any unusual transactions of the company.

The Code further provides that the board of directors should appoint a management executive or an officer of the company as an investor liaison officer so as to ensure that all information pertaining to the company is distributed fairly, in a timely fashion and costless to all shareholders. The Code further encourages constructive dialogue between institutional investors and the companies and specifies that the board of directors should make sure that the agenda and the overall organisation of the general meetings do not eliminate substantial dialogue and the decision-making procedure.

In addition to the above, the Code provides for the submission of the following reports:

- a* a report by the board of directors on corporate governance, which should be included in the annual report with respect to listed companies, stating whether the company complies with the Code and the extent to which it implements its principles; and
- b* a remuneration report that is submitted to the shareholders each year as part of the company's annual report. This report should be the main vehicle through which the company reports to shareholders on directors' remuneration.

The Companies Law generally promotes the communication of information through electronic and telecommunication means, particularly with respect to public listed companies. Section 127A of the Companies Law provides that, with respect to companies listed in a regulated market, a notice for the calling of a general meeting shall be issued, free of charge, in a manner ensuring fast access to it on a non-discriminatory basis, using such media as may reasonably be relied upon for the effective dissemination of information to the public throughout the EU Member States. For the purposes of the question and answer procedure, a company listed in a regulated market shall be deemed to have given an answer if the relevant information is already available on its website in a question and answer format.

Furthermore, provided certain conditions are satisfied, the Companies Law gives a member of a company listed in a regulated market the right, through the use of electronic means or postal services and at the address designated by the listed company in a regulated market, to:

- a* put items on the agenda of the AGM, provided that each item is accompanied by reasons justifying its inclusion, or a draft resolution to be adopted at the general meeting; and
- b* table draft resolutions as an item on the agenda of a general meeting.

Last but not least, the Companies Law additionally provides that a company listed in a regulated market may offer participation in the general meeting by electronic means, including:

- a* mechanisms for casting votes, whether before or during the meeting. The mechanisms adopted shall not oblige the member to be physically present at the meeting or to appoint a proxy who shall be physically present at the meeting;
- b* real-time transmission of the general meeting; and
- c* real-time two-way communication enabling members to address the general meeting from a remote location.

VI OUTLOOK

It is generally recognised that one of the main causes of the banking crisis in Cyprus was failed corporate governance and risk management strategies. The financial crisis has highlighted the significance of following corporate governance rules and the use of these rules as preventative measures and tools for creating a risk-efficient economic environment. It has been recognised that, in a bid to attract investors following the crisis, companies must actively promote transparency, risk management and corporate governance. This is particularly important for increasing investor confidence.

DENMARK

*Jacob Christensen, Søren Toft Bjerreskov and Nicholas William Boe Stenderup*¹

I OVERVIEW OF GOVERNANCE REGIME

There is one regulated market in Denmark where a public limited liability company can have its shares admitted to trading: Nasdaq Copenhagen.

In the past few years, the governance regime in Denmark has been subject to further regulation and changes, both in terms of soft and hard law. The entry into force of the Danish Companies Act (DCA) in 2010 with subsequent amendments has played a major role as the regulation of governance has become more intensive and specific. More recently, the entry into force of the Market Abuse Regulation (MAR)² on 3 July 2016 has introduced new rules on, *inter alia*, insider lists, delay of disclosure of inside information and notifications from persons discharging managerial responsibilities. As regards soft law, in May 2013 the Danish Committee on Corporate Governance adopted a set of new corporate governance recommendations substantiated by compliance surveys and suggestions from the European Union.³

i Sources of law and other regulations

In Denmark, the DCA is the primary act with regard to corporate governance. However, governance regulation is also covered in the Danish Financial Statements Act (DFSA) and the Danish Securities Trading Act (DSTA) and the MAR, and is furthermore supplemented by a number of executive orders.⁴

These regulations can be described as the sources of hard law on corporate governance in Denmark.

Nasdaq Copenhagen has a separate set of rules called 'Rules for issuers of shares', which must be observed by listed companies. These rules have been issued on the basis of Section 21 of the DSTA, which requires the operator of a regulated market to establish clear and transparent rules.

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2 Regulation (EU) No. 596/2014 of 16 April 2014.

3 The recommendations were updated in November 2014 to reflect the recommendations in Commission Recommendation 2014/208/EU of 9 April 2014 on the quality of corporate governance reporting ('comply or explain').

4 Including the executive order on takeover bids, the executive order on issuers' duty to provide information, the executive order on major shareholders, the executive order on conditions for admission of securities to official listing and two executive orders on prospectus requirements.

With the entry into force of the DCA in 2010, the revised sections regulating governance provided management with more flexibility but also obligations to make ongoing assessments to determine whether decision-making is established on a proper basis or whether external assistance is needed.

As mentioned above, the Danish Committee on Corporate Governance adopted a set of new corporate governance recommendations in May 2013. The revised recommendations have been reduced in number from 79 to 47, and they focus on transparency, openness and value creation to a greater extent than before. The recommendations provide guidance for best practice on corporate governance in listed companies; they are solely recommendations and do not constitute rules of law. The purpose of the recommendations is to ensure through transparency that investors and other relevant parties are given the opportunity to assess the circumstances of a specific company. Although they are only recommendations, they are anchored in the DFSA, which requires listed companies to submit a statement on how the company applies the principles of corporate governance (the comply or explain principle).

ii Enforcement

Enforcement of the corporate governance regulations depends on whether the specific regulation is legislation or rules set out by the regulated market.

As regards legislation, the rules regulating corporate governance in the DCA are mainly rules on liability. If the management does not act in accordance with the specific sections regulating its responsibilities, the members may become liable to the company, and to the shareholders or the creditors, or both, if losses occur. Disputes on such matters are settled by the Danish courts.

The Danish Business Authority can impose fines on the management for failing to meet, in a timely manner, its obligations towards the Danish Business Authority under the DCA or the DFSA, or both (e.g., mandatory registrations, or preparation and publication of annual reports).

As regards the rules set out by the regulated market, if a company fails to comply with these rules, the operator may give a reprimand or impose a fine.

II CORPORATE LEADERSHIP

i Governance structures

Under Danish company law, a limited liability company may choose between two different types of governance structures.

A Danish limited liability company may choose the traditional Danish governance structure where the company is managed by a board of directors responsible for the overall and strategic management. The board of directors must appoint an executive board consisting of one or more persons to be responsible for the day-to-day management. In public limited companies, the majority of the members of the board of directors and the board's chairman and vice chairman may not be members of the executive board.

Alternatively, limited liability companies may choose a governance structure where the company is managed solely by an executive board. This executive board must be appointed by a supervisory board that oversees it, and thus the supervisory board has no responsibility for the overall and strategic management. A member of the executive board must not also be a member of the supervisory board.

The board of directors or the supervisory board of a public limited company must have at least three members.

In addition to these two governance structures, a private limited liability company has the further option of being managed solely by an executive board.

Where a limited liability company has employed an average of at least 35 employees during the previous three years, the employees of the company are entitled to elect among themselves a number of employee representative board members, to be appointed on the same conditions as those applying to members elected by the shareholders. Private limited companies in which the employees exercise their right to elect members must have a board of directors or a supervisory board.

The majority of Danish companies have the traditional management structure, namely a board of directors and an executive board, and the following paragraphs are therefore based on Danish limited liability companies with this governance structure.⁵

ii Board structure and practices

Gender equality

In 2012, the Danish parliament adopted a bill with the aim of creating a more equal ratio of men to women on the boards of directors of Danish companies.

The bill introduced new provisions in the DCA⁶ and the DFSA,⁷ pursuant to which certain types of companies are required to set target ratios and to implement a policy for gender equality to increase the share of the under-represented gender in the company's management levels in general. The companies must also report on the status of progress towards satisfying these requirements in their annual reports. However, the new rules do not impose any mandatory quotas to be met in terms of ratios of men to women on the boards of directors.

The rules are, *inter alia*, applicable to state-owned public companies, listed companies,⁸ large commercial enterprises,⁹ large commercial foundations and a number of financial sector entities.

Where an entity already has an equal gender ratio in its management – pursuant to the explanatory notes to the bill, this means at least 40 to 60 per cent of each gender – the entity is not required to set target ratios or implement a policy. Information in this respect must, however, be included in the annual report of the entity. Furthermore, there is a *de minimis* threshold regarding the requirement to implement a policy of gender equality. Thus, companies with fewer than 50 employees are not subject to the requirement of implementing this policy.

5 The Danish Committee on Corporate Governance recommends that listed companies are organised in accordance with the traditional management structure.

6 Section 139a.

7 Section 99b.

8 Enterprises with other securities than shares (for instance bonds) admitted to trading on a regulated market in an EU or EEA country will also be subject to the new rules. This applies regardless of the size of the enterprise.

9 Enterprises in accounting class C that exceed two of the following three thresholds of the DFSA in two consecutive financial years: (1) a balance sheet total of 156 million kroner, (2) a net turnover of 313 million kroner and (3) an average of 250 full-time employees.

Failure by a company to observe the obligation to set target ratios, prepare a policy for gender equality or reporting in the annual report may result in a fine, but the fact that a company does not achieve the target figures will not in itself give rise to a fine.

The Danish Business Authority has prepared guidelines enabling the companies to fulfil the requirements.

The new rules entered into force on 1 April 2013.

Liability of directors

The management of a Danish limited liability company owes a duty of loyalty to the company and its shareholders and must at all times act in their best interests.

A management member who, by wilful misconduct or negligence, causes damage to the company or the company's shareholders, creditors or any third party can be held liable for damages under the culpa standard.¹⁰

The culpa assessment is made by comparing the act or omission in question to a normal standard of care (i.e., what can reasonably be expected from a diligent person (*bonus pater familias*) in similar circumstances). In this respect it may be of significant importance if a specific rule or duty to act has been contravened, for example, rules or duties contained in the DCA, the company's articles of association or any other regulations or guidelines applicable to management members.

Under Danish company law there is a 'business judgement rule', which prescribes that, as a main rule, the management will not be held liable when exercising a rational business judgement, even if an error in that judgement leads to financial losses. The decision must have been taken on a well-informed and qualified basis.

In Danish case law, the board of directors has generally not been found liable in financial distress cases where a business judgement has resulted in financial losses, provided that the chances of overcoming the financial difficulties were not unrealistic at the time the business judgement was made.

In general, Danish courts have been reluctant to render management members liable for the exercise or lack of exercise of their powers and duties unless clear, specific duties have been breached. This may, however, be changing since the trend is probably towards stricter liability for management members.

In recent years, Danish company law has provided company management with a greater degree of freedom of choice; for example, certain legal requirements and documents may be waived in connection with mergers if the management considers such a decision to be prudent and justifiable. This tendency leads to an intensified focus on the potential liability of the management, especially when these requirements have been waived and losses occur.

¹⁰ Section 361 of the DCA.

III DISCLOSURE

All Danish companies are required to fulfil certain obligations as regards disclosure of information.

i Limited liability companies

Most Danish limited liability companies are subject to audit obligations, and the general meeting must therefore elect one or more approved auditors.¹¹

The management must provide the auditor with any information that is likely to influence the assessment of the company. Additionally, the management must provide the auditor with information, assistance and access to make whatever investigations are deemed necessary to complete the audit work; where the company is a subsidiary of a group of companies, the management owes a similar duty to the auditor of the parent company.¹² Moreover, the auditor may request that members of the company's management provide any information that is deemed to be of importance to the assessment of the company and, if the company is a parent company, its group.

In general, the executive board must ensure an appropriate review process for the company's auditor and ultimately present the annual report with specifications and audit reports to the board of directors in good time for the annual report to be adopted at the company's annual general meeting.

The management must present the annual report for the shareholders' approval in a timely manner. It is the responsibility of each individual member of the management to ensure that the annual report is prepared, audited and approved by the management and the shareholders, and that it is submitted to the Danish Business Authority within five months¹³ of the end of the financial year and in accordance with all requirements. As of 1 January 2014 it has been possible for companies to prepare and submit annual reports in English only provided that the company's general meeting passes a resolution in this respect and the resolution is incorporated into the company's articles of association.

In December 2014, the Public Register of Shareholders was introduced to create more openness and transparency about the ownership of Danish companies for the purpose of discouraging money laundering, creating more confidence in companies and improving the public authorities' investigative tools in connection with white-collar crime. The entry into force of the Register has made it mandatory for Danish limited liability companies to have significant shareholdings and voting rights registered and made public in the IT system of the Danish Business Authority.

ii Listed companies

Companies whose shares are admitted to trading on a regulated market in Denmark¹⁴ are required to disclose certain information pertaining to inside information, shareholdings and financial statements. These rules are described in the following.

11 Section 144 of the DCA.

12 Section 133 of the DCA.

13 Section 138(1) of the DFSA.

14 Article 17 of the MAR and Sections 27 to 30 of the DSTA.

Inside information

Companies whose shares are admitted to trading on a regulated market in Denmark must, as soon as possible, disclose inside information if this information pertains directly to the company's activities. Significant changes concerning already disclosed inside information must be disclosed immediately after the changes occur, and through the same channels as used for any previous disclosures.

Inside information disclosed to a third party in the normal exercise of his or her profession must simultaneously be disclosed in a complete and effective manner, unless the third party is subject to a duty of confidentiality.

The company is obliged to have established disclosure procedures ensuring that relevant information is disclosed in compliance with the applicable law. In connection with the disclosure of information, the company must ensure that inside information is disclosed in a manner that enables fast access and complete, correct and timely assessment of the information by the public.¹⁵ The company must, as far as possible, ensure that the information is disclosed simultaneously to all categories of investors in all Member States of the European Union or countries with which the EU has entered into an agreement for the financial area or where the company has requested or received approval of securities.

The company may delay the disclosure of inside information to protect legitimate interests (e.g., ongoing sensitive negotiations) provided that the delay will not mislead the public and provided that the information can be handled confidentially; however, the decision to delay the disclosure is at the company's own risk. If the company learns or ought to have learned that the inside information no longer remains confidential (i.e., if the information has been leaked), the company must disclose this inside information as soon as possible.

Simultaneously with the disclosure of the aforementioned information, the company must submit the information to the Danish Financial Supervisory Authority (FSA). Where an issuer has delayed the disclosure of inside information, it shall inform the FSA that disclosure of the information was delayed and shall, upon request, provide a written explanation of how the conditions for delay were met.

Shareholdings

A listed company must immediately publish a company announcement and at the same time notify the FSA of the company's collective share (or that of its subsidiaries, or both) of the company's securities (treasury shares), of the voting rights in the company or of the equity derivatives (financial instruments) in the company provided that (1) the voting rights of the securities, the voting rights' or the equity derivatives' voting rights or nominal value individually or jointly represent at least 5 per cent of the entire voting rights or the entire share capital of the company respectively; or (2) a change in an already announced shareholding has the effect that the limits of 5 per cent, 10 per cent, 15 per cent, 20 per cent, 25 per cent, 50 per cent or 90 per cent and the limits of one-third or two-thirds of the voting rights or nominal amount of the share capital are reached or no longer reached, or the change has the effect that the limits specified in (1) above are no longer reached.¹⁶ Persons discharging

15 Article 17(1) of the MAR.

16 Section 29 of the DSTA.

managerial responsibilities¹⁷ and their closely associated persons¹⁸ in listed companies with Denmark as their home country must notify the FSA of transactions¹⁹ conducted on their own account relating to the company's shares or other securities linked to such shares. This notification must be given electronically to the FSA promptly and no later than three business days after the transaction. The FSA publishes the notifications immediately after receipt.

Non-compliance with these rules is punishable by a fine.²⁰

Financial statements

A listed company must, no later than three weeks prior to the annual general meeting, but no later than four months after the end of the financial year, publish the annual report approved by the board of directors. Without undue delay, after the annual report has been approved by the annual general meeting, the company must then submit the report to the Danish Business Authority.

The company must also publish approved interim financial statements for the first six months of the financial year as soon as possible and within two months of expiry of the six-month period. Additionally, The Danish Committee on Corporate Governance recommends that listed companies publish quarterly reports.

Recommendations on corporate governance

The Danish recommendations on corporate governance²¹ comply with Danish and EU company law, the Organisation for Economic Co-operation and Development's Principles of Corporate Governance and recognised best practice, and they are aimed primarily at Danish companies whose shares are admitted to trading on a regulated market.²² The objective behind the recommendations is above all to promote productive and responsible management of listed companies for their long-term benefit. These recommendations are intended to increase public confidence in the companies via timely disclosure and transparency.

The soft law recommendations enable listed companies to organise their governance optimally in accordance with the comply or explain principle.²³ This principle allows each

17 A 'person discharging managerial responsibilities' means a person within an issuer, an emission allowance market participant or another entity referred to in Article 19(10) of the MAR, who is: (1) a member of the administrative, management or supervisory body of that entity; or (2) a senior executive who is not a member of the bodies referred to in point (1), who has regular access to inside information relating directly or indirectly to that entity and power to take managerial decisions affecting the future developments and business prospects of that entity; ref. Article 3(25) of the MAR.

18 A 'person closely associated' means: (1) a spouse, or a partner considered to be equivalent to a spouse in accordance with national law; (2) a dependent child, in accordance with national law; (3) a relative who has shared the same household for at least one year on the date of the transaction concerned; or (4) a legal person, trust or partnership, the managerial responsibilities of which are discharged by a person discharging managerial responsibilities or by a person referred to in point (1), (2) or (3), which is directly or indirectly controlled by such a person, which is set up for the benefit of such a person, or the economic interests of which are substantially equivalent to those of such a person; ref. Article 3(26) of the MAR.

19 Only if the market price of the transactions carried out during a calendar year constitutes a total amount of €20,000 or more.

20 Section 93 of the DSTA.

21 www.corporategovernance.dk.

22 However, the recommendations may also provide guidance for non-publicly traded companies.

23 According to Section 107b of the Financial Statements Act and Nasdaq's rules, listed companies must adopt the comply or explain principle when reporting.

company to decide whether and to what extent it wishes to comply with the recommendations. If a company fails to comply with a recommendation, it must explain why and specify its chosen approach, and this voluntary element aims to ensure adequate flexibility for each company.

Pursuant to Section 107b of the Financial Statements Act, information on how the companies apply the principles of corporate governance must be included either in the management commentary in the annual report or published via the company's website²⁴ together with an exact reference thereto in the management commentary.

IV CORPORATE RESPONSIBILITY

While the executive board is responsible for the day-to-day management of a company, the board of directors is in charge of its overall and strategic management, and of ensuring a proper organisation of the company's business. Additionally, the board must ensure that:

- a* the executive board performs its duties properly and as directed by the board of directors;
- b* the bookkeeping and financial reporting procedures are satisfactory;
- c* adequate risk management and internal control procedures have been established;
- d* the board of directors receives ongoing information as necessary for the board of directors to assess the limited liability company's financial position; and
- e* the financial resources of the limited liability company are adequate at all times, and that the company has sufficient liquidity to meet its current and future liabilities as they fall due.

In the event of a capital loss, if it is established that the equity of a limited liability company represents less than half of the subscribed capital, the management of the company must ensure that a general meeting is held within six months from the actual date on which the loss is established.²⁵

At the general meeting, the board of directors must report on the financial position of the company and, if necessary, submit a proposal for measures that should be taken (e.g., a proposal for injection of additional funds or a proposal for dissolution of the company). If the general meeting does not vote in favour of the proposal, and the board of directors is of the opinion that it would not be justifiable to keep the company in operation, the board of directors should resign.

The failure to realise an evident loss and, consequently, the failure to respond in a situation where a reaction is required may often trigger liability. However, non-compliance does not automatically entail liability for the board of directors.

The objective behind the provision is to motivate the management to take an active part in overseeing the company's financial development, so that relevant measures can be implemented.

24 The Committee on Corporate Governance states that publication on the company's website together with a precise reference thereto in the management commentary in the annual report will create the most transparency.

25 Section 119 of the DCA.

V SHAREHOLDERS

i Shareholder rights and powers

The general meeting is the forum where the shareholders exercise their rights,²⁶ and since access to and participation in the general meeting is a fundamental shareholder right, the DCA contains various rules regarding general meetings.

The general meeting has the supreme authority in all matters relating to the company. Accordingly, the management must comply with all resolutions adopted by the general meeting.²⁷

At the annual general meeting the board of directors presents its report on the activities of the company in the preceding year, and the shareholders adopt the annual report, including the appropriation of profits or covering of losses in accordance with the adopted annual report. Additionally, the shareholders elect the board of directors and the auditor.

Under Danish company law, there are a number of matters only the general meeting can resolve upon (e.g., amendments to the articles of association or election of a majority of the board of directors). Also, there are a number of matters where the general meeting's decision-making authority may be delegated to the board of directors, for instance, the authority to decide on a capital increase if a provision to this effect is included in the articles of association.

Generally, the general meeting may not pass a resolution if it is clear that the resolution is clearly likely to give certain shareholders or others an undue advantage to the detriment of other shareholders or of the company.²⁸

As the main rule, all business transacted at general meetings is decided by a simple majority of votes.²⁹ However, to restrict the powers of the majority shareholders and thereby to protect minority shareholders, the DCA stipulates qualified majority in certain cases:

- a* any proposed resolution to amend the articles of association must be passed by at least two-thirds of the votes cast as well as at least two-thirds of the share capital represented at the general meeting;
- b* certain amendments to the articles of association must be passed by at least nine-tenths of the votes cast as well as at least nine-tenths of the share capital represented at the general meeting;³⁰ for example, if shareholder rights to exercise voting rights in respect of their own or other shareholders' shares is restricted to a specific part of the votes or the voting share capital; and
- c* amendments to the articles of association, whereby the shareholder obligations towards the company are increased, require unanimity.

26 Section 76 of the DCA.

27 Provided that the Danish company law does not prescribe that the specific resolution is to be adopted by the management.

28 Section 108 of the DCA.

29 Section 105 of the DCA.

30 Section 107 of the DCA.

The DCA also provides minority shareholders with other minority rights, including under certain conditions the right to compulsory redemption,³¹ the right to appoint an additional auditor³² or the right to submit a proposal for special investigation.³³

ii Shareholders' duties and responsibilities

Under Danish company law, shareholders do not have any specific duties as to the performance and operations of the company, and thus shareholders have the right to be passive investors.

If, however, a shareholder decides to attend the company's general meetings, the shareholder may not contribute to the passing of resolutions where those resolutions clearly are likely to give certain shareholders or others an undue advantage to the detriment of other shareholders or the company.

Shareholders may only be held liable for losses that they inflict intentionally or with gross negligence on the company, other shareholders or third parties.³⁴

iii Shareholder activism

In recent years, the role of shareholders in Danish listed companies has attracted a lot of attention. Generally Danish listed companies have dispersed ownership, and thus the dialogue between the management of the company and the shareholders can be complicated, even though the DCA has made it possible to use electronic media as means for conducting general meetings.

To promote positive interaction between management and shareholders, the Danish recommendations on corporate governance call upon companies to promote active ownership, including shareholders' attendance at general meetings.³⁵ The Committee states that:

As owners of the company, the shareholders should actively exercise their rights and influence at general meetings in order to help the company's management protect the interests of its shareholders as best as possible and thereby ensure an appropriate and balanced development of the company in the short and the long term.

As it also appears from the foregoing quote, Danish company law is based on the premise that the company's communication with the shareholders primarily takes place at the general meeting.

In November 2016, the Committee published a Stewardship Code for institutional investors (aimed at Danish institutional investors that have equity investments in Danish listed companies) to encourage the kind of stewardship in Danish listed companies that is beneficial to their value creation. The Code recommends that institutional investors publish an active ownership policy containing, among other things, a voting policy, and that they publish whether or how they cast votes at general meetings in the listed companies.

As is the case for the corporate governance recommendations, the seven stewardship principles are soft law to be applied on a comply or explain basis. The Stewardship Code

31 Section 73 of the DCA.

32 Section 144 of the DCA.

33 Section 150 of the DCA.

34 Section 362 of the DCA.

35 Section 1.2.1 of the Danish recommendations on corporate governance.

entered into force on 1 January 2017, and consequently, institutional investors with the calendar year as the financial year must report in accordance with the Code for the first time in spring 2018.

iv Takeover defences

Hostile tender offers are permitted under Danish law but they are not very common.

As a general rule, the board of directors is allowed to use defensive measures if it believes that the transaction is not in the best interest of the company. In public tender offers under Danish law, the acceptance period is four to ten weeks, except when regulatory approvals are necessary. Within the first half of this offer period, the target's board of directors must issue a statement to the shareholders in the company. The statement must include the board of directors' opinion of the offer, including its opinion of the consequences of the offer for all the company's interests, particularly for the employees, and the offeror's strategic plans for the company. Usually, the statement will include a recommendation to accept or reject the offer. According to the Danish corporate governance recommendations, the board of directors – from the moment it obtains knowledge that a takeover bid will be submitted – should not, without the acceptance of the general meeting, attempt to counter the takeover bid by making decisions that in reality prevent the shareholders from deciding on the takeover bid themselves; for example, acquiring treasury shares, selling prime assets or obtaining loans to scare off the potential hostile buyers.

Traditionally the most common defensive measures in Danish companies have been structural and often implemented in connection with the formation of the company or in relation to transfer of ownership to foundations or other successions. Some companies have divided their shares into two share classes with different voting rights (high-vote A shares and low-vote B shares, typically in the ratio 1:10) to protect the company from a takeover. Some companies have adopted rules capping the shareholder's maximum holding of voting rights, a practice that is often seen in financial institutions. If a shareholder holds more than the maximum number of shares, the excess voting rights will be treated as non-voting shares at the general meetings. Some companies also have had provisions in their articles of association that prohibit employees from competing companies being elected to the board of directors. In addition, many companies have authorised the board of directors to acquire the company's own shares, typically up to 10 per cent of the issued shares and voting rights, which theoretically allow for greenmail-based defences. Further, the ability to use shareholder rights plans ('poison pills', designed to allow existing shareholders to purchase shares at substantial discount) or the introduction of contractual change of control-based initiatives to deter potential acquirers in connection with a takeover, is very limited in Denmark and there is no tradition of applying these defensive measures. Moreover, the board of directors may not increase the company's share capital or carry out other transactions solely as defensive measures. Further, equal treatment protection is generally afforded minority shareholders.

The board of directors will not be in conflict with the Danish corporate governance recommendations by seeking competing takeover bids. When directors realise that their company might be subject to a takeover, they may seek out as many interested buyers as possible. The process often leads to a non-public auction including several potential buyers. The board of directors may take into account a variety of factors, when assessing public bids, with price typically being the most important factor.

The breakthrough rule and the anti-frustration rule introduced in the Takeover Directive are not mandatory for Danish companies, but in accordance with the Directive companies have the option to adopt the rules in their articles of association (also known as opt-in).

The directors are allowed to express their opinion on whether or not they believe that the shareholders should accept the offer, but in the end it is up to the shareholders whether they wish to tender their shares to an offeror. However, if the board of directors tries to hinder a serious tender offer, publicly or non-publicly, without the approval of the shareholders, they may incur a civil liability towards the shareholders, if the board of directors does not act in the best overall interest of the company and the shareholders.

v Contact with shareholders

As a general rule, confidential information must not be disclosed to the shareholders of a limited liability company because members of the board of directors are bound by secrecy. Further, if the company has its shares admitted to trading on a regulated market, privileged information often constitutes inside information and is therefore covered by the pertinent regulations in the MAR³⁶ governing the safeguarding and disclosure of inside information.

Thus, whether or not the company is listed, the main rule is that confidential information must not be disclosed by the board of directors to the company's shareholders; however, certain circumstances may allow for exceptions to the company and securities law regulations.

Some Danish corporate law commentators assume that a member of the board of directors may disclose information to the shareholder who has appointed him or her if the disclosure concerns limited and specific information and if the disclosure is in the interests of the company. This understanding is especially substantiated where the member of the board of directors is a representative for the shareholder.

According to other Danish corporate law commentators such a disclosure should be approved by the board of directors. The company's articles of association or the rules of procedure for the board of directors may stipulate such a right to disclose information.

In the event of such a disclosure, the shareholder is obliged to keep the received information confidential and not pass the information to any third party.

With respect to a company's disclosure of information to a shareholder, the board of directors may, depending on the specific circumstances, be entitled to disclose confidential information to a shareholder (including, on a case-by-case, need-to-know basis, inside information) subject to the following criteria:

- a* the disclosure is in the interests of the company;
- b* the disclosure concerns specific, limited information and is limited as much as possible;
- c* the board of directors of the company approves the disclosure;
- d* the disclosure forms part of the normal business conduct of the board;
- e* the shareholder is notified of the fact that the information constitutes inside information; and
- f* the shareholder undertakes to keep the information confidential and not to pass the information to any third party, and will not trade or instigate trading in the company's shares until the information has been made public.

36 Additionally, Danish antitrust law may limit the board of directors' ability to disclose confidential information.

As previously mentioned, any disclosure of information must be in the short or long-term financial interests of the company. Thus, the company cannot disclose information to the shareholder merely on the grounds of 'political' interests, regardless of whether these interests are shared by the management of the company.

It also follows from the foregoing that the board of directors may not continually (particularly not automatically) disclose information to a shareholder. Information may be disclosed on an *ad hoc* basis only, if and when the board of directors finds it to be in the interests of the company. Any disclosure of information to a shareholder is subject to a principle of proportionality whereby the disclosure of information is kept to a minimum and where the company's benefits in disclosing this information outweigh the drawbacks of the disclosure.

Therefore, a scheme of periodic disclosure of information to certain shareholders is generally considered problematic, as it would contradict the criterion of only disclosing specific and limited information; however, certain specific circumstances may arise whereby periodic disclosures may take place.

Disclosure of information may, as an example, typically take place if the company requires the shareholder to make a decision in a non-published matter where the position of the shareholder is significant. An example of such a disclosure may be major strategic measures that would depend on the approval of certain major shareholders, and where the company would not want to publish information without having secured prior approval.

In practice, it is advisable to document by written statement the decision of the board of directors to disclose any information as well as the shareholder's obligation to keep the received information confidential.

Disclosure of information by the company is subject to the basic legal principle of equality in company law whereby shareholders in comparable situations – for example, if the shareholders all hold approximately the same number of shares in the company – as the main rule shall be treated on equal terms. Thus, when disclosing information, shareholders in comparable situations must be treated equally and be granted the same access to company information.

VI OUTLOOK

In 2016, the Danish parliament passed an amendment to the DCA making it mandatory for Danish unlisted limited liability companies to register and make public the company's 'actual owners' via the IT system of the Danish Business Authority. An 'actual owner' is defined as the natural person who ultimately directly or indirectly holds or exercises control over a sufficient amount of the shares or voting rights or who exercises control by other means. The amendment was passed to create more transparency for the purpose of preventing owners from hiding behind various company structures, and it is the outcome of a political agreement regarding implementation of measures preventing tax havens. These new rules are expected to enter into force in June 2017.

New EU rules on shareholders' rights are on the way. The negotiations about the proposal to amend the Directive on shareholders' rights have been concluded at EU level and the amendments are expected to be adopted in spring 2017. The object of the proposed

amendments to the Directive on shareholders' rights (Directive 2007/36 EC) is to encourage corporate governance in listed companies by making it easier for shareholders to exercise active ownership and to make share trading more transparent.

The proposals entail, *inter alia*, that the shareholders in listed companies are given a right to a say on the remuneration policy with respect to the remuneration of the company management. Companies are to draw up and publish a policy on the remuneration of members of the board of directors and the executive board that lays down the detailed rules on fixed and variable remuneration of members of management. Shareholders will be given a right to vote on the remuneration policy at the general meeting. Afterwards, the remuneration must comply with the adopted remuneration policy. At this point in time, the rules on drawing up a remuneration policy are only included in the Danish recommendations on corporate governance. Accordingly, Danish listed companies have not yet been subject to a statutory obligation to draw up a remuneration policy (because of the comply or explain principle of the recommendations, where reasons are to be given for any non-compliance).

The proposal also means that companies must present a remuneration report that is to contain information about the individual remuneration of members of management. The shareholders will be given a right to participate in a guiding vote on the remuneration report at the company's general meeting. It means that the report is not binding on the company, but gives the management an insight into the shareholders' position on the remuneration.

The final adoption of the proposal by the European Council and the European Parliament is expected to take place in spring 2017.

FINLAND

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I OVERVIEW OF GOVERNANCE REGIME

Finnish corporate governance is based primarily on the Finnish Companies Act (624/2006, the Companies Act). The Companies Act regulates the governance of companies, such as the role of the board of directors, the managing director and the shareholders as well as their duties and responsibilities. For listed companies also the Finnish Securities Markets Act (746/2012, the Securities Markets Act) plays an important role, governing for example disclosure and transparency issues. Listed companies must also comply with the rules of Nasdaq Helsinki Ltd (the Helsinki Stock Exchange) as well as with the regulations and guidelines issued by the Finnish Financial Supervisory Authority (FIN-FSA). In addition to national laws, directly applicable EU legislation has increasing importance in regulating the governance of listed companies. The European Securities and Markets Authority (ESMA) also issues guidelines and technical standards for listed entities.

In addition, self-regulation is central to Finnish corporate governance. The Finnish Corporate Governance Code of 2015 (the Code), issued by the Finnish Securities Market Association and applicable as of 1 January 2016, is the main regulation in this respect, together with the Helsinki Takeover Code (applicable as of 1 January 2014). Both codes are applied on a ‘comply or explain’ basis (i.e., the codes are not mandatory but any deviation from the regulations of the codes shall be disclosed with an explanation).

Enforcement of regulations applicable to listed companies may be carried out by the FIN-FSA or the Helsinki Stock Exchange through disciplinary procedures. In addition, the law may be enforced through actions in local courts.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure alternatives

The Finnish corporate governance structure lies between the Anglo-Saxon one-tier model and the two-tier model traditionally more common in continental Europe. A company can choose between having both the board of directors and a supervisory board, or just the board of directors. If the company has a supervisory board, this organ supervises the administration

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of the company, which in turn is the responsibility of the board of directors and the managing director. In early 2017 less than 4 per cent of Finnish listed companies featured supervisory boards. Boards of listed companies typically consist of five to 10 members.

Legal responsibilities of the board

The board is responsible for the overall management of the company's affairs and the appropriate organisation of its operations. The board is also responsible for ensuring adequate surveillance of the company's accounts and finances, as well as for several administrative decisions specified in the Companies Act. A key task of the board is the appointment and dismissal of the managing director (the chief executive), who in turn is responsible for the executive management of the day-to-day operations and financial matters. Board members and the managing director have a general duty to act with due care and in the interest of the company in all matters.

The chairman of the board is responsible for convening the board, but does not otherwise have specific statutory duties beyond those of ordinary board members.

Decision-making and representation

The board shall take all the major decisions affecting the company. The specific limits of the board's general competence in relation to the authority of the managing director can depend on the size of the company and its established governance practices. In addition, the board has certain administrative responsibilities that cannot be delegated, such as in relation to the registration of new shares.

In individual cases the board may make a decision in a matter falling under the competence of the managing director. The board may also submit a matter falling under its general competence to the general meeting to decide. In listed companies this latter option has at times been used when approving significant acquisitions or divestments.

The board takes all its decisions as a whole, and its decision-making power may not be delegated to the managing director or board subcommittees. The board can, however, authorise the executive management or another party to for example negotiate, finalise and execute within set parameters the final decision concerning a particular matter. Typically such authorisations are in force only for a limited period.

In the Companies Act a distinction is made between decision-making authority and the right to represent the company. By law, the board as a whole is entitled to represent the company in all matters. In practice, the articles typically provide that, for example, the managing director or the chairman, each alone, as well as two board members or other designated representatives together, can represent the company.

Board committees

Efficient organisation of the board's work may require the establishment of board committees for handling certain matters. The Code includes a description and division of tasks for audit, compensation and nomination committees. Following the implementation of the Audit

Directive and Regulation,² the Companies Act recognises the preparatory role of the audit committee in listed companies. However, the board as a whole is responsible for the eventual decisions even when the board has delegated preparatory responsibilities to committees.

The board of a listed company is required to monitor the company's financial reporting process, as well as the effectiveness of internal control, audit and risk management systems. The board is also responsible for the proposal on the selection of the statutory auditor. In addition, the board must review and monitor the independence of the auditor and, in particular, the provision of non-audit services to the audited entity. The preparatory work for discharging these responsibilities can be delegated to the board's audit committee. The Companies Act requires that the audit committee of a listed company consists of non-executive board members and that at least one member of the audit committee has competence in accounting or auditing. Another board committee may be tasked with the aforementioned duties provided that its composition meets the requirements set for the audit committee.

Remuneration of directors and executive management

The remuneration for the board members and the basis for its determination are set by the annual general meeting. The Code recommends that non-executive directors should not participate in share-based remuneration schemes. The remuneration for the executive management is set by the board. The board may establish a remuneration committee to prepare matters pertaining to management and employee remuneration.

According to the Code, the company shall issue on its website a regularly updated remuneration statement containing a description of remuneration within the company. The statement describes the financial benefits granted to the board and the managing director, and contains information on the decision-making process and key principles for determining remuneration.

Board and company practice in takeovers (takeover defences, share issuance and repurchase, etc.)

Just as in all other matters, the board has a general duty in takeover situations to act with due care in the interest of the shareholders. According to the Securities Markets Act, a listed company must directly or indirectly belong to a body that has issued a recommendation on takeover situations. For this purpose, the Finnish Securities Market Association has issued the Helsinki Takeover Code. The Helsinki Takeover Code is based on the 'comply or explain' principle and contains recommendations on the actions of the target board and the bidder. With regard to defensive measures adopted in relation to a proposed takeover, the Securities Markets Act requires that a share issue or any other measure by the target company that may prevent or materially hamper the completion of the bid must, as a main rule, be resolved upon by the general meeting.

The articles of association of some listed Finnish companies feature provisions that may act as a priori takeover defences, such as differentiated shares classes or vote cutters that limit the number of votes that any one shareholder can cast. Some listed companies also feature in

2 Directive 2014/56/EU of 16 April 2014 amending Directive 2006/43/EC and Regulation (EU) No. 537/2014 of 16 April 2014, respectively.

their articles a Finnish version of a ‘poison pill’, which provides for a mandatory redemption by the bidder of the other shares upon exceeding a set threshold (typically one-third or half of all shares or votes) at a price determined as specified in the articles.

ii Directors

Appointment, nomination and term of office

In Finland, the annual general meeting typically elects all the directors. However, fewer than half of the board members can be appointed in some other manner, if so specified in the articles. In listed companies, the term of a director generally ends with the conclusion of the next annual general meeting following appointment. However, the general meeting can remove a director that it has appointed at any time during the term. The prevailing practice, as recommended by the Code, is to have all board seats up for election each year. The number of a director’s terms has not been limited by legislation or in the Code.

The board has traditionally handled the nomination of the director candidates has usually been handled by the board, with the board’s nomination committee undertaking the preparatory work. However, during the recent years the establishment of an external nomination board has become more commonplace. A nomination board typically consists of representatives of the largest shareholders and often includes the chairman of the board as well. In early 2017, around 30 per cent of listed companies had established a nomination board.

In addition to the above-mentioned formalised nomination procedures, any shareholder can present a competing proposal on director nomination in the general meeting.

Competency and diversity

The Companies Act provides the minimum requirements that all board members must fulfil: a director must be an adult natural person who is not bankrupt or under guardianship and whose legal competency has not been restricted. The Code recommends that a majority of the directors shall be independent of the company, and that of the said majority at least two directors shall be independent of significant shareholders. The Code recommends that the managing director should not be elected the chairman of the board. There is no statutory duty to include employee representatives in the board, and such representatives are very rare in listed companies.

The Code recommends that both genders should be represented in the board. According to a survey published in 2016, 90 per cent of the boards of Finnish listed companies featured both genders, with females constituting 25 per cent of all directors.

Legal duties and right to information

The boards of Finnish listed companies are typically composed of non-executive directors. In some companies the managing director is also a board member, but other executive directors are rare. Finnish corporate law does not generally make a distinction between executive and non-executive directors in terms of their rights, duties or liability.

According to the Code the company shall provide the board with sufficient information for the board to discharge its duties. The board has generally broad authority to require executive management to compile and prepare information to form a basis for the board’s decision-making and the discharging of its supervisory duties. Executive and non-executive

directors have the same right to information. It is considered good practice to ensure that in particular the chairman of the board is always kept well-informed of any new developments, as the chairman is responsible for convening the board when necessary.

Although the board has the authority to request information from the management and employees in relation to its supervisory role, it is considered good practice to organise such information-gathering in a formalised and coordinated fashion.

Conflicts of interest

The Companies Act prohibits a director from participating in the consideration pertaining to a contract, a transaction or legal proceedings between that director and the company. Such participation is also prohibited in a matter between the company and a third party if the director is to derive a material benefit therefrom that may be contrary to the interests of the company. The fact that a director may derive benefit from a decision as a shareholder of the company does not, by itself, lead to a conflict of interest.

Each director must in all matters independently evaluate whether a conflict of interests is at hand. Directors should also provide the board with the relevant information to assess the situation if the director in question ultimately deems himself or herself as not conflicted despite factors that can generally indicate a possible conflict of interest. In practice, directors sometimes excuse themselves from participating in relation to matters where an outside influence or interest could be perceived to exist regardless of whether it would meet the statutory definition of a conflict.

Liability

The Companies Act provides for remedies when a board member has failed to fulfil his or her duties or tasks, including the general duty of care. The basis for liability is wider with regard to damage caused to the company itself. Firstly, a director is liable for damages for the loss that he or she has negligently caused to the company in violation of the general duty of care. Secondly, a director is also liable to the company, a shareholder or a third party for damage caused either deliberately or negligently in violation of the provisions of the Companies Act (other than just the duty of care) or the company's articles of association.

Generally, the burden of proof lies on the person claiming a breach and loss. However, there is a presumption of negligence in cases of a violation of a detailed provision of the Companies Act (i.e., other than the general principles) or of the articles of association, as well as in the event of an act to the benefit of a related party, in which case the director in question must prove that he or she acted with due care.

The provision of directors and officers (D&O) insurance paid by the company to cover the civil liability of board members or executive officers is allowed. D&O insurance is commonly used in listed companies.

The Companies Act also provides criminal sanctions for the violation of certain of its provisions, such as those concerning the distribution of funds or voting limitations. Actions of directors in this capacity may also result in criminal liability under, for example, the Finnish Penal Code (39/1889) (the Penal Code) and the Securities Markets Act.

III DISCLOSURE

i General

The EU Market Abuse Regulation (MAR)³ has been directly applicable in Finland since 3 July 2016. The MAR sets out the key rules that apply to issuers' disclosure requirements, administration of inside information and managers' transactions, among other things.

The MAR requires issuers to publicly disclose inside information as soon as possible. Under the MAR, information is deemed to be inside information if (1) it is of a precise nature and has not been made public, (2) it relates, directly or indirectly, to one or more issuers or to one or more financial instruments, and (3) if it were made public, the information would be likely to have a significant effect on the prices of those financial instruments, or on the price of related derivative instruments.

Information is precise in nature if it is specific enough to enable a conclusion as to the possible effect of the event or circumstance on the price of the relevant financial instrument. In a lengthy process such as negotiations or corporate investments, information concerning intermediate steps in the process, such as the stage of negotiations, may also be deemed precise information.

The MAR allows delaying the disclosure of inside information if (1) immediate disclosure is likely to prejudice the legitimate interests of the company, (2) the delay is not likely to mislead the public, and (3) the company is able to ensure the confidentiality of the information. At the time of public disclosure of inside information, issuers are required to record reasons for delaying the disclosure and to notify the FIN-FSA that the disclosure was delayed.

The Securities Markets Act and related government decrees set requirements for listed companies' disclosure obligations in relation to regular financial reporting. To promote consistency in disclosures, listed companies are recommended to prepare a written disclosure policy, specifying the company's guidelines and procedures applied in communicating with the capital markets and investors. Further regulations related to disclosure obligations are set forth in the rules of the Helsinki Stock Exchange and the regulations and guidelines of the FIN-FSA and ESMA.

Pursuant to the MAR, listed companies have an obligation to maintain insider registers of persons having access to inside information. Unlawful disclosure of inside information is prohibited. Engaging or attempting to engage in insider dealing, recommending that another person engage in insider dealing, and inducing another person to engage in insider dealing are also prohibited. Unlawful disclosure of inside information (such as tipping) is sanctioned in the Penal Code and may result in up to two years' imprisonment. The Helsinki Stock Exchange has issued guidelines regarding the management of insider issues, as well as the procedures regarding disclosure requirements applicable to insiders and the trading of securities by insiders.

The MAR requires transactions by issuers' managers and persons closely associated with them to be notified promptly (and no later than three business days after the date of the transaction) to the issuer and the FIN-FSA. The issuer shall then make the information public.

³ Regulation (EU) No. 596/2014 of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

The threshold for the notification is €5,000 within a calendar year for each person. Once the threshold has been reached, all further transactions in the issuer's financial instruments must be notified and published.

The Securities Markets Act requires that listed companies disclose a yearly corporate governance statement in which the company shall present information on its governance framework and corporate bodies and state its compliance with the Code. If the company chooses to deviate from a certain provision of the Code, it must state its reasons for doing so (the 'comply or explain' principle). Moreover, the company shall keep available a remuneration statement with full disclosure at the individual level of the remuneration of the board members and the managing director. With regard to other executives, disclosure of the main principles for remuneration and the related decision-making process is sufficient.

Both the Companies Act and the Securities Markets Act require that certain disclosed information is kept available on the company's website. The Code also includes more detailed guidance on publishing the information in an easy-to-find, investor-friendly manner. All information published under the regulatory disclosure requirements shall be disseminated to the media and the release storage of the stock exchange and kept available on the company's website for at least five years. However, the financial statements, half-yearly financial reports and corporate governance statements shall be kept available on the website for at least 10 years.

ii Financial reporting and accountability

Listed companies shall prepare annual financial statements and reports by the board of directors as well as an interim report for the first six months of the financial year. The consolidated financial statements shall be prepared in compliance with international financial reporting standards. Pursuant to the amended Transparency Directive,⁴ implemented in Finnish legislation in November 2015, listed companies are no longer required to publish quarterly financial information for the first three and nine months of the financial year. However, most of the listed companies have continued publishing financial information on a quarterly basis.

The financial statements must be published within four months from the end of the financial year and at the latest three weeks before the annual general meeting. In addition, a financial statement release, as required by the rules of the Helsinki Stock Exchange, must be published within three months from the end of the financial year. The financial statement release shall contain the material contents of the financial statements.

Listed companies are required to publish their future prospects in the report by the board of directors once a year. However, most Finnish listed companies have chosen to include their future prospects also in the interim reports and the financial statement release. The FIN-FSA has emphasised that future prospects should be presented together with relevant analysis and linked to risks and uncertainties that may prevent these prospects from being realised. The description of risks and uncertainties should cover company-specific issues associated in particular with the company's business, industry and operating environment. If it becomes likely that the financial performance will differ materially from previously disclosed future prospects, a profit warning shall be issued without undue delay.

According to the Securities Markets Act, the FIN-FSA may impose a penalty payment for any failure to comply with the ongoing disclosure obligation, disclosure of periodic

4 Directive 2013/50/EU of 22 October 2013 amending Directive 2004/109/EC.

information and publication and storage of regulated information. A breach of the disclosure obligations set forth in the Securities Markets Act may also result in criminal sanctions under the Penal Code.

iii Auditors

Listed companies must appoint at least one auditor or an audit firm approved by the Finnish Patent and Registration Office. The length of an engagement of a particular auditor or audit firm may not exceed 10 years. The engagement may last longer provided the requirements are met concerning a public tender process for the statutory audit, and the process is conducted in compliance with the amended Audit Directive and Regulation.⁵ The auditor shall submit annually to the company's board of directors a written confirmation of his or her independence, a notification regarding threats to independence as well as measures taken to safeguard independence, and a notification regarding engagements other than the statutory audit performed for the company.

Restrictions apply in relation to the provision of non-audit services for listed companies by their auditors and audit firms. The first set of restrictions concern services that involve the management or decision-making of the audited entity. Bookkeeping and the preparation of accounting records and financial statements for the audited entity are also prohibited. Furthermore, the total fees for non-audit services by the auditor or the audit firm are limited to no more than 70 per cent of the average of the fees paid for the statutory audits of the audited entity in the most recent three consecutive financial years. According to the Code, the company shall disclose the fees paid to the auditor during the financial year, separating fees paid for non-audit services.

IV CORPORATE RESPONSIBILITY

The Code sets out the main responsibilities of the board of directors relating to internal control and risk management. According to the Code, the board shall ensure that the company defines the operating principles of internal control and shall monitor the functioning of that control. The Code further provides that the company shall disclose the major risks and uncertainties that the board is aware of and the principles along which the risk management of the company is organised. The company shall also disclose the manner in which the internal audit function of the company is organised.

In addition to audit committees, it is also becoming more common to have separate compliance functions in listed companies. In recent years, some listed companies have also established responsibility and ethics committees.

Corporate social responsibility reporting is common. Certain responsibility disclosure matters shall be included in the company's annual report. Many Finnish companies use report formats such as those of GRI.⁶ The Finnish government has made a resolution to commit to promote corporate social responsibility and issued an action plan relating to social responsibility. Listed companies are required to include in their corporate governance statement a description of the applicable policies regarding diversity, including gender balance and educational background of the board and the supervisory board. Listed companies also

5 Directive 2014/56/EU of 16 April 2014 amending Directive 2006/43/EC and Regulation (EU) No. 537/2014 of 16 April 2014, respectively.

6 International independent standards organization Global Reporting Initiative.

need to disclose information on policies, risks and outcomes regarding environmental matters, social and employee-related aspects, and respect for human rights, as well as anti-corruption and bribery issues.

Furthermore, the MAR requires that listed companies set up appropriate whistle-blowing procedures in line with existing rules applicable to financial institutions.

V SHAREHOLDERS

i Shareholder rights and powers

Shareholders exercise their decision-making powers and participate in the supervision and control of the company through general meetings. The most significant share-related rights include the right to vote in a general meeting, the right to submit a matter dealt to the general meeting and the right to ask questions at a general meeting.

Usually, the general meeting convenes once a year in the annual general meeting. An extraordinary general meeting may be convened if the board of directors deems it necessary, if shareholders with at least 10 per cent of the shares so demand in writing, or if this is otherwise required by law.

Finnish law does not provide for special rights for long-term shareholders, such as extra votes or extra dividend rights.

ii Matters to be brought to the general meeting

The general meeting decides on matters falling within its competence pursuant to the Companies Act and the company's articles of association. Unanimous shareholders may also make decisions on matters falling within the competence of the board of directors or the managing director of the company unless otherwise explicitly specified in the Companies Act.

Matters that, according to the law, shall be decided upon by the general meeting include the election of board members and determining their compensation, the election of the auditor of the company, and the amendment of the company's articles of association. In addition, all decisions relating to the shares or share capital of the company shall be approved by the general meeting, including share repurchases, share issues and issues of rights entitling the holder to shares. However, the general meeting may authorise the board of directors to decide on a share issue, a repurchase of the company's own shares or an issue of special rights entitling the holder to shares. Such an authorisation must specify the maximum number of shares that may be issued and, in the case of share repurchases, the price range for the repurchase. The board of directors may be authorised to decide upon all the other conditions. Dividend distributions shall also be decided upon by the general meeting. The dividend distribution may not exceed the proposal made by the board of directors. The only exception is that shareholders holding at least 10 per cent of the shares in the company may request the payment of a minimum dividend corresponding to half of the profits of the financial year but not more than 8 per cent of the equity of the company. The general meeting shall also resolve upon certain corporate restructurings, such as mergers and demergers, as well as the dissolution of the company.

iii Decision-making at the general meeting

Each shareholder has the right to participate in a general meeting and to use voting rights at the meeting. Unless otherwise provided in the company's articles of association, all

shares carry equal rights. Shares with multiple voting rights or differing dividend rights are permitted, as are shares that do not have any voting rights. Some Finnish listed companies have share classes with multiple voting rights.

Resolutions by a general meeting usually require a majority of the votes cast. However, certain resolutions require a qualified majority so that the underlying proposal is supported by at least two-thirds of votes cast and shares represented at the meeting.

Decisions requiring a qualified majority in a listed company include:

- a* amendment of the articles of association;
- b* directed share issues;
- c* issuing option rights and other special rights entitling to shares;
- d* acquisition and redemption of own shares;
- e* mergers and demergers; and
- f* a decision to enter into liquidation or terminate a liquidation procedure.

Foreign shareholders commonly use proxy voting to participate in general meetings of Finnish listed companies, and the recommendations given by proxy advisers have during recent years become more relevant for listed companies with a large number of foreign shareholders.

iv Dissenting shareholders

Dissenting shareholders may require that a vote be passed on a matter under consideration by the general meeting. However, voting at general meetings is uncommon in practice. The key rights of a shareholder include the right to have matters submitted to the meeting and the right to ask questions at the meeting. In practice, these rights give the shareholders an effective tool for raising issues for discussion with the board of directors and management of the company.

v Objecting to a decision by the general meeting

Shareholders may also object to a decision by the general meeting by bringing an action against the company. However, this would require that a procedural provision of the Companies Act or the articles of association had been breached. Furthermore, the breach would need to have had an effect on the contents of the decision or the rights of a shareholder or otherwise be contrary to the Companies Act or the articles of association. An action based on the breach must be brought within three months from the decision.

In addition, a decision by the general meeting may be deemed void irrespective of time limits if there has been a grave breach of the law. Examples can include situations where the provisions regarding the notice to a general meeting have been materially breached, and where decisions clearly in breach of the principle of equal treatment of shareholders have been made.

Board decisions are not subject to shareholder approval. However, the board may transfer matters in its decision-making power to be decided upon by the general meeting. Board decisions may not be contested by a shareholder unless the decision is based on an authorisation by the general meeting, such as with regard to a share issue.

vi Shareholders' duties and responsibilities

Protection of minority rights

The Companies Act provides for the protection of the interests of minority shareholders through the requirement of equal treatment. This means that no corporate body, including the general meeting, may make decisions giving an undue advantage to some shareholders or other persons at the expense of other shareholders or the company. Although, according to the main rule, the general meeting shall adopt decisions supported by a majority of votes, the minority may also force certain decisions, such as requiring the distribution of a minimum dividend out of the company's profits.

Controlling shareholders and institutional investors

Neither Finnish legislation nor self-regulation specifically regulate controlling shareholders or institutional investors, or establish any particular duties for them. However, there is a general obligation to launch a takeover bid when a shareholder's ownership exceeds certain levels (30 per cent or 50 per cent of the voting rights in the company). There is also an obligation to redeem all the minority shares when a shareholder holds more than 90 per cent of all the shares and voting rights in the company. The proposed amendment to the Shareholders' Rights Directive (SHRD II),⁷ which is currently in the EU legislative process, contains rules that require institutional investors and asset managers to publicly disclose their engagement policies and how they are implemented.

A shareholder of a Finnish company is liable for damages only if he or she has through a wilful or negligent act or omission violated the Companies Act or the articles of association.

Shareholder activism

Shareholder activism has been fairly moderate in Finland. However, there is a growing tendency, especially among the institutional investors, to take a more active role. Institutional shareholders are also more frequently publishing ownership policies and thus publicly setting out their role as shareholders.

Except for the provisions of the law relating to shareholder liability, shareholders are not governed by any code or other corresponding regulation.

Say on pay

The general meeting decides on the remuneration payable for the board and committee work, as well as the basis for its determination. The board of directors decides on the remuneration and other compensation payable to the managing director.

There are no say-on-pay rules as such in Finland. That is, there is no requirement to bring a remuneration programme or an item relating to the remuneration of the executive management to the general meeting, nor is there any requirement to seek the opinion of the general meeting in this respect. Shareholders may, however, use their right to ask questions at the general meeting in relation to the information contained in the remuneration statement of the company that shall be held publicly available on the company's website. This right is specifically set forth in the Code.

⁷ Proposal for a Directive on amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (2014/0121 (COD)).

The proposed adoption of SHRD II would subject the company's remuneration policy and remuneration report to a shareholder vote; Member States can implement this requirement either through a binding vote or an advisory vote framework.

Contact with shareholders

As described in Section III above, Finnish listed companies are subject to the MAR's general disclosure requirements. Shareholders also receive information on all matters proposed to be decided upon by the general meeting. The notice to a general meeting shall be published and made available to the shareholders no later than three weeks prior to the general meeting and shall include information on the decisions proposed to be taken. Shareholders also have the right to ask questions at the general meeting, and in practice often do so in connection with the managing director's presentation of the results of the company.

The company may generally contact individual shareholders as long as the contact is in the interest of the company and in accordance with the principle of equal treatment. The contact may not be aimed at giving one shareholder undue benefit at the expense of other shareholders or the company. Situations where the company engaging in discussions with a major shareholder can be in the interests of all shareholders may include planned share issues or other corporate restructurings. In such instances, the company would have to have due confidentiality arrangements in place, and the shareholder in question would be prevented from trading with the securities of the company upon receiving inside information.

Large shareholders acting together will have to observe the rules relating to acting in concert, which may trigger an obligation to launch a public takeover bid if the joint holding of shareholders acting in concert would exceed 30 per cent or 50 per cent of all votes.

vii Takeover defences

Shareholder and voting rights plans

In Finland a company may have different share classes that may grant different voting rights in the general meeting. The general meeting of the company may resolve to amend the company's articles of association and set up dual-class stock. However, this is usually done before the company is listed because of applicable qualified majority requirements.

White-knight defence⁸

The board has a general duty to act in the best interest of the company and its shareholders. According to the preparatory works of the Companies Act, in a takeover bid situation, seeking the best possible outcome for the shareholders means that the board shall undertake the measures needed to achieve as good a bid as possible.

Pursuant to the Helsinki Takeover Code, if the board of the target company is contacted with the purpose of proposing a takeover bid and the board considers the contact serious, the board shall evaluate what measures may be required to secure the interests of the shareholders. The board must take active steps to ensure that the best possible outcome is achieved for the shareholders.

The Helsinki Takeover Code's explanatory notes state that the board of the target company may also seek competing bids, and that this may, in certain situations, reflect

⁸ The white-knight defence relates to a situation where a third party (the white knight) acquires a target company that is being taken over by a party deemed hostile by the target company management.

required prudence in a takeover situation. There is, however, no explicit obligation to seek a competing bid. If a potential alternative purchaser is known to the board, it would, for example, be justified for the board to consider whether it would be in the interests of the shareholders to approach that other party.

Staggered boards

In a Finnish listed company, the term of a board member usually ends with the conclusion of the next annual general meeting following his or her appointment. The general meeting may also dismiss board members elected by the shareholders at any time during their term of office.

Staggered boards are generally deemed to have limited use in Finland. Pursuant to the Companies Act, it is possible to stipulate in the company's articles of association that board members have longer terms than are set forth in the default rule under the Companies Act. The Code recommends that the board shall be elected annually at the annual general meeting. According to the rationale of this recommendation, shareholders should have the option to evaluate the performance of the board on a regular basis. The rationale also states that good corporate governance requires that the entire board is elected annually at the annual general meeting.

It may be stipulated in the company's articles of association that less than half of the directors are elected in some other manner specified in the articles. The articles may stipulate, for example, that a certain party, appoints those directors. The party eligible to appoint a director also has the power to dismiss that director during his or her term of office.

VI OUTLOOK

There is an increasing focus on corporate governance in Finland and an interest in complying with best practices. Efforts have been made to develop uniform corporate governance practices for listed companies in through self-regulation. For example, guidelines for general meetings have been developed by the Advisory Board of Finnish Listed Companies to address practical procedures followed at meetings. As discussed above, the Code and the Helsinki Takeover Code also provide a framework for best practices in corporate governance in general.

The ownership structure of many Finnish listed companies remains relatively concentrated. There has been an increasing awareness of the relationships between large shareholders and listed companies. In particular, there have been concerns regarding shareholders being deemed to be 'acting in concert' for the purposes of triggering mandatory bid obligations. The White List for approved shareholder cooperation issued by ESMA in November 2013 has not addressed many of the concerns that often arise in connection with, for example, different types of shareholder cooperation or different corporate transactions. Concerns related to insider information also arise in connection with large shareholders having board representation in listed companies. Special arrangements are often needed to ensure that insider regulation is complied with in certain related-party transactions, or in the planning thereof.

FRANCE

*Didier Martin*¹

I OVERVIEW OF GOVERNANCE REGIME

i Sources of law, regulation and best practice

Corporate governance rules are mainly set out in statutory provisions contained in the French Commercial Code and in recommendations contained in corporate governance codes (such as the French Association of Private Enterprises (AFEP) – Movement of French Enterprises (MEDEF) Code) – or in positions expressed by various professional bodies and associations.

Indeed, the AFEP-MEDEF Code has become a reference in matters of corporate governance. It is based on recommendations issued over the past 21 years and sets the corporate governance standards for listed companies.

ii Enforcement of the listed company regime

Besides compulsory rules, the implementation of corporate governance principles is also monitored by the French Financial Markets Authority (AMF), which publishes an annual report assessing corporate governance practices and executive directors' compensation in listed companies.

Moreover, although corporate governance codes and the positions expressed by professional bodies or associations do not have any legal authority and are considered to be 'soft law', these rules are generally applied by companies. This can be explained by market pressure, since compliance with these rules is a criterion used by proxy advisers in their recommendations on how to vote on shareholders' resolutions. Almost all large listed companies have selected the AFEP-MEDEF Code and, since its amendment in June 2013, application of the AFEP-MEDEF Code's provisions has been monitored by the High Committee for Corporate Governance, which issued its first annual report in October 2014,² and a guide on the application of the AFEP-MEDEF Code in December 2014.³

iii Recent developments of the corporate governance regime

In 2016, three years after the 'say-on-pay' procedure was added to the AFEP-MEDEF Code – and although the average rate of approval by shareholders of say-on-pay resolutions has increased from 86.7 per cent in 2015 to 90.6 per cent in 2016 for CAC40-listed companies

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2 'High Committee for Corporate Governance Annual Report 2014'. The High Committee for Corporate Governance issued its third annual report in October 2016.

3 'Application Guide for the AFEP-MEDEF Corporate Governance Code of Listed Corporations of June 2013'. The High Committee for Corporate Governance issued its second guide in December 2016.

– shareholders voted against executives’ compensation for the first time, in two companies. The decisions to reject the relevant resolutions were justified not only by the high level of remuneration granted, but also by the poor quality and insufficiency of the information provided. These negative votes and the subsequent lack of reaction from the boards of directors of the companies concerned gave rise to much debate, notably regarding the consultative nature of the say-on-pay vote, and caused the legislator to introduce, in December 2016, a say-on-pay procedure that is both mandatory and binding (see Section V.iii, *infra*).

Further progress has also been made in the revised AFEP-MEDEF Code of November 2016, in particular with provisions aimed at reinforcing the role of the strategy committee in listed companies, improving directors’ independence, increasing the role of corporate social responsibility (CSR) – especially concerning the environment – and laying down or clarifying the principles that apply to executive compensation (the new code now provides that the quantifiable criteria for variable remuneration must be preponderant).

In 2016, the absence of whistle-blowing procedures *per se* in French law led the legislator to implement a regime to protect whistle-blowers (see Section IV.ii, *infra*).

On 17 June 2016, new EU rules on statutory audits aiming at improving audit quality and restoring investor confidence in financial information became applicable in France.⁴

iv Distinctive aspects of the corporate governance regime in France

Corporate governance in France has changed considerably during the past 17 years as a result of the increase of foreign shareholdings in CAC 40-listed companies. Regulations have also been used to address market failures and restore public confidence, in particular regarding executive compensation.

In core areas, such as director independence and board committees, the French corporate governance regime is converging with existing best practices. Differences in governance structures can still be found, although the one-tier system is prevalent in France, with approximately 85 per cent of major listed companies adopting this structure.

v Recent trends

The practice of extra-financial analysis and rating has developed considerably to enable investors to include extra-financial performance of companies in their investment criteria. Extra-financial analysis organisations assess companies’ sustainable development policies to evaluate how listed companies take into account environmental, social and governance issues.

Although extra-financial analysis organisations are not regulated, a Voluntary Quality Standard for Corporate Sustainability and Responsibility Research⁵ has been drawn up, setting out guidelines, rules and commitments regarding the transparency, accountability and verifiability of the processes involved in extra-financial analysis. The AFEP-MEDEF Code now takes into account information on non-financial issues (see Section IV.iii, *infra*) while Directive 2014/95/EU dated 22 October 2015, which will soon be transposed into French law, introduced an obligation to disclose non-financial and diversity information for large companies (see Section III.iii, *infra*).

4 French executive order No. 2016-315 dated 17 March 2016 relating to audit quality.

5 The initiative is promoted by the Association for Independent CSR Research and approved by the European Commission.

The level of disclosure of financial information has been increasing, particularly regarding remuneration policy, under pressure from shareholders and proxy advisers, and after several controversies concerning executive compensation and severance packages.

Another notable trend is the preference among listed companies for the one-tier governance structure (i.e., with a single board of directors).⁶ Companies with a one-tier board tend to combine the positions of chair of the board and CEO. An increasing number (42.9 per cent) of CAC 40-listed companies have appointed a lead director, notably to counterbalance the concentration of power in the CEO's hands (when he or she is also the chair of the board).⁷ The AFEP-MEDEF Code now provides that lead directors should be independent directors.⁸

II CORPORATE LEADERSHIP

i Board structure and practices

Structure

Listed companies in France may have either a one-tier governance structure comprising a board of directors in charge of the company's general management together with a CEO (who may or may not be a director) who is the legal representative of the company; or a two-tier structure comprising a management board, whose chair is the legal representative of the company, and a supervisory board that supervises the management board and must not interfere in the management of the company.

ii Composition of the board

Under the one-tier system, the board of directors is composed of a minimum of three and a maximum of 18 members. Under the two-tier system, the supervisory board is also composed of between three and 18 members.

The percentage of women on the boards of CAC 40-listed companies has continued to rise, reaching 36.4 per cent as of December 2015, to comply with French law, according to which, by 2017, there should not be less than 40 per cent of women (or men) on boards of directors or on supervisory boards.

While French law does not provide for specific details concerning the presence of independent directors, corporate governance codes strongly recommend the appointment of a certain proportion of independent members. According to the AFEP-MEDEF Code, independent directors should account for half of the members of the board in widely held corporations that do not have controlling shareholders. In other corporations, at least one-third of the board should be composed of independent directors.⁹

Election of board members representing employee shareholders is an obligation in state-controlled companies, in listed companies where the employees hold more than

6 AMF, '2015 Report on Corporate Governance and Compensation of Executives of Listed Companies' (85 per cent of the sampled companies have this one-tier structure).

7 Prerogatives commonly attributed to the lead independent director include communication with shareholders of the company not represented on the board, prevention of conflicts of interest, evaluation of directors' performance and remuneration, coordination of the independent directors' activities and coordination of the work of board committees.

8 Paragraph 6.3 of the AFEP-MEDEF Code as revised in November 2016.

9 Paragraph 8.3 of the AFEP-MEDEF Code.

3 per cent of the share capital¹⁰ and in companies that employ, jointly with their subsidiaries, more than 1,000 employees in France or more than 5,000 employees worldwide, except for those that already have employee representatives on their board.¹¹ There should be one employee shareholder representative on any board with fewer than 12 members and two on boards with more than 12 members.¹²

Representation and management of the company

In companies with a one-tier structure, the board of directors decides whether the management of the company is carried out by the chair of the board or by a separate CEO. The CEO has the broadest powers to represent the company and act on its behalf in all circumstances. Limitations on the CEO's powers can be set out in the articles of association or decided by the board, but are not enforceable against third parties.

In companies with a two-tier structure, the management board is vested with the broadest powers to act in any circumstances on behalf of the company, which is represented by the chair of the management board.

Legal responsibilities of the board

In companies with a one-tier structure, the board of directors is responsible for determining the corporate strategy and supervising its implementation. It is also responsible for controlling the management of the company, for appointing and removing the chair, CEO and deputy CEOs and determining their remuneration, and for convening the shareholders' meetings.

In companies with a two-tier structure, the supervisory board supervises the management board and carries out the verifications and inspections it considers appropriate. The supervisory board also has specific attributions, which are similar to those attributed to the board of directors.

Delegation of board responsibilities

Decisions taken by the board of directors are collective decisions and cannot be delegated to one or more specific directors or to third parties.

The board of directors or supervisory board may give specific mandates to certain members to study identified issues.

Separation of roles of CEO and chair

The chair organises the work of the board of directors and chairs the meetings. He or she also ensures that the different decision-making bodies of the company operate properly. Although it is not expressly specified as being one of his or her responsibilities, the chair can communicate directly with shareholders but will remain bound by an absolute duty of confidentiality and is thus prohibited from disclosing privileged information.

10 Article L 225-23 of the French Commercial Code.

11 Article L 225-27-1 of the French Commercial Code. A 2015 law has lowered the threshold above which the board should include employee representatives from 5,000 to 1,000 employees in France and from 10,000 to 5,000 employees worldwide.

12 Article L 225-27-1 II, L 225-79-2 II and L 226-5-1 of the French Commercial Code.

Remuneration of directors and senior management

Non-executive directors' remuneration consists exclusively of attendance fees. Any other remuneration is prohibited, except that resulting from either an employment contract non-executive directors may otherwise have with the company for separate functions, or a special temporary assignment. The shareholders' meeting decides the total amount of the attendance fees, but the board determines the amount allocated to each director. In accordance with the 'duty of care' imposed on board members, which requires assiduity and involvement, these fees usually include a variable portion that depends on attendance at board meetings and, as the case may be, committee meetings. Non-executive members may not be granted shares or share options free of charge.

Executives' remuneration generally includes fixed and variable components and stock options or performance shares, or both. The AFEP-MEDEF Code provides that variable remuneration must be capped at a specific percentage of the fixed part, and that the chair of the board should not receive any variable remuneration, stock options or performance shares.¹³

When determining the overall compensation of an executive, the board of directors takes into account all components such as bonuses, stock options, performance shares, directors' attendance fees and pension schemes.

While it is recommended that the fixed part of the remuneration is reassessed only every three years, variable remuneration and stock options or free share awards should reward both short-term and medium-term performance. Quantitative performance criteria must be simple, objective, measurable and coherent with the corporate strategy and not solely determined by stock price. Four main categories of quantitative criteria can be identified: financial ratios (notably return on capital employed), revenue growth (as well as free cash flow, operating profit, and earnings before interest, tax, depreciation and amortisation growth), increases in the share price and performance in comparison with the company's main competitors. It also provides that quantitative performance criteria do not necessarily have to be financial criteria.¹⁴ Furthermore, the AFEP-MEDEF Code recommends that a specific cap be set for qualitative criteria.

Benchmarking with other companies operating in the same market is common, although proxy advisers tend to consider that it is not a sufficient justification.

Executives' remuneration is decided by the board of directors or supervisory board on the recommendation of the remuneration committee. Shareholders have a consultative vote on the remuneration (see Section V.iii, *infra*). If the shareholders vote against the relevant resolution, the board must deliberate on the issue and publish a press release explaining its decision despite the result of the vote.

Top-hat pension plans and any commitment by a listed company to pay a termination fee to a director in the event that he or she ceases to be a director are subject to the procedure for related-party transactions, and are subject to shareholder approval upon renewal of the relevant directors' terms of office. Also, the pension amounts paid out must be linked to performance conditions, and the increase in the amount of the beneficiaries' rights must be capped. The French Commercial Code also prohibits remuneration, indemnities and any other kind of benefits to be paid in the event of termination of a director's term of office, if they are not subject to conditions based on performance.

13 Paragraph 24.2 of the AFEP-MEDEF Code.

14 Paragraph 24.3.2 of the AFEP-MEDEF Code.

The AFEP-MEDEF Code recommends capping termination fees at a maximum of two years' annual fixed and variable compensation, taking into account the non-compete compensation and any potential severance payment due as a result of the termination of the employment agreement if any.¹⁵

Committees

An audit committee is compulsory in listed companies, and their powers have been reinforced following the European reform of audit quality, which entered into force in France on 17 June 2016. The AFEP-MEDEF Code also recommends the creation of a remuneration committee (headed by an independent director and with one member being an employee representative)¹⁶ and a nomination committee (the two may be combined). Members of committees should be non-executives and a majority of the members should be independent (two-thirds in an audit committee, which must include a member with accounting and finance skills). Most companies also have other specialised committees dedicated to strategy, internal control, CSR, ethics, science and technology, and risks.

Board and company practice in takeovers

During a takeover bid, the board of directors may adopt any provisions to thwart the takeover, without shareholder approval, subject to the powers expressly granted to general meetings and with due regard to the company's corporate interests. However, companies may amend their articles of association (with the shareholders' approval) to opt out of the ability to adopt anti-takeover measures without prior shareholder approval.

iii Directors

Role and involvement of outside directors

The AFEP-MEDEF Code emphasises the importance of having a significant proportion of outside directors (or independent directors) on the board to improve the quality of proceedings. Outside directors have the same rights as other directors, but they are encouraged to play an active role and protect themselves against possible liability.

Legal duties and best practice

Directors principally have the legal duty to act in the best interests of the company and to be 'diligent'. Pursuant to case law, other specific duties, such as the duty of loyalty or the duty of care, are also incumbent upon directors.

Civil liability

In companies with a one-tier structure, the chair of the board, CEO and members of the board of directors can be held liable in relation to the company, shareholders or third parties for any breach of laws, regulations or the company's articles of association, as well as wrongful acts of management by directors in carrying out their duties. Breach of the duty of loyalty is also recognised by case law.

15 Paragraph 24.5.1 of the AFEP-MEDEF Code. Pursuant to a decree dated 27 July 2012, public sector executives' remuneration was capped at €450,000 per year (i.e., 20 times the average of the lowest wages in public sector companies).

16 Paragraph 17 of the AFEP-MEDEF Code.

If a wrongful act is committed, the CEO and directors may only be held liable if it can be proved that a loss has been suffered and that there is a direct causal link between the loss and the wrongful conduct. This civil action may be brought:

- a* by the company, either acting directly through its legal representatives, or through a derivative action called an *ut singuli* action, which is exercised by a shareholder acting on behalf of the company; or
- b* by a third party (e.g., creditors or employees) or shareholders (who are distinct from third parties), if the loss suffered is distinct from that suffered by the company. Whereas actions brought by third parties require that the wrongful act be deemed to be unrelated to the directors' duties (traditionally defined as wilful misconduct that is particularly serious and incompatible with the normal exercise of duties), actions brought by shareholders, following a decision of the French Supreme Court,¹⁷ do not require that this condition be met.

In the case of insolvency of a company, directors who have committed acts of mismanagement can be held liable for all or part of the company's debts.

In companies with a two-tier structure, the same rules apply to members of the management board. While members of the supervisory board cannot be held liable for mismanagement, they can be held liable for negligent or tortious acts committed in the performance of their duties, and may be held civilly liable for criminal offences committed by members of the management board if, although aware of the offences, they did not report them to the general meeting.

Criminal liability

The chair of the board, CEO, members of the board of directors or members of the management board and the supervisory board can be sentenced to five years' imprisonment or ordered to pay a fine of €375,000, or both, for having:

- a* distributed sham dividends in the absence or on the basis of false inventories;
- b* published or presented to the shareholders annual accounts not providing, for each financial year, a fair representation of the results of the operations; or
- c* directly or indirectly used the company's assets, in bad faith, in a way that they know is contrary to the interests of the company, for personal purposes.

Appointment and term of office of directors

Members of the board of directors or supervisory board are appointed by the ordinary general meeting of the shareholders. Under certain circumstances, the board of directors may appoint new members by co-optation, subject to the shareholders' meeting subsequently ratifying the appointments.

Directors are appointed for a term set out in the articles of association, up to a maximum of six years (four years in the two-tier system). In practice, because of the influence of the AFEP-MEDEF Code, the four-year term of office is prevalent. Re-election is possible, and 92.4 per cent of the companies listed on the SBF Index rotate renewal of the terms of office

17 Court of Cassation, 9 March 2010.

to avoid replacement of all directors at the same time. The office of members of the board of directors can in any event be terminated upon a decision by a shareholders' meeting at any time, without specific reason (*ad nutum*).

Specific requirements include:

- a* In the absence of an express provision in the articles of association, directors over 70 may not represent more than one-third of the members of the board.
- b* Employees may be appointed as board directors only if their employment contract corresponds to actual duties performed for the company and as long as the employee-director remains in a position of subordination in relation to the company. The number of directors with an employment contract cannot exceed one-third of the entire board.
- c* To guarantee the availability of directors, French law prohibits members of boards of directors or supervisory boards of listed companies from simultaneously holding more than five directorships.¹⁸ The AFEP-MEDEF Code now recommends setting this limit at three directorships for executive directors. Furthermore, a recent order dated 20 February 2014 provides that executives of credit institutions and investment companies cannot hold more than three offices as executive director and more than four offices as board member.

Members of boards of directors are no longer required to hold a specific number of shares, unless this condition is provided for in the company's articles of association. The AFEP-MEDEF Code, however, provides that directors should be shareholders and hold a fairly significant number of shares fixed by the articles of association or the board's internal rules.

Conflicts of interest of directors

French law and corporate governance codes require that directors must inform the board of directors of any conflicts of interest, whether actual or potential, and should abstain from voting on such matters.

Under French law there are also some prohibitions or specific procedures for related-party transactions, which can create a conflict of interest: directors are prohibited from contracting loans from the company or arranging for the company to act as guarantor in respect of their obligations. Also, to be valid, any significant transaction between the company and one of its executives or directors, a direct or indirect shareholder holding more than 10 per cent, or another company having executives or directors in common, must receive prior authorisation from the board (without the directors concerned voting), while grounds for approving related-party transactions must be detailed and re-assessed annually. Related-party transactions entered into between a parent company and a wholly owned subsidiary are no longer subject to the authorisation procedure. Finally, specific information must be given to shareholders regarding agreements entered into between a subsidiary of

18 The 2016 AFEP-MEDEF Code provides that an executive director should not hold more than two other directorships in listed corporations, including foreign corporations, not affiliated with his or her group. He or she must also seek the opinion of the board before accepting a new directorship in a listed corporation. Furthermore, a non-exclusive director should not hold more than four other directorships in listed corporations, including foreign corporations, not affiliated with his or her group.

a company and a director or major shareholder of the parent company. The AFEP-MEDEF Code provides that the internal rules of the board should set out provision on the prevention and management of conflicts of interest.¹⁹

The auditors present a report on the authorised transactions to the shareholders' meeting, and the shareholders vote on them. If a transaction is not approved by the shareholders, the interested party and the directors can be held liable for any adverse consequences of the transaction for the company.

III DISCLOSURE

i Financial reporting and accountability

Reporting of financial information required by French law for listed companies is subject to regulations that distinguish between 'periodic information' and 'ongoing information'.

Periodic information is information provided by listed companies at regular intervals. Most notably, this includes the requirement to disclose an annual financial report, a half-yearly report and quarterly financial information.

Ongoing information is information published by listed companies to notify the public without delay of all information likely to have a material impact on the share price. It also includes disclosures related to the crossing of thresholds or share transactions carried out by an issuer's executives or board members.

Compliance with corporate governance is mentioned in the report on internal control, risk management and the preparation and organisation of the board's work, which is issued by the chair of the board every year.

ii Auditors' role, authority and independence

External auditors are required to audit the company's accounting documents and check whether the accounting principles applied in the company comply with the applicable accounting standards. They certify that the annual or consolidated accounts give a true and fair view of the financial situation of the company. They draft a general report on the accounts, as well as special reports on specific corporate transactions (share capital increases, contributions in kind, related-party transactions, etc.), which are presented to the annual general meeting of the shareholders.

They are also required to draft a report on internal control and risk management, in which they present their observations on the report prepared by the chair on internal control and risk management. Many listed companies also ask their auditors to prepare specific reports on corporate social responsibility matters. The reform regarding auditing, which transposed Directive 2014/56/EU, was adopted in France on 17 June 2016. It features mandatory statutory auditor rotation and enhanced transparency and reporting requirements by audit firms (including a detailed report to shareholders, a report intended for the audit committee and a report for the authorities on any irregularities). It also establishes a list of non-audit services that cannot be provided by the statutory auditor or audit firm to the audited entity, imposes limitations on the fees charged for non-audit services²⁰ and enhances the role of the audit committee.

19 Paragraph 19 of the AFEP-MEDEF Code.

20 Non-audit services are capped at 70 per cent of annual fees.

iii Corporate social and environmental responsibility (CSR)

Over the past few years, CSR has been increasingly taken into account in the corporate governance of listed companies.²¹ As no reference guide regarding this matter existed, in 2014 the MEDEF issued its first guide on CSR initiatives to support the sharing of best practices.²² Furthermore, the government issued a report on CSR,²³ providing advice to reinforce the involvement of companies in CSR issues, and launched a CSR Platform, a think-tank supervised by the French Prime Minister. In November 2013, in the context of a draft European Directive²⁴ suggesting that non-financial reporting should be mandatory, the AMF issued its first report²⁵ on how listed companies disclose information on CSR. It concluded that, even though efforts had been made, there was still room for improvement, and issued a series of recommendations. Directive 2014/95/EU of the European Parliament dated 22 October 2015 introduced an obligation to disclose non-financial and diversity information for large companies. The upcoming transposition of this text will require changes to French legislation by making disclosure of this information mandatory for large companies. In the future, companies will have to explain the environmental and social risks related to their activities and how they intend to manage these risks.

IV CORPORATE RESPONSIBILITY

i Risk management

French listed companies must set up a special risk committee, known as the ‘audit and risks committee’, which is responsible for issues relating to internal control and risk management.

ii Compliance policies and whistle-blowing

Prior to the entry into force of the ‘Sapin II Law’ dated 11 December 2016, there were no whistle-blowing procedures *per se* in French law, even if several rules provided for alert procedures in, for example, the fields of labour law (in cases of discrimination or harassment) and banking (in cases of money laundering suspicions). External auditors are also required to inform the board of any irregularities found during their audit.

The Sapin II Law, in addition to this patchwork of different regimes, has introduced legal protection for whistle-blowers, in both public and private organisations, for any alerts in any field when there is a threat to public interest.²⁶ Whistle-blowers are granted immunity from criminal liability under certain conditions.²⁷

21 For example, CSR committees have been created.

22 ‘Guide on Sectoral CSR Initiatives’, dated 8 October 2014. The second edition of the guide was published on 18 July 2016.

23 See the report entitled ‘Organisations’ responsibility and performance’ dated 13 June 2013.

24 Draft directive dated 16 April 2013 of the European Commission.

25 The AMF published its third report in November 2016.

26 Except for medical secrecy, legal privilege and intelligence and national security secrets.

27 Article 122-9 of the French Criminal Code.

iii Corporate social responsibility

Corporate social responsibility has been progressively taken into account under French law.²⁸

In particular, French listed companies are obliged to publish data in their management report 'on the way they take account of the social and environmental consequences of their activity as well as on the company's undertakings in favour of sustainable development and the fight against discrimination and the promotion of diversity'.²⁹ They should also mention any non-financial key performance indicators, if applicable.³⁰

The AMF also recommends³¹ that French listed companies draw up a list of the types of industrial and environmental risks and provide a description of material risks to which they are exposed as a result of their business activities and characteristics.

CSR was specifically introduced into the AFEP-MEDEF Code in the update of November 2016. The AFEP-MEDEF Code now provides that the board of directors should be informed of the main CSR issues regarding the company,³² and that the shareholders and investors should be informed of the significant non-financial issues for the company.³³

V SHAREHOLDERS

i Shareholder rights and powers

Equality of voting rights

The French Commercial Code lays down a principle of proportionality of voting rights, according to which voting rights attached to capital or dividend shares must be in proportion to the share of the capital they represent. However, it provides for the following exceptions:

- a* shares that are fully paid up and that have been registered in the name of the same shareholder for at least two years are automatically granted double voting rights, unless the articles of association provide otherwise following a shareholder decision. (Nonetheless, it appears that a large number of companies have opted out and maintained the 'one share one vote' principle, in accordance with proxy advisers' recommendations);
- b* the voting rights attached to preference shares can be suspended or cancelled; and
- c* limitation of voting rights – for example, a potential target's articles of association may include a provision limiting the number of votes that may be exercised by a single shareholder, regardless of the number of shares held. Under AMF rules, however, these voting right limitations will be inoperative where a party acquires two-thirds or more of a target's outstanding share capital or voting rights through an offer.

Powers of shareholders to influence the board

Shareholders' rights regarding corporate governance are in practice very limited. Their only means of action is in exercising their voting rights at shareholders' meetings on the appointment or dismissal of board directors and on related-party transactions. They may also express their opinion regarding directors' compensation by casting an advisory vote at the general meeting.

28 See Law No. 2001-420, dated 15 May 2001.

29 See Article L 225-102-1 C.com, as amended by Law No. 2011-672, dated 16 June 2011.

30 See Ordinance No. 2004-1382, dated 22 December 2004.

31 See AMF Recommendation on risk factors, dated 29 October 2009.

32 Paragraph 3.1 of the AFEP-MEDEF Code.

33 Paragraph 4.2 of the AFEP-MEDEF Code.

When they represent a certain percentage of the share capital, they can propose their own candidates to the shareholders' meeting. In addition, the shareholders' meeting can decide at any time to replace the board. The shareholders may also put questions to the board on corporate governance matters, which the board must answer at the shareholders' meeting or request, in court, the appointment of an expert who will present a report on a specific transaction. Finally, decisions or actions of the company violating mandatory provisions relating to remuneration and related-party transactions may be cancelled at the request of a shareholder.

Decisions reserved to shareholders

Decisions reserved to shareholders are those that fall within the ambit of the ordinary or extraordinary general meetings of the shareholders. Ordinary general meetings of the shareholders may notably decide on the approval of the annual accounts, appointment and dismissal of directors or members of the supervisory board, appointment of auditors, approval of related-party transactions, etc. Extraordinary general meetings of the shareholders can amend the articles of association of the company and decide, *inter alia*, to increase or reduce the share capital.

Rights of dissenting shareholders

Dissenting minority shareholders may bring a claim arguing that majority shareholders have committed an abuse of majority that, if successful, could result in cancellation of the decision and the award of damages. This cause of action requires that two cumulative conditions be met: the decision must have been taken with the sole purpose of favouring the members of the majority to the detriment of minority shareholders, and it must be contrary to the company's corporate interests.

Benefits for long-term shareholders

Besides automatic double voting rights, which are only granted to shareholders evidencing that they have held their registered shares for at least two years, listed companies may grant loyal shareholders increased dividends, also known as 'loyalty dividends'. French law provides that payment of these loyalty dividends also requires that the shares have been held for more than two years. In addition, the dividends may not be more than 10 per cent higher than ordinary dividends, and the relevant shares must represent, for a particular shareholder, no more than 0.5 per cent of the company's capital.

Board decisions subject to shareholder approval

Related-party agreements are subject to shareholder approval, as are all decisions that fall within the scope of the ordinary or extraordinary general meetings of the shareholders.

Also, the AMF recommends that listed companies organise a consultative vote of the shareholders prior to making any disposal of a significant asset. In addition, to better supervise all major asset disposals, the AMF requests more detailed reporting from shareholders and recommends that best practices be followed to demonstrate that the transactions are in accordance with the corporate interest.

ii Shareholders' duties and responsibilities

Controlling shareholders' duties and liability

Pursuant to the AFEP-MEDEF Code, controlling shareholders must take particular care to avoid possible conflicts of interest, ensure transparency of the information provided to the market and equitably take all interests into account. They may be held personally liable if they use their votes in their own interest to the detriment of other shareholders and the company (majority abuse).

Institutional investors' duties and best practice

The AFEP-MEDEF Code does not specifically address the issue of institutional investors. There is a separate governance code for asset managers, containing recommendations on voting at shareholders' meetings of the companies in which the funds are invested, and reporting on such voting. In addition, the AMF has recently required that asset management companies report to shareholders and unit holders of collective investment schemes about their practices as regards exercising voting rights in the sole interest of shareholders and to provide an explanation if they do not exercise these rights.

There is no code of best practice for shareholders.

iii Shareholder activism

Say on pay

In response to recent corporate scandals, the Sapin II Law has implemented a new mandatory and binding regime for the say-on-pay procedure.³⁴

Shareholders will now be required to approve *ex ante*, annually, the compensation policy (i.e., the principles and criteria for setting, allocating and granting the fixed, variable and exceptional components of the total compensation and benefits of any kind attributable to the chairman of the board and to executive officers).³⁵ If the shareholders' meeting does not approve the compensation policy for a given year, the principles and criteria previously approved shall continue to apply, and the board must submit a new proposal at the next shareholders' meeting. In addition to the approval of the compensation policy *ex ante*, the new law also provides for a binding vote *ex post* on the remuneration granted (binding say on pay).³⁶ Payment of variable or exceptional compensation shall be made conditional upon approval by the shareholders' meeting and no payment may take place prior to the shareholders' approval.

The regime adopted by France goes beyond the proposal for a directive amending Directive 2007/36/EC on shareholder rights.

Proxy battles

Shareholders of French listed companies can appoint any person as proxy, thus giving rise to an increase in the use of professional proxy solicitors.

34 Article L 225-102-1-1 of the French Commercial Code.

35 Article L 225-37-2 of the French Commercial Code.

36 Article L 225-100 of the French Commercial Code.

Professional proxy solicitors must disclose their voting policy. On 18 March 2011, the AMF published a specific recommendation,³⁷ which notably urges proxy advisers to issue voting policies in a transparent manner, communicate with listed companies, submit draft reports to the relevant company for review and take measures to avoid conflicts of interest.

Since a report issued on 19 February 2010, the European Securities and Markets Authority (ESMA) also recommends that proxy advisers issue a code of conduct regarding conflicts of interest, transparency and communication with the shareholders. In March 2014, six proxy advisers made public their 'Best Practice Principles for Shareholder Voting Research and Analysis'.³⁸

iv Takeover defences

Shareholder and voting rights plans, and similar measures

A French company may first try to identify its shareholding by providing in its articles of association an obligation to disclose any interests over 0.5 per cent in its share capital or a right to request certain information from the central securities depository (Euroclear France) as to the identity of its shareholders and the size of their shareholdings.

Also, articles of association may include a provision limiting the number of votes that may be exercised by a single shareholder. This limitation will, however, be suspended for the duration of the first shareholders' meeting following completion of the offer, provided that the offeror has acquired at least two-thirds of the target's shares in the offer.

Also, the directors have the right to take measures to frustrate an unsolicited offer, provided that the measures are not against the corporate interests of the target company. As a consequence, the target's board is not required to obtain the shareholders' prior authorisation before implementing a sale or acquisition of strategic assets, the sale of a block of treasury stocks to a 'white knight' or arranging a counter-offer.

By way of derogation, the company's articles of association may impose an obligation of neutrality on the management of the target during offer periods.

Notably, proxy advisers and institutional investors recommend voting (1) for the implementation of statutory limitations preventing the board from putting defensive measures in place, and (2) against financial authorisations that are not suspended in the event that an offer is filed.

French law also permits equity warrants to be issued during an offer period. The warrants may be issued free of charge to all shareholders of the target prior to the closing of the offer and may entitle the holders to subscribe for new shares on preferential terms.

This issuance can be authorised by the shareholders:

- a* either during the offer to allow the target to defend a hostile bid (in which case the shareholders' authorisation only requires a simple majority of votes cast at a shareholder meeting, whereas an authority to issue equity securities directly usually requires a two-thirds majority vote of the votes cast; and only a quorum of 20 per cent on first call and no minimum on second call (instead of 25 per cent and 20 per cent in a normal extraordinary general meeting); or

³⁷ See AMF Recommendation on risk factors, dated 29 October 2009.

³⁸ Glass, Lewis & Co, Institutional Shareholder Services Inc, Manifest Information Services Ltd, PIRC Ltd and Proinvest, and IVOX GmbH, which has been recently acquired by Glass, Lewis & Co.

- b in advance, in view of a potential offer, by way of delegation given by the shareholders to the board of directors that can be used during an offer period.

White-knight defence

There should be no legal objection to a target board seeking a third party (a ‘white knight’) to make a competing offer for the target. Theoretically, a target could alternatively issue new shares to a third-party ‘friendly’ shareholder. However, such an issue would generally require specific shareholder approval and therefore the tactic would, in practice, be unusual.

When arranging for a white-knight defence, the target’s board of directors must comply with the company’s interest and ensure that it does not infringe on the principle of free interplay of bids and counterbids and maintains a level playing field.

Staggered boards

The AFEP-MEDEF Code recommends to avoid replacement of the board as a whole but enhance a smooth replacement of directors.³⁹ As a result, French companies commonly use staggered boards.

Efficiency of staggered boards as a takeover defence under French law is limited, as the general meeting of the shareholders may dismiss directors at any time and without cause.

v Contact with shareholders

Mandatory and best-practice reporting to all shareholders

Listed companies have developed various communication practices that differ for individual shareholders or financial investors.

Financial communication tools (specific sections of the company’s website, financial publicity, publication of a shareholders’ letter, shareholders’ guides and even custodial services) and club and advisory committees are generally used to maintain contact with individual shareholders. To assist listed companies, notably in the use of social media as a means of sharing information, the AMF has published several recommendations and created briefing sheets covering usage and best practices in different areas, ranging from online and social media strategy to shareholder guides and consultative committees.⁴⁰

Telephone or individual meetings, road shows, conferences organised by brokerage firms, analysts’ and investors’ days, and on-site visits are used to communicate with institutional and financial investors.

Selective meetings and communications, circumstances of meetings with individual shareholders

It is customary for investor relations services to organise meetings or conference calls with large shareholders prior to shareholders’ meetings. This same approach may be taken with proxy advisers, who also often seek meetings with the chairman of the remuneration committee.

39 Paragraph 13 of the AFEP-MEDEF Code.

40 AMF Recommendation 2014-15 for listed companies on communication using their websites and social media; AMF Recommendation 2015-09 on ‘Communication by companies aimed at promoting their securities to individual investors’; and AMF, ‘Study on communication practices among listed companies’, December 2015.

These meetings allow shareholders to be fully informed before voting. The AFEP-MEDEF Code provides that where there is a lead director, he or she can be in charge of relations with shareholders.⁴¹

Individual meetings may also be organised regularly between senior executives, the investor relations department and analysts and investors. For investors, one-on-one meetings provide an opportunity to assess the vision that senior managers have for their company, their analysis of the competitive environment, market trends, etc.

Executives should, of course, be especially careful not to disclose privileged information, in particular in view of the entry into force on 3 July 2016 of Regulation (EU) 596/2014 on market abuse, which, among other things, widens the scope of regulation regarding market soundings and raises the amount of the penalties.

Listed companies generally have ‘quiet periods’ preceding the release of the company’s annual, half-yearly and quarterly financial information, during which they must refrain from any contact with analysts and investors.

Information received by shareholders before shareholders’ meetings

Shareholders are informed of the date of the meeting 35 days in advance. Companies make certain documents available on their websites at least 21 days before the meeting. These documents must include a summary statement of the company’s situation and its annual financial statements, the draft resolutions, etc.

VI OUTLOOK

The emergence of the following trends has become apparent in French corporate governance regulation.

Although the say-on-pay procedure provided for by the AFEP-MEDEF Code has been criticised for its inefficiency in influencing the level of executive remuneration, it has improved the quality of the information disclosed by French listed companies in connection with their remuneration policies for the future. Proxy advisers continue to show an increased interest in the performance criteria in connection with variable and equity compensation, as well as the definition of the qualitative criteria used by companies,⁴² encouraging them to disclose the expected level of achievement of the quantitative targets. It is not clear yet if the new say-on-pay procedure will have a direct effect on the level of executive remuneration, and, pending publication of an implementation decree, there is still considerable uncertainty regarding the exact scope of the *ex ante* and *ex post* shareholder vote, which should be clarified in the coming years.

The AMF and the AFEP-MEDEF Code also recommend greater transparency on the remuneration paid to executives upon leaving the company (executives’ termination fees). As the AMF has pointed out several companies in its annual report on corporate governance, it is likely that the departure of executives will now be subject to greater transparency.

The rules relating to the role of proxy advisers have been improved to allow the orderly development of shareholder activism and proxy fighting. Although the ESMA still entrusts proxy advisers with the task of issuing a code of conduct, it released a call for evidence on the

41 Paragraph 6.3 of the AFEP-MEDEF Code.

42 In 2016, ISS for the first time introduced a quantitative pay-for-performance assessment for the largest European companies.

impact of the Best Practice Principles to determine whether this approach is satisfactory. The ESMA finds that the industry is moving in the right direction but encourages the industry group to address in the coming months the areas it has identified for improvement.⁴³

The introduction of CSR into the AFEP-MEDEF Code and the AMF's recommendations on the subject should also lead French listed companies to discuss CSR matters more frequently within their boards. This could be reflected in the increasing number of CSR committees and the inclusion of this component in executives' compensation.

Finally, a proposal for a directive amending Directive 2007/36/EC on shareholder rights and Directive 2013/34/EU on corporate governance aims at overcoming short-term approaches in corporate governance. The proposal focuses on four specific issues apart from the say-on-pay procedure: fostering the long-term engagement of shareholders, facilitating transmission of information regarding shareholding composition, encouraging transparency on related-party agreements and improving the reliability of proxy advisers. On 16 December 2016, the EU's Permanent Representatives Committee adopted an agreement on the text of the future Directive.

43 See ESMA, 'Call for Evidence: Impact of the Best Practice Principles for Providers of Shareholder Voting Research and Analysis', June 2015, and 'Report: Follow-up on the development of the Best Practice Principles for Providers of Shareholder Voting Research and Analysis', December 2015.

GERMANY

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I OVERVIEW OF GOVERNANCE REGIME

The corporate governance of German stock corporations, the legal form most common among listed companies in Germany, is determined by both statutory law and non-binding best practice rules.

The statutory laws most relevant for the corporate governance of German stock corporations are:

- a* the Stock Corporation Act, which sets out the – largely mandatory – framework for the organisation of a stock corporation as well as the rights and duties of the corporate bodies, the management board, the supervisory board and shareholders’ meeting, as well as the shareholders;
- b* the EU Market Abuse Regulation (MAR), which entered into force on 3 July 2016 and replaces the existing Market Abuse Directive (MAD) and the national laws implementing the MAD, including large parts of the Securities Trading Act. The MAR, *inter alia*, governs market abuse and market manipulation, disclosure of non-public information and directors’ dealings;
- c* the Securities Trading Act, which still contains provisions on the enforcement of violations of the MAR under German law;
- d* the Securities Acquisition and Takeover Act, which contains rules on mandatory and voluntary takeover offers and defensive measures;
- e* the Commercial Code, which, *inter alia*, sets out the accounting rules applicable to German companies; and
- f* the Co-Determination Act and the One-Third Participation Act, granting employees co-determination rights on a supervisory board level.

In addition, the German Corporate Governance Code, a collection of best practice rules and non-binding recommendations for the corporate governance of stock corporations, has a growing influence over how corporate governance is practised in Germany. The Corporate Governance Code was first adopted on 26 February 2002 by an expert commission appointed by the German federal government. It has since been revised several times, most recently on 24 June 2014. The latest amendments aim to further improve the transparency of compensation received by members of a stock corporation’s management board by

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recommending that the disclosures regarding the management board members' remuneration include information on remuneration received from third parties with a view to the services as a management board member.

Although the rules and recommendations set out in the Corporate Governance Code are not legally binding, the management board and the supervisory board must declare annually whether and to what extent their company complies with the Corporate Governance Code and in cases where it does not, explain the reasons for the non-compliance (comply or explain). A deviation from a recommendation may be justified, for example, as being in the interests of good corporate governance.

II CORPORATE LEADERSHIP

i Board structure and practices

Mandatory two-tier structure

The Stock Corporation Act provides for a mandatory two-tiered board structure of German stock corporations consisting of the management board and the supervisory board.

Composition, appointment and dismissal

Management board

The management board must have one or more members. If the registered share capital of the stock corporation amounts to more than €3 million, or where the Co-Determination Act requires that the management board must include a labour director, the management board must consist of at least two members.

Members of the management board are appointed by the supervisory board. The Corporate Governance Code requires that, when appointing management board members, the supervisory board must pay attention to diversity and shall, in particular, aim for an appropriate representation of women on the management board.

Members of the management board may not be appointed for a period exceeding five years. For first-time appointments, the Corporate Governance Code recommends that an appointment for a full period of five years should not be the rule. The appointment may be renewed or the term of office may be extended, provided that the term of each such renewal or extension shall not exceed five years. Under the Stock Corporation Act, a management board member's term of office may be renewed or extended, at the earliest, one year before the expiration of the term. A common practice to circumvent this prohibition against premature extension of the term of office is to dismiss and immediately reappoint a management board member for a new term of office. The Federal Court of Justice recently held that this practice does not constitute a violation of the statutory prohibition.

The supervisory board may only dismiss members of the management board for good cause. Good cause is, in particular, deemed to exist in the event of material breaches of duty, a management board member's inability to properly discharge his or her duties (e.g., owing to long-lasting illness or a lack of required skills or knowledge) or where the general meeting has adopted a vote of no confidence, provided that the vote has not been adopted for apparently inappropriate reasons.

Supervisory board

The supervisory board must consist of at least three members. The maximum number of supervisory board members permitted by law increases depending on the amount of the stock corporation's registered share capital from nine members for stock corporations with a registered share capital of up to €1.5 million to 21 members for stock corporations with a registered share capital of more than €10 million. In any event, the total number of supervisory board members must be divisible by three.

Members of the supervisory board are generally elected by the shareholders' meeting. The articles of incorporation may provide that certain shareholders or the respective holders of certain shares shall have a right to designate members of the supervisory board. Such designation rights may only be granted in respect of up to one-third of the number of members of the supervisory board to be elected by the shareholders.

Where a stock corporation generally has more than 500 employees, the One-Third Participation Act provides that one-third of the supervisory board members must be employee representatives. In companies with more than 2,000 employees, the Co-Determination Act requires that half of the supervisory board members be employee representatives.

On 6 March 2015, the German parliament adopted the Act for the Equal Participation of Women and Men in Leadership Positions in the Private and Public Sectors. The Act provides for a mandatory 30 per cent quota for the representation of women on supervisory boards of listed companies with more than 2,000 employees, as well as certain target ratios for the representation of female members in their management boards and senior management. These requirements will apply from 1 January 2016. In addition, companies with more than 500 employees must, by 30 June 2015, adopt certain target ratios regarding the representation of female members on their supervisory and management boards as well as in their senior management. The Act will enter into force shortly after it has passed the second chamber of the German parliament, the Federal Council representing the federal states. The Federal Council approved the act on 27 March 2015 and it was entered into force on 1 May 2015.

According to the Corporate Governance Code, the supervisory board must be composed such that its members jointly have the knowledge, ability and experience to properly carry out its tasks and shall include an adequate number of independent members. There is an ongoing debate in Germany regarding the required experience and expertise of supervisory board members. Many commentators call for a further 'professionalisation' of the supervisory boards of German stock corporations. For example, there have been demands that supervisory board members should not only jointly, but individually, have the necessary knowledge, ability and experience.

The Corporate Governance Code defines an independent member as someone who has no business or personal relations with the stock corporation, its executive bodies (which include the management board and the supervisory board), or any controlling shareholder or enterprise associated with the latter that could cause a substantial and 'material' conflict of interests. Regrettably, the Corporate Governance Code does not explain when a conflict of interest would be deemed material, but rather has deliberately refrained from including a catalogue of cases in which there is a presumption of a material conflict of interest in favour of a more flexible case-by-case assessment.

The Corporate Governance Code recommends that, in its report to the general meeting, the supervisory board should inform the general meeting of conflicts of interest supervisory board members have and how they have been dealt with. According to a recent decision by the Federal Court of Justice, the Corporate Governance Code does not require that the

report to the general meeting describe the conflicts of interest in detail. In the case before it, the court considered it sufficient that the report named the supervisory board members with respect to whom conflicts of interest had arisen, the topics of the supervisory board's agenda to which the respective conflicts related and how the conflicts had been dealt with.

The Corporate Governance Code further recommends that supervisory board members should not hold directorships or similar positions or advisory roles for important competitors of the stock corporation. Moreover, not more than two former members of the stock corporation's management board should be members of the supervisory board at any time.

Former members of the management board of a listed company may not be elected to the company's supervisory board for two years following their resignation or dismissal as members of the management board. In addition, it is not permitted for anyone to be a member of the supervisory boards of more than 10 companies at the same time.

In practice, the term of office of supervisory board members is about five years. Renewed appointments are permissible.

ii Legal responsibilities and representation

Management board

The management board is responsible for managing the business of the stock corporation and legally represents the corporation in relation to third parties. Under the statutory concept, all members of the management board manage and represent the corporation jointly. However, in practice, the rule is that the corporation is represented by each member of the management board acting individually or by two members of the management board acting jointly.

In managing the business of the corporation, the members of the management board must apply the care of a prudent and diligent businessperson. Failure by a member of the management board to meet this standard of care will render him or her personally liable for damages incurred by the corporation as a result.

The fiduciary duties that they owe to the stock corporation require members of the management board to give the stock corporation's interests priority over their own when concluding transactions with the corporation. Failure to do so may lead to a management board member's personal liability for any damages suffered by the corporation in connection with the transaction.

In the *ARAG/Garmenbeck* decision of 1997, the German Federal Supreme Court held that a member of the management board could not be held personally liable if, in making an entrepreneurial decision, he or she had adequate information and believed they were acting in the best interests of the stock corporation. This 'business judgement rule' was codified in the Stock Corporation Act in 2005.

The management board is obligated to manage the stock corporation independently; accordingly, it is not subject to instructions by the supervisory board or the general meeting. However, the shareholders may determine in the stock corporation's articles of incorporation that certain transactions require the consent of the supervisory board. Where the articles of incorporation do not contain a catalogue of transactions requiring supervisory board consent, the supervisory board may set forth such a catalogue in the by-laws of the management board.

The management board may ask the general meeting for instructions on certain transactions. Pursuant to the Federal Supreme Court's *Holz Müller* decision of 1982, the management board is obligated to obtain the general meeting's approval where the proposed transaction is of outstanding importance and could substantially affect the shareholders' rights.

Supervisory board

The supervisory board is responsible for supervising and controlling the management of the stock corporation's business by the management board. To this end, the supervisory board is entitled to inspect the corporation's books and records and may, at any time, request the management board to report to it about the corporation's affairs. The right to request reports from the management board extends to the corporation's legal and business relationships with affiliated companies as well as to the affairs of the corporation's affiliates if they could have a significant impact on the corporation.

Like members of the management board, members of the supervisory board must act in the best interests of the stock corporation and must demonstrate the care of a prudent and diligent businessperson. One of the notable responsibilities of the supervisory board is enforcing damage claims of the stock corporation against members of the management board. In the *ARAG/Garmenbeck* decision, the Federal Supreme Court held that, as a general rule, the supervisory board is obligated to assess the existence and enforceability of possible claims against members of the management board and, if its assessment reaches the conclusion that they exist and are enforceable, to pursue the claims. The supervisory board may only refrain from doing so in exceptional cases, where pursuing the claims would entail significant disadvantages for the corporation that outweigh the possibility of recovering the corporation's damages from the management board members. In recent years, in particular in the wake of the financial and economic crisis of 2008, this has led to a significant increase in the number of lawsuits brought by corporations against former members of the management board.

Members of the supervisory board are obligated to keep confidential any non-public information that they receive in their capacity as supervisory board members. This obligation prohibits the disclosure of information to any person who is not a member of the supervisory board or management board. In 2016, the Federal Supreme Court clarified the scope of a supervisory board member's confidentiality obligation. The decision concerned the question whether knowledge that a person acquires in his or her capacity as a supervisory board member of a bank may be attributed to that person's employer, another bank. The court made clear that the confidentiality obligation prohibits the disclosure of confidential information to the supervisory board member's employer. Moreover, the obligation may not be waived by the general meeting or the supervisory board in advance. As a consequence, knowledge acquired by a person in his or her capacity as a supervisory board member may not be attributed to that person's employer.

In its *Nürburgring* decision of 2016, the Federal Supreme Court clarified that the supervisory board's responsibility to supervise the management imposes a duty on the members of the supervisory board to avert actions by the management that may be detrimental to the company and that do not fall within the ambit of the business judgement rule. Accordingly, a supervisory board member may be subject to criminal liability if, by consenting to certain transactions, the supervisory board member enables behaviour of the management that is not covered by the business judgement rule. The decision concerned a limited liability company with an optional supervisory board. However, the Federal Supreme Court refers to its jurisprudence on the duties of supervisory board members of stock corporations. It, therefore, appears likely that the Federal Supreme Court would apply the same principles in the case of a stock corporation.

iii Delegation of board responsibilities

The Stock Corporation Act contemplates that all members of the management board manage the stock corporation collectively and are also collectively responsible for their actions.

However, in practice, responsibility for the management of certain business divisions or certain functions (e.g., finances, accounting, controlling, human resources, tax, legal, compliance) is delegated to individual members of the management board. The effect of this delegation is that the respective members of the management board become primarily responsible for the delegated tasks. However, delegation does not fully relieve the other members of the management board from all responsibilities with respect to the delegated tasks. They remain responsible for monitoring and controlling the discharge of the delegated tasks by the delegate.

iv Roles of the chair of the management board and the chair of the supervisory board

Where the management board consists of more than one person, the supervisory board may appoint one of them as chair. The chair is responsible for administrative tasks relating to the work of the management board, such as preparing and chairing meetings and keeping minutes, as well as for coordinating and supervising the work of the management board. He or she typically is in charge of liaising with the supervisory board and represents the management board in public, and thus has a prominent position among the other members of the management board. The manner in which many chairs of management boards discharge these responsibilities in practice has given rise to the perception that the position is comparable to that of the chief executive officer of a US corporation. However, from a legal perspective, this is not the case. In particular, the chair has no right to give instructions to other management board members and is not entitled to decide matters against a majority of the other members of the management board.

The members of the supervisory board must elect a chair and a deputy chair. The chair of the supervisory board is a largely administrative role that is not endowed with any particular powers. The chair calls, prepares and chairs meetings of the supervisory board. Typically, the articles of incorporation provide that the chair of the supervisory board also chairs the general meeting.

In a German stock corporation, it is not possible for the chair of the management board to also be chair of the supervisory board. The Stock Corporation Act provides that, with very limited exceptions, membership of both the supervisory board and the management board of the same corporation is incompatible.

v Compensation of members of the management board and the supervisory board

As part of the German legislature's response to the financial crisis, the principles governing the compensation of members of the management board were fundamentally revised in 2009. In the legislature's view, the structure of management compensation, particularly in regards to variable compensation components, was at least partly responsible for the perceived focus of management decisions and business strategies on short-term profits, rather than on long-term growth.

Accordingly, the total compensation of each member of the management board (e.g., fixed salary, variable salary components and pensions) as well as each of its individual components, must be reasonable in light of both the duties and responsibilities and the individual performance of that management board member as well as the situation of the

company. In listed companies, the compensation must be geared towards a sustainable development of the company. This means, in particular, that the basis of assessment for variable components must be a period of several years. There is a controversial debate among German legal scholars and practitioners as to whether it suffices to assess variable compensation components on the basis of a two-year period or whether a longer assessment period is required.

The compensation of members of the management board is determined by the full body of the supervisory board, usually following a recommendation by a committee established for that purpose. In the absence of any particular circumstances, the compensation may not exceed usual compensation levels. When determining the compensation of a member of the management board, the supervisory board must therefore compare the proposed compensation both with the compensation structure of peer companies (horizontal comparison) and with the company's own compensation structure (vertical comparison). Under the Corporate Governance Code as amended by the Corporate Governance Commission on 13 May 2013, the supervisory board should also consider the relationship between the compensation of the management board and that of senior managers with the total staff, including the development of the compensation over time. The supervisory board should also place caps on compensation in terms of the aggregate amount and in terms of individual components.

If, after the compensation has been determined, the situation of the company changes for the worse because of circumstances that can be attributed to the management board, and continuing to pay the compensation as originally determined would be unreasonable, the supervisory board is not only entitled but, in the absence of any particular circumstances, also obligated to reduce the compensation (including pensions) to an appropriate level.

The 2009 reform of the provisions governing compensation of management board members also introduced a 'say on pay'. The general meeting may pass a non-binding resolution regarding the approval of the structure for the management board members' compensation. A draft bill that provided for a mandatory and binding vote of the general meeting on the company's compensation structure did not pass the German legislature before the general elections on 22 September 2013. It is widely expected that Germany's grand coalition government will re-introduce the bill during the current parliamentary term.

The German Corporate Governance Code recommends that severance payments to members of the management board should not exceed an amount of two times the annual compensation, and that severance payments in the event of a change of control of the company should not exceed 150 per cent of that amount.

The supervisory board members' compensation is determined in the articles of incorporation or by the general meeting. Like the management board members' compensation, it must bear a reasonable relationship to the duties of the supervisory board members and to the condition of the company.

The supervisory board members' compensation may also comprise variable components. The Corporate Governance Code recommends that variable components should be based on the corporation's long-term performance. The details of how supervisory board members' variable compensation may be structured are the subject of debate among legal scholars and practitioners. In 2004, the Federal Supreme Court held that stock options do not constitute permissible components of supervisory board members' compensation.

Under the Stock Corporation Act, contracts between a member of the supervisory board and the stock corporation relating to services outside the scope of the supervisory board member's statutory duties require the consent of the supervisory board. In a widely noted

decision, the Federal Court of Justice held that the management board will act in breach of its duties if payments are made to a supervisory board member without the supervisory board's prior consent to the contract. Although the supervisory board may approve the contract and the payments owed to the supervisory board member thereunder after the services have been performed, the management board will breach its duties if payments are made in mere anticipation of the approval. The Court held that, in the absence of the prior consent by the supervisory board, the contract gives rise to a conflict of interest of the supervisory board member.

Stock corporations must disclose the aggregate remuneration granted to members of the management board and the supervisory board, respectively, in their financial statements. In addition, listed companies must disclose the remuneration of each individual member of the management board. According to the Corporate Governance Code, for financial years beginning after 31 December 2013, the information to be disclosed with respect to each member of the management board should, among other things, set out the benefits (including fringe benefits) actually achieved by the management board member in the relevant financial year, as well as the maximum and minimum amounts of the variable compensation that would have been achievable in that year. The general meeting may opt out of these disclosure requirements for a period of not more than five years by passing a resolution with a majority of 75 per cent of the capital represented. To improve the ease of comparison over time and with other companies, the Corporate Governance Code recommends that important facts and figures regarding the management board's compensation should be prepared and presented using a standardised table format, the template for which is set out in an annex to the Corporate Governance Code.

vi Committees

The Stock Corporation Act does not require the supervisory board to form any particular committee, but it provides for the ability of the supervisory board to form committees, in particular for the purpose of preparing its deliberations and supervising the executions of its resolutions.

Where the supervisory board is composed of both shareholder and employee representatives, the Co-Determination Act requires that the supervisory board form a reconciliation committee composed of the chair of the supervisory board, his or her deputy and one member of the supervisory board elected by the shareholder and the employees, respectively.

Mirroring a recommendation contained in the Corporate Governance Code, the Stock Corporation Act provides since 2008 that the supervisory board may form an audit committee to deal with matters relating to the preparation of the corporation's financial statements, the effectiveness of the internal audit and risk management systems as well as the conduct of audits and ensuring the auditor's independence. According to the corresponding provision of the Stock Corporation Act, the responsibilities of the audit committee comprise monitoring the accounting process and the efficacy of the internal control system, the risk management system and the internal audit system as well as additional services provided by the stock corporation's auditor. The Corporate Governance Code mirrors the statutory description of the audit committee's responsibilities. Where the supervisory board of a corporation whose securities are traded or that has applied for its securities to be admitted to trading in an organised market has elected to form an audit committee, at least one member of the committee must have expertise in the areas of accounting and auditing. However, the

Corporate Governance Code recommends that the chairman of the audit committee should have specialist knowledge and expertise in the application of accounting principles and internal control processes. Additionally, the chairman shall be independent and may not have been a member of the company's management board in the past two years. The chairman of the supervisory board should not at the same time be the chairman of the audit committee.

The Corporate Governance Code further recommends the formation of a nomination committee that is composed exclusively of shareholder representatives and whose task is to propose suitable candidates that the supervisory board may recommend to the general meeting for election to the supervisory board. In the most recent amendments to the Corporate Governance Code, the corporate governance commission set aside its previous recommendation that the chairman of the supervisory board should also chair committees competent for agreements with members of the management board, such as a nomination or compensation committee.

vii Board and company practice in takeovers

In the event the company becomes the target of a takeover offer, the management board and the supervisory board must publish, *inter alia*, on the internet, a reasoned statement regarding the offer. The statement is intended to enable the shareholders to make an informed decision on the offer and must, in particular, contain the management board and the supervisory board's assessment of the consideration offered by the bidder, the expected consequences of a successful takeover offer for the company, its employees, the employee representatives (i.e., the works council), the terms and conditions of employment and the company's production and other sites, the goals pursued by the bidder, and information on whether the members of the management board and the supervisory board intend to accept the offer.

III DISCLOSURE

i Regular reporting and disclosure requirements

The management board and the supervisory board of a listed company must publish annually a statement on the company's website regarding the company's compliance with the recommendations of the Corporate Governance Code. To the extent the company does not comply, the statement must explain the reasons for the non-compliance (comply or explain). If the company's statement turns out to be incorrect, this will – according to a recent decision of the Federal Court of Justice – only give rise to a shareholder's right to challenge the general meeting's vote approving the management board's and the supervisory board's conduct of the company's affairs where the incorrectness of the statement amounts to more than a mere formality because it is significant in the circumstances of the individual case and a reasonable shareholder would have required the correct information to appropriately exercise his or her rights.

Stock corporations must disclose their annual financial statements (consisting of the corporation's balance sheet and profit and loss statement as well as the notes thereto) by publishing them electronically in the German Federal Gazette.

Together with the annual financial statements, the stock corporation must publish, *inter alia*, the management report and the statement regarding compliance with the Corporate Governance Code.

The management report of listed stock corporations and stock corporations that have only issued securities other than shares for trading in an organised market and whose shares are traded in a multilateral trading system must contain a separate corporate governance statement. The corporate governance statement must contain:

- a* the statement by the management board and the supervisory board regarding compliance with the Corporate Governance Code;
- b* information regarding any practices and standards applied by the corporation in addition to statutory requirements, such as codes of conduct or codes of ethics, as well as information on where these practices and standards have been made publicly available; and
- c* information regarding the composition of the corporation's management board, supervisory board and any committees formed by them as well as the manner in which they conduct their affairs, for example, by summarising the content of or referring to the by-laws of the management board or supervisory board.

The Corporate Governance Code requires the management board and the supervisory board to report each year in the corporation's annual report on the corporation's corporate governance, including on any deviations from the recommendations of the Corporate Governance Code. The relationship between the corporate governance report on the one hand and the statutory obligations to deliver a corporate governance statement and to make a declaration regarding compliance with the Corporate Governance Code on the other is not entirely clear. In practice, the significant overlap between the contents of each of the three statements has led to the same information being published several times in different contexts, forms and media. It appears doubtful whether this multiplication of information is conducive to the goal of increasing the transparency of corporate governance structures.

The management board of a stock corporation over which another enterprise can exercise a dominating influence must, within the first three months of each financial year, prepare a report on the corporation's relations with affiliated companies. This report must specify, *inter alia*, all transactions the corporation has conducted with its dominating enterprise or with companies affiliated with the dominating enterprise, any consideration given or received in connection with these transactions as well as any acts taken or not taken by the reporting corporation on the instructions or in the interests of the dominating enterprise or its affiliated companies and, if any such acts or omissions were disadvantageous to the reporting corporation, whether it has received compensation for any disadvantage caused by the acts or omissions.

Disclosure of inside information

On 3 July 2016, the MAR entered into force, replacing the MAD and the provisions of German law implementing the MAD, including, for example, certain provisions of the Securities Trading Act. The MAR maintains the general features of the previous regulations but provides for changes in important details. Most notably, the new rules also apply to issues with financial instruments, including debt instruments, admitted to trading on a multilateral trading facility (MTF). As of 3 July 2017, the MAR will also apply to financial instruments admitted to trading on an organised trading facility, a new category of trading facilities introduced by the recast Directive on Markets in Financial Instruments.

As a general rule, any issuer of securities admitted to trading on an organised market or an MTF in Germany (or for which a request for admission to trading has been made) is

obligated to disclose, without undue delay, any information directly relating to the issuer that is not publicly known, if the information could have a material impact on the market price of the relevant securities.

Disclosure of this information must be made in the German language in at least one mandatory stock exchange newspaper of nationwide circulation or through a system for the electronic dissemination of information, as well as on the issuer's website. Prior to disclosing it to the public, the issuer must inform the management of each stock exchange on which the securities or derivatives thereof are traded and the Federal Financial Services Supervisory Authority of the information.

An issuer may, on its own responsibility, delay disclosure of inside information if disclosure is likely to prejudice the issuer's legitimate interests, the delay is not likely to mislead the public and the issuer ensures the confidentiality of the inside information. Upon disclosure, the issuer must inform the Federal Financial Services Supervisory Authority that disclosure was delayed, and why.

ii Directors' dealings

The MAR also governs the disclosure of directors' dealings, extending the scope of application to persons discharging managerial responsibilities (PDMR) within an issuer, as well as persons closely associated with them, such as spouses, registered partners or dependent children. In addition to the members of the management board and the supervisory body of a stock corporation, PDMR comprise senior executives who have regular access to inside information and the power to make decisions that affect the issuer's developments and business prospects. PDMR must immediately disclose in writing to the Federal Financial Services Supervisory Authority any transaction regarding shares, debt instruments or related derivatives conducted on their own account. Relevant transactions now include purchase and sale, as well as pledging and lending. The written disclosure notice must contain, with respect to each transaction in the securities, the names of the person and the issuer; the reason for the notification; the nature of the transaction; the designation and identification number of the securities; the date of the conclusion of the transaction; and the price, number and nominal value of the securities.

The disclosure obligation does not apply if the total value of all transactions conducted by a single person within a calendar year does not exceed €5,000.

The issuer is obligated to publish a transaction notified to it without undue delay on the internet or in a mandatory stock exchange newspaper with nationwide circulation.

Where previously none existed in German law, the MAR introduced a prohibition on transactions by or for the account of a person with access to inside information during a 'closed period' of 30 days before the public announcement of an interim or year-end report. However, the issuer may exempt the person for individual transactions under exceptional circumstances, such as severe financial difficulty, or for transactions under employee share or saving schemes and similar transactions.

iii Disclosure of shareholdings in listed companies

Any person whose shareholdings in shares of a company with its corporate seat in Germany admitted to trading on the organised market on a stock exchange of a Member State of the European Union reach, exceed or fall below the thresholds of 3, 5, 10, 15, 20, 25, 30, 50 or 75 per cent of the voting rights in the company, by way of an acquisition, a disposal

or otherwise, is obligated to disclose this circumstance to the Federal Financial Services Supervisory Authority and the company without undue delay, but in any event no later than four trading days thereafter.

For the purpose of calculating the relevant threshold amounts, the Securities Trading Act provides that voting rights arising from shares held by a third party may be attributed to the person obligated to disclose the shareholding. Voting rights will, for example, be attributed if the third party is a subsidiary of the person obligated to disclose the shareholding, or if the person obligated to disclose the shareholding, by other means set forth in the Securities Trading Act, has a controlling influence on the exercising of the voting rights arising from the shares. The same holds true for shares held by third parties who act in concert with the person obligated to disclose the shareholding. As a result of the broad attribution provisions of the Securities Trading Act, and because a direct shareholding in the listed company is not a prerequisite for triggering the disclosure obligation, indirect holders of relevant shareholdings may also be subject to these disclosure requirements. The disclosure obligation may, therefore, apply even to remote indirect holders whose relevant shareholding results only from the attribution of shares held by third parties.

The company must publish the disclosure notice in a mandatory stock exchange newspaper with nationwide circulation without undue delay, but in no event later than nine calendar days after receipt thereof.

IV CORPORATE RESPONSIBILITY

The concepts of corporate responsibility and corporate compliance have gained a lot of importance in Germany over the past couple of years. This development has been accelerated by a number of corporate scandals regarding corruption, violation of antitrust or data protection and privacy laws that have attracted a lot of publicity and have led to various reactions by the courts and the legislature.

All DAX30 companies and most other German listed companies have in the meantime adopted compliance programmes and have created a compliance organisation headed by a chief compliance office or a member of the management board to whom responsibility for compliance has been delegated. The role and responsibilities of a compliance officer must be taken seriously. This was emphasised by a recent decision of the German Federal Court of Justice in which the Court found a compliance officer personally liable and responsible pursuant to criminal law for failing to take action to stop fraudulent billing practices of which he had become aware.

Nearly all compliance programmes emphasise the importance of the 'tone from the top' for a corporation's compliance culture, and measures are taken to ensure compliance manuals are distributed and employees are trained with respect to compliance-related issues. Many companies have established whistle-blowing hotlines.

The increased significance of corporate compliance has also led to an increase in measures taken by companies to address and sanction non-compliance. Where a suspicion of non-compliance arises, companies conduct internal investigations, often with the assistance of external lawyers or auditors, to determine the nature and magnitude of the non-compliance. Most recently, the focus of the discussion on corporate compliance has, therefore, moved from the framework for establishing compliance management systems to the legal framework for, and boundaries of, the conduct of internal investigations. Conflicts arise, in particular, with respect to employee data protection, the statutory protection against self-incrimination

afforded the accused in investigations by state authorities as well as the scope of attorney–client privilege. At the end of 2010, the German government introduced a bill that attempts to balance the need of companies to conduct internal investigations with the protection of employee data. The bill for the Employee Data Protection Act was heavily criticised by the parliamentary opposition as well as by experts. On 26 February 2013, the then ruling coalition decided to discontinue the legislative proceedings. A new bill is expected to be introduced by the new grand coalition government during the current parliamentary term. In November 2010, the Federal Bar Association adopted guidelines for the conduct of internal investigations. In October 2010, a court held that minutes of interviews with employees conducted in the context of internal investigations by lawyers retained by the corporation were not protected by attorney–client privilege against seizure by state prosecutors; however, the legislature has now extended the privilege against seizure to any attorney admitted to the bar. In 2012, the European Commission published a proposal for a general data protection regulation, which, *inter alia*, addresses processing of employee data for the purposes of compliance.

V SHAREHOLDERS

i Shareholder rights and powers

Equality of voting rights

As a general rule, all shares in a German stock corporation provide for equal rights, including equal voting rights, rights to receive dividends and information rights.

Voting rights are usually exercised per share or in proportion to the par value of the shares. The Stock Corporation Act prohibits the creation of shares with multiple voting rights.

The articles of incorporation of non-listed stock corporations may provide for limitations on a shareholder's voting rights by way of maximum voting rights or staggered voting rights. With the approval of the general meeting, a stock corporation may issue non-voting preferred shares in a nominal amount of up to half of its registered share capital.

ii The powers of shareholders to influence the board

The shareholders of a stock corporation have no direct influence on the management board. They have no right to give instructions to the management board or to otherwise direct the management of the corporations. Their influence is limited to electing the members of the supervisory board members, who in turn appoint and remove the members of the management board.

When the Stock Corporation Act was adopted in 1965, the German legislature recognised that a shareholder whose shareholding represents a majority of the voting rights or the share capital of a corporation may *de facto* have a dominating influence on the stock corporation's management because of its ability to elect and dismiss the shareholder representatives on the corporation's supervisory board. Accordingly, the Stock Corporation Act provides for a set of rules regarding the influence of controlling shareholders on a stock corporation's management and business.

Under these rules, a dominating shareholder must compensate any disadvantage suffered by the corporation as a result of any exercises by the controlling shareholder of its dominating influence. Any such disadvantage must be compensated, at the latest, by the end of the fiscal year during which it was caused.

The dominating shareholder may 'legalise' its influence on the stock corporation by concluding a domination agreement with the stock corporation. Once a domination agreement has been concluded, the Stock Corporation Act recognises the shareholder's right to give instructions to the management board. To become effective, the domination agreement – which for tax reasons is often concluded together with a profit transfer agreement under which the corporation must transfer all of its annual profits to the dominating shareholder – must be approved by the corporation's general meeting with a supermajority of at least 75 per cent of the share capital represented at the meeting.

In consideration of the ability to directly influence the management of the corporation, the shareholder is obligated to compensate any loss incurred by the corporation during the term of the domination agreement and to acquire, at another shareholders' request, that shareholder's shares against adequate compensation.

iii Decisions reserved for shareholders

Certain decisions are reserved for the shareholders' meeting by statutory law, such as the appointment of members of the supervisory board, the appropriation of distributable profits, the appointment of the auditor, the amendment of the articles of association, measures to increase or reduce the share capital or obligations to transfer assets of the company.

In addition, certain decisions of the management board are subject to approval of the general meeting. The Federal Court of Justice has held in its *Holz Müller* and *Gelatine* decisions that certain decisions by the management board that could fundamentally affect the shareholders' rights and economic position, such as the sale or the hive-down of a business division into a subsidiary if the division contributes a significant portion of the corporation's revenue, require the approval of the general meeting. Another important example concerns the delisting of a company (i.e., the company's complete withdrawal from the stock exchange). In 2002, the Federal Court of Justice held, in its high-profile *Macrotron* decision, that a delisting required the approval of the general meeting and that the company had to offer an adequate cash compensation to dissenting shareholders. In July 2012, the Federal Constitutional Court formally upheld this decision but emphasised that neither delisting nor downgrading affects the constitutional rights of the shareholders. In light of the Federal Constitutional Court's decision of 2012, the Federal Court of Justice, on 8 October 2013, expressly reversed the *Macrotron* decision. In a case involving the 'downgrading' of a company (i.e., the change from trading on the regulated market to a qualified segment of the open market), the Federal Supreme Court held that not only the downgrading, but also a delisting did not require the approval of the general meeting and a cash compensation offer to dissenting shareholders.

iv Takeover defences

Once the bidder has published its decision to make a takeover offer, the management board may no longer take any actions that could prevent the success of the offer. There are, however, some statutory exceptions to this 'prohibition of frustrating action'.

The management board remains entitled to solicit competing offers from third parties (white knights) and to take actions approved by the supervisory board.

Moreover, the management board may take such actions as would also have been taken by the prudent and diligent managers of a company that is not the subject of a takeover offer. This means that the management board continues to be entitled to take all measures that are in the ordinary course of the company's business or that are intended to implement a business strategy that the company has embarked on before the publication of the takeover offer.

Finally, the management board may take defensive measures (such as repurchasing shares equalling up to 10 per cent of the registered share capital, establishing increased majority requirements for shareholder votes, electing shareholder representatives in the supervisory board at different points in time to create a 'staggered board' and at the same time increasing the majority requirements for their dismissal, selling important assets of the corporation or acquiring a direct competitor of the bidder) authorised by the general meeting before the takeover offer was announced and approved by the supervisory board.

The vote authorising defensive measures must be adopted with a supermajority of at least 75 per cent of the share capital represented at the shareholder meeting. The authorisation to take defensive measures may not be granted for a period of more than 18 months. Previously, the Corporate Governance Code contained a suggestion that the management convene a shareholder meeting only 'in appropriate cases' to allow shareholders to discuss the takeover offer and decide on defensive measures. As most recently amended, the Corporate Governance Code now provides that a shareholder meeting should be convened whenever the company is faced with a takeover offer.

The German legislator has exercised the 'opt-out' provided for in Article 12 Paragraph 1 of the Takeover Directive (Directive 2004/25/EC). Accordingly, the rules of the Takeover Directive regarding defensive measures do not automatically apply to German target companies. However, in accordance with Article 12 Paragraph 2 of the Takeover Directive, the Securities Acquisition and Takeover Act allows companies to provide in the articles of association that, instead of the above-described rules, the company will comply with the Takeover Directive's rules regarding defensive measures. To date, no Germany company has made use of this 'opt-in'.

v Rights of dissenting shareholders

Any shareholder who was present during a shareholders' meeting and objected to a resolution adopted at that meeting is entitled to file an action against the shareholders' resolution in court with the intention to have it declared void. The plaintiff-shareholder must have been a shareholder of the corporation on the date on which the agenda of the shareholders' meeting was published and must have entered his or her objection into the record of the shareholders' meeting.

Shareholders representing at least 5 per cent of the stock corporation's registered share capital are entitled to request that the management board call a shareholders' meeting, and shareholders representing at least 5 per cent or €500,000 of the corporation's registered share capital are entitled to request that topics are put on the agenda of the shareholders' meeting.

vi Shareholders' duties and responsibilities

All shareholders are subject to a duty of loyalty in relation to the corporation and the other shareholders. Under the duty of loyalty, shareholders are, in particular, prohibited from causing harm to the corporation. This means that, in certain circumstances, a shareholder may be obligated to vote in favour of a measure that is in the interests of the corporation; for example, a restructuring of the corporation's capital structure to avoid insolvency.

VI OUTLOOK

On 13 October 2016, the German government's Commission on Corporate Governance published its latest proposals for modifications of the Corporate Governance Code. While the largest part of the modifications is a reaction to previous changes in law, some of them are more far-reaching.

While the current version points out the management board's legal obligation to ensure compliance with the laws and internal rules, the Commission proposes that the management board be obligated to implement a compliance management system and to publish its basic features online. The compliance management system is to be proportionate to the risks that the company is exposed to. Moreover, the compliance management system is to give employees and third parties the opportunity to safely report compliance violations. In the Commission's view, this would lead to greater trust in the corporation by both investors and the general public. At the same time, a compliance management system is supposed to lead to better overall compliance and thus to mitigate the risk of legal liability.

A second proposed modification relates to variable components of the management board's compensation. The modification, if ratified, would put a stronger emphasis on the long-term view. The proposals clarify that variable compensation components should be based on the future development of the company and should not be paid out early.

The Commission also proposes that the chairman of the supervisory board should be prepared to discuss with investors issues falling within the sole competence of the supervisory board. The proposal makes clear that such discussions are not prohibited under German law. The Commission goes on to say that discussions with investors are desirable. As the supervisory board is the only corporate body with which investors would be able to discuss issues falling exclusively within its purview, discussions between the chairman of the supervisory board and investors are in the interest of transparency and good governance.

GREECE

*Sofia Kizantidi and Efi Palaiologou*¹

I OVERVIEW OF GOVERNANCE REGIME

An unprecedented and long financial crisis, dramatic market changes and EU interventions have strongly influenced the corporate governance regime in Greece, which is drawn from two main sources of law: the company law containing the rules applicable to companies limited by shares² and the specific corporate governance legislation applicable to listed companies.³ These provisions are complemented by other mandatory rules contained in a regulation issued by the Hellenic Capital Market Commission (HCMC),⁴ the Athens Exchange Rulebook and other separate laws.

The latest comprehensive reforms of the corporate governance rules and the extensive changes to the practices of corporations in this field clearly follow international trends and EU measures. Amendments to company law mainly touched upon disclosure obligations and protection of minority shareholders, while specific corporate governance rules imposed control committees and notification obligations.

In 2010, as a result of the transposition of a directive⁵ into the Greek legal framework, a new mandatory requirement was introduced for listed companies to disclose a statement of corporate governance as a specific section in the annual management report. This statement is made by the board and contains, as a minimum, the information required in the law. A key element of the corporate governance statement is the reference to the code to which the company is subject or chooses to apply, and to the corporate governance practices implemented that are beyond the requirements of the law. The company is also required to indicate the internet site where this information is available. Pursuant to the rule in place, the corporate governance statement must include a description of the internal control and risk management systems in connection to the financial reporting process, the information required by the provisions of the Directive on takeover bids, information on the shareholders' meeting and its powers and the shareholders' rights, and the composition of the board. Further, the law requires the company to explain any deviations from the stipulations of the relevant code, adopting the 'comply or explain' principle.

Reacting to this rule, the Hellenic Federation of Enterprises has taken the initiative and drafted a corporate governance code in an attempt to promote corporate efficiency and provide companies with a 'well-run' and sustainable model that follows the international benchmark

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2 Codified Law 2190/1920.

3 Law 3016/2002.

4 Code of Conduct for listed companies, HCMC Decision No. 5/204/2000.

5 Directive 2006/46/EC.

of Organisation for Economic Co-operation and Development principles. Following this lead, the newly established Hellenic Corporate Governance Council has established a new, soft-law code, which was introduced as the new Greek Corporate Governance Code (the Code or Greek Code). The Code is mostly relevant to companies whose shares are admitted to trading on a regulated market, but, as explicitly stipulated, it is designed to prove useful to all Greek companies limited by shares. Its goal is to provide the Greek corporate sector as a whole with a useful tool for the standardisation of corporate governance practices. Hence, the code consists of two types of provisions: 'general principles' and 'special practices', the latter concerning only listed companies.

In view of the financial crisis and the particularities of the banking sector associated with governmental involvement in terms of guarantees, high-stake systemic consequences in the event of bank failure and the important role of stakeholders (depositors), there has been strong appetite for specific corporate governance rules. Therefore, Law 4261/2016 transposing Directive 2013/36/EU, was introduced to regulate access to the activity of credit institutions and prudential supervision of credit institutions and investment firms. In particular, Law 4261/2016 provides that institutions shall have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure

Listed and non-listed Greek companies limited by shares follow the one-tier system. The board of directors is in charge of the general management and leadership of the company.

Composition of the board

The boards of all Greek companies limited by shares must comprise at least three members. The Greek Code recommends as best practice a minimum of seven and a maximum of 15 members.

There is a compulsory distinction between executive, non-executive and independent non-executive members. The number of non-executive board members should not be lower than one-third of the total number of board members, and there should be at least two independent non-executive directors on the board. The Code recommends that the majority of the members of the board should be non-executive, the independent members should comprise at least one-third of the board and the executive members should number at least two. Pursuant to the law, in cases where there are representatives of the minority shareholders on the board, there is no obligation for the appointment of independent members. However, the draft of the new corporate governance law seems to abandon this flexible approach to the members of the board, and provides that half of the non-executive members should be independent and, in any case, no fewer than two should be independent.

Independent board members are appointed by the general meeting of shareholders and the executive and non-executive directors are nominated by the board.

It is prohibited for independent, non-executive members to possess more than 0.5 per cent of the share capital during their terms of office and to have a dependent relationship with the company or with parties related thereto. Circumstances that suggest dependency pursuant to the law include a business, professional or employment relationship with the company or its subsidiaries, the position of president or manager in the company or its subsidiaries and the status of being married to or being a relative, up to the second degree, of an executive member or a manager or a majority shareholder of the company.

The Greek Code has expanded the scope of these circumstances to include cases where the member has already completed 12 years on the board or has served as the auditor of the company within the past three years, or controls either directly or indirectly over 10 per cent of the company's voting rights. Such a clause will be put to good use, especially if there is an amendment to the law to include, as proposed, a general provision obliging the board to examine on a yearly basis the independence of its members, in principle and in substance. If interdependency is detected, the board should demand the member's resignation and inform the general meeting of shareholders accordingly.

The law has been severely criticised for not providing professional quality selection criteria for board members, such as experience, skills or other similar considerations. These aspects, combined with the fact that in most Greek companies a 'reference' shareholder exists, may be the source of potential conflicts of interest. To address this gap in the requirements set by the law, the Code introduced an explicit obligation for the board to inform the shareholders adequately and in good time about candidates' profiles. The board should opine on the independence and the adequacy of each candidate.

The Code encourages companies to pursue diversity, mainly by ensuring gender balance on their boards as well as in managerial positions.

Although the board should act collectively, in practice, most of its duties are carried out by its executive members, who are engaged in the day-to-day management of the company. Until the issuance of the Code, there was no requirement for a minimum number of executive members and in some cases the only executive member of the board was the chief executive officer (CEO).

Legal responsibilities of the board

All the activities of the company that facilitate its objectives directly or indirectly fall under the competence of the board, except for issues that by law fall within the scope of the general meeting.

Representation of the company

The board represents the company and acts on its behalf. The board is free to decide on the allocation of powers among its members and must record the powers of the executive and non-executive members in the internal regulations of the company. Third parties are protected if the board acts beyond its power or the company's objectives.

Delegation of board responsibilities

It is a general principle that the board should act collectively. The CEO is usually granted a wide power of representation, but the company's statutes may allow the board of directors to assign certain decision-making powers either to one or more of its members, or to a third party. However, pursuant to a newly enacted prohibition, boards in listed companies cannot delegate further decisions regarding their transactions with parties related to company parties

(as defined by International Accounting Standard 24). The assignee may further delegate the relevant responsibilities provided that this is allowed by the statutes and by the decisions of the board. Certain independence requirements and notification obligations for third parties are set out in the law to avoid conflicts. Even after delegation, the board may still exercise its powers and remains fully responsible for decisions within the scope of its responsibilities. Third parties are similarly held responsible to board members.

Separation of the roles of CEO and chair

The separation of the roles of CEO and chair is not explicitly provided by law, but it is a growing trend in Greek companies. The Greek Code recommends that their responsibilities should primarily be clearly defined by the board and, when the same person exercises both roles, an independent vice chairman should be appointed with specific duties such as the power to request that the chairman include specific items in the agenda, to coordinate with non-executive board members and give voice to their views, to lead the board's evaluation of the chairman, lead the meeting of non-executive board members and lead discussions on corporate governance issues with the shareholders.

Remuneration of directors

The law holds the board of directors responsible for setting up the remuneration policy of each company, including the fees for managers and auditors. The remuneration of the non-executive members should relate to the time dedicated to attending board meetings and performing their duties. In general, company law does not distinguish between remuneration in listed companies and non-listed companies. For listed companies, the total of the remuneration and any other compensation of non-executive board members should be reported in the annex of the annual financial statements.

The Greek Code explicitly provides that the remuneration of the executive members should comprise a fixed and a variable part, or other benefits, calculated on the basis of an appropriate balance. In contrast, the remuneration of the non-executive members should not, according to the Code, include bonuses or stock options or other benefits that relate to the results achieved.

Bonuses may be granted to members only upon deduction of the amount corresponding to the regular reserves and to the 'first' dividends (which should be at least 6 per cent of the share capital). Special permission from the general meeting is required to enter into an employment or service agreement with a member of the board. Where such an agreement is considered to be of an everyday business nature, however, it may be exempted from this requirement. Any other amounts paid to a board member are legally binding only upon approval by the general meeting. The law grants the right to minority shareholders to oppose and request the reduction of the board's remuneration.

Stock option schemes addressed, *inter alia*, to the members of the board provided under company law are also subject to the approval of the general meeting or the board itself upon the authorisation of the general meeting. In several cases involving listed companies, abuses of stock option schemes have been detected by the competent authorities, especially in recent years. The Code suggests that stock options should not vest within three years of the grant date and their exercise price should be no lower than the average closing share price of the past 30 trading days prior to the grant date.

Loans or credits granted by the company or by its subsidiaries to the members of the board, founders, managers or their relatives, as well as to legal entities controlled by the

above persons, are null and void. The granting of guarantees and securities to such persons is only allowed provided the company's interests are protected and the general meeting grants its approval.

Generally, the Greek Code and a draft proposal for a new law that has been publicised in the past, in an attempt to address existing remuneration provisions considered fragmentary and inadequate, dedicate a special part to the reform and unification of the remuneration systems of corporations. In particular, to ensure transparency the Code recommends the inclusion of an annual report on the remuneration of the board members in the corporate governance statement, where the whole compensation package for each member shall be described, as well as details of the proportion of variable and fixed payments, and of the criteria on the basis of which the variable payments for the executive board members will be determined. Moreover, the Code has clearly defined the role of the remuneration committee and its competencies. The Code also recommends the establishment of a right for the board to demand full or partial recovery by its executive members of any bonuses granted on a misleading basis.

Within the same context of ensuring transparency, a proposed draft of a new law stipulates that the remuneration policy of each company, as currently in force, should be posted on the internet. The same draft expands the obligation for listed companies to publish in their annual financial reports the remuneration of non-executive members, so that the companies will also be obliged to publish the total remuneration of each board member (executive and non-executive), as well as the amounts received by the five most highly paid people in the company.

For state-owned companies, a restriction has been put forward by recent legislation on the amounts paid to their managers and CEOs, as well as to the members of their boards.⁶

Committees

Prior to 2008, the establishment of committees was not compulsory for companies, although in practice in many large corporations committees were operating with the task of assisting in the basic decision-making areas, such as financial reporting, internal audit, management and determination of remuneration for board members and executives. In 2008⁷ the audit committee was introduced as being compulsory for listed companies. The audit committee assists the board in monitoring the financial information process, the effectiveness of the internal controls system and the risk management unit, as well as the progress of the financial reports; it further monitors the independence and impartiality of the financial auditors. The committee consists of at least two non-executive members and one independent non-executive member from the board. These members must all be appointed by the general meeting. The financial auditor has to cooperate with the audit committee and report all the deficiencies regarding the financial reports and the internal audit unit. Recently, in 2017, the legislative framework on audit committees was amended. Currently, the audit committee, which is constituted as either an independent committee or a committee of the board of directors, consists of at least three members. The members can be non-executive members of the administrative body of the audited entity or members appointed by the general meeting

6 Law 3833/2010 as amended and Law 4093/2012.

7 Law 3693/2008.

of shareholders of the audited entity, or both. The majority of the committee members are independent from the audited entity and at least one member of the committee is a suspended or retired certified public accountant or a person with accounting and auditing competence.

Furthermore, the creation of two additional committees, a remuneration and a nomination committee, which would assist the board, are recommended by the Code.

Board and company practice in takeovers

Greece has incorporated Directive 2004/25/EC on takeover bids. During takeover periods, the board is required to decide only on regular business matters and refrain from acting in a way that could lead to the cancellation of the bid. The board must publish a document stating its reasoned opinion regarding the bid, specifically regarding its consequences for the company, its shareholders and employees.

ii Directors

Legal duties and best practice

Directors of listed companies have an explicit legal obligation to constantly pursue the reinforcement of the long-term financial value of the company and to protect the general corporate interest.

Conflicts of interest

The duty of loyalty imposed on the members of the board, or any third party exercising the powers thereof, prohibits them from seeking to promote their own interests to the detriment of the company's interests and requires the prompt disclosure of any potential conflict between their interests and the interests of the company. In the general government sector, officers are required to perform their duties with integrity, objectivity, impartiality, transparency and social accountability, act exclusively in the public interest, and respect and abide by the rules of discretion and confidentiality regarding matters that come to their knowledge in the performance of their duties. In addition, incompatibilities and conflicts of interests are required to be reported for the period prior to, during and after the performance of general government officers' duties mainly with respect to activities, people and entities related to the aforementioned duties.

As regards the financial institutions, the competent supervisory authority (Bank of Greece) may specify, by way of derogation from the general provisions on *sociétés anonymes*, the procedures, maximum limits and any other terms regarding credit institutions' loans of any type, other credits, guarantees, as well as holdings in the persons maintaining, directly or indirectly, close links with the credit institution, to ensure that such transactions are not carried out under preferential terms compared with those generally applied by the credit institution or in a manner that may operate to the detriment of the credit institution's prudent and sound management. More specifically, as regards credit institutions' loans of any type and other grants of credit to persons maintaining close links with the credit institution, the Bank of Greece provides for a decision by the general meeting or the board of directors of the credit institution on the matter, if such a procedure is provided for in the institution's articles of association.

Liability

Each member of the board can be held liable by the company for any wrongful conduct within the context of the management of the company's affairs, and for omissions or misleading statements included in the financial statements. The members are requested to demonstrate the qualities of prudent and diligent businessmen or businesswomen, and the care required must be judged on the basis of the duties and capacity of each member. Members will not be held liable where a relevant lawful resolution of the general meeting has been taken, or for business decisions taken in good faith, based on sufficient information and to serve the company's interests. The Code has drawn attention to the need for board members to receive adequate information during the decision-making process, especially in cases of transactions entered into between the company and parties related thereto. This provision aims to avoid conflicts of interest, given that in Greece most listed companies are controlled by majority shareholders.

Since 2010, there has been a collective duty and liability of the board to ensure that the annual financial statements, the annual report and the corporate governance statement are drawn up and published according to the law and pursuant to international accounting standards.

Shareholders may claim damages for direct losses suffered if the members of the board acted intentionally. In a case of indirect damage suffered by a shareholder (loss of share value), the general meeting may decide the filing of an action. The same right is attributed to shareholders having one-tenth of the share capital, who may request that the board file an action and, if a period of six months has lapsed, they may request that the court appoint special representatives to that effect.

It should be pointed out that most of the time the courts are not able to apply the 'business judgement rule', especially when the possible liability is derived from complex business transactions. Furthermore, the success of the claim presupposes that the loss suffered and the link between the conduct and the loss can be proven by the applicant. Gathering evidence for both of these elements may prove a very costly and time-consuming process and very often hinders the enforceability of claims against the board. Criminal liability could also be founded on several provisions.

III DISCLOSURE

i Financial reporting and accountability

In addition to annual financial statements, listed companies are requested to disclose annual and half-yearly financial reports, as well as annual and half-yearly reports by the board of directors. In the latter, the board should outline the performance of the company, significant events and risks, and transactions with related parties; these reports should also include the statement of corporate governance and refer to the corporate governance practices and systems of internal control and risk management.

Reporting is also required for ongoing company events that relate to the convening of general meetings, the resolutions adopted thereby, cases of capital increase, and transactions by executives and related to companies' own shares, etc.

Corporate governance rules provide for the establishment of a corporate announcements department.

Recently, draft amendments to the provisions ruling the content of the management report and the corporate governance statement have been set under public consultation,

to implement the relevant provisions of Directive 2013/34/EU as amended by Directive 2014/95/EU. Based on the relevant European law provision (Article 19a of Directive 2014/95/EU), large undertakings, which are 'public interest' entities employing more than 500 employees, shall include in their management report, except for the financial statement, a non-financial statement containing information required for the understanding of the development, position of the company and its operations in relation to environmental, social and employment issues, human rights issues, anti-corruption and bribery matters.

Furthermore, public consultation has been initiated on a draft provision for the transposition of the European law rule referring to the corporate governance report.

ii Auditor's role and authority, and independence

Financial statements of companies limited by shares are audited by external auditors appointed by the general meeting of shareholders for the relevant financial year. Small undertakings pursuant to Directive 2013/34/EU are not under any legal audit obligation but may opt to undergo one. Auditors are liable to the company and may be held liable by shareholders or third parties in cases of intentional cause of damage.

Statutory auditors are subject to a set of professional ethics principles, including confidentiality, objectivity and professional secrecy. They are required to be independent in the performance of their tasks and should not interfere with the company's internal audit work. Pursuant to the law that implemented relevant EU rules, in the case of statutory audits of 'public interest' entities, auditors have to further confirm annually in writing to the audit committee their independence, disclose any additional services rendered and discuss with the committee the safeguards applied to mitigate any relevant problems. Moreover, auditors that carry out statutory audits of public interest entities must publish annual 'transparency' reports on their websites regarding their corporate structure, quality assurance reviews, etc.

IV CORPORATE RESPONSIBILITY

i Risk management

A listed company's board is required to take measures to identify and assess business risks and establish an internal audit unit, which must preserve its independence and, pursuant to the Code, should report to the audit committee of the board of directors.

Pursuant to this, the audit committee of the company must monitor the effectiveness of the company's internal control and risk management systems, unless that responsibility expressly lies with the board itself or another committee of the board. To that effect, the audit committee should periodically review these systems to properly identify, manage and disclose relevant risks.

With respect to the banking sector, in particular, institutions shall ensure that: (1) granting of credit is based on sound and well-defined criteria and that the process for approving, amending, renewing and refinancing credit is clearly established; (2) they have internal methodologies that enable them to assess the credit risk of exposure of different kinds; these internal methodologies shall not rely solely or mechanistically on external credit ratings. Where own-funds requirements are based on a rating by an external credit assessment institution or based on the fact that exposure is unrated, this shall not exempt institutions from additionally considering other relevant information for assessing their allocation

of internal capital; (3) the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposure of institutions is operated through effective systems; and (4) diversification of credit portfolios is adequate.

ii Compliance policies and whistle-blowing

In limited cases, legal provisions establish alert procedures and disclosure obligations for professionals and individuals holding certain offices with regard to specific violations such as money laundering. Although there is no general requirement in law for a company procedure dealing with whistle-blowing, the Code provides for the establishment of proper internal communication channels intended to support the role of the system of internal controls and the role of the employees. It is specifically suggested that a whistle-blowing policy should be in place for the reporting of illegal acts of company employees. Customers, statutory auditors and external counsels may serve as important sources of information and should thus be given means of communicating with the company. Usually, large companies that have either experienced relevant problems in the past through employees' illegal behaviour or are part of multinational groups have already adopted whistle-blowing reporting practices.

iii Corporate social responsibility

In the Code, good practices and effective business operations require that a company's board is also able to effectively read the social (and customer) business context within which it is called to act. Hence, as a best practice model, the board should take into consideration the interests of stakeholders such as employees, creditors, customers and social groups that are influenced by the way the company operates, provided that these interests are not in conflict with the interests of the company. Corporate governance, social responsibility and sustainable growth are said to constitute the three main pillars of a business, which needs to develop on a solid social grounding.

Large companies' boards have to disclose in their management reports information on certain non-financial performance issues, including environmental and employee matters.

V SHAREHOLDERS

i Shareholder rights and powers

Equality and voting

The basic principle applied in the legal regime for corporates is that all shares of the same class are equal as regards ownership and voting rights (the 'one share, one vote' rule), with the sole exception of non-voting preference shares. While common shares necessarily carry voting rights pursuant to the Companies' Law, preference shares may be issued with no voting rights and provide exceptional rights such as preferential payments of first dividend or preferential repayment of contribution in the case of liquidation.

The main tool available to shareholders for controlling corporate governance arrangements and influencing the objectives of a corporation is their participation in general meetings. The law lays down the matters that fall within the exclusive competence of the general meeting and refer mainly to major corporate decisions, including approval of financial statements, distribution of profits, changes in the share capital, election of the board, and merger, transformation, dissolution or revival of the company. Exceptionally, under certain conditions, the board may decide upon the aforementioned matters; for example, members

of the board may be elected by the board itself when members have resigned, or in certain cases of share capital increases or distribution of profits (within the relevant financial year and based on a prior general meeting authorisation).

Corporate governance concerns with regard to shareholder engagement brought about the EU intervention and the adoption of the directive on the exercise of certain rights of shareholders in listed companies,⁸ which introduced minimum standards to remove obstacles that deter shareholders from voting. This directive has been transposed into law in Greece via recent legislation focusing on procedural issues and certain – rather limited – material aspects of shareholder participation.

In companies limited by shares, minority shareholders owning one-twentieth of the paid-up share capital have the right to put forward a request for the convocation of a general meeting, specifying the agenda to be discussed. They may also request that specific matters be added to the agenda of an already convoked meeting, in which case they are subject to observing minimum time frames for prior notification of such requests to the board.

To attend, participate and vote in a general meeting of a non-listed company, the shareholder should proceed with depositing the relevant shares (at the company's treasury or the Deposits and Loans Fund, or any bank in Greece). In listed companies, however, it is especially provided, in the implementation of the aforementioned Directive, that the exercise of rights of general meeting participation and voting should not require the blocking of shares or any other formality or procedure that could limit any possible sale or transfer thereof within the period until the general meeting is held. In an attempt to reconcile precautionary measures for ensuring safe voting for shareholders with the need to facilitate cross-border voting, verification of shareholder identity in the latter case is effected through the records of the entity where the securities are kept. The crucial date for determining the rights of a shareholder to participate and vote in a general meeting of a listed company is the fifth day prior to the general meeting date (record date system); this system of shareholder recognition with regard to the company, which may foster instances of empty voting, was a significant shift from the previous shareholder recognition status and has thus given rise to strong – and, for now, theoretical – debate.

Voting by proxy is in general permitted, and especially for listed companies it is explicitly stipulated in law that this right may not be restricted by the articles of association. A proxy may proceed with split voting when acting for different shareholders. When casting the votes, the proxy is required to follow the directions, if any, of the appointing shareholder.

ii Shareholders and the board of directors: interaction between ownership and management

The election of the board, as already mentioned, is within the powers of the general meeting of the shareholders, except where the articles of association of the company provide for the right of one or more shareholders to appoint members thereof. Shareholders' appointees in total cannot exceed one-third of the number of the board members. Removal of members of the board is once again a matter falling within the sole competence of the general meeting, with the exception of cases of shareholders' appointees, who may be removed by the relevant appointers (or by means of a court decision following a petition filed by shareholders representing at least one-tenth of the share capital).

⁸ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies.

The general meeting of the shareholders is declared in law as the highest in the corporate hierarchy and, in this context, shareholders acting as a company body may impose certain courses of action on the board of directors; nonetheless, it is generally accepted in case law and by scholars that the foregoing principle does not alter the fact that the board of directors is solely responsible for standard management decision-making. During the corporate law reform of recent years, an attempt has been made to improve the position of the shareholders with respect to their rights, albeit neither revolutionary nor sufficient. Further to the aforementioned rights referring to general meetings and agenda items, minority shareholders are entitled to information on company affairs and assets, and on board member remuneration (which has to be announced in the annual meeting of the shareholders), except for cases where the board has significant reason to refuse to comply with requests for this information, etc.

iii Takeover defences

Shareholder and voting rights plans, and similar measures

Law 3461/2006 constitutes the core regulation of the takeover bid processes regarding target companies whose shares are listed on a regulated market and transposes the EU Takeover Directive (Directive 2004/25/EC). The Directive aimed at setting minimum standards for ensuring equal treatment of shareholders, protection of minority shareholders in the event of change of control, prohibiting market manipulation and abuse and ensuring that shareholder have sufficient time and information to make a properly informed decision on the bid.

Greek law provides for mandatory offers where direct or indirect control of more than the one-third of the voting rights in a company, and hence the control of said company, is acquired. The law imposes the same obligation on shareholders who hold more than one-third but less than half of the voting rights and acquire within six months more than 3 per cent of the voting rights.

Although, the board of the target company is obliged by law to make public its opinion on the bid and its reasoning on the effects of the takeover on the company's interests as well as its employees, the board neutrality rule provided in Article 9 of the Directive is adopted by Greek law as mandatory for target companies that fall within its scope. This rule weakens the board's power to raise obstacles to hostile bids since, during the bid period, the support of the general meeting of the shareholders is required for any actions taken outside the normal business of the company and may frustrate an offer. Companies may decide to opt out of the implementation of this rule if the offeror is not subject to the rule.

The Greek legislator has, however, opted out of the implementation of the breakthrough rule introduced by the Takeover Directive and instead allows general meetings of the shareholders of target companies to opt in and apply the rule. Based on this, restrictions on the transfer of securities already provided in the articles of association of the target company or in contractual agreements do not apply as regards the offeror during the period provided for the acceptance of the bid. Similarly, restrictions on voting rights do not apply in the general meeting of the shareholders that authorises the adoption of post-bid defences. Finally, at the first general meeting following a successful takeover bid, and if the offeror holds at least 75 per cent of the voting rights, restrictions on transfers of securities or voting rights or special rights for appointment of board members do not apply and facilitate the offeror to easily remove the board and modify the articles of association.

Further, for a period of three months following a takeover, the bidder that has acquired more than 90 per cent of the voting rights can squeeze-out minority shareholders while the latter have a similar sell-out right if the same threshold is reached.

White-knight defence

Within the Greek environment, mechanisms against hostile takeovers are not often tested, since a large number of firms are in the safe harbour of family control and less exposed to hostile acquisition. This, however, becomes more and more relevant in the current environment of the ever-growing need for capital.

VI OUTLOOK

Reforms during the past decade in the corporate governance regime have been introduced mainly through mandatory legal provisions. The adoption of a corporate governance code is a shift towards more flexible and business-friendly tools. Recent developments, including recapitalisation of banks, capital controls restrictions, imposed since last year, and companies struggling with non-performing loans, have highlighted the need for stronger corporations that can cope with an ever-changing and still troubled environment. Challenges lie with the need to review the systems the boards operate, especially controlling and managing conflicts of interest, as well as the role of the monitoring authorities and the judicial system, which in many instances have proven insufficient to assist the implementation of corporate governance rules. Discussions also focus on board remuneration and performance issues that relate to the general financial situation of the company, the enhancement of the role of existing internal committees and the establishment of new ones that could monitor the business operations and the board. A debate is still going on as to the need for a new law that shall codify sparse provisions. In the same context of effective management organisation, prevention of conflicts and principles that ensure prudent and effective remuneration policies, Directive 2013/36/EU on credit institutions and investment firms was incorporated into Greek law. Furthermore, the Commission has acknowledged the need for a general review of the current corporate governance framework for European undertakings and has highlighted the need for enhancing the level of asset managers' and shareholders' involvement, transparency and transmission of cross-border information.

The corporate governance framework has been significantly changed and developed in recent years; however, we posit that the financial crisis and difficult business environment will bring about more debate on the need for adapting corporate governance regulation. Market players are faced with the challenge to seek new transparent yet efficient ways to rebuild trust and address society's expectations of a 'business renaissance'. Difficult times call for creativity and action both from the regulators as well as the business community and once again the operational framework of corporates will need to improve to attract investment and foster development.

GUATEMALA

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I OVERVIEW OF GOVERNANCE REGIME

The sources of law concerning corporate governance of listed companies in Guatemala are the Political Constitution of the Republic; company articles of incorporation; commercial, trade, financial and civil statutes; and the principles of disclosed truth and good faith. Best practices guidelines and internal additional frameworks for corporate government are non-binding in Guatemala; however, corporate statutes provide basic guidelines concerning conflicts of interest, as well as the responsibilities and duties of directors.

The listed companies regime is enforced by the General Commercial Registrar, who mainly oversees company compliance in legal and regulatory matters concerning business structure, incorporation, corporate bodies' designation, directors' and officers' appointments, supervisory board appointments, mergers and voluntary wind-ups.

In the case of financial services companies, the Superintendency of Banks and the Securities and Commodities Market Registrar also function as enforcement bodies overseeing compliance of legal and regulatory standards concerning licensing, financial operations and activities, capital adequacy and solvency.

The National Stock Exchange operates as a *de facto* enforcement body with regard to the information disclosure of listed companies.

In Guatemala, by statutory disposition, corporate government is in charge of the direction of the business and the appropriate management of the company. The bodies that comprise corporate government are direction, management and auditing. In force since 1970, the applicable statute, the Commercial Code, has seen no amendment with regard to the nature of the corporate governance regime.

A particularity of the Guatemalan corporate governance regime, in terms of international regulatory standards, is that the law omits specific regulation concerning fiduciary duties of directors, officers and auditors owed to the shareholders and, for example, to creditors if the company were to approach insolvency. However, responsibility for illicit actions or actions beyond their powers is duly regulated.

Since August 2013, following the mandatory share conversion from bearer to nominative shares instated by the Forfeiture Law, a notable corporate governance issue has been the suspension of companies and shareholders' rights in companies that were not compliant with the mandatory conversion.

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II CORPORATE LEADERSHIP

i Board structure and practices

Articles 162 and 184 of the Commercial Code contemplate the possibility of designation of a two-tier corporate governance regime comprising a board of directors, or a sole administrator, and a supervisory board, if so decided by the shareholders.

Even though the law contemplates a two-tier corporate governance regime, in practice the convention in listed companies is for single-tier corporate governance through either a board of directors or a sole administrator.

Legally contemplated in Articles 44 and 47 of the Commercial Code, a common practice in large listed companies is the utilisation of a third tier in the corporate governance regime, comprising one or more executive officers legally defined as managers.

Pursuant to Article 162 of the Commercial Code, when the board of directors system is chosen over that of a sole administrator, the shareholders decide the number of directors to be appointed, as well as their respective positions on the board. Moreover, Article 169 of the Commercial Code establishes that a company's articles of incorporation may contemplate the appointment of substitute directors. With the exception that the shareholders appoint directors for a shorter term, Article 162 of the Commercial Code further establishes that directors' appointments have a three-year term, at the end of which the directors will remain in position as long as the replacement directors have not been appointed or have not effectively occupied their position as such.

According to Article 164 of the Commercial Code, the board of directors legally represent the company, which implies that all directors represent the company unless otherwise stated in the articles of incorporation, in which case the articles of incorporation should provide the framework concerning the authorisation of directors to perform acts on the company's behalf.

As established in Article 163 of the Commercial Code, the articles of incorporation shall establish the responsibilities of the directors. However, the Commercial Code provides a range of responsibilities concerning directors as follows:

- a* Article 47 establishes that among the board's responsibilities are:
 - the representation of the company before the judiciary; and
 - the execution of acts and contracts related to the company's commercial purposes;
- b* Article 55 establishes that the board has the responsibility to brief the shareholders, at least yearly, of the activities of the board and the financial situation of the company; and
- c* Article 162 establishes that the board will be responsible for the direction of the company's business. The chairman's control over the board is established through the stipulation in Article 167 of the Commercial Code that the chairman will have the decisive vote in board meetings, unless the articles of incorporation state otherwise.

The chairman's control over the company is exercised in two ways:

- a* through the chairman's representation of the company's executive body in all matters and business, as stated by Article 166 of the Commercial Code; and
- b* through the chairman's legal mandate to preside over the shareholders' meetings, according to Article 47 of the Commercial Code.

Unless otherwise stipulated by the articles of incorporation, pursuant to Article 48 of the Commercial Code, or by unanimous consent of the shareholders pursuant to Article 166,

Article 48 forbids the delegation of a director's responsibilities to a fellow director or to a substitute; nevertheless, the regulation indicates that if a director has enough powers, the director may grant and revoke special powers of attorney.

Article 166 states that the board of directors may appoint one of its members as a delegate to execute specific acts, as a 'special executor'. While both the Sole Director and the members of the Board have to be registered by law at the General Mercantile Registrar, there is no legal obligation to register the special executor.

From a legal standpoint, as stated by Article 166 of the Commercial Code, the chairman is considered as the representative of the executive body in all matters and business of the corporation, and thus there is no separation of the board member and executive officer roles and responsibilities.

However, even though CEO and chairman's roles and responsibilities are not separated by law, if contemplated in the articles of incorporation or so resolved by the shareholders, and pursuant to Articles 181 and 182 of the Commercial Code, a general manager with the most ample powers of representation and execution may be appointed by either the shareholders or the board. The general manager will have additional responsibilities as stated by the articles of incorporation or the shareholders.

The chairman of the board will preside over the shareholders' meetings as well as report to shareholders on the board's activities at least yearly. Moreover, as part of the company's general administration, the general manager's report is also required by law to be included in the report to the shareholders presented by the chairman of the board.

Communications between shareholders and directors or officers are not expressly or specifically addressed by law, thus, pursuant to Article 5 of the Constitution (which contemplates freedom of action), shareholders may communicate with directors or officers as they deem necessary.

Remuneration of directors and senior management is neither regulated nor limited in terms of the amount of wages or expenses payable to either a director or a senior management member.

The establishment and functioning of specific committees or other organisational means of direction is subject to the stipulations in the articles of incorporation or the shareholders.

ii Directors

Outside directors are neither contemplated nor regulated by Guatemalan law; however, the contemplation of the appointment of such directors is not forbidden by law.

Considering that Article 5 of the Guatemalan Constitution states that all that is not expressly forbidden by law shall be legal, and that Article 15 of the Commercial Code prescribes that companies shall be regulated, first and foremost, according to their articles of incorporation, the role and involvement of outside directors, as well as information disclosure, on-site visits of subsidiaries and communications with lower management will be specifically regulated by the company articles of incorporation.

Pursuant to Articles 15 and 163 of the Commercial Code, directors will have the duties that the articles of incorporation state; nonetheless, as stated by Article 162 of the same legal body, directors have under their care the management and direction of the company's business.

If contemplated by the articles of incorporation or designated and appointed by the shareholders, outside directors will have the same duties as inside directors unless otherwise stated by the company's articles of incorporation.

The Commercial Code contemplates two types of liability of directors, general liability and specific liability, provided that the direct result of the actions of the directors was to the financial detriment of the company, the shareholders or creditors.

With regard to the general liability of directors, Article 171 of the above-mentioned law states that directors shall be liable for any actions attributed to them that result in damage caused to the company, shareholders or creditors. The regulation also contemplates that all directors shall be jointly liable for those actions.

Pursuant to Article 172 of the Commercial Code directors shall be jointly liable:

- a* for the payment and amount of the capital contribution of the shareholders;
- b* for the existence of net profits by the company and their distribution among shareholders as dividends;
- c* for the accounting of the company, including when it is not carried out according to law and the accounts are not true; and
- d* for the precise fulfilment of the agreements reached by the shareholders.

Article 50 of the Commercial Code provides for the possibility of one director, part of a board, acting solely under his or her own liability when omission concerning a specific matter may result in damage to the company.

As established by Article 52 of the same legal body, the board of directors will have joint and unlimited liability for the damages that may be caused by the directors to the company. The directors that vote against the actions that constitute damage against the company shall be exempt from their liability to the company.

Pursuant to Article 45 of the Commercial Code, and unless the articles of incorporation of the company state otherwise, directors will be appointed by means of a shareholder resolution.

The appointment of directors is made through a shareholder election in a cumulative voting system (CVS), as established by Article 115 of the Commercial Code. Under the CVS, each shareholder with voting rights will have as many votes as shares owned times the number of directors to be elected for appointment.

Under the above-mentioned provision, during the process of election, the shareholder can cast all the votes in favour of one specific director, or distribute the shareholder's total amount of votes among the number of directors being elected for appointment.

Under Article 169 of the Commercial Code, any director who has a direct or indirect interest in any operational aspect of the business of the company must disclose it to the other directors, refrain from participation in the deliberation and resolution of the matter and leave the meeting's premises.

Moreover, pursuant to Article 170 of the same legal body any director standing to gain personal benefit derived from matters not pertaining to the company's business will have the obligation of disclosing it to the board for the pertinent determinations; in the case that the director fails to comply with the disclosure he or she will be held liable to compensate the company in the amount of the personal benefit received and the director will be removed from the board.

The involvement of outside directors with executives will be addressed by the articles of incorporation, in the event that the designation and appointment of outside directors is considered and their interaction with executives allowed.

III DISCLOSURE

Pursuant to Article 368.4 of the Commercial Code, every company shall have an orderly record of the financial statements of the company that shall comply with the generally accepted accounting principles. As stated by Article 377 of the same legal body the financial statements shall comprise the balance sheet, statement of income and any auxiliary statements concerning the true financial situation of the company.

As established by Article 374 of the Commercial Code, the balance sheet and the statement of income shall be produced from the beginning of the operations of the company and at least yearly. Pursuant to Article 379 of the same legal body the balance sheet will truthfully and reasonably reflect the financial situation of the company. As required by Article 380 of the Commercial Code, all companies shall publish their balance sheets in the Official Gazette as of the closing of their yearly operations.

Under Article 55 of the Commercial Code, directors shall be held accountable for their activities as members of the board of directors, as well as for the financial information of the company.

Pursuant to Article 188 of the Commercial Code, and additionally to attributions set by the articles of incorporation and other legislation, the supervisory board, if appointed, shall:

- a* inspect the management of the company and examine its balance sheet to confirm its precision and veracity;
- b* verify that the company's accounting is being carried out according to the generally accepted accounting principles;
- c* perform audits on cash and securities held by the company;
- d* require directors to render reports on the development of the company's business operations;
- e* convene shareholder meetings when the causes for wind-up arise or when, according to their opinion a certain matter requires the attention of the shareholders;
- f* submit to both the board's and the shareholders' consideration any matter they consider necessary;
- g* attend the board of directors' meetings, without voting rights, whenever they deem it necessary;
- h* attend the shareholders' meetings, without voting rights, to render their report and opinion on the financial statements and on initiatives that are, in their judgement, suitable; and
- i* in general, supervise, look after and inspect, at any given time, the company's operations.

Even though the Commercial Code does not provide for specific regulation concerning a member of the supervisory board's independence, the Code does address conflicts of interest for supervisors in Article 193, stating a refrain from action in any case that represents direct or indirect personal gain, having the duty of disclosing the matter to the shareholders.

Given the absence of a corporate governance code of best practice, the 'comply or explain' model is not applicable in Guatemala.

Mandatory disclosure matters will generally be subject to any and all legal provisions that state the obligatory nature of the disclosure; some of those mandatory disclosures are presented in the form of information available to the shareholders prior to a shareholders' meeting. As established by Article 38.1 of the Commercial Code concerning the disclosure for examination of the company's accounts and documents, as well as the financial and economic policies of the company, the information shall be made available to the shareholders

at least 15 days prior to the scheduled date of the shareholders' annual meeting. Moreover under Article 24 of the Securities and Commodities Market Law, and as required by Articles 1 through 4 of the National Securities Exchange's Information Disclosure and Update Rule for Issuing Entities, disclosure is also mandatory for the company's shares to maintain trading status. The information will be available to current and potential shareholders, and, *inter alia*, it includes:

- a* yearly audited financial statements;
- b* quarterly statements of conditions of the first three quarters for each year of operations since the point at which the company's shares were issued for public offering;
- c* financial indexes of the projections stated in the issuance prospectus;
- d* amendments or modifications to the company's articles of incorporation or company information;
- e* changes in the structure of the corporate group or control structure in the issuing company concerning major shareholders, directors, executives and outside advisers;
- f* changes in the appointment of external auditors;
- g* the creation, development, change or cancellation of business ventures, products or services offered by the issuing company;
- h* the current rating of the securities subject to public offering; and
- i* yearly reports of the board of directors and the supervisory board.

Shareholders tend to be elected and appointed to the board of directors and thus one-on-one meetings are uncommon. Moreover, in large companies with numerous shareholders, in which the directors are not shareholders, one-on-one meetings are more likely; however, this practice is uncommon.

IV CORPORATE RESPONSIBILITY

Guatemalan companies are not required by law to appoint either a special risk officer or committee, unless mandatory under the Regulation of the Law against Money or Other Assets Laundering or the Anti-Money and Other Asset Laundering Law, in which case the participation of the compliance officer will be mandatory and limited to anti-money laundering compliance matters.

In terms of financial, currency and liquidity risk management, pursuant to the exercise of their rights, each shareholder can appoint either an auditor or an inspector, who can propose initiatives to the shareholders in terms of risk management.

Pursuant to Article 3 of the National Securities Exchange's Information Disclosure and Update Rules for Issuing Entities, the information provided will be public and under no circumstances will be considered to be provided under a non-disclosure provision. Under those terms and with regard to information that might post a reputational risk to a company, the board of the company shall disclose the administration's plans to address those issues.

As the chairman of the board is considered to represent the executive body of a company and has the decisive vote on matters subject to the board's consideration, the chairman's influence over the board and the board's influence over executives and officers is considerable, and it could be stated, therefore, that tone from the top is normally emphasised in Guatemalan companies.

Whistle-blowing activities are not specifically regulated in Guatemala; however, they are mandatory when they concern illegal acts that may be publicly prosecuted. Legislation

has not yet been developed in the sphere of private enterprise; the only legal incentives for whistle-blowing concern criminal activities from or within a company in that, if known by an officer, executive or employee and not reported, the officer, executive or employee may be subject to criminal prosecution for concealment or failing to notify the authorities.

Corporate social responsibility (CSR) practices have increased in Guatemala in the past 10 years; CentraRSE,² a non-profit initiative by the organised private sector, seeks to promote awareness and promote the adoption of CSR practices in the private sector. Following Guatemala's participation in the Dominican Republic–Central America Free Trade Agreement (CAFTA-DR) in 2006, CSR in respect of employees and the environment has grown. However, Guatemala has been subject to allegations and legal actions for non-compliance with CSR practices regarding employees pursuant to CAFTA-DR provisions.

V SHAREHOLDERS

i Shareholder rights and powers

Pursuant to Article 101 of the Commercial Code, each issued share of the company will represent one vote. The provision contemplates the existence and issuance of preferential shares with priority rights over dividends and post-wind-up capital returns, stating that such preferential shares may have voting rights limited to the matters concerning changes to the capital structure or changes in the by-laws.

As stated by Article 105.2 of the same legal body each share gives the owner the right to vote at the shareholders' meeting.

Article 116 of the Commercial Code contemplates the possibility of voting agreements between shareholders for a maximum term of 10 years.

Shareholder influence can be exercised first and foremost by the election and appointment of shareholders as directors, a common case in Guatemala. However, shareholders may also influence the board personally, through an appointed inspector or auditor, directly or indirectly through supervision and inspection as stated by Articles 184 and 188 of the Commerce Code.

Moreover, if subject to a shareholder resolution, the board could be instructed to execute a decision.

Shareholders will have decisive power over the board, *inter alia*, in the following matters:

- a* financial statement approval;
- b* distribution of dividends;
- c* amendments or modifications to the articles of incorporation;
- d* increase or decrease in company capital;
- e* voluntary wind-up; and
- f* mergers.

Pursuant to Article 154 of the Commercial Code, resolutions adopted by the majority of shareholders also bind dissenting ones; however, dissenting shareholders will have contesting, annulment and withdrawal rights over the majority's resolution.

² <http://centrarse.org>.

Shareholder resolutions shall be contested or annulled if adopted under infraction of the law or the company's articles of incorporation, as stated by Article 157 of the Commercial Code.

Under Article 95 of the Commercial Code founding shareholders will have a maximum participation of 10 per cent of the net profits of the company for a period of no longer than 10 years. In that regard, the participation to which founding shareholders are entitled will be paid only after other shareholders are paid dividends for at least 5 per cent of the nominal value of their stock. The enforceability of this provision is subject to the possession of founder share certificates as stated by Article 96 of the Commercial Code.

Board decisions may also concern shareholder decisions. Shareholder approval of specific board decisions will be established by the articles of incorporation; these decisions may include the appointment of executive officers such as the general manager, and the approval of the yearly financial statements.

ii Shareholders' duties and responsibilities

As established in Articles 27 through 29 of the Commercial Code shareholders owe the company the duty of fulfilling their monetary and non-monetary capital commitments.

Pursuant to Article 134 of the Commercial Code, in general terms the shareholders will have the duty to meet at least yearly, within the four months following the closing of the company's previous meeting to:

- a* discuss, approve or deny approval of the company's financial statements, the board of director's administration report, and the supervisory board inspection report;
- b* elect and appoint or revoke appointments of directors and supervisory board members, as well as to set the duties and responsibilities of those appointed;
- c* hear and pass a resolution on the company's project for dividend distribution; and
- d* hear and resolve any other matters set by the articles of incorporation.

As provided by Article 130 of the Commercial Code, shareholders will have no voting rights in matters where they have personal or third-party interests contrary to those of the company; if non-compliant, the shareholder will be liable for the damage caused.

Under law institutional investors' duties are equal to those of any other shareholder. Best practices in their participation as shareholders of a company include the appointment of either a proxy or a power of attorney familiar with the corporate purpose of the company as well as the nature of its operations to provide useful insight in the shareholders meetings; moreover, given their financial nature, institutional investors should be compelled to provide financial input on the company's operations.

Guatemalan enforcement agencies lack best practice guidelines or codes for shareholders; however, each shareholder should participate in the best interests of the company provided that the company's performance shall impact directly on their returns.

iii Shareholder activism

Shareholders' say on pay of directors, officers and executives of a company will be stipulated by the articles of incorporation, or in a resolution of the shareholders' meeting.

Pursuant to Article 174 of the Commercial Code a derivative action may be brought against directors on the company's behalf following the previous agreement of the shareholders

appointing a designee to bring the suit against the administration of the company; if the designee does not file suit within two months of the agreement, any shareholder may do so on the company's behalf.

Regardless of the previous provision and as stated by Article 175 of the Commercial Code, a derivative action may be brought against one or more directors by shareholders who represent 10 per cent of the company's stock, provided that they are acting in the interests of the company and not their own interests, and that the claimants did not vote to waive the director's liability.

Current regulation does not address either proxy battles or shareholder campaigns; however, given that shareholders may perform any acts not expressly banned by law and that shareholders votes may be delegated through proxies, it is likely that if a change in corporate policy or governance is sought by a minority shareholder, he or she will use a proxy battle as the most efficient way of achieving this objective considering that the only other way to obtain the votes would be to pay in additional capital.

iv Contact with shareholders

As mentioned above, and pursuant to Article 38.1 of the Commercial Code, the mandatory standard of reporting to the shareholders is for the board to provide availability of all documents, statements and reports to the shareholders within the 15 days prior to the shareholders' meeting. The documents shall be made available in the company's registered offices.

As the law omits to address selective meetings and communication, and provided that the mandatory reporting right to the shareholders is standard to all contact with shareholders, the provisions for selective meetings and communication would have to be regulated by the articles of incorporation.

Under the law, all registered shareholders of the company have the right to review the same information prior to the shareholders' meeting as mentioned above.

Pursuant to the shareholders' voting agreement rights established in Article 116 of the Commercial Code, shareholders could agree on a no vote on the issuance of stock by the company, or agree upon a vote against the increase in capital that would represent the issuance of new shares; this would generate the effect of a standstill agreement.

Shareholders will be able to receive and verify company information within the 15 days prior to the shareholder meeting. Neither proxy solicitation nor seeking shareholders' opinions in advance is common practice in Guatemala. The most common issues concerning large blocks of shareholders are fights over company control, over the appointment of directors to the board and the subscription of new shares to dilute the share percentages of opposing groups.

v Takeover defences

The Commercial Code contains few regulations regarding mergers, leaving rules for acquisition and takeover outside the commercial regulation. According to the current legislation, mergers can be carried out in two specific forms: (1) consolidation, resulting in a new company, and (2) absorption, where one company survives the other. As stated before, takeovers and acquisitions are not regulated by law, therefore few rules are contemplated with regards to shareholder defences in relation to takeovers.

Pursuant to Article 261 of the Commercial Code, the shareholder that opposes a merger can opt for separation from the company. However, in the case of limited partnership

with share capital and general limited partnership shareholders, both their equity (capital contribution) and personal unlimited liability will continue to secure compliance from the company in respect of those of its obligations that originated before the merger agreement.

Another defence contemplated by law is the right to appeal (challenge, contest, impugn or refute) resolutions of the shareholder's meeting, if the resolutions were passed in breach of the company's by-laws or in breach of law, and these will be resolved before a court of law.

White-knight defences and similar tactics (such as the white-squire tactic) are neither contemplated by law nor prohibited by it.

Staggered boards are also not contemplated by law. The board of directors can only be appointed for a maximum period of three years and can be removed, according to Article 178 of the Commercial Code, without the need to express a determined cause, as long as there is a resolution from the board. Therefore, the possibility of having staggered boards is only plausible if contemplated in the company's by-laws and as long as this protection does not exceed the three-year time frame.

VI OUTLOOK

The Guatemalan Ministry of Economy in a joint effort with the Foundation for the Development of Guatemala is pushing forward reforms to the Commercial Code that will, *inter alia*, introduce fiduciary duties for directors and officers, and minority shareholder protection provisions. Moreover, in a joint effort, the Superintendency of Banks and the Guatemalan Central Bank are promoting a new Securities Market Law, which seeks to introduce reforms to allow companies to access alternative means of financing and to promote alternative investment structures for investors. These reforms were expected to reach Congress during the 2015–2016 legislation period; however, they were not addressed by Congress. With a new elected Congress in place, the expectations for reform continue and, if they are authorised, the reforms could entail an abrupt change to the corporate governance regime and to power struggles among shareholders, as well as to compliance matters for companies.

INDIA

*Justin Bharucha and Priya Makhijani*¹

I OVERVIEW OF GOVERNANCE REGIME

Corporate governance is an increasingly important issue in the Indian economy. The past decade has seen a number of scandals² and shareholder disputes,³ all of which indicate lacunae, if not lapses, in governance.

Regulators have responded to these challenges by amending and, in some cases, introducing new legislation, and shareholders are resorting to activist intervention in companies to secure their rights. This coupled with the closely held shareholding of Indian companies,⁴ as well as the several factors that contribute to India's ranking on the Transparency Index, keep corporate governance on the radar.

The Indian corporate governance framework focuses on: (1) protection of minority shareholders; (2) accountability of the board of directors and management of the company; (3) timely reporting and adequate disclosures to shareholders; and (4) corporate social responsibility. The regime emphasises transparency through disclosures and a mandatory minimum proportion of independent directors on the board of each company.⁵

However, as is common in India, the corporate governance regulatory framework is comprised of statutes and regulations that require supervision by multiple regulators:

- a* the Securities and Exchange Board of India (SEBI) is the principal regulator for listed companies;
- b* the Ministry of Corporate Affairs (MCA) and the registrar of companies (the Registrar), administer the Companies Act 2013 and relevant rules that apply to all companies, including listed companies; and

1 Justin Bharucha is a founding partner and Priya Makhijani is an associate at Bharucha & Partners.

2 Starting with the Satyam issue in 2009. See www.thehindu.com/specials/timelines/satyam-scandal-who-what-and-when/article7084878.ece.

3 Most recently in the Tata group.

4 See, *inter alia*, Securities and Exchange Board of India, 'Report of the Takeover Regulations Advisory Committee', dated 19 July 2010; and Umakanth Varottil, 'The Advent of Shareholder Activism in India', *Journal on Governance*, Vol. 1. No. 6, (2012). Also note that in 2010, a new requirement was introduced for all listed companies (and those seeking to list) to maintain a minimum level of public shareholding of 25 per cent.

5 See Section II.i, *infra*, on independent directors.

- c* additionally, sector-specific regulation also applies and this can have a significant impact on the governance regime.⁶

Perhaps the most significant issue that Indian regulators must address is ensuring that independent directors can fulfil their obligations in the closely held and controlled world of Indian corporates.

II CORPORATE LEADERSHIP

i Board structure and practices

Indian law prescribes a one-tier board,⁷ with additional stipulations as to the constitution of the board depending on whether or not the company is listed and, for unlisted companies, the quantum of paid-up share capital.

Private companies must have a minimum of two directors and unlisted public⁸ companies must have at least three directors. In each case, at least one director must be a person resident in India.

All listed companies, as well as all unlisted public companies having paid-up share capital of 1000 million Indian rupees or more or a turnover of 3000 million Indian rupees or more, must have at least one woman director.⁹

Additionally, for listed companies:

- a* a minimum of one-third of the directors of all listed companies are to be independent directors;
- b* there should be a mix of executive and non-executive directors with at least half the board comprised of non-executive directors;
- c* at least one-third of the board should be comprised of independent directors if the chairman is a non-executive director who is also neither a promoter nor a relative of a promoter of the company, failing which (i.e., if the chairman is an executive director) at least half the board must be comprised of independent directors; and
- d* where the non-executive chairman is a promoter of the company or is related to any promoter or person occupying management positions at the level of the board of directors or at one level below the board of directors, at least half the board of directors of the listed company must consist of independent directors.

Disqualifications from appointment as director

A person does not qualify for appointment if that person is of unsound mind, an undischarged insolvent, sentenced to imprisonment for at least six months and less than five years has lapsed

6 For example, the Insurance Regulatory and Development Authority, which regulates companies in the insurance sector, promulgated a discussion paper on 11 August 2016 proposing mandatory listing for insurance companies.

7 However, see Section II.i, *infra*, on committees of the board.

8 Under Indian law a public company may list its securities on a stock exchange or continue as an unlisted entity. The principle distinction between a private company and an unlisted public company is that no private company may have more than 50 shareholders and there is no cap on the number of shareholders of a public company (whether or not that public company is listed). There are other distinctions, including in relation to compliance.

9 Who may or may not be an independent director; see following subsections.

from the end of that sentence, convicted of an offence concerning related-party transactions, or has not paid call money on shares of the company. A company may prescribe additional disqualifications in its articles of association.

Every director must submit a list of entities in which he or she has an interest¹⁰ when taking office and update that list when necessary and at least annually.

Independent directors

Listed companies and unlisted public companies with paid-up share capital of 100 million Indian rupees or more, or a turnover of 1 billion Indian rupees or more, or an aggregate of outstanding loans, debentures and deposits exceeding 500 million Indian rupees must appoint an independent director.

An independent director is a non-executive director who:

- a* is not and should not have been a promoter;¹¹
- b* does not and should not have had, directly or through a relative,¹² any pecuniary relationship¹³ with the company¹⁴ during the immediately preceding two financial years where the transactions exceed the lower of 2 per cent or more of the company's gross turnover or total income or 5 million Indian rupees; and
- c* individually or through or with relatives:
 - does not hold 2 per cent or more of the total voting power of the company;
 - does not hold or has not held the position of a key managerial personnel, nor is or has been an employee in the company¹⁵ in the immediately preceding three financial years;
 - is not nor has been an employee or proprietor or a partner, in any of the three immediately preceding financial years of: (1) a firm of auditors or company secretaries in practice or cost auditors of the company;¹⁶ or (2) any legal or consulting firm that has or had any transaction with the company¹⁷ amounting to 10 per cent or more of the gross turnover of the firm; or
 - is not a chief executive or director, by whatever name called, of any non-profit organisation that receives 25 per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate companies or that holds 2 per cent or more of the total voting power of the company.

10 Includes directorships and shareholding interests.

11 Or its holding, subsidiary or associate companies.

12 A relative means any person who is related to another, *inter alia*, by way of: (1) husband; (2) wife; (3) father; (4) mother; (5) son; (6) son's wife; (7) daughter; (8) daughter's husband; (9) brother; (10) sister; or (11) members of a Hindu undivided family.

13 'Pecuniary relationship' does not include receipt of remuneration, from one or more companies, by way of sitting fees, nor a transaction conducted on equal terms with any member of the general public and at the same price as is payable or paid by members of the public.

14 Or its holding, subsidiary or associate companies or their promoters or directors.

15 Or its holding, subsidiary or associate companies.

16 Or its holding, subsidiary or associate companies.

17 Or its holding, subsidiary or associate companies.

Generally, an independent director is a person who has significant expertise relevant¹⁸ to the company.

Indian legislators and regulators have emphasised the requirement for and role of independent directors as a significant factor contributing towards good corporate governance.¹⁹ While there is no doubt that reducing promoter nominees on the board necessarily reduces direct promoter control of the board, there is reason to continue to monitor the real impact of independent directors given the concentration of promoter control in the Indian economy.²⁰

The fact that shareholders retain the ultimate authority to appoint and remove a director is not uncommon but poses unique challenges in India.²¹

Who can represent the company

The board of directors is entitled to perform all acts and things that the company itself is authorised to do, provided the acts of the board of directors shall always be subject to: (1) the Companies Act 2013; (2) the memorandum and articles of association of the company; (3) restrictions and conditions that may follow from resolutions passed in general meeting; and (4) applicable law. Of course, no director may act on behalf of the company unless duly authorised by a resolution of the board.²²

The Companies Act 2013 sets out a list of matters that mandatorily require shareholder approval. These include:

- a* sale, lease out or disposal of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of the undertakings;
- b* investing otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation; and
- c* borrowing money, where the money to be borrowed, together with the money already borrowed by the company will exceed the aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business.

18 For example, with reference to finance, law, management, sales, marketing, administration, research, corporate governance and technical operations.

19 The regulatory discourse on independent directors suggests that ensuring the appointment of independent directors is an end in itself. While not incorrect, the efficacy of independent directors is subject to scrutiny and question in the Indian context and, arguably, practice must evolve to allow for increased freedom of action by independent directors.

20 Each instance of a lapse in corporate governance results in significant discussion of the relevance and role of independent directors. See, for example: <http://timesofindia.indiatimes.com/business/india-business/Role-of-independent-directors-in-focus/articleshow/55123638.cms>; <http://economictimes.indiatimes.com/wealth/real-estate/independent-directors-in-real-estate-developers-boards-press-exit-buttons-on-rera-fear/articleshow/54574616.cms>; and www.livemint.com/Companies/rcUibmcykkPea3DFnsYktI/Are-Tata-group-independent-directors-doing-justice-to-their.html.

21 See Section V.ii, *infra*, on the Tata dispute.

22 In *Dale and Carrington Inv. (P) Ltd. and Anr. v. P.K. Prathapan and Ors.* AIR 2005 SC 1624, the Supreme Court held that directors are agents of the company to the extent they have been authorised to perform certain acts on behalf of the company and that no director may act independently of that authority.

Note also that for listed companies the Listing Regulations set out specific responsibilities for the boards of listed companies including, *inter alia*, selecting, monitoring, compensating and replacing key managerial personnel to run the affairs of the company; ensuring the integrity of the accounting and financial reporting systems of the company; and monitoring and managing potential conflicts of interest.

Subject to these requirements and any additional stipulations set out in a company's articles of association, the board may delegate its responsibilities to a committee of the board, an individual director, a key managerial person or such other person as the board deems fit.

Typically officers of the company are authorised to execute routine operational matters²³ and the board may also issue a standing authority to a director or senior managerial personnel, *inter alia*, to execute contracts. It is paramount only that where the subject matter of the authority is expressly stated to be subject to shareholder approval, then that approval must be sought before the authority is exercised.

Chairman's control of the board

Indian companies may designate a chairman of the board who holds office for the duration of the appointment, or not make such a designation, in which event any director must be appointed chairman for the purpose of each meeting.²⁴

A designated chairman may or may not exercise a casting vote – the determination must be set out in each company's articles of association.

A chairman presides over the meetings of the board and the shareholders. The Companies Act 2013 provides the chairman with the discretion to finalise the contents of the minutes of the meetings of the board and the shareholders and to finally determine any disputes relating to the contents of the minutes.²⁵

The effective executive responsibility vests with a managing director²⁶ or an executive director.²⁷ A chief executive officer (CEO) is a recognised designation but a CEO need not necessarily be a director.

No person can hold office²⁸ as chairman and managing director or chief executive officer of the company except when:

- a* the articles of association of the company provide otherwise; or
- b* the company does not carry on multiple businesses.

Generally, a designated chairman is accorded significant respect as the leader of the board but, subject always to the determination of each company, does not necessarily exercise significant authority.

23 Which may include the operation of bank accounts.

24 Of the board as well as general meetings.

25 Of course, a challenge alleging oppression of minorities will likely impugn this determination by the chairman.

26 'Managing director' means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting or by its board of directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

27 'Executive director' is a director who is also working for the company in an executive capacity.

28 Nor reappointed.

Remuneration of directors

Private limited companies have no cap on the remuneration that may be paid to directors and senior management. However, the Companies Act 2013, prescribes the following conditions with respect to the remuneration that may be paid by public companies to their directors and managers:

- a* the total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed 11 per cent of the net profits of that company for that financial year. However, this limit may be exceeded if the excess is approved by the shareholders and the MCA;
- b* further, unless authorised by the shareholders in a general meeting:
 - the remuneration payable to any one managing director, or whole-time director or manager, cannot exceed 5 per cent of the net profits of the company and, if there is more than one such director, remuneration shall not exceed 10 per cent of the net profits to all such directors and managers taken together; and
 - the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed: (1) 1 per cent of the net profits of the company, if there is a managing or whole-time director or manager; and (2) 3 per cent of the net profits in any other case; and
- c* directors may also receive sitting fees subject to prescribed caps.

Note that the remuneration paid to a director is deemed to include the consideration paid to the director for any services that director provides to the company, save and except where those services are professional services and the consideration paid is the fee for the services.

Directors drawing remuneration above the limits prescribed by the Companies Act 2013 are required to refund the excess remuneration to the company.

Remuneration of independent directors

An independent director is not entitled to any stock option in the company and may receive remuneration by way of a fee for attending meetings, reimbursement of expenses incurred for participation in meetings and profit-related commission as approved by the shareholders of the company.

Code of conduct

Independent directors are required, *inter alia*, to:

- a* uphold ethical standards of integrity and probity;
- b* act objectively and constructively;
- c* devote sufficient time and attention to the company;
- d* not abuse office as director to the detriment of the company; and
- e* refrain from any action that would lead to the loss of independence.

Roles and functions of independent directors

The duties of independent directors include, *inter alia*:

- a* undertaking appropriate induction and regularly updating their skills, knowledge and familiarity with the company and the environment in which the company operates;

- b seeking appropriate clarification or amplification of information and, where necessary, take external expert advice at the cost of the company;
- c striving to attend all board meetings of the company;
- d ensuring that their concerns are addressed by the board or at least recorded in the minutes of the relevant board meetings;
- e participating constructively and actively in the committees of the board in which they are chairpersons or members;
- f ensuring that related-party transactions are in the interests of the company;
- g ascertaining and ensuring that the company has adequate and functional vigil mechanisms that do not prejudice a person who uses those mechanisms; and
- h reporting concerns about unethical behaviour, actual or suspected fraud or violation of the companies.

In the ongoing management dispute at Tata Sons Limited, the holding company of the Tata Group, an independent director²⁹ was removed by the shareholders following comments he made in favour of Cyrus Mistry.³⁰ This has invited significant comment on the role of independent directors and their capacity to genuinely influence governance.³¹

Committees of the board

Indian law mandates committees for companies that meet specified criteria:

- a Audit committee: every listed company³² must have an audit committee. The audit committee must consist of a minimum of three directors, with independent directors forming a majority of this committee. The audit committee must, *inter alia*, confirm all related-party transactions for public listed companies.
- b Nomination and remuneration committee: every listed company³³ must have a nomination and remuneration committee comprising three or more non-executive directors, of which not less than half should be independent directors.
- c Stakeholders relationship committee: every company that has more than 1,000 shareholders, deposit holders, or holders of other securities, must have a stakeholders relationship committee to consider and resolve the grievances of security holders of the company. The chairperson of this committee must be a non-executive director.
- d Risk management committee: pursuant to the Listing Regulations, every listed company must have a risk management committee, the specific duties of which are defined by the board.

29 Nusli Wadia.

30 The former chairman of Tata Sons Limited, who was removed from office.

31 See footnote 22, *supra*.

32 Additionally, the following public companies are also required to set up an audit committee and a nomination and remuneration committee: (1) companies having paid-up capital of 100 million Indian rupees or more; (2) companies having turnover of 1 billion Indian rupees or more; (3) companies having, in aggregate, outstanding loans or borrowings or debentures or deposits exceeding 500 million Indian rupees or more.

33 *Ibid*.

Takeovers

The board of a target company must act in compliance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 and the fiduciary duty each director owes the company.³⁴ Where the board believes that a takeover is not necessarily in the best interests of the company, it may seek a counter-offer from a white knight or otherwise act within the scope of the law to better protect the company.

ii Directors

Independent directors play an increasingly important role in India. While their engagement is in the ordinary course limited to board meetings, they have the fullest right to call for all documents and records and also visit company premises and interact with the executives other than simply at board meetings. While all directors are treated on equal terms, an executive director will necessarily be more aware of management proposals and initiatives even while those proposals and initiatives are at nascent stages, whereas independent directors will generally receive notice of these matters only when the management seeks board approval in respect of the proposals and initiatives.

Appointment, term, and succession

Directors are appointed by shareholders. The board may appoint a director subject to that appointment being approved by the shareholders in due course.³⁵ Of course, every person being appointed as director must qualify as such.³⁶

While it is possible for private limited companies to appoint permanent directors, two-thirds of the directors in public companies must mandatorily retire by rotation annually.

Independent directors may be appointed for a term not exceeding five consecutive years, which can be extended for a further five-year period. Thereafter, reappointment is possible only after three years during which the independent director must not associate with the company.

Liabilities and duties of directors

Indian law is clear that every director is a fiduciary and is principally obliged to protect the interests of the company. A director nominated by a shareholder or a lender must nonetheless act in the best interests of the company.³⁷

Indian jurisprudence is clear that a director of the company is liable for the acts of the company only to the extent that the director was actively involved in the relevant act. However, increasingly Indian regulators and investigating agencies follow the principle that the burden of proof lies on each director to demonstrate the absence of responsibility and

34 See Section II.ii, *infra*, on liabilities and duties of directors.

35 In the event a director is appointed by the board, his or her appointment must be regularised and approved by the shareholders on or before the final date for holding the following annual general meeting, either at the annual general meeting or at a separate extraordinary general meeting.

36 See Section II.i, *supra*, on disqualifications from appointment as director.

37 Without ignoring the interests of the nominator. See *Firestone Rubber v. Synthetic Rubber* (1971) 41 Comp Cas 377; *Needle Industries v. Needle Industries* AIR 1981 SC 1298; and *Offshore Services v. Bombay Offshore Suppliers* (1994) 2 Comp LJ 407.

this principle also finds place in the Companies Act 2013. It is therefore imperative that each director fully discharges the duty of care that the law imposes, and ensures that dissent, if any, is appropriately recorded.

III DISCLOSURE

All companies must make periodic filings with the Registrar with respect to changes in directors, audited financial statements, and shareholding pattern.

Listed companies are subject to the following significant disclosure requirements, which are event based and periodic:³⁸

- a* outcomes of board meetings must be disclosed within 30 minutes of the closure of the meeting, where the meeting was held to consider, *inter alia*, fundraising, financial results, buyback of securities, voluntary delisting, and other such prescribed matters. In other circumstances, all material information must be disclosed within 24 hours from the occurrence of the relevant event;
- b* specified transactions³⁹ must be disclosed irrespective of any threshold or materiality;
- c* other transactions that are material in terms of the policy adopted by the board must be disclosed;
- d* related-party transactions must be approved by the audit committee and any omnibus approval granted must be limited to one year. Additionally, all material related-party transactions require shareholder approval and the related party, if a shareholder, must abstain from voting on that resolution;
- e* the annual report must set out, *inter alia*, a corporate governance report;
- f* promoters, key managerial personnel, directors and employees of every listed company must disclose to that company the number of securities acquired or disposed of by that promoter, key managerial person, director or employee, as the case may be, if the value of the securities traded over any calendar quarter, aggregates to a traded value in excess of 1 million Indian rupees; and
- g* substantial acquisition of shares or voting rights⁴⁰ of a listed company must be reported to the relevant company as well as to the stock exchange. Further, any change in shareholding or voting rights of any person who, together with persons acting in concert, holds shares entitling them to 5 per cent or more of the shares or voting rights in a company must also be disclosed.⁴¹

i Auditor's responsibility

The Companies Act 2013 casts an obligation on statutory auditors to report any instances of fraud noticed by them during the course of their audit that have been or are being committed against the company by its officers or employees. Where the fraud involves or is expected to involve an amount of 10 million Indian rupees or more, the auditor must report this to the MCA, and where it involves a lesser amount, the auditor must report this to the audit committee.

38 Quarterly.

39 For example, M&A activity including joint ventures.

40 Acquisition of 5 per cent or more of the shares or voting rights.

41 The obligation to disclose arises even if the change results in that person's shareholding or voting rights falling below 5 per cent.

IV CORPORATE RESPONSIBILITY

i Risk management

Each company must formulate a risk management policy with respect to risks, if any, that threaten the existence of the company.

Of course, the requirements are more robust for listed companies, especially the top 100 listed companies determined on the basis of extant market capitalisation. These companies must mandatorily constitute a risk management committee whose role and responsibilities are set by the board.

ii Vigil mechanism

Listed companies⁴² must establish a vigil mechanism, to facilitate whistle-blowing. The vigil mechanism is supervised by the audit committee⁴³ and must operate to preclude prejudice to whistle-blowers. Equally, frivolous complaints will not be entertained and the complainant may be censured.

iii Corporate social responsibility

Companies meeting specified criteria⁴⁴ must establish a corporate social responsibility (CSR) committee, comprising at least three directors of which at least one must be an independent director (the CSR Committee). The CSR Committee formulates and monitors a CSR policy and ensures that the company spends at least 2 per cent of the average net profit for the three immediately preceding financial years on CSR activities.

V SHAREHOLDERS

Indian law recognises equality of voting rights subject to contract between shareholders. It is not uncommon for certain identified matters to require an affirmative vote from identified shareholders or a class of shareholders.

Indian law also recognises preference shares (which are common) and equity shares with differential rights (which are not as prevalent).⁴⁵ Preference shareholders are entitled to vote only on matters that affect their rights or, on all matters, if a dividend due is not paid to them. Equity shares with differential rights are entitled to vote in accordance with their terms; for example, non-voting shares do not carry a vote.

42 The Companies Act 2013 also requires companies that accept deposits from the public, and that have borrowed money from banks and financial institutions in excess of 500 million Indian rupees, to establish a vigil mechanism.

43 In cases where the company does not have an audit committee, the board of directors shall nominate a director to perform the role of the audit committee for the purpose of the vigil mechanism.

44 Companies having a net worth of 5 billion Indian rupees or more, or a turnover of 10 billion Indian rupees or more or a net profit of 50 million Indian rupees or more during any financial year.

45 There are no separate rights available to long-term shareholders – tenure of shareholding is not the basis for determining the extent of rights of a shareholder.

i Requirement for shareholders' approval

Indian law requires mandatory shareholder approval for certain matters.⁴⁶ A company's articles may stipulate additional matters that require shareholder approval. Additionally, dissenting minority shareholders may seek redress from the National Company Law Tribunal (NCLT) if the majority shareholders are mismanaging the company or oppressing the minority. Necessarily, each petition is evaluated on facts. The MCA may also prefer the petition, but as a matter of fact will exercise this power only in unique circumstances.

Shareholder activism is still a relatively underdeveloped concept in the Indian corporate sector partly because most of India's large corporates remain closely held. Derivative actions, while not expressly provided for at law, are seen in few cases and Indian courts have held that the shareholder will be allowed to sue on behalf of the company if he or she is bringing the action *bona fide* for the benefit of the company for wrongs to the company for which no other remedy is available.⁴⁷ A derivative action is not maintainable if the plaintiff has an ulterior motive in bringing the action as it cannot then be regarded as *bona fide* in the interest of the company. It has also been held that derivative actions may be entertained, provided there exists valid cause of action.⁴⁸

Communication with the shareholders is ordinarily conducted at the general meetings of the company. The Companies Act 2013 requires all companies to have a minimum of one general meeting of the shareholders in each financial year. Several significant items of business, including appointment or reappointment, as the case may be, of statutory auditors, directors, approval of financial matters, etc. are transacted at this meeting. Shareholders of the company are also entitled to call for extraordinary general meetings of the company. While it is uncommon, direct communication from the top management to the shareholders, by way of letters and press releases, is also seen.

Generally there is no direct contact between directors and shareholders and while a shareholder may address correspondence to the company and the board, generally, direct contact between directors and shareholders is limited to their interaction at a general meeting. On the rare occasion that there is direct contact, this usually occurs in circumstances where a company is addressing a specific issue.⁴⁹

ii Recent developments

The Tata dispute

Corporate governance regularly features in Indian public discourse, most recently with reference to the dispute at the Tata Group. Tata Sons Ltd is the principal holding company of the Tata Group, and the Tata Trusts and the Pallonji Group are the majority shareholders in Tata Sons.⁵⁰

On 24 October 2016, Cyrus Mistry, a member of the Pallonji Group, was removed as chairman of Tata Sons and thereafter as chairman of several Tata Group companies.

46 See Section II.i, *supra*, on who can represent the company.

47 *Darius Rutton Kavasmaneck v. Gharda Chemicals Limited*.

48 *Rajeev Saumitra v. Neetu Singh I.A.* No. 17545/2015 in CS(OS) No. 2528/2015.

49 For example, Cyrus Mistry's open letter; see Section V.ii, *infra*, on the Tata dispute.

50 The Tata Trusts hold approximately 66 per cent and the Pallonji Group approximately 18 per cent respectively of the shareholding of Tata Sons Limited.

Cyrus Mistry approached the NCLT with a petition alleging oppression of minority shareholders and mismanagement. He also issued open letters alleging lapses in governance⁵¹ at the Tata Group.

When Nusli Wadia, an independent director of Tata Motors,⁵² issued public comments in favour of Mistry, he was removed from office.

While the dispute will play out in due course, it has attracted significant comment on corporate governance in India, especially as, prior to this, the Tata Group was reputed to adhere to high standards of governance and compliance.⁵³ The summary removal of Nusli Wadia from office has also highlighted the limitations under which independent directors operate.

The relative silence of regulators and institutional shareholders also points to the divergence between legislative intent and practical effect.

Nonetheless it is fair to say that the emphasis on corporate governance and transparency over the past decade has resulted in a much higher level of scrutiny and analysis of this dispute than has been witnessed previously, and we hope this trend continues.

VI OUTLOOK

Corporate governance has assumed significance in recent times. At present, in the Indian context, the biggest challenge facing implementation of a sound corporate governance regime is the fact that a large number of Indian companies continue to remain significantly controlled by promoters, and do not have adequate professionally qualified managerial personnel. The closely held, promoter-driven nature of these companies may also substantially limit the role of independent directors and their consequent impact on the functioning of the company.

Despite these concerns, India has witnessed several instances of growing shareholder activism in recent times. This, coupled with the increased mandatory disclosures, is changing the landscape of corporate governance in India, and it is likely that as far as corporate governance is concerned Indian companies will only improve.

51 Including lapses that occurred during his term as chairman.

52 Tata Motors Limited, Tata Chemicals Limited and Tata Steel Limited.

53 Cyrus Mistry's open letter has arguably tarnished that reputation, at least in the short term.

IRELAND

*Paul White*¹

I OVERVIEW OF GOVERNANCE REGIME

In Ireland, the corporate governance of business organisations is derived from a mixture of corporate law,² statutory regulations and codes (for the most part non-binding). In addition, for privately owned corporations, the governance architecture is often explicitly dealt with in the constitutional documents and by-laws (known as the constitution or articles of association), and is also often addressed as a matter of contract between the shareholders in a shareholders' agreement.

For the purposes of this chapter, we will focus on corporate governance in public or listed companies.

i Corporate governance requirements for listed companies

In Ireland, companies listed on the Main Securities Market are required to comply with both the UK Corporate Governance Code (the Corporate Governance Code) and the Irish Corporate Governance Annex.

The terms of the Corporate Governance Code are dealt with elsewhere,³ and it is not proposed that those terms be restated here. An important basis or feature of the Corporate Governance Code is the 'comply or explain' approach to compliance. Under the Irish Stock Exchange Listing Rules, companies listed on the Main Securities Market are expected to comply with the Corporate Governance Code or set out an explanation for any deviation from its provisions in the annual report to shareholders.

The Irish Corporate Governance Annex asks for meaningful, evidence-based descriptions in the annual report of how the Code is applied rather than 'recycling' descriptions that replicate the wording of the Code.

The Irish Annex identifies the following key recommendations for inclusion in the annual report:

- a* an explanation as to why the number of non-executive directors is regarded as sufficient;
- b* a description of the skills, expertise and experience of each director – including government appointees;
- c* the process followed in selecting and appointing new directors;
- d* the methodology in the annual evaluations of the directors individually and collectively;
- e* the factors taken into account when determining a director's independence;

1 Paul White is a partner at A&L Goodbody.

2 A mixture of primary legislation and common law.

3 See UK chapter.

- f* a description of the work carried out by the audit committee generally, and in relation to risk oversight more specifically; and
- g* a description of the remuneration policy, how performance elements are deferred and any clawback arrangements.

Furthermore, companies listed on the smaller market – the Enterprise Securities Market – are also encouraged to adopt a corporate governance code on admission to that market.

In practice, a number of them adhere to the Principles of Corporate Governance issued by the UK Quoted Companies Alliance.

ii Banks and other financial institutions

Banks and insurers in Ireland follow, on a statutory and mandatory basis, separate Corporate Governance Requirements issued by the Central Bank of Ireland in 2016. Banks are required to follow the Corporate Governance Requirements for Credit Institutions 2015 (the Credit Institutions Requirements) and insurance undertakings follow the Corporate Governance Requirements for Insurance Undertakings 2015 (the Insurance Undertakings Requirements). Captive insurance and reinsurance undertakings are required to follow the Corporate Governance Requirements for Captive Insurance and Captive Reinsurance Undertakings 2015.

These separate Requirements replaced the Central Bank Corporate Governance Code for Credit Institutions and Insurance Undertakings 2013, and the Corporate Governance Code for Captive Insurance and Captive Reinsurance Undertakings 2013. The requirements apply to all credit institutions and insurers based in Ireland, including reinsurance firms. Different standards apply to Irish subsidiaries of foreign-regulated firms in a number of areas.

The significance of the Credit Institutions Requirements and the Insurance Undertakings Requirements are that they are mandatory; in other words, the comply or explain approach to compliance does not apply.

The Credit Institutions Requirements include:

- a* boards must have a minimum of seven directors in major institutions and a minimum of five in all others;
- b* requirements on the role and number of independent non-executive directors (including internal and external evaluation, training and professional support);
- c* criteria for director independence and consideration of conflicts of interest;
- d* limits on the number of directorships that directors may hold in financial and non-financial companies to ensure they can comply with the expected demands of board membership of a credit institution or insurance company;
- e* clear separation of the roles of chair and chief executive officer;
- f* a prohibition on an individual who has been a chief executive officer, director or senior manager during the previous five years from becoming chair of that institution;
- g* a requirement that board membership is reviewed at a minimum every three years;
- h* a requirement that boards set the risk appetite for the institution and monitor adherence to this on an ongoing basis;
- i* minimum requirements for board committees, including audit and risk committees;
- j* prescriptive measures around how and when board meetings must be held, and attendance by directors;
- k* a requirement for an annual confirmation of compliance to be submitted to the Central Bank;.

- l* the use of videoconferencing where a director cannot attend a meeting; and
- m* the audit committee ‘as a whole’ must have relevant financial experience and one member must have an ‘appropriate qualification’.

Corporate governance themes such as diversity and risk are reflected in the Requirements also. For example, the Credit Institutions Requirements provide that a chief risk officer must be appointed to oversee the institution’s risk management function and a risk committee must be established. The chairman of this committee must be a non-executive director and the committee must be composed of a majority of non-executive directors. The audit and risk committees must have a minimum of three members.

The board or nomination committee is also required to establish a written diversity policy for consideration in future board appointments.

II CORPORATE LEADERSHIP

i Introduction

The principal leadership role for any company is played by the board of directors. The role of the director is governed principally by the Irish Companies Act,⁴ the primary source of corporate law in Ireland, and by principles established by case law (in this regard it is worth noting that English case law is regarded as having persuasive authority in Ireland). This body of law is further supplemented by a growing suite of regulations, codes and guidelines, many of which have been mentioned elsewhere throughout this chapter. Below is a brief (and non-exhaustive) discourse on some of the more significant aspects of the law surrounding directors and the structures and practices of boards in Ireland.

ii Board structure and practices

One-tier structure

Generally, the board of directors of an Irish company is structured as a one-tier body (usually comprising both executive directors and non-executive directors), unlike in other jurisdictions where two-tier structures are more common. Irish law does not prohibit the two-tier board, but it does not arise in practice: were it to do so, directors would be likely to face the same liability regardless of their position within a two-tier board system.

Composition of the board

Every Irish public company must currently have at least two directors, but the articles of association of the company (i.e., its constitution) may provide for a greater minimum number (as may any applicable corporate governance code that applies to the company). Since the Companies Act 2014 was enacted on 1 June 2015, private companies limited by shares are permitted to have a sole director but they must also have a separate company secretary. A body corporate is prohibited from becoming a director of an Irish company. As in other jurisdictions, a public company or a large private company will generally have a combination of executive and non-executive directors on its board, whereas a small private company will generally have all executive directors.

⁴ The Companies Act 2014 (the Act was commenced on 1 June 2015).

Authority of the directors to represent the company

A director can only enter into a proposed contract on behalf of a company where it is within his or her permitted delegated authority to do so, unless that contract, or bind, or commitment has been approved by the board. The authority of the director may be actual or ostensible. Actual authority is usually rooted in the service contract between a company and the director. It can also be implied, for example, by the ordinary course of the business of the office that the director holds, such as managing director or chief executive officer. However, even where no actual authority exists, the company may still be bound by the director's actions when he or she acts within his or her ostensible or apparent authority (i.e., where he or she is held out by the company as having the authority, for example, of a particular office-holder such as managing director or chief executive officer). In grappling with the principles surrounding actual and ostensible authority, it is also necessary to bear in mind the related principle often referred to as the rule in *Turquand's case*⁵ (or the indoor management rule). Essentially, if a third party is dealing with a company, he or she is not obliged to enquire into the regularity of its internal proceedings. However, this rule is not absolute and there are limits to its scope and operation. Under the Companies Act 2014, private limited companies have the contractual capacity of a natural person. The board of directors and individuals authorised by the company are entitled to bind it. Persons authorised may be registered on a register maintained in the Companies Registration Office as being entitled to bind the company, although this is not a mandatory requirement.

Legal responsibilities of the board

The root source of all corporate authority lies with the shareholders. However, as in other jurisdictions, shareholders generally delegate the management of the company to the board of directors and allow the directors to exercise all the powers of the company except those that must, under statute, be exercised by the shareholders.

Chair

While the chair of a company has additional roles (and, to an extent, responsibilities) – including chairing the board of directors and shareholder meetings – he or she does so as a director. As a director, he or she is subject to the same duties and has the same authority as that of any other board member. Where a company adopts a standard constitution or articles of association, the chair will enjoy a casting vote in the event of an equal number of votes being cast in respect of any matter at board level.

Significantly, for Main Securities Market-listed companies, the Corporate Governance Code contains a number of provisions relating to the role of chair: the chair has responsibility to ensure that a culture of openness and debate prevails, that adequate time is available for discussion of all topics by the board and that all directors are made aware of shareholders' concerns, and must also agree and regularly review the training and development of each director.

Delegation of board responsibilities

In general, the board of directors may delegate its authority to an individual director, to employees or to committees established by the board. Having delegated powers, the directors

⁵ *Royal British Bank v. Turquand* (1856) 6 E & B 327 [1843-60] All ER 435.

are not absolved from all responsibility in relation to the delegated actions, as the directors will continue to be under a duty to investigate the operations of the company diligently and with skill.

It is also open to a director, subject to the constitution or articles of association of the company, to appoint an alternate to fulfil his or her duties on his or her behalf, generally in relation to a specific action or time period. Whereas the alternate is personally liable for his or her own actions, the appointing director again is not absolved and can be held responsible along with the alternate.

Chief executive officer

Not unlike the role of chair, Irish statute law is not particularly prescriptive in relation to the role of managing director or chief executive officer. In general, the powers of the chief executive officer are not fixed by law, but depend instead upon the terms of the service agreement agreed from time to time between the board and the chief executive.

To ensure that there is a clear division of responsibilities between the running of the board and the running of the company's business, the Corporate Governance Code and Central Bank Requirements (among others) recommend that the role of chair and chief executive officer should not be fulfilled by the same individual. The Corporate Governance Code also suggests that no former chief executive officer should become chair of the same company and that the division of responsibilities between the chair and the chief executive officer be clearly established, set out in writing and agreed by the board.

Committees of the board

As mentioned, Irish companies commonly delegate certain matters to committees established by the board. Audit, remuneration and nomination committees are not uncommon, depending on the size of the company. The boards of certain companies, including listed companies, credit institutions, and insurance and reinsurance undertakings, are required by law to establish an audit committee (and perhaps other committees, such as a remuneration committee, a nomination committee and a risk committee).⁶

Board and company practice in takeovers

The two principal sources of responsibility imposed upon directors of a company in the course of a takeover offer are common law and the Rules of the Irish Takeover Panel (the Takeover Rules), which, unlike the equivalent rules in the United Kingdom, have the force of law in Ireland. Two other important sources of duties and obligations are the Listing Rules of the Irish Stock Exchange and the Irish Companies Act.

The Takeover Rules, in particular, cover a wide range of matters relating to takeovers, and it is the responsibility of each company director, whether executive or non-executive, to ensure, so far as he or she is reasonably able, that the Takeover Rules are complied with during offer periods. In essence, the Takeover Rules prohibit a company from taking any action that might frustrate the making or implementation of an offer for the company or depriving the shareholders of the opportunity of considering the merits of such an offer at any time during the course of the offer or at any earlier time at which the board has reason to believe that the making of such an offer may be imminent.

⁶ See Section III.ii, *infra*, for further information.

iii Directors

Non-executive or outside directors

Under Irish law, no distinction is drawn between the non-executive director and any other director, and so non-executive directors owe the same duties as other directors to the company, its creditors and employees.

Where non-executive directors are appointed on the nomination of a third party, most commonly a shareholder, the nominee is entitled to have regard to the appointer's interests, but only to the extent that they are not incompatible with his or her duty to act in the interests of the company.

The non-executive director has attracted much attention recently in terms of the importance of the role as independent watchdog. The Corporate Governance Code, for example, requires the non-executive directors of listed companies to 'constructively challenge' board strategy. In addition, it recommends that the board should appoint one independent non-executive director to be the senior independent director to provide a sounding board for the chair and that the board should not agree to a full-time executive director taking on more than one non-executive directorship or the chair in a FTSE 100 company or equivalent Irish company (FTSE 350 equivalent). There are some recent sources of guidance for non-executive directors on care, skill and due diligence, which are available to Irish non-executive directors.

Duties of directors

The duties of directors in Ireland are grounded in case law, legislation and related rules and codes. These duties, predictably, echo those in other jurisdictions.

Since 1 June 2015, a codified set of principal directors' duties has been in force in Ireland, under the Companies Act 2014. The list of eight codified duties has its origins in the common law developed by the courts in Ireland and the United Kingdom.

The principal fiduciary duties of directors that have been enumerated in the Act are as follows:

- a* the duty to act in good faith in what the director considers to be in the interests of the company;
- b* the duty to act honestly and responsibly in relation to the conduct of the company's affairs;
- c* the duty to act in accordance with the company's constitution and exercise his or her powers only for the purposes allowed by law;
- d* the duty to not use the company's property, information or opportunities for his or her own or anyone else's benefit unless this is expressly permitted by the constitution or approved by resolution of the members in a general meeting;
- e* the duty to not agree to restrict the director's power to exercise an independent judgement, unless this is expressly permitted by the company's constitution, or the director believes in good faith that it is in the interests of the company for a transaction or arrangement to be entered into for him or her to fetter his or her discretion in the future by agreeing to act in a particular way to achieve this, or the directors agreeing to this has been approved by resolution of the members in general meeting;
- f* the duty to avoid any conflict between the director's duties to the company and his or her other, including personal, interests unless the director is released from this duty in accordance with the constitution, or by a resolution of the members in general meeting;

- g* the duty to exercise the care, skill and diligence that would be exercised in the same circumstances by a reasonable person having both (1) the knowledge and experience that may reasonably be expected of a person in the same position as the director; and (2) the knowledge and experience that the director has; and
- h* the duty to have regard to the interests of the company's employees in general and of its members.

These duties are owed to the company and are enforceable by the company in the same way as any other statutory duties owed by the director to the company. The Act provides that these principles are based in common law and equitable principles and that the new statutory duties must be interpreted and applied as such.

Directors' compliance statement

As a result of a new obligation introduced by the Companies Act, public limited companies are required to include a compliance statement in the directors' annual report accompanying their company's financial statements. This requirement applies in respect of financial years commencing on or after 1 June 2015.

Directors must acknowledge that they are responsible for securing their company's compliance with its 'relevant obligations' (which includes obligations under tax law and other company law provisions that impose serious penalties for non-compliance).

Directors must also, on a comply or explain basis, confirm: (1) that they have drawn up a 'compliance policy statement', appropriate to their company, setting out the company's policies regarding compliance; (2) that appropriate arrangements or structures are in place that are, in the director's opinion, designed to secure material compliance with its relevant obligations; and (3) that they have reviewed, during the financial year, the arrangements or structures that have been put in place to secure this material compliance. If these statements, confirmations and reviews have not been made or carried out, the directors must specify in their directors' report the reasons why not.

Statutory audit confirmation

The Companies Act introduced a new statutory obligation on the directors of all companies to include a statement in their directors' report that so far as each director is aware, there is no relevant audit information of which the company's auditors are unaware, and each director has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information, and to establish that the company's auditors are aware of that information. This is similar to the obligation that has existed in the United Kingdom since 2006.

Liability of directors

Directors are not liable for the commitments and obligations of the companies they serve.

Directors can be held personally liable or be subject to fines and, in very serious circumstances, imprisonment for breaches of various statutory provisions such as those relating to company law, environmental law and health and safety law. Examples under the Irish Companies Act include where the director engages in insider dealing or where the director makes false or misleading statements in certain circumstances.

Under the Companies Act, a new streamlined Summary Approval Procedure (the SAP) has been created to enable companies to carry out certain activities that would otherwise be

prohibited. The SAP is only available to public limited companies for a members' voluntary winding up, the prohibition on pre-acquisition profits or losses being treated in a holding company's financial statements as profits available for distribution, and the prohibition on entering into loans or quasi-loans to directors or other connected persons.

Under the SAP rules, a directors' declaration of solvency and shareholder approval is required, and in some cases, a confirmatory auditors' report is also required. The SAP rules provide that a court may declare a director personally responsible without any limitation of liability, for all or any liabilities of the company where a declaration is made without having reasonable grounds for the opinion on the solvency of the company as set out in the declaration.

In the context of entering a contract on behalf of a company, a director can be made personally liable where he or she commits a tort or fraud on behalf of the company (or induces the company to do so), where he or she gives a personal guarantee, or where he or she fails to make the other party aware that he or she is acting as an agent for the company.

In the context of insolvency, directors may also face personal liability in a limited number of circumstances, for example, where they engage in fraudulent or reckless trading, misapply company assets or make an incorrect declaration of solvency in the context of a voluntary liquidation. On insolvency, a director may also face restriction for five years or disqualification for up to five years or such other period as the courts think fit.

Appointment, term of office, removal

The appointment and removal of directors is generally governed by the company's constitution or articles of association. The right to elect directors is generally reserved to shareholders save where a casual vacancy arises. The directors usually have the right to fill a casual vacancy, by a resolution of the directors passed at a board meeting or by unanimous written resolution of the directors, but this appointment might then, particularly with public companies, be subject to shareholders' confirmation at the next annual general meeting (AGM) after such an election. Under the Companies Act, the directors of a public limited company are required to retire by rotation unless the company's constitution provides otherwise. For listed companies to which the Corporate Governance Code applies, all of the directors must be reappointed annually.

Apart from the terms of the constitution or articles of association, shareholders also have a statutory right to remove directors by way of resolution passed by simple majority, subject to the director's right to attend the shareholders' meeting in question and to make representations.

Conflicts of interest of directors

The area of directors' conflicts of interest has been the subject of a number of judicial decisions over a number of years and an extensive body of case law has developed around it. The key principles are, as mentioned, that a director should not place himself or herself in a position where his or her duty to the company conflicts with his or her own personal interests, and that a director should not gain from his or her fiduciary position. Added to this common law is a host of statutory provisions setting out different checks and balances primarily aimed at the protection of shareholders and creditors.

III DISCLOSURE

i Financial reporting and accountability

Companies are required to disclose details of their accounts at their AGM and in their annual return, which is filed in and publicly available at the Companies Registration Office. Under the Companies Act, related party transactions that are material and have not been concluded under normal market conditions are required to be disclosed in the notes to the company's accounts.

Company accounts must be audited by a qualified auditor and the auditor's report is distributed to shareholders and included in the annual return.

Companies with securities admitted to trading on a 'regulated market' (in Ireland, this is the Main Securities Market of the Irish Stock Exchange) must disclose financial and other information to shareholders on a regular basis. The Transparency Regulations 2007 (as amended, most recently twice in 2015) and related Rules issued by the Central Bank of Ireland (which implement the EU Transparency Directive (2004/109/EC)) require the publication of annual and half-yearly financial reports. They also require companies to publish information that is disclosed to them by persons who have acquired or disposed of voting rights in the company.

The Companies Act provides a definition of a 'traded company' for the first time in Irish law. A 'traded company' includes a public limited company that has shares or debentures admitted to trading on a regulated market in an EEA state.

Traded companies are required to include, in the directors' report, a corporate governance statement in respect of the financial year concerned. This statement must be included as a specific section of the directors' report and must include the following information:

- a* a reference to the corporate governance code to which the company is subject, including all relevant information concerning corporate governance practices applied in respect of the company, which are additional to any statutory requirement, and details of where the text of the relevant corporate governance code is publicly available. If the company departs from the corporate governance code, details of this, and of the reasons for the departure, should be included;
- b* a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process;
- c* information already required by the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006 relating to the company's share and control structures (where the company is subject to this Directive);
- d* the operation of the shareholder's meeting and its key powers, and a description of shareholders' rights and how they can be exercised; and
- e* the composition and operation of the board and its committees.

The company's auditors, when preparing their report to the members to be read at the AGM, must establish that the corporate governance statement addresses the information required under the Companies Act, and provide an opinion on certain aspects of the report. Companies that comply with the Central Bank Code are also required to submit an annual compliance statement to the Central Bank of Ireland.

In June 2016, the European Union (Statutory Audits) Regulations 2016 (the 2016 Regulations) came into effect in Ireland. The 2016 Regulations give effect to the Statutory Audit Directive 2014/56/EU, which amended the original Statutory Audit Directive (Directive 2006/43/EC) in various ways.

The new regime was designed to enhance (1) the independence of statutory auditors and (2) the quality and credibility of statutory audits, across the EEA.

Public listed companies are regarded as 'public interest entities' (PIEs) for the purpose of the legislation and the following new provisions now apply to them:

- a* PIEs are obliged to rotate their auditor firm after a maximum of 10 years (from date of initial appointment);
- b* there are tighter restrictions on the provision of non-audit services by auditors to PIEs;
- c* the selection and appointment of the statutory auditors must adhere to specified procedures, which must be established by the PIE; and
- d* there are detailed requirements regarding the establishment of audit committees in PIEs.

ii Audit committees

The requirement for public interest entities to establish an audit committee has been in place in Ireland since the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010 (the Regulations) were published, giving effect to Directive 2006/43/EC on statutory audits.

In December 2011, the Regulations were amended to reduce the number of independent directors on an audit committee from two to one, bringing the requirement back in line with the Statutory Audits Directive. These Regulations, as amended, were not revoked by the Companies Act 2014 and as a result, public interest entities must continue to comply with the requirements of the Regulations with regard to audit committees.

'Public interest entities' are (1) companies whose transferable securities are admitted to trading on a regulated market of any Member State, namely, the Main Securities Market of the Irish Stock Exchange; (2) credit institutions; and (3) insurance and reinsurance undertakings.

The responsibilities of the audit committee include monitoring the financial reporting process, monitoring the effectiveness of the company's systems of internal control, internal audit and risk management and monitoring the statutory audit of the annual and consolidated accounts.

The 2010 Regulations also contain provisions on many aspects of auditing, including the approval of statutory auditors and audit firms, educational standards of auditors, the establishment of a public register of auditors, independence of auditors and arrangements regarding third-country auditors. A notable provision of the 2010 Regulations is that statutory auditors or audit firms may only be dismissed where there are proper grounds. Divergences of opinions on accounting treatments or audit procedures are not considered to be proper grounds for dismissal.

Under the Companies Act, 'large' private companies that meet certain financial thresholds are required to have an audit committee on a comply or explain basis.

The provisions of the Companies Act and the Regulations are consistent in relation to the responsibilities of the audit committee and its composition.

The Companies Act provides that the requirement to establish an audit committee applies to public limited companies that do not fall within the scope of the Regulations. In such cases, the provisions relating to 'large private companies' apply to the relevant public limited companies irrespective of the balance sheet amount or the amount of turnover of that public limited company.

Listed companies following the UK Corporate Governance Code must additionally comply with the relevant provisions relating to audit committees, or explain why not.

Financial institutions and insurance undertakings must also comply with the relevant provisions on audit committees contained within the Central Bank of Ireland's Corporate Governance Code for Credit Institutions and Insurance Undertakings, which operates on a statutory basis, rather than a comply or explain basis.

iii Market disclosure

Listed companies must also comply with certain disclosure requirements contained in the Listing Rules, the new EU Market Abuse Regulation (MAR) (as implemented in July 2016) and the Takeover Rules. Pursuant to the earlier EU Market Abuse Directive, Irish companies listed on the Main Securities Market have been required to release 'inside information' to the market without delay (except where limited circumstances exist for deferring such information). Under the MAR, companies listed on the smaller Enterprise Securities Market are within the scope of the market abuse regime for the first time and such companies are now required to put systems in place to ensure both their initial and their ongoing compliance with market abuse legislation. The MAR also introduces more significant record-keeping and reporting obligations where market disclosure has been delayed.

iv Disclosure of share interests

Under the Companies Act, directors, shadow directors and company secretaries must disclose to the company, in writing, interests they have in shares and debentures in the company, its subsidiary or holding company. Specifically, they must disclose the subsistence of their interest, the number of shares of each class and the amount of debentures of each class of the company, subsidiary or holding company. Under the Companies Act, the threshold at and above which that interest in a public company just be disclosed has been reduced to 3 per cent. The Companies Act also provides that certain transactions and arrangements between directors and persons connected to them, and the company or its subsidiary, must be disclosed in the company's accounts.

In addition, persons discharging managerial responsibilities are obliged to disclose their interests and that of close family members in shares of companies whose shares are admitted to trading on a regulated market, under the MAR. Under the Transparency Regulations 2007 and related Central Bank Transparency Rules, major shareholders in issuers whose shares are admitted to trading on a regulated market in Ireland must disclose the voting rights held by them.

v Beneficial ownership

In 2016, the European Union (Anti-Money Laundering: Beneficial Ownership of Corporate Entities) Regulations 2016 came into operation. All corporate and other legal entities, but excluding companies listed on an EU 'regulated market', must comply with the Regulations. The Regulations require entities incorporated in the state to hold adequate, accurate and current information on the controllers and beneficial owners of more than 25 per cent of their entity.

Listed companies on the Main Securities Market and Enterprise Securities Market of the Irish Stock Exchange are not required to comply with the Regulations, as they are subject to disclosure requirements that are consistent with this law.

IV CORPORATE RESPONSIBILITY

There are no specific legal requirements or guidance in Ireland regulating corporate social responsibility. However, Irish companies are increasingly aware of corporate social responsibility issues. Most public listed companies acknowledge the need for and benefits of providing information to shareholders and the public on corporate social responsibility.

Legislation exists in Ireland that is designed to protect whistle-blowers. The Protected Disclosures Act 2014 aims to ensure workers are protected from reprisal where, in good faith and in the public interest, they disclose information relating to wrongdoing in the workplace. Employers are required to publish and put in place policies and procedures to deal with whistle-blowing. The Act protects workers in all sectors. For employees who believe that they have been unfairly treated as a result of disclosing company malpractice, there are also remedies under employment law, and in particular unfair dismissals legislation.

V SHAREHOLDERS

Recent years have seen a move internationally towards enhanced rights for shareholders. In Ireland, as with other aspects of corporate law, the rights and responsibilities of shareholders are primarily determined by the Irish Companies Acts, supplemented by common law. A significant development in shareholders rights, and one that Ireland shares with its EU neighbours, is the Shareholders Rights Directive, implemented in Ireland by the Shareholders' Rights (Directive 2007/36/EC) Regulations 2009. Since 2014, preliminary steps have been taken by the European Commission to amend the Shareholder Rights Directive to improve engagement with shareholders, among other goals. Proposals include a requirement for public interest entities to publish information country by country, on profits or losses before tax, taxes on profits or losses and public subsidies received. Other proposals being considered are provisions that would enable shareholders to vote at least every three years on a listed company's remuneration policy for directors.

Agreement on the substantial requirements for an amending Directive was made in December 2016, and it is expected to be adopted by the European Council and Parliament in 2017.

i Shareholder rights and powers

Equality of voting rights

Every registered shareholder entitled to attend meetings of an Irish company is also entitled to vote on any shareholder matter, unless the company's constitution or articles of association or the terms of issue of the shares dictate otherwise. Many private companies in Ireland have only one class of ordinary shares in issue, with each share carrying equal rights in relation to voting, dividends and on a winding-up. However, it is also quite common for an Irish company to introduce different classes of shares, for example voting and non-voting, or a share class that might attach weighted voting rights either generally or on a particular matter.

Rights accrue only to those persons who are registered in the register of members of the company and not to beneficial holders. There is some suggestion that in future direct and indirect holders of shares may be given equal rights, but this has yet to materialise in Ireland.

Other rights of shareholders

Shareholders in Irish companies enjoy all the usual rights associated with membership of a company, for example the right to receive copies of financial information, pre-emption rights and the right to wind up the company.

Shareholders of some Irish listed companies also enjoy certain additional and enhanced rights following the introduction of the Shareholders' Rights Regulations 2009. For example, a general meeting can be called by members representing only 5 per cent of the voting capital of a company listed on the Main Securities Market (10 per cent for companies listed on the smaller Enterprise Securities Market). In addition, members holding 3 per cent of the issued capital of a company listed on the Main Securities Market, representing at least 3 per cent of its total voting rights, have the new right to put items on the agenda and table draft resolutions to be adopted at AGMs. Listed companies are allowed to offer members participation in and voting at general meetings by electronic means (although there is likely to be debate about exactly what this means) and will also be allowed to offer the possibility of voting by correspondence in advance. However, neither of the latter provisions is mandatory and companies are merely permitted to provide these facilities.

Decisions reserved to shareholders

Generally, the shareholders do not have a role in deciding or approving operational matters, regardless of size or materiality. An exception to this principle arises under the Listing Rules of the Irish Stock Exchange in relation to large transactions.

Under Irish law, there is a list of structural matters that are reserved to be decided by the shareholders by ordinary resolution (or simple majority) of those who vote. Examples include the consolidation or subdivision of shares, the payment of compensation to former directors and the purchase 'on market' of the company's own shares. Certain other actions are also reserved but require a special resolution (or 75 per cent of the votes). Examples of these matters include the alteration of the memorandum and articles of association of the company, the giving of financial assistance in connection with the purchase of the company's own shares and the reduction of share capital.

Rights of dissenting shareholders

A number of remedies are open to disgruntled shareholders under Irish law. Perhaps the remedy that is most often talked about is the statutory right of minority shareholders to seek potentially far-reaching redress under Section 212 of the Act on the grounds of majority shareholder oppression, where shareholders can also apply to court to have the company wound up on just and equitable grounds. Here it must be shown that the act or measure complained of has as its primary motive the advancement of the interests of the majority shareholders as opposed to the interests of the company as a whole. Mere dissent by a minority is insufficient to support a claim for redress. The Companies Act permits the courts to award compensation for any loss or damage as a result of oppressive conduct.

ii Shareholders' duties and responsibilities

Controlling shareholders

The Irish company is legally separate from its shareholders, even its controlling shareholder. The powers, rights, duties and responsibilities of the controlling shareholder, like any other shareholder, will be determined by the terms of issue of the shares, the constitution or articles

of association of the company and any applicable shareholders' agreement. However, the actions of a controlling shareholder should always be measured in the context of the various remedies open to minority shareholders.

Institutional investors

Corporate governance is currently a key concern for institutional investors, along with so many other interested parties. The UK Stewardship Code sets out good practice for institutional investors when engaging with UK listed companies and will be relevant to how those institutional investors engage with Irish listed companies. Although there are currently no plans to introduce a similar code in Ireland, it is likely that Irish institutional investors will view this code as the standard of best practice in the area.

iii Shareholder activism and shareholder remedies

Shareholder activism is relatively underdeveloped in Ireland. However, there are a number of signs of change.

Shareholders can bring proceedings where the directors are exercising their powers or conducting the affairs of the company in a manner oppressive to the shareholders or in disregard of their interests. As indicated above, courts can grant relief under Section 212 where it can be proved by a member that the affairs of the company have been conducted in an oppressive manner against him or her or any of the members of the company, including members who are directors themselves.

Aggrieved members may also take a derivative action (i.e., an action in the name of the company itself) where the company has been wronged, with one shareholder representing the body of shareholders. This typically arises in circumstances where the directors of a company are responsible for taking actions in the company's name and refuse to take that action. Derivative actions will be permitted where an *ultra vires* or illegal act has been perpetrated against the company, where more than a bare majority is required to ratify the wrong in question, where members' personal rights have been infringed or where fraud has been committed on a minority of members.

iv Takeover defences

Certain takeover defence mechanisms may risk conflicting with the Irish Takeover Panel Rules. As a rule, in any defensive action, it is imperative that the board ensure that their actions do not amount to 'frustrating actions' and that a level playing field is afforded to all potential bidders.

A company that has received a bid is not prevented from seeking alternative bids elsewhere (though this may possibly be subject to any inter-party agreement). The offer of the third party may be announced at any time except where the Takeover Panel directs that the third-party white knight make its intentions clear. In general terms, the directors must provide equality of information to all parties.

v Contact with shareholders

Mandatory and best practice reporting to all shareholders

Under the Transparency Regulations 2007 (as amended), companies whose securities are admitted to trading on a regulated market are required to publish annual and half-yearly financial reports. The annual report contains audited financial statements, a management

report and responsibility statements. The half-yearly report contains a condensed set of financial statements, an interim management report and responsibility statements. Responsibility statements contain certain confirmations, including that the financial statements represent a fair and true view of the financial status of the company.

Members enjoy the right to access certain information from the company, including the company memorandum and articles of association, resolutions and minutes of general meetings, company registers and the annual financial statements, directors' reports and auditors' reports. However, in private companies, members are not entitled to receive the more interesting operational, trading or business information. This is usually reserved to the board of directors unless otherwise provided in the articles of association or negotiated in any shareholders' agreement.

Listed companies follow the Corporate Governance Code, which sets out the best practice guidelines for corporate governance. Listed companies must comply with the Code or explain any deviations to shareholders. In addition, the Irish Corporate Governance Annex to the Listing Rules encourages Irish listed companies to provide more detailed explanations of their actions and in particular any deviation from certain aspects of the Corporate Governance Code to promote dialogue with shareholders.

Twenty-one days' notice must be given for an AGM. In the case of private companies, seven days' notice is required for an extraordinary general meeting (EGM). However, if it is proposed to pass a special resolution at the EGM, then 21 days' notice must be given. EGMs of listed companies (other than meetings for the passing of a special resolution) may be held on 14 days' notice, but only where the company offers all members the facility to vote by electronic means at general meetings and the company has passed a special resolution, approving the holding of EGMs on 14 days' notice, at its immediately preceding AGM or at a general meeting held since that meeting. However, if it is proposed to pass a special resolution at the EGM of the listed company, then 21 days' notice must be given. The Companies Act 2014 contains a provision that allows private limited companies to dispense with holding a physical AGM. A unanimous written resolution of all members must be passed instead, acknowledging receipt of financial statements, etc.

For listed companies, 20 business days is the minimum period recommended under the Corporate Governance Code.

VI OUTLOOK

i New legislation in the pipeline

Companies (Accounting) Bill

The Companies (Accounting) Bill is expected to be enacted during 2017. The Bill will transpose the Accounting Directive (Directive 2013/34/EU (as amended) into Irish law. Among other provisions, the Accounting Bill proposes to give effect to a specific requirement of the Accounting Directive, which is to eliminate the existing non-filing of accounts exemption for unlimited companies with a particular non-EU/EEA shareholding structure.

Directive on disclosure of non-financial and diversity information

The EU Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups had a transposition deadline of 6 December 2016, with companies expected to publish their first reports in 2017. Implementation of the Directive is still awaited in Ireland.

The Directive makes amendments to the Fourth and Seventh Accounting Directives on Annual and Consolidated Accounts (Directives 78/660/EEC and 83/349/EEC respectively), to include new provisions on the disclosure of non-financial information, and new provisions on boardroom diversity.

The Directive applies to large public-interest entities that exceed, on their balance sheet dates, the criterion of the average number of 500 employees during the financial year.

- a* non-financial disclosures will be comprised of a statement in the company's annual report including material relating to environmental, social and employee-related matters, respect for human rights, and anti-corruption and bribery matters (on a comply or explain basis); and
- b* diversity policy disclosures will be comprised of specific information on the company's diversity policy for its administrative, management and supervisory bodies, to be disclosed in the company's corporate governance statement (on a comply or explain basis). Information on all aspects of the diversity policy will be required, including age, gender, geographical diversity and educational or professional background.

The Directive is expected to be implemented into Irish law in Q1 or Q2 of 2017, following the enactment of the Companies (Accounting) Bill.

JAPAN

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I OVERVIEW OF GOVERNANCE REGIME

i Sources of law and enforcement

Companies in Japan are generally regulated by the Companies Act.² Further, listed companies in Japan are also regulated by the Financial Instruments and Exchange Law (FIEL)³ and the Securities Listing Regulations published by each securities exchange in Japan (SLRs). As the securities exchanges in Japan, in publishing their SLRs, generally follow the SLRs published by the Tokyo Stock Exchange (TSE), which is the largest securities exchange in Japan, the information we provide hereafter focuses on the SLRs published by the TSE, and references to ‘SLRs’ are to the SLRs published by the TSE.

In the event that a company violates the Companies Act, depending on the specific provision that is violated, shareholders or creditors of the company are generally entitled to bring a lawsuit against the company. The Financial Services Agency of Japan is responsible for enforcing the FIEL and, depending on the specific provision that is violated, may levy monetary fines, prison sentences, or even both, in connection with certain violations thereof. SLRs are enforced by the specific securities exchange that published the applicable SLR. Violations of the SLRs generally lead to the securities exchange requiring that company submit an improvement plan. In extreme cases, securities exchanges may even delist the shares of the company.

ii Nature and recent developments in the corporate governance regime

The Companies Act, which has been in effect since 2006, allows a company some flexibility with its governance organisation, such as whether to have a board of directors and whether to have a corporate auditor. Revisions to the SLRs on 30 December 2009, however, require a listed company to have one or more independent directors or corporate auditors (i.e., outside directors or corporate auditors (as defined below) who are not likely to have a conflict of interest with the company’s shareholders). If an independent director or corporate auditor has business or other relationships with the company (e.g., if the director or corporate auditor is a main business partner, consultant or a major shareholder of the company), this relationship must be disclosed, and the reasons the person was appointed as an independent director or corporate auditor must also be provided in the company’s corporate governance reports under the SLRs. Further, the Companies Act reform bill was enacted on 1 May 2015

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2 Act No. 86 of 26 July 2005.

3 Act No. 25 of 13 April 1948.

(the Companies Act as amended by this bill is hereinafter referred to as the Reform Act), and the Reform Act states that if a large public company that is required under the FIEL to submit a securities report does not have an outside director, it must explain the reason for this in its business report and upon its annual shareholders' meeting. On 5 February 2014, the TSE announced a revision to the SLRs requesting that listed companies make efforts to elect at least one independent 'director' because, in practice, most listed companies had elected an independent 'corporate auditor'. In addition, the TSE released Japan's Corporate Governance Code (the Code)⁴ on 1 June 2015. The Code, which is applicable to all companies listed on securities exchanges in Japan, establishes fundamental principles for effective corporate governance, including a structure for transparent, fair, timely and decisive decision-making by companies, which pays due attention to the needs and perspectives of shareholders and also customers, employees and local communities. The Code stipulates that listed companies should appoint at least two independent directors.

In Japan, roughly speaking, there were two types of governance systems prior to enactment of the Reform Act, one being a company with a corporate auditor and the other being a company with committees.⁵ In a company with a corporate auditor, the corporate auditor is an organisation that audits the directors' execution of their duties. This type of organisation is the primary type of company in Japan. On the other hand, in a company with committees (without a corporate auditor), three stipulated committees perform auditing and monitoring functions:

- a* a nominating committee that decides on the agenda of nominating or dismissing directors at shareholders' meetings;
- b* an audit committee that audits the execution of duties of executive officers and directors; and
- c* a compensation committee that determines compensation for each executive officer and director.

A majority of each of these committees must consist of outside directors. In a company with committees, because a board may delegate substantial parts of its decision-making authority over the management of the company to the executive officers, the board is expected to monitor the execution of the executive officers' duties rather than to make decisions (although a director can serve concurrently as an executive officer). This type of organisation was first introduced in 2003 and is used only by a limited number of large companies in Japan.

The Reform Act further introduced a new type of governance structure, a company with an audit committee, anticipating that the new structure will make it easier for Japanese companies to select a monitoring model involving outside directors. A reduction of costs for selecting the monitoring model is achieved by decreasing the number of outsiders. A company with an audit committee is not required to possess a nominating committee or compensation committee. The audit committee must have more than three directors as members, and the majority of them must be outside directors.

4 The Code is available at www.jpix.co.jp/english/equities/listing/cg/tvdivq000008jdy-att/20150513.pdf.

5 Following enactment of the Reform Act, companies with committees are now called companies with nominating committee, etc., but the meaning of the term is unchanged. As a matter of convenience, we hereinafter refer to this type of company as a 'company with committees'.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure and composition of the board

Japanese companies generally use a one-tier board structure. Under the Companies Act, although a company may choose not to have a board of directors, the typical form of management structure is a company with a board of directors, where the board has decision-making authority. In a company without a board of directors, while there is no board, unless otherwise provided in the company's articles of incorporation (articles), a majority of the directors will decide business matters on behalf of the company. As compared with a company with a board of directors, however, shareholders of a company without a board have broader decision-making authority, such as the ability to approve certain competitive activities or to approve activities that result in conflicts of interest of directors.

A company with a board of directors is required to have three or more directors. A company without a board, on the other hand, is required to have only one or more directors. A company with committees must also have a board, and therefore it is required to have three or more directors. In Japan, no director is required to be a representative of the employees of the company.

A company with an audit committee is required to have a board as well, and therefore, to have three or more directors. In addition, as described above, in a company with an audit committee, under the Reform Act, the audit committee must have more than three directors as members, and the majority of them must be outside directors.

Legal responsibilities of the board

Except for a company with committees, a company with a board of directors generally must have a corporate auditor. In a company with a corporate auditor and a board of directors, the board has decision-making authority over the management of the company, and representative directors and other authorised directors are responsible for executing the company management decisions. The corporate auditor generally audits the execution of duties by directors, with a view to compliance with law.

In a company with committees, while the board may have decision-making authority over the management of the company, it usually delegates substantial portions of this authority to executive officers, and representative executive officers are responsible for executing the company management decisions. Accordingly, for example, executive officers may be delegated the authority to decide on the acquisition of important assets, incurrence of significant debt, appointment of important employees and establishment of important organisational changes, while those are items that would be determined by a board of directors in a company with a corporate auditor. The board of a company with committees would then, *inter alia*, determine the agendas of shareholders' meetings, approve competitive activities and activities that result in conflicts of interest of directors, and appoint committee members. The audit committee audits the execution of duties by directors with a view not only to compliance with laws, but also the appropriate performance of their duties.

In a company with an audit committee, under the Reform Act, the core role of the board of directors is to set the basic management policy, to develop the internal control system, and to supervise the execution of business by other directors, including the CEO and other executive officers. Although important business decisions, such as disposing of or acquiring important assets, are required to be made by the board of directors, its shareholders

can, through the company's articles, enable the board to delegate these decisions to the CEO or other executive officers. Also, if the majority of the board is held by outside directors, the board can delegate these decisions to the CEO or another executive officer.

Delegation of responsibilities

In a company with a corporate auditor and a board of directors (which is typical of Japanese companies), the board often delegates decisions on certain matters regarding day-to-day operations to individual directors, such as representative directors or other executive directors. However, the board may not delegate certain important company matters to individual directors, including:

- a* disposing of or acquiring important assets;
- b* incurring significant debts;
- c* electing or dismissing important employees, including managers;
- d* issuing shares at a fair price (except in the case of an open company, as defined below); and
- e* approving audited financial statements.

In a company with committees, the nominating committee, audit committee and compensation committee each has its own authority under the Companies Act and cannot further delegate substantial parts of their responsibilities. Apart from the committees' responsibilities, the board has sole decision-making authority over the management of the company with respect to certain matters, which include:

- a* basic management policy;
- b* matters necessary for the execution of the audit committee's duties; and
- c* if there are two or more executive officers, matters relating to the interrelationship between executive officers.

Similarly in a company with an audit committee, under the Reform Act the audit committee has its own authority and cannot further delegate a substantial part of its responsibility. Apart from the audit committee's responsibility, the board has sole decision-making authority over the management of the company with respect to certain matters, which include:

- a* basic management policy; and
- b* matters necessary for the execution of the audit committee's duties.

A board of directors in a company with committees often delegates decision-making authority over the management of the company to the executive officers (as described above). The board may not, however, delegate certain important matters (in addition to the above-mentioned matters) to executive officers (or to individual directors, because each individual director in a company with committees generally does not have decision-making authority), including:

- a* approval of share transfers (if the company is a closed company);
- b* holding of shareholders' meetings;
- c* appointment or removal of committee members;
- d* election or dismissal of executive officers; and
- e* determining the contents of agreements for mergers, demergers or share exchanges.

In Japan, normally the board appoints the CEO or its equivalent from among its representative directors (in the case of a company with a corporate auditor and a board of directors) or representative executive officers (in the case of a company with committees). Generally, the CEO will chair the board meeting, and will perform the role of chair of the board in this sense.

As stated above, in a company with an audit committee, under the Reform Act, although important business decisions such as disposing of or acquiring important assets are required to be made by the board of directors, its shareholders can, through the company's articles, enable the board to delegate these decisions to the CEO. Also, if the majority of the board is held by outside directors, the board can delegate these decisions to executive officers.

Remuneration of directors

In a company with a corporate auditor and a board of directors, the aggregate amount of remuneration of all directors is determined at a shareholders' meeting (if not provided in the articles), and the board determines the remuneration of each director within the parameters of this aggregate amount. The same would apply to a company with an audit committee under the Reform Act. In addition, in a company with an audit committee, the audit committee is given the power to express its view on the election, dismissal, resignation and compensation of other directors at the shareholders' meeting so that the shareholders can make an informed decision on these matters.

On the other hand, in a company with committees, the compensation committee determines the remuneration of each director in accordance with the remuneration policy prescribed by the committee (therefore, shareholders' approval is not required).

An 'open company' (i.e., a company, typically listed, whose articles do not require, as a feature of all or part of its shares, the company's approval for any transfer of those shares, whether it is a company with a corporate auditor, a company with an audit committee or a company with committees) must disclose the aggregate remuneration of all of its directors, corporate auditors and executive officers to its shareholders in its business report. In addition, a listed company must disclose the following information in its securities report: the amount of remuneration and a breakdown by type of payment (e.g., salary, bonus, stock option or retirement payment) for each director, corporate auditor and executive officer if his or her remuneration for the relevant fiscal year is ¥100 million or more (out of 2,442 companies listed as of 30 June 2016, there were 414 directors, corporate auditors or executive officers who received ¥100 million or more as remuneration for the fiscal year ending March 2016); and an explanation of the company's policies for remuneration of directors, corporate auditors and executive officers, and how remuneration is determined if these policies are put in place (e.g., as set forth above, 'remuneration for a director consists of fixed compensation and a bonus, with the fixed portion determined based on the position of the individual and the bonus determined based on the performance of the company and the individual').

The Code stipulates that, in addition to making information disclosure in compliance with relevant laws and regulations, listed companies should disclose and proactively provide information regarding their boards' policies and procedures for determining the remuneration of senior management and directors to enhance transparency and fairness in decision-making and ensure effective corporate governance.

Board and company practice in takeovers

Listed companies in Japan generally use a 'precaution-type anti-takeover measure',⁶ whereby a company announces a takeover process rule but does not issue any securities at first. Although there are many variations of this measure, generally the company announces in advance a certain takeover process rule to the effect that a takeover bidder must provide sufficient information to a board of directors about the bidder and the terms of its bid before the beginning of its takeover, and the bidder refrains from purchasing the shares of the company unless the board of the company completes its analysis of the terms of the bid (but the analysis by the board must be completed within a certain period, such as 60 days). If these procedures are respected by the bidder, the board will not implement anti-takeover measures, but where the board decides that the value of the company would be damaged, or maximising value would be difficult under the takeover (including if the bidder does not comply with the procedures), usually based on analysis by a third-party committee, certain anti-takeover measures may be implemented, typically the issuance of share purchase warrants free of charge to all shareholders that cannot be exercised by the bidder.

In Japan, the *Bull-Dog Sauce* case⁷ was the first case where actual share purchase warrants were issued to shareholders as an anti-takeover measure. In this case, the Supreme Court found that the decision of whether control by a specific shareholder would harm the value of the company or damage the common interests of shareholders should be ultimately determined by the shareholders who hold its corporate value, and that if, at a shareholders' meeting, the shareholders decide that the takeover would harm the value of the company or damage the common interests of the shareholders, that decision should be respected. In this case, because the issuance of share purchase warrants was approved by more than 80 per cent of the voting rights, the Supreme Court found that the issuance was valid.

Since this case, we have seen fewer attempts at hostile acquisition.⁸ In addition, a tender offer regulation under the FIEL was amended in 2007 to the effect that the offeror must disclose more information prior to the tender offer, and that the target company has the right to issue a questionnaire to the offeror. As a result, the total number of listed companies that have adopted anti-takeover measures has slightly decreased for eight consecutive years (from 570 companies at the end of July 2008 to 451 companies at the end of November 2016).

ii Directors

Appointment, nomination, term of office

Directors are elected by a resolution at a shareholders' meeting. In a company with a corporate auditor and a board of directors, the board generally nominates directors with two-year terms of office (maximum). On the other hand, in a company with committees, the nominating

6 The Code stipulates that anti-takeover measures must not have any objective associated with entrenchment of the management or the board.

7 Supreme Court, 7 August 2007.

8 For example, in November 2012, PGM Holdings commenced a hostile takeover bid against Accordia Golf, but the tender offer failed to acquire 20 per cent of the shares. In addition, in March 2013, Cerberus Capital Management, LP commenced a hostile takeover bid against Seibu Holdings Inc, but Cerberus Capital Management, LP only acquired 3.26 per cent (originally held 32.22 per cent and ended up holding 35.48 per cent) through the tender offer. Further, in December 2014, Prospect Co., Ltd. commenced a hostile takeover bid against Yutaka Shoji Co, Ltd, but the tender offer failed to acquire 51 per cent of the shares.

committee nominates directors with one-year terms of office (maximum). Further, in a company with an audit committee, under the Reform Act, a director who is a member of the audit committee must be nominated separately from the other directors, and the statutory maximum term of office for a director who is a member of an audit committee is two years, while for other directors it is one year.

Directors can be dismissed at any time by a resolution at a shareholders' meeting. Directors can seek damages for dismissal from the company if they are dismissed without justifiable grounds.

Liability of directors

Generally, directors must perform their duties with the duty of care of a prudent manager in compliance with all laws and regulations, and the articles and resolutions of shareholders' meetings, in a loyal manner.

In addition to the foregoing, in Japan the 'business judgement rule' is applied when considering whether a certain decision of a director complies with the director's duty of care of a prudent manager to the company. Under the business judgement rule in Japan, even if a director has made a certain decision that has resulted in damage to the company, the director is, in principle, deemed to have complied with his or her duty of care of a prudent manager, unless the director made important and careless mistakes in the recognition of facts, or the process and content of the director's decision-making is particularly unreasonable or improper as determined by a management expert. Nevertheless, Japanese courts are not likely to apply the business judgement rule in cases where it can be shown that the director has a conflict of interest.

Recently, in the *Apamanshop* case,⁹ the business judgement rule was affirmed by the Supreme Court of Japan. In this case, Apamanshop Holdings bought out the subsidiary's minority shareholders at a price per share higher than that set forth in the valuation report to make the subsidiary its wholly owned subsidiary. The Court cited the business judgement rule in finding that the directors of Apamanshop Holdings did not breach their duty of care, because a smooth purchase of the minority shareholders' shares was beneficial in maintaining good relationships with Apamanshop's member shops who were shareholders of Apamanshop, the corporate value of the subsidiary after the restructuring was expected to increase and the decision-making process employed by Apamanshop's directors (i.e., the management committee convened to discuss the purchase and a legal opinion was obtained) was not found to be unreasonable.

Role and involvement of outside directors

Outside directors are defined under the Companies Act as directors who are not serving and who have not previously served as executive directors, executive officers or employees (including managers) of the relevant company or any of its subsidiaries. Under the Reform Act, this requirement is tightened.¹⁰ In a company with committees, a majority of the members of each committee must be outside directors, with each committee required to consist of at least three members. In a company with an audit committee, under the Reform Act, the audit

9 Supreme Court, 15 July 2010.

10 For example, directors who are serving as executive directors, executive officers or employees (including managers) of a company's parent company or sibling company also do not qualify as outside directors.

committee must have more than three directors as members, and the majority of them must be outside directors. On the other hand, in a company with a corporate auditor and a board of directors, there are no such outside director requirements concerning board composition.

The TSE requires listed companies to have one or more independent directors or corporate auditors (see Section I, *supra*). Therefore, it is considered that persons who work for a company's parent company or its business partner, or consultants who receive significant fees from a company, etc., cannot be independent directors or corporate auditors of the company. Further, on 5 February 2014 after submission of the Company Act reform bill (which states that if a large public company that is required under the FIEL to submit a securities report does not have an outside director, it must explain the reason why in its business report and at its annual shareholders' meeting), the TSE announced a revision to the SLRs that requests that listed companies make efforts to elect at least one independent director (see Section I, *supra*).

The Code stipulates that if (1) the organisational structure of a company is either that of a company with a corporate auditor and a board of directors or a company with an audit committee, and (2) independent directors do not constitute a majority of the board, to strengthen the independence, objectivity and accountability of board functions in matters of nomination and remuneration of the senior management and directors, the company should seek appropriate involvement and advice from independent directors in the consideration of such important matters as nominations and remuneration by, for example, establishing optional advisory committees under the board to which independent directors make significant contributions.

Legal duties and best practice for directors

The legal duties of outside directors are generally the same as for other directors or executive officers. Where provided for in a company's articles, however, the company may contractually limit the liability (to the company) of its outside directors who are not aware of the wrongdoing and not grossly negligent in performing their duties to the extent of the larger of both an amount determined in advance, within the range provided in the articles, and an amount equal to double his or her annual remuneration.

Outside directors generally should review the performance of management, conflict of interest issues, the process and propriety of management decisions and general compliance, and work to improve the corporate culture. Although other directors should take on these roles as well, outside directors are expected to do so more effectively because of their objective position.

Recently, many companies in Japan have organised third-party committees to audit or review conflict of interest issues, such as management buyout transactions, internal investigations, anti-takeover measures, etc., and an outside director is often included as a member of the committee.

In a company with a corporate auditor and a board of directors, a company with committees or a company with an audit committee, if a director intends to carry out any transactions involving a conflict of interest, approval must be obtained at a board meeting, at which that director may not participate. At the board meeting, the potentially conflicted director must disclose material facts about the transaction. After the transaction, the director must also report material facts about the transaction to the board without delay.

In addition, in a company with an audit committee, under the Reform Act, an ex-ante approval by the audit committee of a self-dealing transaction between a director and the company has the effect of switching the burden of proof regarding the violation of a director's duty from the director to the plaintiff shareholders.

iii Auditors

In a company with a corporate auditor, the corporate auditor audits the execution of the directors' duties, including preparation of financial statements. To ensure the independence of the corporate auditor, its term of office must continue until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within four years from the time of its election (in a closed company, the term of office may be extended until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within 10 years from the time of its election). On the other hand, a company with committees does not have a corporate auditor. Instead, the audit committee, which consists of directors whose terms of office are one year (maximum), audits the execution of directors' duties, including preparation of financial statements (see Section II, *supra*). Similarly, a company with an audit committee does not have a corporate auditor. In a company with an audit committee, which consists of directors whose terms of office are two years (maximum), the audit committee is responsible under the Reform Act for auditing the execution of directors' duties, including preparation of financial statements.

In addition, a 'large company' (i.e., a company with either stated capital in the balance sheet at the end of the most recent fiscal year of ¥500 million or more, or total liabilities as of the end of its most recent fiscal year of ¥20 billion or more) and a company with committees are required to have an accounting auditor, which must be either a certified public accountant or an audit firm. An accounting auditor's terms of office must continue until the conclusion of the annual shareholders' meeting for the last fiscal year, which ends within one year from the time of their election.

To ensure the independence of corporate auditors, under the Reform Act, a corporate auditor or a board of corporate auditors in a company with a corporate auditor, and an audit committee in a company with an audit committee, are given the power to determine the contents of proposals regarding the election and dismissal of accounting auditors to be submitted to a shareholders' meeting, while, in a company with committees, an audit committee has had this power since prior to the enactment of the Reform Act.

III DISCLOSURE

i Financial reporting and accountability

A representative director or representative executive officer must prepare a financial statement within three months after the end of each business year. A large company that is required to file a securities report under the FIEL (for example, a listed company or a company with at least 1,000 shareholders as of the end of any fiscal year within the past five years is required to file a securities report) must prepare a consolidated financial statement under the Companies Act. However, the FIEL requires all listed companies to prepare a securities report that includes consolidated financial statements (unless they do not have any subsidiaries to be consolidated under the FIEL), as well as a quarterly report. In addition, a representative

director or representative executive officer of a listed company must submit a confirmation letter as an attachment to its securities report or other reports, in which he or she confirms that the description of the report is written properly in accordance with the FIEL.

A company with a board of directors must attach financial statements and business reports to the convocation notice of its annual shareholders' meeting. The company must also keep those documents at its head office for five years, beginning two weeks (one week, in the case of a company without the board) prior to the date of the shareholders' meeting. Under the FIEL, a listed company is required to submit its securities report within three months after the end of its fiscal year.

ii Communications with shareholders

Under the Companies Act, directors, corporate auditors and executive officers must sufficiently explain the specific issues related to the agenda of the shareholders' meeting if an enquiry is made by a shareholder. In addition, to improve investor relations, Q&A sessions during shareholders' meetings are now actively encouraged in Japan. Furthermore, Japanese listed companies often hold informal meetings with investors about financial statements and related issues.¹¹

IV CORPORATE RESPONSIBILITY

i Internal control

Boards of large companies must develop internal control systems that ensure that directors comply with laws and the articles, and that company operations are appropriate. On the other hand, there is no legal requirement for internal control systems for companies that are not categorised as large companies as long as these companies have a board of directors.

Additionally, in a company with committees, regardless of its size, the board must develop internal control systems that ensure that executive officers comply with laws and the articles and that company operations are appropriate. A listed company must submit internal control reports that describe the systems in place to ensure that the financial reports of the company are properly made in compliance with laws.

Further, in a company with an audit committee, under the Reform Act, regardless of its size the board must develop internal control systems that ensure that directors comply with laws and the articles and that company operations are appropriate.

Specific contents of the internal control systems may be decided at the discretion of the company. In its internal control rules, a company often provides general matters related to the control of information and documents; crisis management systems; necessary internal rules and organisations; and compliance programmes, etc.

11 The Code stipulates that listed companies should, proactively and to the extent reasonable, respond to requests from shareholders to engage in dialogue so as to support sustainable growth and increase corporate value over the mid to long term, and that the board should establish, approve and disclose policies concerning the measures and organisational structures aimed at promoting constructive dialogue with shareholders.

Under the Whistle-blower Protection Act, the employer of a whistle-blower is prohibited from treating the whistle-blower in any disadvantageous manner, such as by demotion or reducing his or her salary, if this is in response to the employee's whistle-blowing.¹²

ii Corporate social responsibility to employees and wider society

In Japan, a company is required to hire a certain number of persons with a disability and to take measures to continue to employ elderly persons under affirmative action-related laws. Activities related to corporate social responsibility by some companies involve actions to be taken in the interests of their stakeholders, such as preserving the environment, supporting volunteer work and creating jobs, although these are not generally required by law.

V SHAREHOLDERS

i Shareholder rights and powers

Voting rights

In general, a company must treat its shareholders equally depending on the class and number of shares owned, and therefore each voting share has the same voting right. The Companies Act does, however, allow for the following exceptions: certain minority shareholders' rights, such as rights to propose an agenda for a shareholders' meeting, to inspect accounting books and to apply to a court for dissolution of the company, and different treatment for each shareholder in closed companies in terms of rights to dividends or distribution of residual assets or voting rights at shareholders' meetings pursuant to the articles.

In a company with a board of directors, matters provided for in the company's articles and the Companies Act may be resolved at a shareholders' meeting. In the sense that each director must observe resolutions passed at shareholders' meetings, shareholders have an influence on the board.

Under the Companies Act, shareholders' approval is required for certain matters, including the following:

- a* amending the articles;
- b* mergers, corporate demergers, statutory share exchanges, statutory share transfers, assignment of business and reduction of stated capital;
- c* election or dismissal of directors and corporate auditors; and
- d* decisions regarding dividends of surplus (if a company has an accounting auditor and a board of corporate auditors or committees, however, and the term of office of its directors is no more than one year, the authority to determine the distribution of dividends of surplus can be delegated to the board by the articles).

Rights of dissenting shareholders

Shareholders who object to the proposed agenda specifically listed under the Companies Act, such as certain amendments to the articles and certain mergers and acquisitions, may demand that the company purchase their shares at a fair price. This price will be determined through

12 The Code stipulates that (1) as a part of establishing a framework for whistle-blowing, companies should establish a point of contact that is independent of the management, and that (2) internal rules should be established to ensure the confidentiality of the information provider and prohibit any disadvantageous treatment.

negotiation between the parties (i.e., the company and the dissenting shareholder) or by court decision. If such a demand is made and the parties are able to come to an agreement on the share price, the company must make the payment to the dissenting shareholder within 60 days of the effective date of the transaction contemplated in the proposed agenda to which the dissenting shareholder objected. If the parties are unable to reach an agreement with regards to the share price within 30 days of the effective date, either the dissenting shareholder or the company may file a petition to a court for a determination of a fair price within 30 days of the expiration of that initial 30-day period.

Recently, in the *Tecmo* case,¹³ the Supreme Court of Japan presented a framework for determining a 'fair price' under appraisal proceedings in cases where a joint share transfer (where two or more companies form a new holding company under the Companies Act) creates synergies. In this decision, the court found that:

- a a fair price should be, in general, the value that the share should have had on the date on which the shareholder made a demand to the company for the repurchase of the share, on the assumption that the share transfer ratio designated in the share transfer plan is fair; and
- b if a share transfer comes into effect through procedures that are generally recognised as fair, the share transfer ratio should be seen as fair unless special circumstances existed that hindered the shareholders' ability to make reasonable decisions in the shareholders' meeting.

ii Shareholders' duties and responsibilities

Major shareholders' duties and practice

Under the Companies Act, shareholders do not owe duties to the company other than paying the required share capital contribution for the shares to which they have subscribed. However, under the SLRs, if a listed company conducts certain transactions with its controlling shareholder, such as issuing shares or conducting mergers or business alliances, the company must obtain an opinion from a third party who is independent from its controlling shareholder that the transaction would not undermine the interests of minority shareholders of the company.

There are no specific duties of controlling shareholders to the company or other minority shareholders under the Companies Act. In an extreme case where a controlling shareholder abuses the company or other minority shareholders (e.g., a transaction with the company involving extremely unfair consideration or a squeeze-out of minority shareholders at an extremely low price), it may be liable for the abusive acts under the Civil Code or other laws, although there are no clear-cut standards for such cases.

iii Shareholder activism

Derivative actions

Under the Companies Act, a shareholder can demand that the company file an action to pursue, *inter alia*, directors or corporate auditors for their liabilities to the company if the shareholder has held shares of the company for the preceding six consecutive months or more. If the company does not file an action within 60 days of receipt of the demand from the relevant shareholder, the shareholder can file an action on behalf of the company.

13 Supreme Court, 29 February 2012.

Further, under the Reform Act, ‘multiple’ derivative actions are allowed, subject to certain conditions, where, *inter alia*, a director or corporate auditor of a company might be sued by a shareholder of the company’s ultimate wholly owning parent company¹⁴ as long as, *inter alia*, (1) the shareholder owns 1 per cent or more of the total voting rights or outstanding shares of the ultimate parent company and (2) the book value of the shares of the company constitutes more than 20 per cent of the total assets of the ultimate parent company as of the date of occurrence of the underlying events that gave rise to relevant obligations of the director or corporate auditor, etc.

Proxy battles

The FIEL stipulates the rules for proxy fights in listed companies. Under the FIEL, a shareholder or the company that solicits a proxy must provide the other shareholders with a certain set of documents (including a proxy and reference materials that set forth the agenda). It is generally considered to be difficult for a shareholder to embark on and succeed in such a proxy fight, mainly because the shareholder does not know the agenda of the shareholders’ meeting until the convocation notice is sent by the company. In the past, because the Companies Act could be interpreted as allowing the company to refuse to provide the names, addresses and other information of other shareholders to a shareholder who wishes to solicit the proxy if the bidder is or works for a competitor of the company, the bidder could encounter even more difficulties. However, under the Reform Act, even if the bidder is a competitor of the company, the company may not refuse to provide the information about other shareholders for that reason. In this sense, one of the hurdles to a shareholder embarking on a proxy fight would be alleviated.

iv Takeover defences

As described above, listed companies in Japan generally use a precaution- type anti-takeover measure. However, since the *Bull-Dog Sauce* case in August 2007, we have seen fewer attempts at hostile acquisition. In addition, the tender offer regulations under the FIEL were amended so that the offeror must now disclose more information prior to the tender offer and the target company has the right to issue a questionnaire to the offeror. In consequence, the number of listed companies that adopt anti-takeover measures has slightly decreased for seven consecutive years.

VI OUTLOOK

The Reform Act enacted in May 2015 has improved corporate governance (e.g., the ‘comply-or-explain’ rule for the appointment of outside directors), and regulates the relationship between parent companies and their subsidiaries (e.g., clarify the liabilities and rights of parent companies with respect to their subsidiaries (including derivative actions by shareholders of a parent company against the directors of its subsidiary)). In addition, the

14 The company that directly or indirectly owns 100 per cent of the shares of the ‘subsidiary’ company, but that is itself not a wholly owned subsidiary of any other company.

TSE formulated the Code in June 2015. The Code has established fundamental principles for effective corporate governance, including a structure for transparent, fair, timely and decisive decision-making by companies, which pays due attention to the needs and perspectives of shareholders and also customers, employees and local communities. Corporate governance will continue to be a hot issue in Japan after the enactment of the Reform Act and the Code.

LUXEMBOURG

*Margaretha Wilkenhuysen and Steven van Waas*¹

I OVERVIEW OF GOVERNANCE REGIME

Luxembourg's main statutes on corporate governance include the 10 August 1915 Act on Commercial Companies (the Act), which was revamped in 2016 to modernise Luxembourg corporate law, the Market Abuse Regulation² and the Securitisation Act.³ On 1 November 2007, Directive 2004/39/EC on Markets in Financial Instruments was implemented to introduce new provisions on transparency for shares and transaction reporting. Companies whose shares are admitted to trading on a regulated market in a Member State of the EU, including Luxembourg, may also be subject to the Act dated 19 May 2006 on Takeover Bids, as amended (the Takeover Bid Act). The Takeover Bid Act notably provides for minority shareholder protection, the rules of mandatory offers and disclosure requirements. Companies intending to admit their shares to trading on a regulated market or to make a public offer may also be subject to the Act dated 10 July 2005 on Prospectuses for Securities (the Prospectus Act), which in particular imposes the requirement for the publication of prospectuses. Transparency Directive 2004/109/EC was also transposed into Luxembourg legislation on 11 January 2008 through the Act on Transparency Requirements (the Transparency Act) in relation to information about issuers whose securities are admitted to trading on a regulated market, as amended. In addition, on 1 July 2011, the Act of 24 May 2011 came into force (the Shareholder Act). It implemented Directive 2007/36/EC on the Exercise of Certain Rights of Shareholders in Listed Companies, aiming to increase shareholder activism and setting out a number of shareholders' rights. Furthermore, the Act dated 21 July 2012 on Mandatory Squeeze-Out and Sell-Out of Securities of companies currently admitted or previously admitted to trading on a regulated market or having been offered to the public (the Squeeze-out Act)⁴ came into force on 1 October 2012, introducing a squeeze-out right in favour of dominant shareholders and a sell-out right in favour of minority shareholders in companies whose shares are admitted to trading on a regulated market.⁵

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2 Regulation (EU) No. 596/2014 as complemented by the Act of 23 December 2016 on Market Abuse implementing Regulation (EU) No. 596/2014, Directive 2014/57/EU and Directive 2015/2392/EU.

3 Act of 22 March 2004 on Securitisation, as amended.

4 See Elisa Faraldo Talmon, Ariane Mehrshahi and Jean-Michel Schmit, 'Présentation générale et réflexions sur la nouvelle loi du 21 juillet 2012 relative aux retrait et rachat obligatoires en dehors d'une offre publique d'acquisition', in *Ace: Comptabilité, Fiscalité, Audit, Droit des Affaires au Luxembourg*, No. 10 (Wolters Kluwer, 2012), pp. 3–12.

5 Until the Squeeze-out Act came into force, a squeeze-out and a sell-out right existed only in the context of a public takeover under the Act dated 19 May 2006 implementing Directive 2004/25/EC on takeover bids.

The Act of 6 April 2013 on Dematerialised Securities entered into force on 18 April 2013. It introduced a legal regime for dematerialised securities, inspired by existing regimes in Belgium, Switzerland and France. The Act of 12 July 2013 implemented into Luxembourg law Directive 2011/61/EU on Alternative Investment Fund Managers. This Act introduced a new partnership structure – the special limited partnership – into Luxembourg law and some technical amendments concerning limited partnerships by shares. It also modernised common limited partnerships. The Act of 30 July 2013 reformed the commission of accounting principles and modified certain rules regarding the annual accounts and consolidated accounts of companies. These rules were further modified by the Act of 18 December 2015, which will be discussed in Section III.

Furthermore, the Act of 28 July 2014 on the Immobilisation of Bearer Shares came into force on 18 August 2014, creating a new practical modality related to the bearer shares without renovating the legal status thereof. In short, this Act has instituted in Luxembourg the requirement to deposit bearer shares with a recognised depositary, which will be appointed by the board of directors or management board of the relevant public limited liability company or partnership limited by shares. The Act allows access to information about the identity of the shareholders holding bearer shares to public authorities while preserving the confidentiality of the information about third parties; indeed, the bearer shares register is not meant to be accessible to the public, but only to the judicial and fiscal authorities.

On 26 June 2015, the Fourth EU Anti-Money Laundering Directive⁶ came into force. One of the most profound changes that will be brought by this directive is the obligation for Luxembourg to ensure that information on the beneficial ownership of Luxembourg companies will be held in a central register. Any person or organisation that can demonstrate a legitimate interest will then be able to consult the information on beneficial ownership. While Luxembourg is not yet obliged to have a central register in place, it is under the obligation to adopt the necessary legislation to comply with the directive by 26 June 2017.

Also worth mentioning is the Act of 10 March 2014, which implements Council Regulation (EC) No. 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society. This Act provides the possibility for a European Cooperative Society (SCE) to be formed *ex novo* by: five or more natural persons resident in at least two EU Member States; five or more natural persons and companies or other legal bodies formed under the law of an EU Member State and resident in (or governed by the law of) at least two different EU Member States; or by companies and firms or other legal bodies formed under the law of an EU Member State and governed by the law of at least two different EU Member States. SCEs can also be formed by more traditional methods, like a merger between cooperatives formed under the law of an EU Member State with registered and head office in the European Union, provided that at least two of the cooperatives are governed by the laws of different EU Member States or by conversion of a cooperative that was formed under the law of an EU Member State and has a registered and head office in the European Union, provided that it has had an establishment or subsidiary governed by the law of another EU Member State for at least two years.

Corporate governance in Luxembourg is statute-based, consisting primarily of the Civil Code, the Act and, for listed companies, the rules and regulations of the Luxembourg Stock Exchange (LuxSE) and the above-mentioned acts. However, the statutory law provisions

⁶ Directive (EU) 2015/849 of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

only give very general governance rules or principles. More specific corporate governance is generally based on a flexible ‘comply or explain’ system, enabling the specific circumstances of companies, such as their size, shareholding structure, activities, exposure to risks and management structure, to be accounted for.

As a supplement to the general statutory law, the LuxSE’s 10 Principles of Corporate Governance (the LuxSE Principles), as modified in October 2009 and revised in March 2013 (3rd edition),⁷ provide guidelines on best practice in corporate governance for all companies listed on the LuxSE and all Luxembourg companies whose shares are traded on a regulated market. The LuxSE Principles consist of general principles that must be complied with and recommendations that, although obligatory in principle, may be deviated from when justified in specific circumstances, provided that adequate explanation is provided. The recommendations are supplemented by guidelines on how a company should implement or interpret them. The obligation to comply or explain does not apply to the guidelines, which are indicative but not binding. All Luxembourg companies whose shares are admitted for trading on a regulated market operated by the LuxSE must follow the LuxSE Principles.

The LuxSE Principles refer to general corporate governance issues, such as duties of the managing board, the management structure, conflicts of interest provisions, remuneration and reporting issues. The LuxSE Principles are highly flexible and adaptable to the activity, size and culture of individual companies. Their stated objective is to provide guidance without being overly restrictive, aiming to encourage transparency and dialogue and to facilitate the exercise of power within companies without restricting freedom of enterprise. They also aim to enable the shareholders of listed companies to be actively involved in the company’s activities.

Unlike certain neighbouring countries, in Luxembourg listed companies are often controlled by one or more major shareholders, rendering it impossible to rely solely on market monitoring to ensure that listed companies comply with the LuxSE Principles. Therefore, a system of monitoring involving the shareholders, the board and the LuxSE, at a minimum, is required to ensure proper observance of the principles of corporate governance.

The other main regulatory authority is the Luxembourg Supervisory Commission of the Financial Sector (CSSF). The CSSF has jurisdiction regarding matters for which the laws or regulations in force require disclosure, whether or not the information is dealt with in the LuxSE Principles, including the authority to impose sanctions. The LuxSE’s role in the external monitoring of compliance with the principles of corporate governance does not affect the CSSF’s legal responsibility as a regulator.

The CSSF is responsible for supervising credit institutions, financial sector professionals, collective investment undertakings, pension funds, stock exchanges, securities markets and so forth. The CSSF’s internal committees are responsible for regulatory work, and it has nine departments charged with the supervision of the financial sector, one department dedicated to the participation of the CSSF in the Single Supervisory Mechanism and one department responsible for the public oversight of the audit profession. The supervision of securities markets department supervises the financial instrument markets and market operators, international and national investigations regarding stock market offences in cooperation with the foreign competent authorities and the Luxembourg Stock Exchange. The department also deals with issues concerning the authorisation of new markets, and is in charge of approving

7 www.bourse.lu/corporate-governance.

prospectuses drawn up for offers of securities to the public and admission of securities to trading on a regulated market, following up on the transparency requirements in relation to issuers of listed securities and handling files relating to takeover bids.

The CSSF's regulatory framework is in line with the relevant European Union directives and aims to promote prudent business policy complying with regulatory requirements, to protect the financial stability of the supervised companies and of the financial sector as a whole, to supervise the quality of the organisation and internal control systems and to strengthen the quality of risk management. The CSSF acts solely in the public interest, and ensures that all financial sector laws and regulations are observed and that international agreements and European directives in the fields of its responsibility are implemented and respected, notably through CSSF circulars concerning the application of legislation. The regulatory framework is continually updated through regular consultation between the government, the legislator and the private sector. EU Commission Recommendation 77/534/EEC of 25 July 1977 concerning a European code of conduct relating to transactions in transferable securities was published in the Luxembourg Official Administrative Gazette on 25 June 1997 and is applicable to companies listed on the LuxSE. However, on 23 September 2010, the Luxembourg Court of Cassation ruled that the recommendation has not been transposed into Luxembourg national law as a binding rule.⁸

As an operationally independent body, the CSSF has sufficient powers to conduct effective supervision and regulation of the Luxembourg securities market. It is funded by taxes levied from companies under its supervision. To conduct its tasks effectively, the CSSF has broad powers including the authority to attend meetings of LuxSE entities, to suspend rulings or to suspend market intermediaries' decision-makers if they fail to observe legal, regulatory or statutory provisions.

Other professionals in the financial sector and private-sector companies also have an indirect regulatory role through their consultative participation with the government and the legislator in the field of regulation.

Apart from listed companies, specific obligations tend to be market-driven commitments rather than legally binding duties as there are currently no codified mandatory rules inducing companies to take corporate governance principles or corporate social responsibility (CSR) issues into account in their internal decision-making procedures. The engagements undertaken so far, with the exception of the LuxSE Principles, are non-compulsory soft law with reputational rather than legal force, and are minor in comparison to other marketplaces.

Corporate governance is, however, gaining momentum. In September 2009, the Association of the Luxembourg Fund Industry (ALFI)⁹ published a Code of Conduct for Luxembourg funds to provide their boards with high-level principles and best practice recommendations. The principle-based Code of Conduct was introduced to formalise and specify best practice in light of the implementation of Directive 2006/46/EC, aiming to facilitate cross-border investments and improve public confidence in financial statements and reports, notably through greater transparency and EU-wide comparability mechanisms. In June 2013, the ALFI published a revised version of the Code of Conduct, which addressed in particular the increased focus on the management of conflicts of interest, risk management and internal controls that have been major features of new regulations and developments in practice since the first version of the Code of Conduct was published in 2009.

8 Luxembourg Court of Cassation, 23 September 2010, No. 54/10.

9 www.alfi.lu.

Since 2003, the Labour and Employment Minister has aimed to bring government, labour and corporate sectors together to educate, inform and drive support for the development of CSR in Luxembourg. Although no CSR legal requirements are in place, a growing number of companies have undertaken commitments. In 2005 the Ministry of Labour and Employment and the ADT-Center,¹⁰ an advisory body specialising in gender, diversity management and CSR issues, began working together under an agreement to promote CSR and to build partnerships between local stakeholders (including small and medium-sized enterprises, multinationals and non-governmental organisations) with the notable aims of promoting and developing CSR within corporations; informing about existing and future best practice; stimulating the debate on CSR in corporations; and raising awareness of CSR principles with the public and corporations. Under the agreement, the Ministry of Labour and Employment is charged with promoting employment for mature, disabled and gifted people, health and safety in the workplace and generating employment.

Additionally, Inspiring More Sustainability Luxembourg (IMS)¹¹ is a non-profit organisation created by six major Luxembourg firms to exchange, discuss and promote CSR policies; it now has over 100 member companies and associations based or operating in Luxembourg. IMS' aims include facilitating the relationship between businesses and the territories within which they operate (including sustainable development, dialogue with local communities and workplace welfare) and general diversity management aimed at preventing workplace discrimination. Since its formation in 2007, IMS has organised numerous conferences and workshops, attracting several thousands of participants.

In line with the above, the Luxembourg Bankers' Association (ABBL),¹² representing the major Luxembourg industry, highlights in its code of conduct¹³ the criterion of diversity in relations between financial sector professionals and their customers.¹⁴ In addition, 2012 saw the release of CSSF Circular 12/552 on central administration, internal governance and risk management, which has been applicable to banks and investment firms since 1 July 2013 and is aimed at ensuring that these entities have a formalised and robust internal governance framework; it also centralises in one single document all the main requirements referring to governance matters and implementing EU rules, including those of the Internal Governance Guidelines of the European Banking Authority.¹⁵ The changes wrought by the circular are significant and of great importance to the internal organisation of banks and investment firms. The circular applies on both a stand-alone and a consolidated basis. CSSF Circular 12/552 has been amended on several occasions. Most recently it was updated further

10 www.adt-center.lu.

11 www.imslux.lu.

12 www.abbl.lu.

13 www.abbl.lu/download/19193/code-of-conduct-2016.pdf.

14 The first principle of the Code is loyalty, fairness and integrity: 'Professionals form an opinion on, and deal with, [...] without discrimination on grounds of origin, skin colour, gender, sexual orientation, family situation, age, state of health, handicaps, adherence to accepted principles of morality, political or philosophical opinions, trade union activities, ethnicity, nationality or religious creed.'

15 CSSF Circular 12/552 on central administration, internal governance and risk management, released on 11 December 2012.

to the adoption of the guidelines of the European Banking Authority on the management of interest rate risk arising from non-trading activities,¹⁶ as well as on the limits on exposure to shadow banking entities that carry out banking activities outside a regulated framework.¹⁷

While CSR commitments displayed on the participating companies' websites have no legal basis, and therefore are not subject to legal enforcement, the unique nature and size of the Luxembourg marketplace has increased the effect of 'peer pressure' on companies.

More specifically, Directive 2006/46/EC of 14 June 2006, implemented by the Act of 5 December 2007, includes a provision on corporate governance practices that listed insurance companies should apply.¹⁸ The Act requires listed companies in the insurance field to dedicate a specific section in their management report to their obligatory and voluntary adherence to corporate governance codes, and all other information purporting to their corporate governance practice. Gradual legislative recognition of corporate governance practice may also follow in other areas in the future, especially as the European Commission adopted an action plan¹⁹ in 2012, outlining initiatives to be implemented in the areas of company law and corporate governance. The key elements of the action plan include (1) increasing transparency between companies and their shareholders, (2) encouraging and facilitating long-term shareholder engagement and (3) improving cross-border initiatives and transactions. These elements may only be achieved through national legislation, therefore bringing corporate governance obligations to the fore (as these corporate governance rules are only applicable to companies listed on a stock exchange).²⁰

Regarding listed companies, the Transparency Act, for example, requires LuxSE-listed companies to publish information regarding their share capital and all regulated information (including financial reporting and shareholding) on their websites, and the Market Abuse Regulation stipulates that complete and effective public disclosure of any inside information must be published on both the company's and the LuxSE's websites (i.e., whenever an issuer, or person acting on its behalf, discloses any inside information to a third party in the normal exercise of business (simultaneously in the event of intentional disclosure, promptly in the event of unintentional disclosure)). Listed companies must also publish their corporate governance charters on their websites. In practice, listed companies tend to publish not only regulated information, but also all past and present press releases and corporate information.

While corporate governance in Luxembourg is currently generally based on voluntary adherence, a growing number of institutional guidelines and codes are being developed. At the same time, the Luxembourg government is working towards promoting corporate governance responsibility on a national level. Of particular note are the dispositions relating to employee representation (see Section IV, *infra*).

The importance of CSR is gathering momentum, as demonstrated by the increasing number of companies opting to follow institutional CSR recommendations or drawing up and publishing their own guidelines. While the majority of CSR is still soft-law based, reputational risk is of increasing importance in the various markets. In addition, the

16 CSSF Circular 16/642.

17 CSSF Circular 16/647.

18 Article 85-1 et seq.: www.legilux.public.lu/leg/a/archives/2007/0211/a211.pdf#page=2.

19 Action plan adopted by the European Commission on 12 December 2012 in the context of its 'Europe 2020' strategy, which generally aims to improve the business environment in Europe by adapting EU company law and governance rules to the modern needs of society and the changing economic environment.

20 See for details: http://europa.eu/rapid/press-release_IP-12-1340_en.htm.

implementation of Directive 2007/36/EC into Luxembourg law by the Shareholder Act marked an important step in Luxembourg CSR legislation. The Shareholder Act applies to companies that have their registered office in Luxembourg and whose shares are admitted to trading on a regulated market in a Member State of the European Union, as well as to Luxembourg companies whose shares are traded on a regulated market outside the European Union if those companies have elected to opt into the rules of the Shareholder Act (see Section V, *infra*). The Shareholder Act goes beyond Directive 2007/36/EC's requirements, and aims to increase shareholders' active participation in their companies by enabling them to exercise their voting rights, ensuring their right to place items on shareholders' meetings' agendas and to ask questions.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure

Although the Act of 25 August 2006, which introduced Article 60 *bis*-1 into the Act, provides the possibility for public limited liability companies to choose a two-tier board structure, the one-tier board structure remains by far the preferred option in Luxembourg, with the company being managed exclusively by a board invested with the broadest powers to act in the name and on behalf of the company.

In a two-tier system, the company is managed by two bodies: the management board, charged with the day-to-day management of the company, and a supervisory board. Article 60 *bis*-1 et seq. of the Act details the supervisory board's responsibilities, which include permanent supervision and appointment of the management board members, the right to inspect all company transactions. No person may at the same time be a member of both the management board and the supervisory board. Members of the supervisory board are liable towards the company and any third party in accordance with general law. However, there is no specific guidance relating to the exercise by members of the supervisory board of their duties.

Composition of the board

The board is composed of appointed members (the company's directors). The Act requires a minimum of three directors; the maximum number of directors is undefined (the LuxSE Principles advise 16 directors as a reasonable limit). While the directors are appointed by the shareholders of the company, the directors choose a chair from among their members. The Act does not provide any specific powers to the chair of the board, although companies may choose, for example, to grant a power of representation to the chair in the articles of association (AoA). However, unlike in other civil law jurisdictions, the chair of the board does not act on behalf of the company in his or her position as chair, but rather on the basis of his or her position as director of the company.

Article 51 *bis* of the Act provides that where a legal entity is appointed as director of a public limited liability company, it shall designate a permanent representative to exercise that duty in the name and for the account of the legal entity. Article 51 *bis* applies only to the public limited liability company. However, an interesting issue in respect of the applicability of Article 51 *bis* to a partnership limited by shares was indirectly raised by the District Court of Luxembourg on 11 December 2013. The question was to establish whether the obligation to appoint a permanent representative of a legal person to a board of a public

limited liability company also applies to the legal person of a general partner of a partnership limited by shares. In its interlocutory decision, the District Court recognised the applicability of Article 51 *bis* to a partnership limited by shares. This decision was implicitly upheld in the Court's judgment of 23 December 2015.²¹

Most AoA provide that any two directors can represent the company without evidence of a board resolution (although in practice the board may ratify actions taken previously by directors acting individually).

The Act provides for three mechanisms: the board can adopt a decision and give specific mandates (limited in time and scope) to one or more of its members, or other individuals, to act on its behalf;²² the AoA may entitle one or more directors to represent the company in any legal proceedings, either individually or jointly;²³ and the appointment of a 'day-to-day' manager. The board may designate a director as a general representative of the company charged with its day-to-day business and individually or jointly representing the company towards third parties for that business (Article 60 of the Act). Power may be delegated to one or more directors, managers or other agents, who may but are not required to be shareholders, acting either individually or jointly. While their appointment, removal from office and powers may be specified, limited or extended by the AoA or the competent corporate body, the Act states that no restrictions to their representative powers may be validly opposed in relation to third parties, even if their appointment is published. The liability of the day-to-day management is based on the general rules relating to mandates. When a member of the board is appointed as day-to-day manager, the Act requires the board to report annually to the shareholders on the salary, fees and any benefits granted to that director.²⁴

A company will generally be bound by acts of its directors or by the person entrusted with its day-to-day management, even if those acts exceed the company's corporate object, unless the company proves that the third party knew that the relevant acts exceeded the company's corporate object or could not, in view of the circumstances, have been unaware of it. The publication of a restriction to a director's powers in the company's AoA is deemed insufficient to constitute such proof.²⁵

Regarding listed companies, LuxSE Principle 4 distinguishes between executive and non-executive managers: executive managers are defined as senior managers who are not board directors but who are members of a body of executives charged with the day-to-day management of the company. There is no other distinction under Luxembourg law, with all board members having the same rights and obligations. A more permanent division of tasks and responsibilities between board members is possible (e.g., by providing for different classes of directors), but any such division is purely internal and is unenforceable towards third parties. It is, however, possible for the board to delegate certain specific powers to individual board members or non-board members in the framework of a specific delegation of power.

Finally, the European Commission has proposed legislation with the objective of attaining a 40 per cent presence of women among non-executive board-member positions

21 Luxembourg District Court, 23 December 2015, Nos. 145 724 and 145 725.

22 Article 1984 et seq. of the Luxembourg Civil Code.

23 Article 53, fourth paragraph of the Act.

24 Article 60 of the Act.

25 Article 60 *bis* of the Act.

in publicly listed companies.²⁶ Luxembourg is currently reported as having an average of less than one in 10 female board members, with over half of the largest companies having no women on their boards at all.²⁷ In 2013, the European Parliament adopted a legislative resolution on this proposal, but the Council of the European Union was not able to reach a general approach on a directive improving the gender balance on company boards.

Separation of CEO and chair roles: chair's role and responsibilities

While the roles of CEO and chair tend to be separated in practice, there are no legal provisions or guidelines pertaining to a separation of roles or responsibilities.

For listed companies, LuxSE Principle Recommendation 2.4 requires that the chair prepares the board meeting agendas after consulting the CEO and ensures that the procedures for preparing meetings, deliberations, decision-making and the implementation of decisions are correctly applied. Under this non-compulsory guideline, the chair should ensure the proper application of the rules of governance and provide advice to the board.

Luxembourg law does currently not provide for a specific procedure for direct communication between the CEO or the chair and the shareholders.

For listed companies, under LuxSE Principle 10 companies should 'establish a policy of active communication with the shareholders' and allow shareholder dialogue with the board and the executive management.

Remuneration of directors and senior management

Directors, as such, are not employees of the company, and their remuneration falls under the general rules on mandates and corporate law. Generally, and unless otherwise provided by the AoA, services rendered by the company directors are considered to be provided remuneration-free. If the AoA authorise remuneration, the global amount to be paid to the directors will be fixed by the general meeting of shareholders, and the board will allocate that amount between board members as it deems fit. The rules on conflicts of interest forbid directors from taking part in or voting on resolutions relating to their own remuneration.

Senior managers are generally employees of the company, and the Luxembourg Labour Code will be applicable as regards their relationship with the company. Concerning listed companies, the LuxSE Principles recommend establishing a remuneration committee to deal with these issues; under LuxSE Principle 8, the company must 'secure the services of qualified directors and executive managers by means of a fair remuneration policy that is compatible with the long-term interests of the company', thereby introducing a sustainable aspect rather than concentrating on short-term gains.

26 Proposal for a Directive on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures of 14 November 2012, 2012/0299 (COD) (<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0614:FIN:en:PDF>). At the same time the European Business School's 'Women on Boards' Initiative published its 'Global Board Ready Women' list online, which contains 8,000 board-ready young graduate women, at http://europa.eu/rapid/press-release_IP-12-1358_en.htm.

27 http://ec.europa.eu/justice/gender-equality/files/womenonboards/impact_assesment_quotas_en.pdf.

Committees

The company's AoA may allow for the creation of committees appointed by the board to ensure that the directors' obligations are fulfilled. The LuxSE Principles advise listed companies to establish, from among the board's members, *inter alia*:

- a* a committee to assist the board in relation to corporate policies, internal control, financial and regulatory reporting, and risk management;²⁸
- b* an audit committee;
- c* a nomination committee to nominate suitable candidates as directors; and
- d* a corporate governance committee to ensure compliance with corporate governance practice.

The AoA will outline the number of members of each committee, their function and scope of powers, and the committees themselves will be appointed by and under the supervision of the board.

LuxSE Principle 3 requires listed companies and their boards to establish such committees as are necessary for the proper performance of the company's tasks. The LuxSE Principles also recommend that the board appoint as many special committees as are needed to examine specific topics and to advise the board. The board itself shall remain responsible for decision-taking.

ii Directors

Although no general legal obligations are in place, the LuxSE Principles require that listed companies' boards have a sufficient number of independent directors (the number depends on the nature of the company's activities and share ownership structure), defining independent directors as not having 'any significant business relationship with the company, close family relationship with any executive, or any other relationship with the company, its controlling shareholders or executive managers which is liable to impair the independence of the director's judgement' (LuxSE Principle 3, Recommendation 3.5). While there are no specific legal provisions regarding independent directors, it is generally understood that all directors, including independent directors, should be provided with timely information for the proper performance of their duties.

Liability of directors

The directors' duties are owed to the company and as such they may be held liable towards the company both on civil and criminal grounds. They are jointly and severally liable in accordance with the general provisions on civil liability²⁹ and the provisions of the Act,³⁰ both towards the company and towards all third parties for any damage resulting from a violation of the Act or of the AoA of the company.

Directors must act in the best corporate interests of the company and are obliged to comply with the Act and with the company's AoA. This includes the obligation to act as reasonably prudent businesspersons. They must manage the company's business in good

28 Should the company not have an audit committee, LuxSE Principle 9, Recommendation 9.1 requires that the board reassess the need to create an audit committee annually.

29 Articles 1382 and 1383 of the Luxembourg Civil Code.

30 Article 59 of the Act.

faith, with reasonable care, in a competent, prudent and active manner, at all times in the company's best interests, and must refrain from doing anything that does not fall within the scope of the company's corporate objectives. The Act also imposes certain general duties on directors, including the general management of the company, representation of the company towards third parties and upholding their duty to avoid any conflict of interests.

The Luxembourg legislator has remained silent on what should be considered a company's best corporate interest. In its judgment of 23 December 2015,³¹ the Luxembourg District Court made some observations on this notion. It explained that it is an adaptable concept the exact interpretation of which depends on the company concerned and the nature of its activities. For some companies, the corporate interest is aligned to the interests of a company's shareholders. For other companies, it includes the interest of the legal entity as a whole, including the interests of shareholders but also those of employees and creditors. The Court remarked that for companies that are used for purposes of financing and pure holding companies, the interest of the company's shareholders will be of overriding importance as the focus of the company's activities is on the rate of return of its investments.

However, it should be noted that directors of LuxSE-listed companies are held to a number of more specific duties under the Transparency Act and the Market Abuse Regulation, in addition to the LuxSE regulations and principles. Under LuxSE Principle 2, the board of a listed company is bound by a fiduciary duty to its company and shareholders, and must act in the company's best interests and protect the general interests of the shareholders by ensuring the company's long-term success.

In the event of misconduct, according to prevailing doctrine and case law, the shareholders' meeting must decide whether to make any claim against a director in connection with faults committed by the director in the performance of his or her functions. Creditors of a company may, under certain circumstances, institute action on behalf of the company if the latter fails to do so and if that failure harms the company's creditors (under Article 1166 of the Civil Code).

Directors' liability towards the company is exonerated further to cover the discharge granted to the board by the annual shareholders' meeting approving the annual accounts. This discharge is valid for the period covered by the accounts presented to and approved by the general meeting of shareholders, provided that they do not contain any omission or false statement of a material fact. Although a discharge given by the general meeting of shareholders extinguishes the board members' liability towards the company, it is important to note that proceedings initiated by third parties are not affected by such a discharge.

The company as well as third parties (including any shareholder or creditor with a legitimate interest) may bring an action against a director. Shareholders may, however, only seek compensation for a prejudice that is distinct from the company's collective damage, and that can be defined as an individual and personal damage. The possibility for a (minority) shareholder to sue a director has recently been given an explicit legal basis in Luxembourg law.³²

If the shareholders have suffered collective damage, it is up to the shareholders' meeting to demand compensation, in which case an action must be brought by the shareholders' meeting on behalf of the company (an action initiated by a single shareholder will be dismissed). The legal basis for the action differs depending on whether the proceedings are invoked by the company or by third parties.

31 Luxembourg District Court, 23 December 2015, numbers 145 724 and 145 725.

32 See Section V, *infra*.

Any action by the company has a contractual basis, whereas an action by third parties will be brought on the grounds of tort liability. Whereas, under contractual liability, only reasonably foreseeable damage is to be repaired (except in cases of fraud), under tort liability all damage caused by the misconduct must be repaired. To elude collective liability, a director must prove that he or she has not taken part in the breach of the Act or of the AoA of the company, that no misconduct is attributable to him or her and that he or she reported the breach at the first shareholders' meeting following his or her discovery or knowledge of the breach.

For listed companies, the LuxSE rules and regulations provide a series of sanctions in the event its rules are breached, including fines or compensation for damage caused to the stock market.

The directors of a public limited liability company are appointed for a period that cannot exceed six years,³³ although they can be re-elected if the company's AoA do not provide otherwise. They may at any time be removed from office by the general meeting of shareholders³⁴ without cause, by simple majority. It is also possible to provide for stricter conditions in the AoA via a supermajority vote to appoint or revoke the directors. Another possibility is to authorise each category of shareholders to nominate candidates, among which the general meeting of shareholders will elect the directors.

Conflicts of interest of directors

Regarding the rules relating to conflicts of interest,³⁵ any director who has, either directly or indirectly, an interest pertaining to property law that is contrary to that of the company in a transaction submitted for approval to the board is obliged to inform the board of his or her conflict, refrain from taking part in the deliberations, abstain from voting and record his or her statement in the minutes of the meeting. A special report regarding the transactions in which one of the directors had a (potential) conflict of interest is then to be prepared and submitted at the next general meeting before voting on any resolutions. If, because of a conflict of interest, the number that is required by virtue of a company's AoA to deliberate and vote on a certain matter is not reached, the board of directors can – unless otherwise provided by the company's AoA – decide to defer the decision to the company's general meeting of shareholders. The above-mentioned obligations do not apply when a decision to be taken by the board relates to the company's normal course of business and is taken under normal conditions.

For listed companies, Principle 5 requires directors to show integrity and commitment. It is recommended that directors of LuxSE-listed companies:

- a* inform the board of any possible conflict of interest;
- b* take decisions in the best interests of the company;
- c* warn the board of possible conflicts between their direct or indirect personal interests and those of the company or an entity controlled by it; and
- d* refrain from taking part in any deliberation or decision involving such a conflict (unless they relate to current operations concluded under normal conditions).

33 Article 51, fourth paragraph, of the Act.

34 Article 2004 of the Luxembourg Civil Code.

35 Article 57 of the Act.

III DISCLOSURE

i Financial reporting and accountability

All companies must file all company accounts annually under the Act; Article 309 imposes consolidated accounting for all Luxembourg-based companies where the company has a majority of the shareholding or voting rights in another entity; is a shareholder or member in another entity and has the right to approve or appoint a majority of the members to the administrative, management or supervisory body of the entity; or is a shareholder or member of another entity and solely controls a majority of shareholders' or members' voting rights in the entity, further to a shareholder or member agreement.

On 18 December 2015, Luxembourg parliament passed an act implementing Directive 2013/34/EU. This act made various changes to the preparation of the annual accounts of Luxembourg companies. Among other things, it changed the rules that are used to determine the size of a company. Depending on whether a company can be categorised as 'small', 'medium' or 'large', various financial reporting obligations apply to it, such as the obligation to draw up consolidated annual accounts or the obligation to use a certain structure of balance sheet and profit and loss account. In addition, the disclosure requirements for small companies changed, and a principle of materiality was introduced (as a result of which information that is considered immaterial may be omitted in the annual accounts).

The LuxSE Principles additionally require that a set of rules be drawn up to regulate the behaviour and the notification obligations relating to transactions of the company's securities, and to specify which transaction information should be made public. These rules should also place the appointment of a compliance officer, charged with monitoring compliance to the rules, under the responsibility of the board. Principle 9 requires directors to 'establish strict rules, designed to protect the company's interests, in the areas of financial reporting, internal control and risk management'. This includes creating, where relevant, an audit committee to discharge the board from its responsibilities of risk management, internal control and financial reporting. The effectiveness of the company's financial reporting, internal control and risk management system must also undergo regular scrutiny.

LuxSE-listed and Euro MTF-traded companies are additionally subject to the internal LuxSE rules and regulations, which contain a number of disclosure rules primarily derived from the Transparency Act as well as the Market Abuse Regulation. Legal obligations do not specifically include impacts outside the jurisdiction, unless the impacts influence the financial reporting obligations, in which case they must be reported.

The CSSF is responsible for verifying LuxSE-listed companies' reports and may issue administrative and criminal sanctions in cases of failure to report or misrepresentation, in particular under the Transparency Act. The company's corporate governance charter should also be made available on its website. In practice, companies publish press releases and past information in addition to regulated information (see Section I, *supra*).

However, since reporting on non-listed companies' social impacts remains on a soft-law basis, there are few legal consequences in cases of misrepresentation or failure to report. Some companies have put internal procedures in place to address complaints that an employee failed to comply with an internal code of conduct.³⁶ It cannot be excluded that a violation of a CSR obligation may potentially be alleged by a third party if a company does not respect

36 See, for example, PricewaterhouseCoopers' corporate governance procedure at www.pwc.lu.

one of its publicly available CSR engagements. However, so far there is no case law or doctrine in the field, and such a claim would depend on the third party being able to prove its personal interest or damage in the claim.

Auditors' role and authority, and independence

The Act of 28 July 2016 on the Auditing Profession (the Audit Act) and Luxembourg legislation exclusively reserve, *inter alia*, statutory audits to statutory auditors and to audit firms that have been approved by the CSSF. Access to the auditing profession is regulated by the Audit Act, and the titles 'auditor' and 'audit firm' are exclusively granted by the CSSF to applicants upon fulfilment of certain criteria. The CSSF also administers a database of statutory auditors, approved statutory auditors, audit firms, approved audit firms, trainee statutory auditors and candidates to the audit profession, including third-country auditors and audit entities registered pursuant to Article 12 of the Audit Act. Registered auditors and registered auditing firms must also be members of the Luxembourg national auditing organisation, the Institute of Registered Auditors, which is charged with enforcing the strict application of the rules of the auditing profession and members' respect of their professional obligations.

The question and definition of the independence of auditors remain unresolved. Under the Luxembourg definition, the requirement for registered auditors and registered auditing firms to be independent from the entity they are reviewing translates as auditors being prevented from being directly or indirectly associated with the decision-making process of the entity reviewed. The auditor is also prevented from auditing the accounts if there is any form of direct or indirect relationship, be it financial, business, employment or other, including the provision of additional services other than audit, between the registered auditor, the registered auditing firm or its network and the entity under review.

The comply or explain model and mandatory disclosure

The LuxSE Principles were drafted to be highly flexible to be adaptable to the size, structure, exposure to risks and specific activities of each company. Their comply or explain system allows companies to deviate from the recommendations when justified by companies' specific circumstances, provided that adequate explanation is provided.

The comply or explain approach, recommended by the Organisation for Economic Co-operation and Development and the European Commission, is favourably received by company boards and investors. The LuxSE Principles consist of three sets of rules: general principles (comply), recommendations (comply or explain) and guidelines. The general principles form the structure upon which good corporate governance should be based and are drafted in a sufficiently broad manner to enable all companies to be able to adhere to them, whatever their particular features. Without exception, all Luxembourg-based listed companies must apply the principles.

Given the flexible comply or explain approach, shareholders (and in particular institutional investors) have a paramount role in the thorough evaluation of a company's corporate governance, should carefully examine the reasons provided by a company whenever it is found to have departed from the recommendations or failed to comply with them, and make a reasoned judgement in each case. The shareholders should be open to dialogue in cases where they do not agree.

Majority or controlling shareholders may see to the internal and external monitoring of the company, with the risks and advantages that this necessarily involves. The principles underline that the controlling or strategic shareholders make judicious use of their power and respect the rights and interests of the minority shareholders.

The possibility of one-on-one meetings of directors with shareholders is not regulated by Luxembourg legislation. While possible, in practice, such meetings will depend on, *inter alia*, the size of the company, its structure, and the number and geographic location of shareholders and directors.

IV CORPORATE RESPONSIBILITY

For listed companies, one of the guidelines in the LuxSE Principles suggests that the board appoint a compliance officer whose duties and responsibilities should be defined by the corporate governance rules. The compliance officer's mission is, *inter alia*, to monitor compliance with rules regarding transactions in the company's shares. The LuxSE Principles further suggest that the compliance officer has access at all times to the chair of the board and the audit committee. Principle 9 requires the board to draw up strict rules to protect the company's interests, notably regarding risk management, internal control and financial reporting. Principle 9, Recommendation 9.1 suggests the board to appoint an audit committee to assist in the board's discharge of liability in the areas of financial reporting, internal control and risk management (see Section III, *supra*).

i Compliance policies and whistle-blowing

Luxembourg's national commission for data protection (CNPD) published guidelines on the rules to be respected by Luxembourg entities putting a whistle-blowing policy in place. This guideline is largely based on the 'Article 29' Group's Opinion 1/2006 on the application of EU data protection rules to internal whistle-blowing schemes in the fields of accounting, internal accounting controls, auditing matters, fight against bribery, banking and financial crime. Notably, a company must notify the CNPD of the implementation of a whistle-blowing policy further to Articles 12 and 13 of the Act of 2 August 2002 on the Protection of Persons with Regard to the Processing of Personal Data.³⁷ The CNPD provides guidelines to ensure that the whistle-blowing policy is perceived to support rather than replace efficient management and CSR. In 2011, Article L271-1 was added to the Luxembourg Labour Code with the aim of encouraging whistle-blowing activities. Article L271-1 states that no disciplinary action may be taken against employees on the mere grounds of their protest against or refusal of something that they consider in good faith to constitute an unlawful taking of interest, corruption or undue influence as defined under Articles 245 to 252, 310 and 310-1 of the Luxembourg Criminal Code, whether committed by their employer, any other person senior in rank to them, their colleagues or any third party in relation to the employer.

37 www.cnpd.public.lu/fr/legislation/droit-lux/doc_loi02082002_en.pdf.

ii CSR for other stakeholders and employees

Non-shareholders

Under Luxembourg law, directors are neither legally required to take the company's impact on non-shareholders into account; nor are they prevented from doing so. One of the guidelines in the LuxSE Principles recommends that the board give proper consideration to its staff policy and code of business ethics in determining the company's values. This could therefore be applied to the board's decision-making process, although it is only a very general guideline.

In practice, an increasing number of private companies are taking social criteria into account in their decision-making and disclosing such information to the marketplace (e.g., the CSR commitments published on the websites of several major Luxembourg-established companies, such as SES and ArcelorMittal, which publicly declare that they will take the social and environmental impacts of the company's operations into account, both on a national and international level). This consideration may extend to other companies or business partners, but on a voluntary basis only.

Employees

Article L426-1 et seq. of the Luxembourg Labour Code introduced a legal requirement for employee representatives on certain company boards. This legal obligation is limited to public limited liability companies fulfilling two criteria: all companies established in Luxembourg and employing over 1,000 employees over a three-year period; and all companies established in Luxembourg in which the state retains a financial participation of over 25 per cent, or that exercise a state-awarded concession.

Despite the lack of a more general legal requirement concerning representation on company boards, it should be noted that employees in Luxembourg workplaces with more than 15 employees have a legal right to representation at work (Article L411-1 of the Luxembourg Labour Code). The central element of workplace representation is the worker's representatives concerned with workers' everyday concerns and directly elected by all employees. As a result of the adoption of the Act of 23 July 2015, workers' representatives saw their duties increased and were given a larger say in certain decision-making processes. The scope of their right to information was also enlarged.

In larger companies employing an average of 150 or more workers over a three-year period, Article L421-1 et seq. of the Luxembourg Labour Code provide for a joint company committee – a joint employer–employee body aimed at improving industrial relations in the workplace. The law requires the company's managing director to inform and consult the joint committee at least once a year on the company's current and prospective staffing needs and on any training, refresher training or retraining implications for employees. The law authorises the joint committee to deliver an opinion on economic and financial decisions that could have a serious effect on the structure of the company or on employment levels. The committee also has the right to take part in joint decisions on a number of issues concerning human rights, such as:

- a* the introduction or running of technical equipment intended to monitor the behaviour and performance of employees at work;
- b* the introduction of, and alterations to, measures relating to occupational health and safety and the prevention of workplace accidents;
- c* the drawing up of, and amendments to, general criteria affecting the selection of staff for promotion, transfer and dismissal and at the recruitment stage; and
- d* the drawing up of, and amendments to, general criteria used in staff assessments.

Unlike in some other European countries, there is no legally backed trade union workplace presence in Luxembourg, although trade unions have a substantial range of rights in the election and operation of employee delegations. Unions also have important rights in joint company committees, and to our knowledge the majority of employee representatives are union members.

Despite an increasing number of non-discrimination laws, including a new equal treatment chapter in the Luxembourg Labour Code³⁸ implementing Directive 2000/78/EC, there is no binding anti-discrimination legislation currently in place specifically targeting non-discrimination on company boards.

V SHAREHOLDERS

i Shareholder rights and powers

Equality of voting rights

The Shareholder Act came into force on 1 July 2011 aiming, *inter alia*, at strengthening the exercise of minority shareholders' voting rights in listed companies to improve the corporate governance of such companies. The Shareholder Act explicitly refers to a principle of equal treatment of shareholders. This principle is limited to the participation of shareholders at the general meeting of shareholders and the exercise of their voting rights at that meeting. The Shareholder Act has amended the previous rule that one vote is in principle attached to one share, henceforth allowing the company to provide for different voting rights for different shares.

The powers of shareholders to influence the board

Article 53 of the Act reserves the management of the company to its board. Should a shareholder be directly involved in the management of the company, he or she may be deemed a *de facto* director and face civil or criminal liability, or both, and generally be liable under the same circumstances as the appointed directors.

Shareholders do, however, control the appointment of the board (and therefore its composition) via a majority decision of over 50 per cent to appoint a new director. In addition, shareholders representing 10 per cent of a company's share capital may force the board to postpone a general meeting of shareholders for a period of up to four weeks.³⁹

Furthermore, during the annual general meeting, the shareholders can question the board on all aspects of the company's management, accounting and so forth throughout the year, and may withhold the granting of discharge. Although previously, shareholders were in practice already allowed to ask questions during the meeting and to receive answers to their questions, the Shareholder Act now expressly lays down that shareholder right in relation to the items on the agenda of the meeting.

Under the Shareholder Act, in addition to the right to ask questions orally during a meeting, shareholders may have the right to pose written questions about the items on the agenda before the meeting is held. If provided for in a company's AoA, questions may be

38 Chapter V (equal treatment), Articles L241-1 to L254-1; see www.legilux.public.lu/leg/textescoordonnes/codes/code_travail/Code_du_Travail.pdf.

39 Article 67(5) of the Act.

asked as soon as the convening notice for the general meeting is published. The company's AoA will furthermore provide the cut-off time by which the company should have received the written questions.

Apart from several specific circumstances (e.g., in the case of confidential information), the company must answer any questions addressed to it. Should several questions relate to the same topic, the company may publish a detailed questions and answers document on its website, in which case the chair should draw the shareholders' attention to the publication.

The Act also allows shareholders to submit questions to management outside a meeting. Any shareholder representing at least 10 per cent of the company's share capital or voting rights, or both, can ask the board of directors or management body questions about the management and operations of the company or one of its affiliates, without the need for extraordinary circumstances. If the company's board or management body fails to answer these questions within one month, the shareholders may petition, as in summary proceedings, the president of the district court responsible for commercial matters to appoint one or more independent experts to draw up a report on the issues to which the questions relate.⁴⁰

Certain matters must also be reported to the shareholders, such as any director's conflict of interest relating to voting on a resolution (see Section II, *supra*).

Furthermore, if a minority shareholder of a public limited liability company finds that directors and members of its management and supervisory boards are negligent or simply not diligent in the performance of their duties, it may sue them. Such an action may be brought by one or more shareholders or the holders of founders' shares, or both, representing 10 per cent or more of the company's voting rights.⁴¹

Decisions reserved to shareholders

Article 53 of the Act provides that a company's management board has the most extensive powers to perform all actions necessary or appropriate to fulfil the company's corporate objective, with the exception of the actions specifically reserved by law to the shareholders' meeting (*inter alia*, all amendments to the company's AoA, approval of annual accounts and allocation of the company's results are reserved to the company's shareholders).

Rights of dissenting shareholders

The Act currently recognises only a few rights of action on behalf of the company in favour of individual shareholders.

The extension of the protection of minority shareholders by stipulating provisions in the company's AoA (e.g., the right of a minority coalition to propose directors, provisions for a more stringent majority for certain decisions, approval clauses or share transfer restrictions) is well recognised insofar as the arrangement does not conflict with Luxembourg's public order rules.

The use of shareholders' agreements of a purely contractual nature is far more common than providing for relevant provisions in the AoA. The use of shareholders' agreements is now explicitly recognised in Luxembourg law. It is important to note that the Act does not state that these type of arrangements need to be limited in time. However, it does set out three types of voting arrangements that are null and void: (1) a shareholders' agreement

40 Article 154 of the Act.

41 Article 63 *bis* of the Act.

that violates the provisions of the Act or that is contrary to a company's corporate interest; (2) an undertaking by a shareholder to vote in accordance with instructions given by the company itself, a subsidiary or any corporate organ of those entities; and (3) an undertaking by a shareholder to those same companies or corporate organs to approve proposals made by the company's corporate bodies.⁴² If votes are cast at a general meeting of shareholders pursuant to an invalid voting arrangement, the votes shall be considered null and void along with any resolutions taken, unless the votes did not affect the final outcome. While the use of shareholders' agreements does allow for discretion and flexibility, any compulsory implementation of this type of arrangement remains at risk.

Providing additional protection in favour of groups of minority shareholders, whether in the AoA or otherwise, is quite common in Luxembourg, particularly among international joint ventures and groupings that use a Luxembourg company structure to promote mutual business activities.⁴³

As a last resort, dissenting shareholders may seek to invalidate a shareholder decision that has been taken on the basis of five grounds that are specified in the Act: (1) a procedural irregularity that influenced or could have influenced the outcome of the decision; (2) a violation with fraudulent intent of the rules governing general meetings; (3) an *ultra vires* act or abuse of power affecting the decision; (4) the exercise at a general meeting of voting rights that have been suspended by legislation other than the Act, provided the quorum or majority required to adopt the decision would not have been met but for the unlawful exercise of these voting rights, and (5) any other cause provided for by the Act.⁴⁴

Also of note is the sell-out right in favour of minority shareholders. Under the Squeeze-out Act, in the event of an individual or legal entity acquiring at least 95 per cent of the share capital of the company and subject to certain conditions being met, the remaining minority shareholders are entitled to exercise a sell-out right within three months of the required notification and publication of the acquisition.⁴⁵

Benefits for long-term shareholders

The Act does not provide for any specific benefits (e.g., extra votes or dividends) for long-term shareholders, although such facilities may be agreed upon in a shareholders' agreement or incorporated into the AoA, or both.

Shareholder approval of board decisions

While the Act does not set out any specific areas in which board decisions must be approved by the shareholders, the AoA of the company may provide that all or certain board decisions must be ratified by the shareholders.

42 Article 67 *bis* of the Act.

43 For further analysis on minority shareholders rights, see also Marc Elvinger, 'Les minorités en droit des affaires: rapport luxembourgeois', *Annales du droit luxembourgeois*, No. 15 (2005).

44 Article 12 *septies* of the Act.

45 See footnote 4, *supra*.

ii Shareholders' duties and responsibilities

Controlling shareholders' duties and liability

All shareholders have certain obligations by law, including the payment of shares, a proportional contribution to any losses suffered by the company and an obligation of loyalty.

In addition, the controlling shareholders are notably prevented from dictating or imposing an increase of the other shareholders' obligations without their prior consent, although this principle has been considerably attenuated by the Squeeze-out Act,⁴⁶ which granted the right to force the acquisition of shares held by minority shareholders to shareholders controlling at least 95 per cent of the share capital.

Institutional investors' duties and best practice

While institutional investors must bear in mind potential reputational repercussions relating to their investments, there are no particular duties imposed specifically on institutional investors and no requirement for institutional investors to specifically consider third-party impacts in their investment decisions. However, a number of Luxembourg-based investors have signed the United Nations-supported Principles for Responsible Investment⁴⁷ (an investor initiative in partnership with the United Nations Environmental Programme Finance Initiative and the United Nations Global Compact). The first of these six principles is to incorporate environmental, social and corporate governance considerations into investment analysis and decision-making processes. Furthermore, a growing number of investors – while not being signatories to the Principles for Responsible Investment – are taking the private initiative to take such risks into account.

Code of best practice for shareholders

Luxembourg has no official code of best practice for shareholders, although companies may draw up internal codes of best practice for their shareholders.

iii Shareholder activism

Shareholder activism is not a defined notion under Luxembourg law, and neither derivative actions nor proxy battles are common practice in Luxembourg.

iv Takeover defences

Takeover bids are covered by the Luxembourg Takeover Act of 19 May 2006 (transposing Directive 2004/25/EC). The scope of this Act is limited to companies whose shares are traded on a regulated market in one or more member states of the European Union. Although Luxembourg law admits the principle of defensive measures, there has been no case law specifically covering the question as yet. In implementing any defensive measures, the board has an obligation to act in good faith with respect to the shareholders' interest.

In the absence of a specific provision in a company's AoA requiring shareholder approval, the board may adopt defensive measures (e.g., issuing new shares within the limits of authorised capital or selling key assets) without the approval of the shareholders, provided that these measures are taken in the best interests of the company. The board may not

46 Ibid.

47 www.unpri.org.

prohibit the shareholders from accepting an offer. It should be noted, however, that measures aimed at frustrating bids in the long term are not generally deemed to be admissible under Luxembourg legislation. It would, therefore, not be possible to repeat defensive measures whenever the bid is repeated or to take defensive measures that have a long-term effect.

Shareholder and voting rights plans, and similar measures

As a general rule, any increase of a Luxembourg company's share capital is decided upon by the general meeting of shareholders. However, the articles of association of a Luxembourg public limited liability company may authorise the board of directors to increase the share capital up to a designated amount in one or more instalments.⁴⁸ The authorisation to do so is only valid for a period of five years, but may be renewed by the general meeting of shareholders. As an inducement for an existing shareholder to purchase more shares, it may be decided to abandon any payment of share premium. Beyond that, there is no possibility for a company to offer a discount on the par value of shares to be issued.

White-knight defence

In Luxembourg practice, the board of any company that is the subject of a takeover bid may seek out a third party with the purpose of the third party making a counter-offer that is more favourable to the company. It can do so without the need for approval by the company's shareholders.

Staggered boards

Directors of a Luxembourg public limited liability company shall be appointed for a term of office that may not exceed six years. However, directors may be removed from office by the general meeting of shareholders at any time and without stating reasons. As a result, a staggered board does not constitute a major obstacle for a hostile acquirer holding sufficient shares to make changes to the composition of the board.

v Contact with shareholders

Pursuant to the Shareholder Act, listed companies must give at least 30 calendar days' notice before holding a meeting (notwithstanding particular requirements under the Takeover Bid Act). By doing so, Luxembourg's parliament has imposed a longer notice period than the 21-day notice period required under Directive 2007/36/EC. Should the quorum not be met at the first meeting, a second meeting must be convened at least 17 calendar days before the meeting is held. The convening notice must be published in the electronic compendium of companies and associations, a Luxembourg newspaper and other media in a manner that ensures the effective distribution of the information to the public throughout the European Economic Area. In the event that all the shares are registered, convening notices may be sent by registered letter to the shareholders, members of the board (or the management board

48 As a result of the entry into force of the Luxembourg Act of 10 August 2016, the AoA of Luxembourg private limited liability companies may now also include an authorisation to the board of managers to issue shares, provided that the shares so issued are either issued to existing shareholders or to a third party that has been approved in accordance with the law.

and the supervisory board) and the statutory auditors. The Shareholder Act requires that, in addition to the agenda, date and place of the general meeting to be held, convening notices must also include:

- a* a clear description of the shareholders' rights to put items on the agenda and to table draft resolutions, the procedure for voting by proxy and a form to be used for that purpose and, if provided for in the company's AoA, the procedure to vote by electronic means;
- b* postal and email addresses that can be used to obtain documents in relation to the meeting;
- c* where applicable, a copy of the 'record date' as defined by the Shareholder Act (i.e., the date by which shareholders must register their shares to participate and vote at the general meeting). The date for listed companies is set at midnight CET on the 14th calendar day before the meeting. The shareholder must notify the company at the latest by this date of its intention to participate in the meeting; and
- d* the company's website address, which must contain all of the above information, as well as a full copy of the draft resolutions.

The Shareholder Act allows distance voting by shareholders in advance of the meeting, provided that the company expressly recognised this possibility and has outlined the related requirements in its AoA. The Shareholder Act details the content of the ballot paper, which must include, *inter alia*, the full identity of the shareholder, the content of the vote cast in advance, the agenda of the meeting and the deadline before which the ballot paper must be received.

The Shareholder Act requires proxy voting to be offered to shareholders, under certain conditions, with the proxy holder having the same rights as the shareholder. The company has no obligation to verify that the proxy holder votes in accordance with the shareholder's instructions.

VI OUTLOOK

While corporate governance is currently, in general, voluntary, a growing number of institutional guidelines and codes are being developed, and the Luxembourg government is working towards promoting corporate governance on a national level.

Notably, Luxembourg is required to bring into force the laws, regulations and administrative provisions necessary to comply with the Fourth EU Anti-Money Laundering Directive by 26 June 2017. Luxembourg is currently working on legislation implementing this directive, which will have a profound influence on beneficial ownership identification.

Furthermore, the second Markets in Financial Instruments Directive and the accompanying Regulation on Markets in Financial Instruments are expected to enter into force in January 2018 and will further improve the functioning of financial markets and reinforce investor protection.

MEXICO

Alberto Saavedra, Alfonso Monroy and Daniel Velázquez¹

I OVERVIEW OF GOVERNANCE REGIME

The corporate governance regime in securities markets with an international reach requires standardisation of corporate governance practices. Mexico has joined the efforts made by international organisations, such as the International Monetary Fund, the World Bank and the Organisation for Economic Co-operation and Development (OECD), through the implementation of several reforms that aim to frame and harmonise best practices and strengthen investors' confidence. Mexico has been taking consistent steps in the strengthening of regulations for corporations, specifically corporate governance, since the mid-1990s because of the economic crisis of that period.

While the Mexican authorities have made significant advances in the way corporate governance is regulated and enforced, there is still a long way to go when practice in Mexico is compared with international standards. The aim of this chapter is to provide a general overview of the Mexican corporate governance framework and regulations, and the areas of opportunity the situation presents.

The Mexican securities market is relatively small when compared with other economies in the developed world, but it is relatively large and lively when compared with other markets in Latin America. Throughout the development of this market, financial and industrial groups have played a key role through the way in which they have traditionally conducted business. Unlike a dispersed ownership model, the predominance of family owned businesses in Mexican securities market shapes the challenges and opportunities for Mexican corporate governance. Consequently, the application and institutionalisation of good governance practices must accommodate the right checks and balances in the controlled share ownership model to encourage investment confidence and to allow shareholder value creation. The typical Mexican public company corporate structure is characterised by having a holding company make most of the key decisions, independent of the vertical, horizontal or conglomerate integration of the group. Decisions on financing, dividend policy and other key firm decisions are made at the holding company level. Because of this relatively centralised structure, and because of the nature of the international markets where most of the principal Mexican firms do business, both the private and public sectors have realised that a robust corporate governance apparatus is necessary for the orderly conduct of business.

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Moreover, owing to the frequent problems of the national economy and financial markets, political discussions on corporate governance reform have usually been focused on regaining investors' confidence, providing security to investors and thus generating a climate that incentivises economic growth.

The federal legal framework is based on civil law and regulates corporations and their internal governance. It is composed primarily of the General Corporations Law (LGSM), the Securities Law (LMV) and the Commerce Code.

The LGSM establishes the basic ways in which companies can organise themselves, including shareholders' rights and other regulations that derive from business organisations. There are six main forms of business organisation, primarily differentiated by:

- a* the degree of partner liability with respect to obligations contracted by the firm;
- b* the freedom awarded for the transfer of interests; and
- c* the degree of participation and influence in the firm's management.

However, although the LGSM regulates six types of business organisation, most have fallen out of use in common practice. The two most commonly used types are:

- a* the business corporation, which is characterised by having its capital stock divided into shares, limiting each shareholder's liability to the amount of the contribution made to the firm; and
- b* the limited liability company, which is characterised by having partners as opposed to shareholders, with no negotiable interest representing the partnership interest and the liability limited to the contribution made to the partnership.

A new type of business organisation was launched in 2016, the business corporation with simplified shares, or SAS, which can be incorporated by a sole or more shareholders and has a limit on revenues. The purpose of this type of private business organisation is to incentivise and facilitate the establishment of micro, small and medium-sized enterprises.

The LMV, which specifically regulates publicly traded companies, governs the following three types of companies:

- a* The investment promotion corporation – one of the most flexible business organisations foreseen in the Mexican regulations because it provides for more protection for minority shareholders and contemplates corporate government standards.
- b* The stock market investment promotion corporation, which allows companies to issue and place shares and offer them to the general public in a less severely regulated environment than the stock market corporation, with the condition that they must adopt the standards applicable for publicly held companies within a period of three years.
- c* The stock market corporation, also known as a publicly held company. These types of firm are required to register their shares with the stock market institutions and to adhere to a more strictly enforceable set of laws.

In addition to the regulations set in place by the state, in 1999 an organisation that unites the main representatives of the private and business sector, the Business Coordinating Council (CCE), issued a voluntary Code of Corporate Best Practices (CMPC) that includes, among other provisions, recommendations on the way a corporate board should be organised, its structure and functions, advice concerning the audit committee, and provisions regarding the protection of minority rights. The CMPC was developed in consultation with a wide array of

experts in the matter and, although originally the CMPC was not mandatory and adoption by private or publicly held companies was voluntary, companies that decided to adopt these best practices sent a message to investors about the professional manner in which they ran their business, thus increasing investor confidence.

Only two short years after the CCE issued the CMPC, an effort was made at the national level to include the provisions of the CMPC in a variety of laws, including the LMV and the Banking Institutions Law, in effect making the CMPC provisions mandatory for all firms regulated by these laws, and prompting their inclusion in the companies' by-laws. In recent years, the CCE has issued revised versions of all the annexes of the CMPC, notably including a requirement assessing board gender diversity in the questionnaire that public companies have to complete and disclose each year for evaluation of the level of adherence to the CMPC.

Mexico's capital market regulator is the National Banking and Securities Commission (CNBV), a decentralised body of the Ministry of Finance that supervises banks and the securities market and is tasked with defending shareholder rights.

The authority assigned to this regulatory body in the diverse financial regulations discussed throughout this chapter is far-reaching, including the imposition of economic fines or requesting that Mexican courts impose penalties and institute criminal proceedings. In addition, the CNBV also has multiple enforcement powers with regards to the timely and full disclosure of the standards of compliance with these practices regarding investors, and compliance by the relevant entities of the CMPC.

In the exercise of its mandate, the CNBV has issued a number of memoranda that regulate diverse aspects of corporate governance, including disclosure obligations. In November 2014, the CNBV adopted new rules to enforce the disclosure of transactions involving securities of public companies' directors and managers, and employees of financial entities and public companies. These new rules show the increased scrutiny and importance the CNBV is giving to transparency in the dealings of individuals involved in positions of influence in public firms.

As a consequence of the issuance of the different memoranda, the CNBV has strengthened the corporate governance of financial institutions and other entities, specifically public companies, further preventing the misuse of material confidential information that could lead to illegal profits by noted persons who, by virtue of their functions and activities, have access to said information and could, in theory, take advantage of it in the public markets. Moreover, confidential information relating to processes like listings in the National Securities Registry, public offers, purchase and sale of shares and other operations of the sort would also be more strictly regulated by these rules.

II CORPORATE LEADERSHIP

Mexican public companies have a one-tier corporate board structure, meaning that managerial and supervisory responsibilities are invested in the board of directors. One of the OECD principles of corporate governance, which is also included in the CMPC, concerns the areas of responsibility of the board, including in relation to its structure, practices and fiduciary duties.

In contrast to other markets, there are still many private firms in Mexico that are managed by sole administrators, although private companies making public stock offerings must adopt a corporate board of directors as proposed by the CMPC and required by the

LMV, to demonstrate that the decisions of the firms are made in a consensual manner and deliberated on by a collegiate body instead of a single individual, with the aim of making decisions in the most objective and impartial manner possible.

It is not only the board of directors that must abide by the governance rules; senior management are also subject to the duties of the LMV, as is the secretary of the board of a publicly held company. The duties of care and loyalty that are incumbent upon the board of directors in other markets are similarly enforced in the Mexican market. Responsibility for the decisions a firm makes falls primarily on the board of directors, and its members are expected to behave and hold themselves to a similar ethical standard as directors in the United States. Moreover, any person with the authority to materially influence the decisions of the shareholders' meetings or the board of directors is also subject to these liabilities because, more often than not, controlling shareholders have decision-making power and thus are also subject to the duties and responsibilities that the corporate governance regulations impose on notable persons or persons with notable influence on a firm. These liabilities have not yet been expanded in the Mexican regulations to include third-party consultants or external auditors.

There are several regulations and restrictions on appointing members of the board of directors. The duties of a member of the board of directors of a public company listed in the Mexican market shall be performed personally or by an alternate director appointed by a shareholder resolution and, in the case of business corporations and limited liability companies, the duties of a director continue, even if their term has expired, until a replacement is named. As with many other markets, the duties of the directors are to the shareholders as a whole, and not only to the group of shareholders that elected them to the board. Directors assume personal responsibility that could arise from civil lawsuits initiated by shareholders and are jointly liable before the company for:

- a* contributions made by shareholders;
- b* the fulfilment of any legal and statutory requirements, such as dividends;
- c* the existence and maintenance of accounting, control record, filing or information systems provided by the law; and
- d* the exact fulfilment of the resolutions adopted by the corresponding shareholders' meeting.

Moreover, there are several specific corporate governance responsibilities and obligations that are imposed on the board of directors:

- a* establishing general strategies for the conduct of business activities of the firm;
- b* approving the policies and guidelines, with the appropriate committee's input, for the use of the assets that are part of the company's wealth; and
- c* monitoring the company's management and direction.

For publicly held companies, minority shareholders that hold at least 10 per cent of the stock are entitled to appoint and revoke, in a shareholders meeting, one member of the board of directors.

The board of directors has the power, *inter alia*, to represent the company in lawsuits; acts of administration for tax purposes, labour matters and general matters; orders to subscribe and issue negotiable instruments; and also to grant powers of attorney.

The meetings of the board of directors must be held at least on a quarterly basis and, to be a legally valid meeting, at least one half of its members must be in attendance. Its resolutions shall be valid when adopted by the majority of the directors at said meeting, and companies can grant a casting vote to the chairman in the event of a tie. The board

of directors of a publicly held company needs to have at least 25 per cent of its members qualified as independent board members. For an individual to be considered independent, he or she should have enough experience, skill and professional prestige and no conflict of interest with the firm and its decisions.

With regards to remuneration or consideration for directors, there are no mandatory rules that set a minimum or maximum monetary amount that board members should receive for their services, but the CMPC put forth a set of guidelines in an attempt to standardise compensation for board members across different firms. Members of the board of directors are also generally entitled to officers' liability insurance if the firm agrees that it is beneficial and in line with the firm's interests.

As a result of the incorporation of the guidelines set forth by the CMPC, there is now a regulatory obligation to create certain bodies within the board of directors to ensure the board fulfils its duties. These include the audit committee, the corporate practices committee and the chief executive officer (CEO), among others.

The purpose of creating these committees is to ensure that the board of directors exercises its duties correctly. The audit committee is responsible for, *inter alia*:

- a* evaluating the internal controls and procedures, and identifying deficiencies, following up with corrective and preventive measures in response to any non-compliance with the operation and accounting guidelines and policies;
- b* evaluating the performance of the external auditors;
- c* describing and valuing non-audit services performed by the external auditor; and
- d* reviewing the financial statements.

The corporate practices committee is responsible for, *inter alia*:

- a* evaluating, hiring, firing and calculating the compensation of the CEO;
- b* reviewing the hiring and compensation policies for the executive officers;
- c* reviewing related party transactions;
- d* reviewing policies regarding the use of corporate assets; and
- e* reviewing unusual or material transactions.

III DISCLOSURE

Mexico has a comprehensive system of information disclosure that has been improved year on year. Certain accounting, administrative and legal information must be disclosed by public companies.

Each public company must file an annual report, which should include, as a minimum:

- a* a report issued by the directors regarding the company's operation, as well as the policies followed by the directors;
- b* a report in which the directors present the main accounting policies and criteria regarding information used to prepare the financial information;
- c* a statement showing the company's financial position;
- d* a statement showing changes in the financial position; and
- e* a statement showing the company's profits and losses.

In addition, publicly held companies need to present in their general shareholder's meeting:

- a* a corporate practices report and an audit report;
- b* a general manager report regarding the company's financial information; and

- c a report regarding operations and activities in which the company participated in terms of the LMV. They must also file quarterly disclosures of unaudited quarterly financial statements (with comparisons to the previous year). Quarterly filings are due 20 days after the end of the first three quarters and 40 days after the fourth quarter. Publicly held companies must immediately disclose material events that could influence market price.

Directors and managers are responsible for the company's relevant information. The general manager becomes the person responsible for signing the company's relevant information with the directors in charge of the main areas, such as finance and legal, as well as complying with the LMV provisions and for the content and timeliness of said information. It must be noted that in November 2014 the CNBV issued the rules and regulations referred to in Section I, above, which came into effect in 2015, with the aim of bolstering controls of directors' and managers' personal transactions in the stock market to prevent insider trading and protect the investing public. These rules and regulations impose certain responsibilities on publicly traded companies – and on their directors and managers because of their access to material and non-public information – which have improved the transparency of the market. They require, for instance, that publicly traded companies not only create and maintain internal controls so that personnel with access to sensitive information are formally made aware of their status, but also that they observe certain reporting obligations regarding record-keeping on the instances and type of access their directors and managers have had to privileged information that may provide them with an unfair advantage. The obligation to maintain these records expires after five years.

The external auditor has an active role in the disclosure of information. The LMV limits the statutory auditors with regard to the advisory relating to financial statements. Also, as mentioned before, the LMV requires companies to set up committees with the intention of delegating roles to the board of directors to create efficiency and transparency. Auditors usually report to management, although they are formally appointed by the board on the audit committee's recommendation. The law requires the auditor to sign the opinion, placing the burden of responsibility and liability on the individual.

Finally, all the information filed with the CNBV is accessible through its Mexican Stock Exchange (BMV) website. All relevant information is also available to the CNBV, the BMV and the public in general.

IV CORPORATE RESPONSIBILITY

Corporate social responsibility is still in the early stages in Mexico. The traditional perspective of Mexican civil society is centred on legal compliance and characterised by a complicated attitude towards the private sector. The interaction between Mexican civil society and business-oriented organisations is still very limited.

To date there is no law that compels companies to establish policies regarding corporate social responsibility. Companies may voluntarily establish social project participation policies at their own discretion.

V SHAREHOLDERS

i Shareholder rights and powers

The corporate governance framework aims to protect shareholders' rights. These rights vary depending on the type of corporation. Basic shareholders' rights include:

- a* the right to access secure methods of ownership registration;
- b* the freedom to convey or transfer shares;
- c* the ability to obtain relevant information on the company on a timely and regular basis;
- d* the ability to participate and vote in general shareholder meetings;
- e* the ability to elect members of the board; and
- f* a share in the profits of the company.

Shareholders' meetings must be held at least once a year. Publicly held companies must discuss in their annual shareholders' meeting:

- a* the appointment of directors and auditors;
- b* the approval of the annual financial statements;
- c* the determination of compensation of the directors; and
- d* the appointment of the chairpersons of the audit and practices committees.

Shareholders' meetings can be ordinary or extraordinary. It is common for meetings categorised as ordinary to also be considered as the annual meeting, and the items discussed are those mentioned above. Extraordinary shareholders' meetings take place whenever necessary to discuss any of the following topics:

- a* the early dissolution of the company;
- b* a capital stock increase or decrease;
- c* the extension of the company's term;
- d* the possibility of company transformation;
- e* a possible change of corporate purpose; and
- f* any other item for which the law or by-laws require a special quorum.

In addition, for publicly held companies governed by the LMV, shareholders have the right to:

- a* appoint one member of the board of directors for each 10 per cent of the voting shares individually or collectively held;
- b* request the calling of a general shareholders' meeting at any time;
- c* appoint one statutory auditor for each 10 per cent of the voting shares individually or collectively held; and
- d* judicially challenge the resolutions adopted at the shareholder's meetings.

In private business corporations and companies governed by the LMV, there is the option to restrict voting rights with respect to some matters, issue shares with no voting rights, grant differentiated rights, impose tag and drag-along clauses, preference rights and deadlock mechanisms.

ii Shareholders' duties and responsibilities

Shareholders have limited responsibilities towards their corporation, such as creating control, management and surveillance bodies, and periodically reviewing the actions of these bodies. The reason for this is that most of the obligations intended for the fulfilment

and execution of healthy corporate governance lie with the management, as previously mentioned, and therefore the activities of the shareholders are not permanent, in contrast to the management obligations.

As an example, in recent years Mexican courts have issued important decisions that have created an interesting precedent in extending shareholders' liability, stating that if the shareholders have effective control of the holding company and intend to evade complying with the law, or cause any damage to any third party, they may be held liable and, thus, it is possible for the corporate veil to be lifted. In addition, the LMV allows for the establishment of causes for shareholders' exclusion or causes for the exercise of separation, even though the list of causes is not established.

On the other hand, shareholders have the right to enforce the corporate governance rules and, if breached, they are entitled to sue the directors and even the company itself in some cases. In the cases of publicly held companies and other regulated financial entities, members of the board of directors shall be liable and accountable to the shareholders for the performance of their duty.

Finally, since 2002 takeover regulations have protected minority shareholders during changes of control, and these provisions have been significantly increased in recent years, as we will more fully explain in the next section.

iii Takeover defences

The LMV generally stipulates the requirements for publicly traded corporations can include takeover defences in their by-laws: (1) they can be approved by 95 per cent of the shareholders; (2) the measure taken once a takeover threat is announced must apply equally to all current shareholders; (3) the prohibition must not be absolute; and (4) it does not otherwise contradict the LMV's tender offer provisions.

Moreover, the LMV stipulates that tender offers launched by companies must apply to all share classes, at the same price, and must be valid for at least 20 business days. Complex shareholding structures serve to protect controlling shareholders and management, and independent appraisals or valuations should be required to set the reasonable price of a tender offer.

However, although there are in fact provisions in the LMV allowing companies to include classic takeover defences in their by-laws, such as a stock option plan (commonly referred to as a 'poison pill'), board approval for high-percentage share acquisitions and 'wolf pack' acquisition limitations, in most cases it is difficult to execute a hostile takeover via the Mexican stock market. As already mentioned, the reality of many publicly traded corporations is that they are controlled by a very small group (often a single family unit) of shareholders, and the percentage of their stocks that is publicly traded, commonly known as the 'float', is much smaller than the stake that would allow someone to acquire control.

VI OUTLOOK

The discussion of corporate governance in Mexico began relatively early, meaning that the regimes, as well as information disclosure and the protection of minority shareholders, have been broadly established by diverse reforms of the Securities Law. The influence of the Anglo-Saxon system and the progress in Mexico can be considered examples of developing countries adapting their legal approaches to international standards as a result of economic globalisation.

As shown in this chapter, Mexico is struggling with the legal regime itself, owing to the regulatory framework only considering public companies. We believe that more time is needed to adapt to the new system, and entities such as investor promoter corporations and stock market investor promoter corporations need more incentives from the Mexican government to develop as start-ups and have greater market access.

Another issue to be dealt with is greater corporate governance in the opening up of the family business model. As touched on briefly in Section I, above, it is estimated that up to 95 per cent of Mexican businesses are still wholly family owned and run, a situation that is in stark contrast with the most robust securities market and system in the world, the United States, where institutional investors hold over 50 per cent of all corporate securities. In Mexico, institutional investors do not hold controlling positions in Mexican corporations, leading to the fragmentation of the corporate governance endeavour.

Some of the recommendations that Mexico could adopt are:

- a* new reforms in line with international standards, such as those of the International Monetary Fund, World Bank and OECD. The country is already making some improvements, with the adoption of the new rule described in Section I, above, but there is still room for significant improvement of our regulations and enforcement of the laws;
- b* incorporation of greater and more detailed disclosure standards regarding gender diversity on board of directors, as well as other instrumental measures to facilitate an extended stakeholder approach;
- c* enforcement of the current laws – the CNBV should continue to strengthen its capacity to monitor disclosure and enforce the corporate governance provisions of the Securities Law. It should also train staff to increase awareness of corporate governance issues and abuses; and
- d* pension funds (AFORES) and other institutional investors have grown in recent years and, therefore, with the National Commission for the Pension System, the CNBV should continue developing corporate governance standards for the AFORES and other institutional investors.

NAMIBIA

*Hugo Meyer van den Berg and Chastin Bassingthwaighte*¹

I OVERVIEW OF GOVERNANCE REGIME

German colonial rule was established in Namibia (then South-West Africa) in 1884 and continued until 1915, when South African forces, on instructions of the British Government, invaded South-West Africa and took control of the capital, Windhoek. In 1919 South-West Africa became a mandate of South Africa and, in terms of Section 1(1) of Proclamation 21 of 1919, Roman Dutch law was made applicable in South-West Africa, as in South Africa. South Africa remained in control of South-West Africa until 1990, when Namibia finally gained independence from South Africa.

As a result of the mandate that South Africa had over Namibia for almost a century, the Namibian legal system is closely linked with the South African legal system and for many years was subject to it. The two countries share a common law (Roman-Dutch law influenced to some extent by English law), and all pre-independence case law and statutes of South Africa are binding in Namibia unless they have been specifically revoked. Furthermore, post-independence case law and legal scholarship in South Africa is still considered persuasive authority in Namibia.

The Companies Act 61 of 1973, enacted in South Africa while South Africa held a mandate over Namibia, was applicable in Namibia as well. It remained in operation until 1 November 2010, when Namibia's own Companies Act 28 of 2004 (the Companies Act) came into operation. The Companies Act of 2004 repeals the Companies Act of 1973 and is the primary legislative instrument that deals with companies in Namibia. On 16 January 2017, the Business and Intellectual Property Act 8 of 2016 also came into operation. This Act establishes the Business and Intellectual Property Authority (BIPA) and sets out its powers and functions. BIPA is responsible for the administration and protection of business and intellectual property in Namibia.

As with the old Companies Act of 1973, the South African Stock Exchanges Control Act 1 of 1985 (SECA) was also made applicable in Namibia and has not been repealed to date. This Act regulates stock exchanges, stockbrokers and loans made against securities. In a drive to establish a more independent economy, however, the Namibian Stock Exchange (NSX) was established in 1992. The Rules of the NSX, together with the SECA, regulate all companies listed on the NSX.

Until recently, the King III corporate governance code of South Africa was used in Namibia as well. However, in 2014, Namibia introduced the Corporate Governance Code for Namibia (the NamCode), prepared by the NSX with the support of FNB Namibia

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Holdings Limited. The NamCode applies to all entities incorporated by statute, under or in terms of the Companies Act or any other legislation applicable in Namibia. Compliance with the NamCode is, however, voluntary.

II CORPORATE LEADERSHIP

In line with international practice, companies in Namibia are represented by two bodies, namely the shareholders, who ultimately own the company, and the board of directors, which is responsible for managing the company. The relationship between the company, its shareholders and the board of directors is determined in terms of common law, the Companies Act and the articles of association of the company. Often, the shareholders of a company will also enter into a shareholders' agreement, which amplifies the roles and responsibilities of shareholders and directors in respect of the company.

i Board structure and practices

In Namibia, companies usually have a one-tier structure. The Companies Act does not make provision for a two-tier structure, nor does it deal with the powers and functions of the chairperson (even though it refers to a chairperson of the board) – these are usually dealt with in the articles of association of each company. The Companies Act does not refer specifically to chief executive officers, although most companies in Namibia have one.

The NamCode recognises what happens in practice and states that each board should elect a chairperson, who should be a non-executive director.² Furthermore, each board must appoint a CEO and establish a framework for the delegation of authority.³ The CEO may not be the chairperson.⁴ The NamCode sets out in detail the responsibilities of the chairperson and the CEO,⁵ and states that the board must consist of a majority of independent, non-executive directors.⁶

The legal position of directors in relation to the company is not settled under Namibian law. Directors have been referred to as agents of the company, trustees and managing partners.⁷ The better view, however, is that the directors stand in a unique or *sui generis* relationship to the company and should not be forced into a specific role or position (although they do reflect various characteristics of each of these roles).⁸ Each director, as an individual member of the board, has certain rights and responsibilities. These rights and responsibilities are set out in the Companies Act, common law, articles of association of the company and, where applicable, the shareholders' agreement.

The board of directors acts primarily in the interest of the company and then in the interest of individual shareholders, in keeping with the duty of good faith that each

2 Principle C2-16 of the NamCode.

3 Principle C2-17 of the NamCode.

4 Principle C2-16 of the NamCode.

5 Principles C2-16 and C2-17 of the NamCode.

6 Principle C2-18 of the NamCode.

7 See *Lochoff v. Jewish Daily Press Ltd* 1942 WLD 255 at 258; *Cohen NO v. Segal* 1970 (3) SA 702 (W) at 706.

8 See, for example, S J Naude, *Die Regsposisie van die Maatskappydirekteur* (Durban: Butterworths, 1970), pp. 42 to 45.

director owes towards the company.⁹ Although directors are appointed by the shareholders or a class of shareholders, directors should not place the interests of the shareholder or class of shareholders who appointed him above the interests of the company. This is confirmed in the NamCode as well.¹⁰

The Companies Act does not provide for delegation of authority to committees established by the board, although the articles of association normally provide for the establishment of committees and delegation of authority to committees. The NamCode also obliges the board to delegate certain functions to well-structured committees, without abdicating its own responsibilities.¹¹

In terms of the NamCode, the board, its committees and individual directors should be subject to annual performance evaluations.¹² Induction of directors as well as on-going training and development must be conducted through formal processes.¹³

Remuneration of board members is not dealt with in the Companies Act and often not in terms of the articles of association. There is no implication in law that a person who acts as director is entitled to remuneration.¹⁴ Remuneration must be provided for in the articles of association authorised by the shareholders in general meeting. The board of the company cannot authorise payment of remuneration to board members. Typically, the articles of the company will state that the board members are entitled to such remuneration as may be authorised by the shareholders in general meeting. The NamCode provides certain guidelines as to the remuneration of board members and senior executives.¹⁵ The NamCode also states that companies must disclose the remuneration of each individual director.¹⁶ Shareholders must approve the company's remuneration policy.¹⁷

ii Directors

Section 1 of the Companies Act defines a director as '[including] any person occupying the position of director or alternate director of a company, by whatever name that person may be designated'. The importance of this definition is that a person will, for purposes of the Companies Act, be a director if, objectively speaking, that person occupies the position of director, regardless of what title he or she has.

Two types of director may be distinguished: executive and non-executive directors. Executive directors are employees or members of the management team of a company who are appointed to positions on the board. They therefore come from within the company¹⁸ and are involved in the day-to-day running of the company. Non-executive directors have

9 See, for example, *Robinson v. Imroth and Others* 1917 WLD 159 at 172; *R v. Mall and Others* 1959 (4) SA 607 (N) at 623.

10 Principle C1-1 of the NamCode.

11 Principle C2-23 of the NamCode.

12 Principle C2-22 of the NamCode.

13 Principle C2-20 of the NamCode.

14 *Phillips v. Base Metals Exploration Syndicate, Ltd (in liquidation)* 1911 TPD 403 at 406.

15 Principle C2-25 of the NamCode.

16 Principle C2-26 of the NamCode.

17 Principle C2-27 of the NamCode.

18 R Naidoo, *Corporate Governance* (2nd edition, Durban: LexisNexis, 2009), p. 114.

no vested interest in the company as they are not involved in the day-to-day running of the company, nor are they employed by the company. They are independent and serve as impartial arbiters.¹⁹

The rights of directors are derived from various sources, including the Companies Act, common law, the company's memorandum and articles of association and agreements concluded between the company and the director (such as service or employment agreements). Sometimes, the rights of directors are also contained in agreements entered into between shareholders.

In terms of the Companies Act, every public company must have at least two directors and every private company must have at least one director.²⁰ Until directors are appointed, every subscriber to the memorandum of incorporation of a company is deemed to be a director of the company.²¹ The majority of the subscribers may, in writing and subject to the articles of association of the company, determine the number of directors and the appointment of the first directors.²² After every change in the board of directors, the company must lodge Form CM29 with the Registrar of Companies. Any person who is appointed as a director or officer of a company at any time after the company has become entitled to commence business must, within 28 days of the date of that appointment or within a further period that the Registrar may allow if a good reason is provided and on payment of the prescribed fee, lodge with the company his or her written consent to that appointment on the prescribed form (Form CM27).²³ This does not apply to the reappointment of a retiring director. The acts of a director of a company are valid notwithstanding any defect that may afterwards be discovered in his or her appointment or qualification.²⁴

The Companies Act disqualifies certain persons from being appointed or acting as a director of a company. No person falling within this category may assume the position as a director within the Republic of Namibia. Furthermore, the Companies Act also provides for the disqualification of directors by an order of the High Court.²⁵ Any person disqualified from being appointed or acting as a director of a company and who purports to act as a director or directly or indirectly takes part in or is concerned with the management of any company, is committing an offence and is liable to a fine of up to N\$8,000 or to be imprisoned for a period not exceeding two years, or both. The statutory disqualifications do not prohibit a company from providing in its articles of association for any further disqualifications for the appointment of, or the retention of office by, any person as a director of that company.²⁶ Furthermore, the High Court of Namibia may make an order directing that, for any period specified in the order, a person, director or officer must not under certain circumstances, without the leave of the Court, be a director of a company or in any way, whether directly or indirectly, be concerned or take part in the management of any company.²⁷

19 Id.

20 Section 216(1) of the Companies Act.

21 Section 216(2) of the Companies Act.

22 Section 217 of the Companies Act.

23 Section 219(3) of the Companies Act.

24 Section 222 of the Companies Act.

25 Section 225 of the Companies Act.

26 Section 225(3) of the Companies Act.

27 Section 226(1) of the Companies Act.

Every company must keep a register of directors, officers and corporate secretaries at its registered office.²⁸ The register must be kept in English and must contain the information prescribed by the Companies Act.²⁹ Except when closed under the Companies Act and subject to any reasonable restrictions that the company may impose in a general meeting, so that not less than two hours in each day is allowed for inspection during business hours, the register of directors of a company must be open to inspection by any person upon payment for each inspection of the prescribed amount or any lesser amount that the company may determine.³⁰ Any company that fails to keep a register is committing an offence and is liable to a fine of up to N\$2,000 and an additional fine that cannot exceed N\$40 for every day the offence continues.³¹

The shareholders of a company may, at a general meeting and notwithstanding anything in its memorandum or articles of association or in any agreement between it and any director, remove a director by ordinary resolution before the expiry of his or her period of office.³² Special notice must be lodged with the company of any proposed resolution to remove a director under this Section or to appoint any person in the place of a director so removed at the meeting at which he or she is removed, and, on receipt of notice of the proposed resolution, the company must, as soon as is reasonably possible, deliver a copy of the notice to the director concerned who is, whether or not he or she is a member of the company, entitled to be heard on the proposed resolution at the meeting.³³ 'Special notice' means that notice of the intention to move the resolution must be given at least 28 days before the meeting at which it is moved.³⁴ If special notice is given and the director concerned makes written representations (which should not exceed a reasonable length) to the company and requests their notification to members of the company, the company must, unless the representations are received by it too late for it to do so, in any notice of the resolution given to members of the company, state that representations have been made and send a copy of the representations to every member of the company to whom notice of the meeting is sent, whether that notice is sent before or after receipt of the representations by the company.³⁵ If a copy of the representations is not sent because it was received too late or because of the company's failure to do so, the director concerned may, without prejudice to his or her right to be heard orally, require that the representations be read at the meeting.³⁶ A copy of the representations must not be sent out and the representations need not be read out at any meeting if, on the application of the company or of any other person who claims to be aggrieved, the court is satisfied that the rights conferred by this Section are being abused to secure needless publicity for defamatory matter.³⁷ None of the above, however, is to be construed as depriving a person removed from office of compensation or damages that may be payable to him or her in respect of the termination of his or her appointment as director. For example, if the removal of the person as director amounted to a breach of contract, the

28 Section 223(1) of the Companies Act.

29 Id.

30 Section 120 read with Section 223(4) of the Companies Act.

31 Section 223(6) of the Companies Act.

32 Section 228(1) of the Companies Act.

33 Section 228(3) of the Companies Act.

34 Section 194(4) of the Companies Act.

35 Section 228(4) of the Companies Act.

36 Section 228(5) of the Companies Act.

37 Section 228(6) of the Companies Act.

person so removed may separately claim damages for the breach. The former director may also claim damages as a result of the termination of any other appointment he or she held that terminated with the appointment as director. Furthermore, none of these provisions should be read as derogating from any power to remove a director that may otherwise exist.³⁸

iii Rights of directors

The rights of directors are derived from various sources. These may include the Companies Act, common law, the company's articles of association and any agreement entered into with the director, such as employment or service agreements.

A director has the right to exercise the powers of his or her office. Each director therefore has the right to be given notice of and attend board meetings, the right to vote at such meetings and the right to take part in the management of the company. Included in the right to be given notice of the board meetings is the right to all information required for the director to make an informed decision,³⁹ as well as the right to be given time to consider the information.⁴⁰ Other directors may not exclude a director from exercising his or her functions (e.g., by holding meetings without notifying a director).⁴¹

Every director has, in terms of common law, a personal right to inspect the accounting records of the company. This enables the director to make informed decisions and to act in the benefit of the shareholders.⁴² The right of a director to inspect the accounting records is also contained in the Companies Act.⁴³ To exercise this right, the director has the right to procure the assistance of an accountant, provided that the company may, if good cause exists, object to the use of an accountant or demand an undertaking from the accountant that he or she will not disclose any information gained in the process.⁴⁴ A director is not required to give reasons for wanting to exercise his or her right to inspect the records of the company.⁴⁵

38 Section 228(8) of the Companies Act.

39 J L Van Dorsten, *The Law of Company Directors in South Africa* (2nd edition, Sandton: Obiter Publishers CC, 1999), pp. 88–91.

40 *Robinson v. Imroth and Others* 1917 WLD 159 at 171.

41 *Pulbrook v. Richmond Consolidated Mining Co* (1878) 9 ChD 610 at 612; *Robinson v. Imroth and Others* 1917 WLD 159 at 170.

42 *Id.*, pp. 91–94.

43 To this effect, Section 292(3) of the Companies Act states as follows: "The accounting records must be kept at the registered office of the company or at any other place which the directors consider proper and must, at all times, be open to inspection by the directors and if those records are kept at a place outside Namibia, there must be sent to and kept at a place in Namibia, and be at all times open to inspection by the directors, financial statements and returns with respect to the business dealt with in those records as will disclose with reasonable accuracy the financial position of that business at intervals not exceeding 12 months, subject to Section 293, and will enable the company's annual financial statements to be prepared in accordance with this Act."

44 *Wes-Transvaalse Boeresake (Edms) Bpk and Another v. Pieterse and Another* 1955 (2) SA 464 (T) at 467; J L Van Dorsten, *The Law of Company Directors in South Africa* (2nd edition, Sandton: Obiter Publishers CC, 1999), p. 92.

45 *Lochoff v. Jewish Daily Press Ltd* 1942 WLD 255 at 259; J L Van Dorsten, *The Law of Company Directors in South Africa* (2nd edition, Sandton: Obiter Publishers CC, 1999), p. 93.

Furthermore, although they have a right to inspect the accounting records, they are not obliged to do so. A managing director, however, is required to examine the correctness of the more important entries in the books of the company.⁴⁶

Directors are not legally entitled to directors' fees, unless the fees are authorised by the company's articles of association or by the shareholders in general meeting.⁴⁷ A director's remuneration may take one of two forms. First, it can be consideration for services rendered as a director, in which case it is referred to as director's fees. Second, it can take the form of consideration for services as an employee, in which case it is referred to as a director's salary.⁴⁸

iv Powers of directors

As with the rights of directors, the powers of directors may be found in various sources, including the common law, the Companies Act, the articles of association and any agreement entered into with the director. Certain powers are reserved for the members, who exercise these powers at general meetings of the company. Other powers may be exercised by the members or the board of directors, depending on the division of powers in the company's articles of association and the provisions of the Companies Act. Where powers are vested in the board of directors, the directors alone can exercise these powers.⁴⁹ A director may not place him or herself in such a position that his or her personal interests conflict or may possibly conflict with his or her duty to act in the best interests of the company.⁵⁰

Under common law, the directors are empowered to do whatever is reasonably incidental to the management of the company's business. This may include the power to enter into contracts, appoint employees, and even cease business operations. The articles of association of a company usually provide for the specific powers of the directors. The articles of association may also impose restrictions on the powers of directors. The powers of the board of directors are exercised by means of resolutions passed at meetings of directors.⁵¹

In terms of Section 39 of the Companies Act, where the objects of a company are stated in its memorandum, there must be included in those objects unlimited objects ancillary to those stated objects. For example, the memorandum for a company whose object is investing in property must state: 'Investing in property and all objects ancillary thereto.' A company has, unless limited by the Companies Act, plenary powers to enable it to realise its objects and ancillary objects, except those specific powers that are expressly excluded or qualified in its memorandum.⁵² These plenary powers are set out in Schedule 2 to the Companies Act.

The Companies Act places various restrictions on the powers of directors. These restrictions apply notwithstanding anything to the contrary contained in the memorandum and articles of association of the company. For example, the directors of a company have no power to allot or issue shares of the company without the prior approval of the company in

46 J L Van Dorsten, *The Law of Company Directors in South Africa* (2nd edition, Sandton: Obiter Publishers CC, 1999), p. 94.

47 *Brown v. Nanco (Pty) Ltd* 1976 (3) SA 832 (W) at 834.

48 J L Van Dorsten, *The Law of Company Directors in South Africa* (2nd edition, Sandton: Obiter Publishers CC, 1999), p. 95.

49 [1935] 2 KB 113 (CA) at 134.

50 J L Van Dorsten, *The Law of Company Directors in South Africa* (2nd edition, Sandton: Obiter Publishers CC, 1999), p. 238.

51 J L Van Dorsten, *The Law of Company Directors in South Africa* (2nd edition, Sandton: Obiter Publishers CC, 1999), p. 141.

52 Section 39(2) of the Companies Act.

a general meeting.⁵³ Any director of a company who knowingly takes part in the allotment or issue of any shares in contravention of this Section is liable to compensate the company for any loss, damages or costs that the company may have sustained or incurred thereby, but proceedings to recover any such loss or those damages or costs must be commenced no later than two years from the date of the allotment or issue.⁵⁴

Another example of where a director's powers are limited relates to share option plans in which the director is interested. An option or a right given directly or indirectly to any director or future director⁵⁵ of a company in terms of any scheme or plan, to subscribe for any shares of that company or to take up any debentures convertible into shares of that company on any basis, is not valid unless authorised in terms of a special resolution of that company.⁵⁶ This, however, does not apply where those shares or debentures are allotted or issued in proportion to existing holdings, on the same terms and conditions as have been offered to all the members or debenture holders of the company or to all the holders of the shares or debentures of the class or classes being allotted or issued.⁵⁷ An option or a right is not invalid in terms of this Section if that director or future director of the company holds salaried employment or office in the company and is given that option or right in his or her capacity as an employee.⁵⁸

A director of a company who purchases a right to make delivery or call for delivery at a specified price, within a specified time, of a specified number of shares or a specified amount of debentures listed by a stock exchange, is committing an offence and is liable to a fine of up to N\$4,000 or imprisonment for up to one year, or both.⁵⁹ This restriction should not be taken as penalising a person who buys a right to subscribe for shares or debentures of a body corporate or buys debentures of a body corporate that confer on the holder of the right a right to subscribe for shares of that body corporate, or to convert the debentures in whole or in part into shares of that body corporate.⁶⁰

The directors of a company have no power, save with the approval of a general meeting of the company, to dispose of the whole or substantially the whole of the undertaking of the company or the whole or the greater part of the assets of the company.⁶¹ A resolution of the company approving such a disposal has no effect unless it authorises or ratifies the terms of the specific transaction.⁶²

v Personal liability of directors

Section 56 sets out instances where, in respect of company names, a director acting on behalf of the company commits an offence. Where the offence concerns a bill of exchange, promissory note, cheque or order for money or goods and the offence leads to the default of

53 Section 229(1) of the Companies Act.

54 Section 229(4) of the Companies Act.

55 'Future director' does not include a person who becomes a director of the company after the lapse of six months from the date on which the option or right is acquired by that person. See Section 231(2) of the Companies Act.

56 Section 231(1) of the Companies Act.

57 Section 231(1) and 230(1)(c) of the Companies Act.

58 Section 231(3) of the Companies Act.

59 Section 232(1) of the Companies Act.

60 Section 232(2) of the Companies Act.

61 Section 236(1) of the Companies Act.

62 Section 236(2) of the Companies Act.

payment in that document, the person who committed the offence is liable for the amount stated on the document.⁶³ The first of these offences involving a company's name is where the director uses or authorises the use of any seal purporting to be the seal of a company where the name of the company is not engraved on that seal in legible characters.⁶⁴ The second offence is where a director issues or authorises the issue of any notice or other official publication of the company, or signs or authorises the signing on behalf of the company of any bill of exchange, promissory note, endorsement, cheque or order for money or goods where the name of the company and registration number is not in legible character on the document.⁶⁵ The third offence is where a director issues or authorises the issue of any letter, delivery note, invoice, receipt or letter of credit of the company where the name and registration number of the company is not on these documents in legible characters.⁶⁶

In terms of Section 430, if it appears (whether in a winding-up procedure, judicial management procedure or otherwise) that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the court may, on the application of the master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in that manner is personally responsible, without any limitation of liability, for any or all of the debts or other liabilities of the company as the court may direct.⁶⁷ Without prejudice to any other criminal liability incurred, where any business of a company is carried on recklessly or with the aforementioned intent, every person who was knowingly a party to the carrying on of the business in that manner is committing an offence and is liable to a fine of up to N\$8,000 or imprisonment for up to two years, or both.⁶⁸

III DISCLOSURE

The Companies Act contains numerous provisions in terms of which directors and auditors are required to make certain disclosures regarding the company, its transactions, its directors and its financial matters. The first disclosure requirements set out by the Act relate to the interests of directors of a company in contracts to which the company is a party.⁶⁹ In terms of the Companies Act, any director 'who is in any way, whether directly or indirectly, materially interested in a contract or proposed contract', and where this contract or proposed contract is significant to the business of the company and is entered into or to be entered into following a resolution of directors taken at a meeting of the directors, or by one or more directors or officers of that company, in accordance with authorisation by the remaining directors of the company, is required to disclose his or her interests therein to the company.⁷⁰ The director should disclose the full particulars of his or her interest, regardless of whether that director's interest exists at the time at which the contract was entered into or arises at any

63 Section 56(5) of the Companies Act.

64 Section 56(3)(a) of the Companies Act.

65 Section 56(3)(b) of the Companies Act.

66 Section 56(3)(c) of the Companies Act.

67 Section 430(1) of the Companies Act.

68 Section 430(3) of the Companies Act.

69 Chapter 8, Part 6 of the Companies Act.

70 Sections 242(1) and 242(2) of the Companies Act.

time thereafter.⁷¹ The disclosure should be made at the meeting of the directors 'at which the question of confirming or entering into the contract is first taken into consideration' or, if this is not possible, at the next directors meeting, on which date reasons for late disclosure should be provided and, if brought by way of a written notice, should be read out at the meeting or signed by all other directors present to confirm that each of them has read the written notice.⁷² General notice of a director's interest in another company or business is acceptable for disclosure purposes if compliant with the relevant notice requirements and brought within the prescribed time.⁷³

The failure to disclose as required has consequences for both the director, who will have committed an offence and is liable to a fine not exceeding N\$4,000 or imprisonment for up to one year, or both, and for the company, because of the invalidity of all resolutions taken by the company regarding contracts or proposed contracts where the provisions relating to disclosure have not been complied with.⁷⁴ The disclosed interests should be reflected in the minutes of the directors' meetings and a register should be kept stipulating all interests of directors and officers as disclosed. The auditor of the company is responsible for ensuring that these minutes and registers are accurately kept.⁷⁵

Auditors are appointed by the members of a company at the annual general meeting, following the initial appointment of auditors by the members or directors of the company upon incorporation, or as otherwise provided for in the Companies Act.⁷⁶ The Companies Act stipulates that the duty of an auditor of a company is to 'report to its members in any manner and on any matters which are prescribed by th[e] Act and carry out all other duties imposed on him or her by th[e] Act or any other law'.⁷⁷ The auditor of a company has a right to access all books, documents and accounting records of a company and may require directors or officers of the company, or both, to provide any information and explanation that the auditor deems necessary for the completion of his or her duties, including all financial information, past and present, of a subsidiary where that company is a holding company.⁷⁸ The appointed auditors are also permitted to attend general meetings of the company, and should receive all notices and information relating thereto that would usually be provided to members of the company.⁷⁹ The powers and duties of auditors are dealt with in more detail in the Public Accountants' and Auditors' Act No. 51 of 1951. The auditor is not an officer of the company, and indeed officers of the company do not qualify for appointment as auditors.⁸⁰ An auditor is to maintain independence during the performance of his or her duties, which should be performed without taking instructions from directors, shareholders or creditors.⁸¹

71 Section 242(1) of the Companies Act.

72 Section 243(1) of the Companies Act.

73 Section 242(3) of the Companies Act.

74 Sections 242(5) and 244 of the Companies Act.

75 Sections 247 to 249 of the Companies Act.

76 Section 277 of the Companies Act.

77 Section 290 of the Companies Act.

78 Section 289(a) and (b) of the Companies Act.

79 Section 289(c) of the Companies Act.

80 Section 283 of the Companies Act, and definition of 'officer' at Section 1; see also *Baker and Others v. McHardy and Others* 1957 (4) SA 541 (N) at 545.

81 M S Blackman, 'Companies', in W A Joubert, ed., *The Law of South Africa* (first reissue, volume 4, part 3, Durban: Butterworths, 1996), paragraph 1; see also *Lipschitz and Another, NNO v. Wolpert and Abrahams* 1977 (2) SA 732 (A) at 741.

The Companies Act provides extensively for financial reporting and accountability, and each company must keep accounting records to fairly present the financial position of the company, its transactions and all other relevant details.⁸² The directors are responsible for ensuring that annual financial statements, compliant with generally accepted accounting practice and including reports by the directors and auditors, are made out every year and presented at the annual general meeting.⁸³ Specific information must be disclosed in the financial statements, as stipulated by the Companies Act, including loans and securities benefitting directors and managers, and emoluments and pensions of directors.⁸⁴ The annual financial statements, with the exception of the auditors' report, must be approved and signed by the directors and thereafter sent to members and to the Registrar.⁸⁵ Members and debenture holders, as well as other individuals as provided for in the Companies Act, must be provided with copies of the annual financial statements without charge and upon demand. Failure to provide them within seven days of a request constitutes an offence, the consequence of which is a fine for each day of non-compliance.⁸⁶ Details regarding what the annual financial statements should contain and disclose are fully set out in Schedule 4 of the Companies Act.

The NamCode, as discussed above, provides the standards regarding corporate governance and, while companies are not statutorily obligated to comply therewith, the intention is for companies to 'apply or explain', with non-compliance with the recommended practices to be explained fully by directors to shareholders and other stakeholders.⁸⁷

IV CORPORATE RESPONSIBILITY

Namibian law does not have an overall law or policy dealing with corporate responsibility. Until recently, companies have generally relied on the King III or industry self-regulation to promote corporate responsibility. The NamCode, however, contains various provisions relating to corporate responsibility. For example, it states that the board is primarily responsible for the governance of risk.⁸⁸ The board must ensure that there is an effective risk-based internal audit.⁸⁹ The board must further be assisted by a risk committee in carrying out its risk responsibilities⁹⁰ and must delegate to management the responsibility to design, implement and monitor the risk management plan.⁹¹ The board must ensure that risk assessments are performed on a continual basis⁹² and that frameworks and methodologies are implemented to increase the probability of anticipating predictable risks.⁹³ The board must ensure that management considers and implements appropriate risk responses⁹⁴ and

82 Section 292 of the Companies Act.

83 Sections 294, 307 and 309 of the Companies Act.

84 Sections 302 to 304 of the Companies Act.

85 Sections 305 and 306 of the Companies Act.

86 Section 316 of the Companies Act.

87 www2.deloitte.com/content/dam/Deloitte/na/Documents/risk/za_Deloitte_NamCode_Brochure.pdf accessed on 1 and 2 February 2015 at p. 3.

88 Principle C2-7 and Principle C4-1 of the NamCode.

89 Principle C2-10 of the NamCode.

90 Principle C4-3 of the NamCode.

91 Principle C4-4 of the NamCode.

92 Principle C4-5 of the NamCode.

93 Principle C4-6 of the NamCode.

94 Principle C4-7 of the NamCode.

must also ensure continual risk monitoring by management.⁹⁵ The board must receive assurance regarding the effectiveness of the risk management process⁹⁶ and must ensure that there are processes in place enabling complete, timely, relevant, accurate and accessible risk disclosure to stakeholders.⁹⁷ Compliance risk must form an integral part of the company's risk management process⁹⁸ and the board must delegate to the management the implementation of an effective compliance framework and processes.⁹⁹

The board of each company must, in terms of the NamCode, ensure that the company complies with applicable laws and must consider adherence to non-binding rules, codes and standards.¹⁰⁰ This will ensure further social responsibility and also ensures protection of employees and other interested parties. Other legislation such as the Labour Act No. 11 of 2007, and policies such as the Minerals Policy and Energy White Paper, contain provisions relating to corporate responsibility and, by ensuring that a board is obliged, or at least motivated, to have knowledge of these measures, will promote corporate responsibility.

The NamCode states that a board must appreciate that stakeholders' perceptions affect a company's reputation.¹⁰¹ Transparent and effective communication with stakeholders is essential for building and maintaining their trust and confidence.¹⁰² The board must therefore instruct management to deal proactively with stakeholder relationships¹⁰³ and strive to achieve the appropriate balance between its various stakeholder groupings in the best interests of the company.¹⁰⁴

V SHAREHOLDERS

i Shareholder rights and powers

According to the Companies Act, every subscriber to the memorandum of association of a company is deemed to be a member on incorporation.¹⁰⁵ Members are thus shareholders whose names are included in the register of members. In terms of the Companies Act, there is little distinction between members and shareholders, and the two terms are largely interchangeable.

The Companies Act stipulates that, subject to its provisions, each member holding a share has a voting right in respect of each share held.¹⁰⁶ Similarly, members of companies that are limited by guarantee, and thus have no share capital, each have one vote.¹⁰⁷ The

95 Principle C4-8 of the NamCode.
96 Principle C4-9 of the NamCode.
97 Principle C4-10 of the NamCode.
98 Principle C6-3 of the NamCode.
99 Principle C6-4 of the NamCode.
100 Principle C6-1 of the NamCode.
101 Principle C8-1 of the NamCode.
102 Principle C8-5 of the NamCode.
103 Principle C8-2 of the NamCode.
104 Principle C8-3 of the NamCode.
105 Section 110 of the Companies Act.
106 Section 201 of the Companies Act.
107 Id.

articles of association of private companies must stipulate the voting rights that attach to shares and various classes thereof,¹⁰⁸ and often preference shares are issued without voting rights or with voting rights applicable only in limited circumstances.¹⁰⁹

The influence that shareholders can exercise over the board is limited to the appointment of directors¹¹⁰ for a specific term and the right to remove directors. The removal of a director, in terms of the Companies Act, is done by way of ordinary resolution, for which special notice must be given to the company, and the director sought to be removed should be notified thereof and allowed to make representations, as discussed above.¹¹¹

Certain decisions regarding the company can only be taken with shareholder input, such as the issue and allotment of shares, which require approval by the shareholders at a general meeting.¹¹² The approval can be general approval given to directors, or specific approval, and this requirement cannot be amended or removed by way of the articles of association.¹¹³ Further restrictions exist regarding the issue and allotment of shares, or debentures convertible to shares, to directors, their nominees, bodies corporate they are involved in as stipulated or any subsidiaries thereof, in which instances specific approval must be granted at a general meeting, and other requirements must similarly be met.¹¹⁴ The rights of dissenting or minority shareholders are addressed below, where the recourse available to them is discussed.

The varying of rights attached to various classes of shares cannot be done without the consent of three-quarters of the holders of that class of shares, or by the passing of a resolution at a meeting of those shareholders, which is to be regarded as a special resolution and all necessary provisions are to be complied with accordingly. According to the standard articles of association, a special resolution, and thus shareholder approval, is also required for: the conversion of any or all paid-up shares to stock; changing the share capital by way of consolidation or division or by the increase in issued shares without an increase of share capital; the subdivision of existing shares; the conversion of ordinary or preference par value shares into no par value shares, and vice versa; the cancellation of shares not taken up on the date of the resolution; the reduction of share capital and stated capital; the capital redemption fund of share premium accounts, subject to the necessary consent and authorisation required by law; and the conversion of preference shares into redeemable shares.

Other decisions that require a special resolution by the shareholders include changing the name of the company,¹¹⁵ amending the memorandum and articles of association,¹¹⁶ converting a public company to a private company,¹¹⁷ altering the company's share capital,¹¹⁸ acquisition by a company of its own shares,¹¹⁹ converting shares into stock,¹²⁰ resolving

108 Section 203 of the Companies Act.

109 Section 202 of the Companies Act.

110 Section 218 of the Companies Act.

111 Section 228 of the Companies Act.

112 Section 229 of the Companies Act.

113 *Id.*

114 Section 230 of the Companies Act.

115 Section 50 of the Companies Act.

116 Section 62 and Section 67 of the Companies Act.

117 Section 24 of the Companies Act.

118 Section 81 of the Companies Act.

119 Section 89 of the Companies Act.

120 Section 106 of the Companies Act.

that a company's affairs be investigated by an inspector appointed by the Minister of Trade, Industrialisation and SME Development,¹²¹ and resolving that the company be wound up by the court.¹²² An ordinary resolution is required to authorise the disposal of the whole or substantially the whole of the undertaking of the company or the whole or greater part of the assets of the company.¹²³

ii Shareholders' duties and responsibilities

In terms of the Companies Act, shareholders have no specific duties, either between themselves or regarding the relationship between themselves and the company. Shareholders' agreements – optional agreements concluded between shareholders and the company in which they hold shares, and which govern the relationship between the company and its shareholders and shareholders' relationships with one another – could create duties, which would thus be binding in terms of the agreement. As companies are separate legal entities, shareholders cannot be held liable for any acts or omissions of the company. No code exists in Namibia governing best practices for shareholders.

iii Shareholder activism

As stated above, the standard articles of association stipulate that the remuneration of directors is to be determined from time to time, in a general meeting. The consequence of this is that the shareholders must take a vote regarding the remuneration of directors, and a simple majority is required to approve the suggested remuneration. Further provision is made in the articles of association for circumstances where directors are required to perform beyond what is ordinarily required of them in their service for the benefit of the company; for example, by travelling abroad. In such circumstances, the company may remunerate the directors for their extra services by way of a fixed amount or a percentage of the profits, and this remuneration can be in addition to or in place of existing remuneration. The same simple majority at a general meeting would be required for the approval of any additional remuneration.

Provision is made in the Companies Act for shareholders to have recourse in the event of their dissatisfaction with the way in which the business of the company is being conducted, and several remedies are available to shareholders. Where members believe that the conduct of the company, either in a specific situation, or generally, is 'unreasonably prejudicial, unjust or inequitable', the members may approach a court for relief, and in some instances relief must be sought within a stipulated time period.¹²⁴ The Companies Act provides for various orders that the High Court may make in such instances, including amendment of the memorandum and articles of association, as well as consequences for companies who fail to comply with these orders. Extensive provision is made in the Companies Act for the appointment of inspectors by the Minister of Trade and Industry (the Minister), upon application by a stipulated minimum number of members, as well as the inspections conducted by these inspectors.¹²⁵ The Minister is also entitled to initiate such investigations when they are found to be reasonably necessary,¹²⁶ and any company to be investigated in this

121 Section 266 of the Companies Act.

122 Section 349 of the Companies Act.

123 Section 236 of the Companies Act.

124 Section 260 of the Companies Act.

125 Sections 262 to 270 of the Companies Act.

126 Section 262 of the Companies Act.

manner should receive prior written notice from the Minister, informing it of the complaint and the pending investigation, and allowing a reasonable opportunity for response thereto, unless the Minister is of the opinion that the notice would defeat the object of the intended investigation.¹²⁷ These investigations can be initiated by other means, including the passing of a special resolution or an order of court.¹²⁸ Upon finalisation of the inspection, a written report is to be compiled and presented to the Minister, following which the Minister has various options, including approaching a court to start winding-up proceedings, or directing the Registrar to take one or more steps.¹²⁹

Derivative action is provided for in the Companies Act, in circumstances where 'a company has suffered damages or loss or has been deprived of any benefit as a result of any wrong, breach of trust or breach of faith committed by any director or officer of that company or by any past director or officer while a director or officer of that company'.¹³⁰ Where, in such circumstances, the company has not instituted proceedings against that director or officer, past or present, to recover the resultant damages or loss of benefit, any member may initiate such proceedings on the company's behalf as are provided for in the Companies Act.¹³¹ This can be done regardless of any ratification or condonation by the company in respect of the director or officer's actions, but only after notice has been served on the company calling for the initiation of proceedings within one month of the date of service of the notice, failing which legal proceedings will be instituted.¹³² The member may then apply to the High Court for the appointment of a curator, to act on the company's behalf for the purposes of initiating and bringing to finalisation the necessary proceedings.¹³³ If the High Court grants the application, in light of the specific provisions of the Companies Act, the High Court may make a provisional order allowing for investigation by the appointed curator into the affairs of the business, and upon submission of the curator's report, the appointment and court order can be confirmed.¹³⁴

Members are entitled to nominate proxies to serve on their behalf at meetings, and the notices for meetings of companies with a share capital should include a proxy form (an example of which is contained in the standard articles of association), indicating that a proxy may appear for a member, and may also speak and vote as instructed by the member.¹³⁵ Namibian legislation is silent on proxy battles and shareholder campaigns, but both occur regularly within the course of business of Namibian companies.

iv Takeover defences

Takeover offers are dealt with in terms of the Companies Act. Depending on the value of the takeover and whether it amounts in fact to the acquisition of one entity over the whole or part of the business of another entity, the Namibian Competition Commission would also need to approve the takeover.

127 Section 265(3) of the Companies Act.

128 Section 266(1) of the Companies Act.

129 Sections 269 and 270 of the Companies Act.

130 Section 274 of the Companies Act.

131 *Id.*

132 *Id.*

133 *Id.*

134 *Id.*

135 Section 197 of the Companies Act.

Takeovers in Namibia may occur in a number of ways. Where companies have few shareholders, it is possible to approach each shareholder individually and buy out that shareholder. Where a company has one major shareholder, the easiest way to achieve a takeover would be to approach the major shareholder with the intention of buying this shareholder out. This is the most common method of achieving a takeover.¹³⁶ It is also possible to issue a 'takeover offer' to shareholders in terms of the Companies Act.¹³⁷ The Companies Act sets out the procedure that must then be followed,¹³⁸ the content of the takeover statements¹³⁹ and liability and offences in respect of takeover offers.¹⁴⁰ The Companies Act also sets out the circumstances under which the shares of the minority under a takeover scheme may be acquired.¹⁴¹

There are a certain number of ways in terms whereof a company may reduce the risk of takeovers. Since any potential offeror would need to know who the shareholders are and where to approach them, limiting access to the share register is advisable. However, in Namibia a company's share register is available to the public and failure to provide access is a criminal offence.¹⁴² Another possible deterrent would be to include 'change in control' provisions in loan agreements in terms whereof the loan repayment is accelerated in events of change in control; any entity taking over the company would then be stuck with this accelerated debt.

It is also possible for a company to avoid a takeover by introducing a shareholder rights plan in terms whereof existing shareholders may purchase additional shares at a discount, if a certain trigger event occurs (e.g., one shareholder obtains more than 10 per cent of the shares). The plan would have to comply with the Companies Act, which places various restrictions on the issue of shares at a discount.¹⁴³ First, the issue must be authorised by a special resolution of the company, which must state the maximum rate of discount at which the shares are to be issued. Secondly, the company must have been in business for more than one year. Thirdly, the issue must be sanctioned by the High Court. Finally, the shares must be issued within one month after sanction by the Court.

A 'white-knight' defence is not common parlance in Namibia, but what it entails (a friendly takeover, usually in cooperation with the target) is generally allowed in Namibia, provided that the provisions of the Companies Act are complied with. If the transaction amounts to a merger and does not fall within the merger thresholds, Competition Commission approval would also need to be obtained.

As with the white-knight defence, the term 'staggered board' (where groups of directors are appointed at different times for multi-year periods) is not a common phrase in Namibia, but boards are often constituted this way. In fact, the NamCode encourages a staggered board and proposes that one-third of the board retires each year.¹⁴⁴ The NamCode also discourages terms of longer than nine years.¹⁴⁵

136 M F Cassim, 'Takeovers and Offers', in H G J Beukes et al., eds, *South African Corporate Business Administration* (revision service 23, Claremont: Juta & Co Ltd, 2015), p. 13-1.

137 Section 320(2)(a) of the Companies Act.

138 Section 320 to Section 324 of the Companies Act.

139 Section 321 of the Companies Act.

140 Section 326 of the Companies Act.

141 Section 327 of the Companies Act.

142 Section 120 of the Companies Act.

143 Section 87 of the Companies Act.

144 Principle C2-18 of the NamCode.

145 Principle C2-18 of the NamCode.

v Contact with shareholders

In terms of the Companies Act, a report may be published following a meeting of the company that sets out the details of that meeting, on the condition that it accurately sets out a summary of all questions and comments regarding any topics that arose at the meeting.¹⁴⁶ Anything addressed at the meeting that could be found to be defamatory to any person, or otherwise detrimental to the company, need not be included, and the report may be circulated and advertised at the expense of the company.¹⁴⁷ As stated above, reporting by the auditor on the prescribed matters is a requirement of the Companies Act.¹⁴⁸ The directors must also compile a report, to be published in the annual financial statements.¹⁴⁹ The report should be in respect of the state of affairs, including business and profit and loss of the company, along with other topics stipulated in the Companies Act, specifically Schedule 4 thereof, and should be presented to the members at the annual general meeting.¹⁵⁰ Failure to comply herewith constitutes an offence, with possible fines or a period of imprisonment, or both.¹⁵¹

Additional reporting is required for public companies, for which interim reports and provisional annual financial statements must be prepared, as set out in the Companies Act.¹⁵² Members have a right to a copy of the most recent audited financial statements, and any interim reports and provisional annual financial statements where applicable.¹⁵³ These copies should be provided on demand and without charge, and may also be requested by debenture holders and judgment creditors, as provided for in the Companies Act.¹⁵⁴

Meetings between individual shareholders and directors are not addressed in the Companies Act, and thus not prohibited, and are not uncommon within Namibia. Directors are often appointed by a specific group of shareholders, with the view to having those shareholders represented at board level. It would thus be expected for that director to meet with the shareholders he or she represents, to report on affairs of the company and to receive guidance with regards to how to vote or get ideas from the shareholder to be presented to the board. However, insider trading is prohibited, and as such any communication that would amount to insider trading, or is made with a view to bring unlawful benefit to any party, is prohibited.

Secrecy agreements and similar agreements regulating the conduct of shareholders between themselves are not specifically addressed in the Companies Act. Where companies or shareholders, or both, find it necessary to regulate their relationship specifically in this regard, the issue of secrecy and similar issues are typically addressed in shareholders' agreements. A shareholders' agreement binds all existing shareholders and governs the relationships of shareholders between themselves. Such agreements can be prepared to be binding on future shareholders, to ensure that newcomers are similarly required to conduct themselves as stipulated. Alternatively, companies may choose to include specific provisions relating to

146 Section 215 of the Companies Act.

147 *Id.*

148 Sections 290 and 309 of the Companies Act.

149 Section 294 of the Companies Act.

150 Section 307 of the Companies Act.

151 Section 307(3) of the Companies Act.

152 Sections 310 and 311 of the Companies Act.

153 Section 316 of the Companies Act.

154 *Id.*

secrecy or other topics in the articles of association of a company. This would automatically be binding on shareholders, both current and future, as well as on the company in respect of its dealings with its shareholders.

Notice periods regarding any general meeting to be held can be stipulated in the articles of association of a company, but if not provided for, 14 days' written notice should be given in the case of general meetings, with 21 days' written notice to be given where the meeting is being held to pass a special resolution.¹⁵⁵ Provision is made for the waiving of these periods, either by members holding a minimum of 95 per cent of the shares approving the shorter notice period prior to the meeting being held, or by written notice of all members to be given before or at the meeting.¹⁵⁶ Notice should be given in the manner prescribed in the articles of association,¹⁵⁷ but should set out details of what is to be discussed at the meeting and what votes are to be taken, if any. As stated above, proxy forms are included to allow for the appointment of proxies for purposes of attending the meeting, and these forms stipulate how that member wishes to vote on each issue to be addressed. Proxy solicitation is not addressed in the Companies Act and occurs within the ordinary course of business between shareholders in Namibia. The primary concern of large blocks of shareholders typically has to do with the voting rights of whatever class of shares they hold, as discussed above.

VI OUTLOOK

The legislative framework dealing with companies has limited provisions promoting good governance. Until recently, the principles of corporate governance applied in Namibia were borrowed from South Africa and international practices. With the introduction of the NamCode and the concomitant support and motivation by the NSX for listed companies to comply with the NamCode, Namibia is fast on its way to establishing a proper, settled framework for the corporate governance of Namibian companies and companies listed on the NSX. What is absent, however, is continuous training and information-sharing sessions to ensure that directors, shareholders, stakeholders and other persons are informed and updated on the development of corporate governance in Namibia.

155 Section 194 of the Companies Act.

156 *Id.*

157 Section 195 of the Companies Act.

NETHERLANDS

*Geert Raaijmakers and Suzanne Rutten*¹

I OVERVIEW OF GOVERNANCE REGIME

i Legal framework: laws and self-regulation

In the Netherlands, the general rules of civil law relating to the governance of companies and listed companies are laid down in Book 2 of the Dutch Civil Code (DCC). This sets out the duties and powers of the various corporate bodies, as well as rules on representation, conflicts of interest and the liability of management board members. The DCC also contains rules regarding financial reporting and disclosure. Compliance with the rules in the DCC can, if necessary, be forced through the courts. In this context, it should be mentioned that a right of inquiry was introduced in Book 2 of the DCC in 1994: shareholders with a specific capital interest (in some cases even former shareholders)² may request a court specially designated for this purpose – the Enterprise Chamber of the Amsterdam Court of Appeal – to initiate an inquiry into the company's policy and affairs. Upon a showing of mismanagement, the Enterprise Chamber can intervene by, *inter alia*, suspending or nullifying a management board decision, suspending or removing management or supervisory board members and appointing temporary board members. In practice, inquiry proceedings have played an important role in the development of law in the area of corporate governance; for example, with regard to the issue of the respective roles of the management board and the shareholders in determining the strategy of the relevant company.

In addition, the Netherlands has rules on the supervision of the business conduct of listed companies, laid down in Chapter 5 of the Financial Supervision Act (FSA). The FSA contains rules on, *inter alia*, the disclosure of major holdings, financial reporting, the prevention of market abuse and the obligations of institutional investors. Supervision of compliance with these rules is carried out by a specially designated body, the Authority for the Financial Markets (AFM).

Alongside these statutory rules, there is a system of self-regulation consisting of codes of conduct containing principles and best-practice provisions drawn up by the sector itself. The first Dutch Corporate Governance Code containing governance rules for listed companies entered into effect in 2004. In December 2016, a revised version (the Corporate Governance Code) was published, with more attention being paid to long-term value creation, culture, reporting of misconduct, risk management and how to apply the Corporate Governance Code in a company with a one-tier board.

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2 *SNS Reaal*, 4 November 2016.

Since the introduction of the first Corporate Governance Code, several sectors have set up their own specific codes, such as the Code of the Dutch Pension Funds and the Housing Corporations Code. In 2010, the Banking Code was introduced to govern Dutch banks. This mirrors the Corporate Governance Code in many respects, but also contains rules specifically targeted at banks (specific expertise of certain committee or board members, the treatment and interests of clients). The Banking Code applies to both listed and unlisted banks. In January 2015, the Banking Code was updated. Listed banks fall under the Corporate Governance Code, as well as the Banking Code.

Both codes adopt a ‘comply or explain’ system: on their websites companies must state how they applied the principles and best-practice provisions and, if applicable, provide a reasoned explanation of why a provision has not been applied. For both codes, there is a separate monitoring committee that annually reports on the extent to which each code has been complied with, and on any problem areas that have emerged in this regard.

ii General: corporate governance developments

On 8 December 2016 the Dutch Corporate Governance Code Monitoring Committee published the revised Corporate Governance Code. The new Code is effective from 1 January 2017, so management reports for the year 2017 have to comply with its provisions. The new Code contains two new themes: long-term value creation and culture. These subjects had already been getting considerable attention in the Netherlands (but also at a European level) over the past couple of years and are now considered as core values for listed companies to focus on and develop further. The underlying notion of the first theme, long-term value creation, is that the existence of a sustainable relationship between a company’s management board and such shareholders as have a long-term vision will serve to benefit the company. To this end, efforts are being made by the legislator to facilitate the exercise of shareholder rights and to make the process more transparent, so that the behaviour of shareholders such as institutional investors is easier to understand and predict. In 2013, this resulted in the passing of the Corporate Governance Act,³ which, *inter alia*, includes a regime aimed at identifying the shareholder (the ultimate investor) of a listed company. Similarly, the European Commission, in its Corporate Governance Action Plan of December 2012, has announced various measures to encourage long-term shareholder engagement. In the course of 2013/2014, a number of initiatives were taken to implement the Action Plan, of which the revision of the Shareholders Directive is the most prominent (see also Section V.i, *infra*). Additionally, the European Commission held a public consultation in March 2016 on long-term and sustainable investment. It sought to gather information on how institutional investors, asset managers and other service providers in the investment chain factor in sustainability information and performance of companies or assets into investment decisions. The consultation is also aimed at gathering information about possible obstacles to long-term, sustainable investment. To date the contributions have not yet been published.

The various accounting scandals at the beginning of this century, the public outrage regarding managers bonuses that were paid during the bank crisis and the recent Panama Papers scandal help to explain why culture (and ethics) is still high on the corporate governance agenda. This second, newly introduced theme in the Code, culture, is strongly intertwined

³ Act of 15 November 2012 in response to the Corporate Governance Code Monitoring Committee’s Recommendation of 30 May 2007 (Bulletin of Acts and Decrees 2012, 588). See also Section V.iv, *infra*.

with the focus on long-term value creation of the company. According to the new Code, companies must adopt values, propagate these values through leading by example, and report on this as well as on their compliance with their internal code of conduct.

In connection with the foregoing, new legislation was adopted in 2014 at EU level, and implemented in the Netherlands in January 2017, to oblige certain large companies to include a non-financial information statement in their management report, as well as a description of their diversity policy in their corporate governance statement (which is already mandatory for such companies).⁴ Through the management reports, this information will be made public, which is necessary to oversee and monitor the company's commitment.

The new Code has also incorporated the call for more transparency, based on the belief that fostering a culture of ethics and integrity can only be achieved if internal actions are made transparent. Therefore the new Code states that deviations from the Code must be explained more fully; a description must be given of any alternative measures taken and, in the event of deviations of more than a year, companies must indicate when application will start or resume. With more transparent supervision, the Corporate Governance Code Committee believes that entities will most likely show greater effort to comply with rules and regulations. Furthermore the Committee aims for a better flow of information to the public because it believes this will enhance the public's trust in financial institutions.

In line with the Fourth and Fifth Anti-Money Laundering Directives, which require Member States to implement and maintain a register of ultimate beneficial owners of all Dutch entities except listed companies as of June 2017, the Dutch government has announced it will introduce legislation in 2017 regarding a modification of bearer shares to make it possible to trace the identity of the shareholder. The proposal alters the shares to book-entry form only and imposes deposit and registration requirements. Additionally a proposal for a central register of shareholders was submitted to parliament in January 2017. This bill proposes the imposition of a register with information regarding shares and shareholders of limited liability companies as well as non-listed public limited liability companies. This will be accessible by public services, notaries and other entities that perform client screenings under the Dutch Money Laundering and Terrorist Financing (Prevention) Act. Lastly, the Dutch government endorsed in 2016 the proposed European directive on disclosure of income tax information by certain undertakings and branches through country-by-country reporting.

In short, the subject of corporate governance remains high on the agenda in the Netherlands. Overall, an actual change in culture and behaviour is expected of companies generally and of the banking sector in particular, with legislative action being taken where self-regulation fails to deliver the desired result.

II CORPORATE LEADERSHIP

i Board structure and practices

Dutch corporate law has traditionally provided for a two-tier board structure, consisting of a management board and a separate supervisory board (each of which is governed by different

⁴ Directive 2014/95/EU.

statutory provisions); however, the institution of a supervisory board is only mandatory for companies subject to the ‘structure regime’.⁵ A company is subject to this regime if, for a period of three consecutive years:

- a its issued capital and reserves amount to not less than €16 million;
- b it has a works council instituted pursuant to a statutory requirement; and
- c it regularly employs at least 100 employees in the Netherlands.

Since 2013, Dutch corporate law has also provided a statutory basis for the one-tier board structure. However, through the influence of international developments, the one-tier board structure had made its way into Dutch corporate practice prior to this legislation. Therefore, the Corporate Governance Code of 2008 already contained provisions relating to listed companies with a one-tier board structure. In 2016, the new Code clarified how companies with a one-tier board must apply the Code by, *inter alia*, specifying that the current rules for supervisory board members also apply to non-executive directors.

The reasons for companies to opt for the one-tier model vary greatly. Generally, the model is considered to be suited to companies in a highly dynamic environment such as companies in the technology sector, complex companies that need to act quickly in crisis situations, companies that are in the process of being listed and in which a major shareholder is closely involved in the company’s management or supervision (family businesses), and companies that form part of an international group or have an international group of shareholders.⁶ In practice, the one-tier model and the two-tier model appear to be growing closer to one another: in companies with a two-tier board structure the supervisory board is now expected to play a more active role, while in those with a one-tier structure it is often required that the majority of board members consist of independent non-executives. According to the new Code, the latter is also mandatory. For this reason, some commentators speak of a convergence towards a 1.5-tier structure.⁷

Management board

The management board is charged by law with the duty to manage the company, subject to restrictions imposed in the articles of association.⁸ It is generally accepted that management in any event includes directing the company’s day-to-day affairs and setting out its strategy. It should be borne in mind that in accordance with the Dutch stakeholder model, the board must take into account various interests, not only those of the enterprise and shareholders, but also those of other interested parties, such as employees and creditors.

In recent years the average size of the boards of Dutch listed companies has declined; a significant number of companies even have two-member boards. The rise of this ‘CEO–CFO model’ can be explained by a number of factors, one of which is the popularity of the executive committee (Exco), in which board members as well as senior managers have seats; in these setups a larger management board makes less sense. Although clearly desirable in terms of efficiency, ExcOs also raise several governance issues that require due consideration. The new Corporate Governance Code Committee does embrace the Exco;

5 Book 2, Title 4, Part 6 of the DCC.

6 See Rients Abma (in Dutch), ‘Naar de one-tier board’, *Goed Bestuur*, 2012/3.

7 Willem J L Calkoen, ‘The One-Tier Board in the Changing and Converging World of Corporate Governance’, dissertation, Rotterdam, 2011, p. 305.

8 Article 2:129 of the DCC.

however, it requires companies to render account of governance issues such as how the interaction between the Exco and the supervisory board will be structured. Furthermore, the Exco's role, duties and composition must be set out in the management report.

Supervisory board

The function of the supervisory board is to supervise and advise the management board and oversee the general state of affairs within the company.⁹ Like the management board, the supervisory board must take into account the interests of the company and its enterprise, as well as those of all other stakeholders.

The supervisory board of a structure-regime company has a number of important rights, including the right to appoint, suspend and remove management board members, and the right to approve (or refuse to approve) certain management board decisions, such as a decision to issue shares, enter into a joint venture, make a major acquisition or large investment, amend the articles of association or dissolve the company.¹⁰

To enable the supervisory board to perform its supervisory duties, the DCC requires the management board to provide the supervisory board at least once a year with information about the company's strategic policy, its general and financial risks and its internal control system. The Corporate Governance Code expands upon the supervisory duties: if the supervisory board consists of more than four members, it must appoint from among its members an audit committee,¹¹ a remuneration committee and a selection and appointment committee, whose duties are also specified.

ii Directors (both management and supervisory board)

Appointment and removal

As previously stated, management board members of structure-regime companies are appointed and removed by the supervisory board. In companies not governed by this regime, the general meeting of shareholders has this power. Under the present Corporate Governance Code, management board members are in principle appointed for a maximum term of four years, but reappointment for successive four-year terms is permitted.

With regard to their removal, it should be noted that management board members have both a corporate and an employment relationship with the company. For a long time, it was unclear whether the removal of a management board member by the supervisory board or general meeting of shareholders terminated both of these relationships, or only the corporate one. In a decision rendered in April 2005, however, the Supreme Court ruled that removal also terminates the employment relationship.¹² Every management board member having been employed for two years or more, is entitled to claim a transition payment when the contract is (1) terminated by the employer, (2) dissolved in court at the employer's request or (3) has ended by operation of law. Only in exceptional circumstances, such as in the

9 Article 2:140(2) of the DCC.

10 Article 2:164 of the DCC.

11 As a result of recently adopted EU legislation the responsibilities of the audit committee will increase in the future; see Section III.ii, *infra*.

12 *Unidek*, 15 April 2005.

event of any seriously culpable act or omission on the employer's part, or other extraordinary circumstances, could the board member be eligible for additional severance pay, referred to as 'fair compensation'.

Under the Corporate Governance Code, the remuneration of a management board member in the event of dismissal in principle may not exceed one year's salary (fixed remuneration component). According to the reports of the Corporate Governance Code Monitoring Committee, however, compliance with this provision in particular has been limited since the Code took effect in 2004. The reason usually given for this is the need to respect existing agreements. In its report published in December 2012, the Monitoring Committee urged that employment contracts be amended on this point; however, as follows from its latest compliance report (2015, published December 2016), non-compliance remains relatively high. The new Code introduced the best practice that no remuneration is justified if the board member ended the contract on his or her own initiative or in the case of seriously culpable or imputable acts.¹³

Supervisory board members of structure-regime companies are appointed by the general meeting of shareholders based on a nomination by the supervisory board.¹⁴ The general meeting of shareholders may, however, overrule such a nomination. The general meeting of shareholders and the works council may recommend persons for nomination. An individual supervisory board member of a structure-regime company may only be removed by the Enterprise Chamber of the Amsterdam Court of Appeal, at the request of the company, the general meeting of shareholders or the works council.¹⁵ However, the general meeting of shareholders may pass a vote of no confidence in the supervisory board as a whole, which results in the immediate removal of all board members. This has been attempted only once; in the *Stork* case (2007), the Enterprise Chamber ordered a standstill by freezing both the removal of the board scheduled by two dissenting hedge funds and the anti-takeover measures enacted by the company.¹⁶

Independence and expertise

The DCC and the codes contain several provisions intended to safeguard the independence of supervisory board members, such as the absence of family ties and business interests.¹⁷ The Dutch Central Bank, in its capacity as regulator of banks and insurance companies attaches great value to the independence of supervisory board members for the purpose of good corporate governance, and in 2012 has, further to the provisions of the code, developed its own policy rules. It requires that supervisory board members are independent 'in mind' (independent with respect to partial interests), 'in state' (formal independence) and 'in appearance' (no conflicts of interest).

A great deal of attention is being paid to the expertise of supervisory board members. For example, under the Banking Code supervisory board members are expected to have knowledge of the risks of the banking business and of the bank's public functions. Moreover, banks are expected to introduce a permanent education programme, while legislation has also been enacted; since 1 July 2012 management and supervisory board members of financial

13 Best Practice 3.2.3 of the Corporate Governance Code 2016.

14 Article 2:158 of the DCC.

15 Article 2:161 of the DCC.

16 *Stork*, 17 January 2007.

17 Principle 2.1 of the Corporate Governance Code 2016.

institutions have been subjected to a stricter ‘fit and proper’ test, to be applied by the AFM or the Dutch Central Bank (DNB). In 2016, an external assessment of this process of testing was conducted by the Ottow Committee.¹⁸ The Committee concluded in its report that the AFM and DNB ‘adequately fulfil their statutory duties’ in assessing members of management and supervisory boards. Nevertheless, the Committee has put forward several proposals aimed at improving and fine-tuning fit and proper assessments to allow the two supervisory authorities to fulfil their statutory mandates even better, such as communicating more transparently about their assessment procedures. The report also contains recommendations for preserving and better safeguarding careful decision-making, fostering diversity in the financial sector and making assessment procedures more efficient and effective. The AFM and DNB have reacted to the report with a list of follow-up actions, which correspond with the recommendations of the Committee.¹⁹

In this context, European harmonisation is intensifying and will have an important impact on national legislation. This is evidenced by the present consultation round of the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) about new guidelines on suitability assessments and the ECB’s consultation on a guide to assessments of board members. The AFM and DNB support this development. As shown in 2015 by the EBA Peer Review Report on suitability, Dutch assessment procedures are considered as good practice, and the proposed European assessment procedures are largely in line with the current Dutch take on assessments.²⁰

Caps on the holding of multiple supervisory board memberships

In the Netherlands, no fewer than four different regimes apply governing maximum numbers of board positions held, depending on legal form and business activity. Notwithstanding these rules, overboarding is also under close scrutiny, by investors as well as regulators.

The number of supervisory positions a management board member or supervisory board member is allowed to hold at large legal entities is limited by law. In principle, a management board member may hold a maximum of two positions as a supervisory board member in addition to his or her management board position; for a supervisory board member the limit is a total of five supervisory positions. The purpose of this is not only to improve the quality of supervision, but also to eradicate the ‘old boys network’.

For listed companies the Corporate Governance Code also contains specific ‘anti-overboarding’ provisions. A management board member may not hold more than two directorships at listed companies; for a director the maximum number of directorships at listed companies is five.

Under the new Code, the approval of the supervisory board is required for a management board member of the company intending to accept a supervisory board membership elsewhere.²¹

For banks and certain types of investment firms, the CRD IV Directive has introduced limitations for ‘significant institutions’ (a concept that is elaborated upon at national level

18 Named after the chairperson, Professor Annetje Ottow. The Committee also comprised Professor Janka Stoker and Jan Hommen.

19 This detailed letter can be found on www.dnb.nl (in Dutch only).

20 Report on the peer review of the ‘Guidelines on the assessment of the suitability of members of the management body and key function holders’ (EBA/GL/2012/06) of 16 June 2015.

21 Best Practice 2.4.2 of the Corporate Governance Code 2016.

under guidance of the European Banking Authority).²² As a rule a management board member is limited to two directorships whereas for a director a maximum of four directorships (in total) or one management board position combined with one other directorship applies. The Dutch implementing rules, which stay very close to the CRD IV regime, entered into force in August 2014.²³

Diversity

Over and above these measures to improve the quality of management and supervision, rules to promote gender diversity within the management boards and supervisory boards of large companies have applied in the Netherlands since 1 January 2013, the target being a division within the board of at least 30 per cent females and 30 per cent males. The rules are of a 'comply or explain' nature: if the target is not met this will not lead to the imposition of sanctions, but an explanation must be given in the management report as to why the target was not met and what steps will be taken towards meeting it. At the end of 2015 it was announced that these rules, which were originally meant to be abolished as of 1 January 2016, will be extended to 2019. This legislation, however, has not yet been adopted. Although the Justice Minister stated in 2016 that he will expect companies to act in accordance with the announcement to extend these rules, at present they do not formally apply.

At EU level, negotiations are still ongoing between the European Parliament and the Council on a draft directive promoting gender diversity within the management of large listed companies.²⁴ Pursuant to the draft directive, by 2020 at least 40 per cent of the non-executive directors of such companies must be women and heavy sanctions will apply in the event of non-compliance. However, there are strong objections on the part of a number of EU member states, including the Netherlands, and it therefore remains to be seen in what form the directive will cross the finish line.

Finally, narrower in scope but still relevant, EU Directive 2014/95 requires 'large' companies to have a description of the diversity policy applied in relation to the undertaking's administrative, management and supervisory bodies.²⁵ This Directive was implemented in Dutch law in December 2016. However, the decree that contains a set of rules on diversity has not yet been formally adopted by the Dutch government.²⁶ Diversity under this Directive has a wider significance than gender alone, but also includes, *inter alia*, background, expertise, nationality and experience.

22 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

23 Act of 25 June 2014 implementing capital requirement directive and regulation (Bulletin of Acts and Decrees 2014, 253).

24 Proposal for a Directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures (COM (2012) 614).

25 Directive 2014/95 of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

26 Directive 2014/95/EU amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

Collective responsibility

Under Dutch corporate law, the management of a company is in principle the responsibility of the board members collectively as well as of each board member individually. The company's articles of association or internal rules may, to some extent, assign certain specific duties to individual board members, but the board as a whole remains responsible. The Management and Supervision Act, which has created a basis for the one-tier board model, expressly authorises the allocation of duties between one or more non-executive members and one or more executive members of a one-tier board. In this case, too, however, the board as a whole remains responsible for the company's management, including the non-executive members (see below).

Representation

The power to manage the company entails, *inter alia*, the power to represent it in transactions with third parties.²⁷ Under the DCC, both the management board as a whole and each board member individually have this power. The articles of association may, however, limit or exclude the individual representative power of one or more board members. For example, the articles may provide that the company may only be represented by the board as a whole or by the chair and the financial director acting together.

Conflicts of interest

Previously the Corporate Governance Code introduced the rule that neither a management board member nor a supervisory board member will be permitted to take part in any discussion or decision-making that involves a subject or transaction in relation to which he or she has a conflict of interest. Now that this rule is implemented under the DCC, it is no longer part of the new Code. The DCC provides subsequently that if the board member nevertheless does take part, he or she may be liable towards the company, but the transaction with the third party will in principle remain valid.

Internal liability

A management board member who has performed his or her duties improperly may be held personally liable to the company. The same liability rules also apply to supervisory board members. In principle, each board member is liable for the company's general affairs and for the entire damage resulting from mismanagement by any other board member (principle of collective responsibility). A board member may, however, avoid liability by proving that he or she cannot be blamed for the mismanagement. The allocation of duties between the board member and his or her fellow board members is one of the relevant factors in that respect. With respect to the one-tier board model, the explanatory memorandum to the Management and Supervision Act specifically states that an internal allocation of duties among the board members is permitted, but that this does not change the directors' collective responsibility for the company's management. The non-executive board members (i.e., those not charged with attending to the company's day-to-day affairs) may therefore be held liable for the mismanagement of an executive board member. For that reason it is advisable that board members keep each other informed of their actions and actively inform each other, sometimes also referred to as a monitoring duty.

27 Article 2:130 of the DCC.

Personal liability of directors (in particular of non-executive directors) is not established easily. It is a well-established concept of Dutch law that personal liability should only arise in situations of apparent mistakes or negligence. In this context, the concepts of, for example, 'severe fault' or 'apparent mismanagement' are developed in case law or are part of statutory provisions. Recent case law, however, reminds us that this does not imply immunity.²⁸

The Supreme Court has held that only the company, or a bankruptcy trustee in cases of insolvency, may sue a board member for mismanagement under Article 2:9 of the DCC; there is no shareholder derivative action under Dutch law.²⁹ However, in certain situations directors may incur personal liability as regards third parties, such as shareholders or creditors of the company on account of tort or on account of specific provisions in the law, such as in the case of insolvency caused by apparent mismanagement.

External liability

As a general rule, management board members will not be personally liable for the company's debts or other obligations as regards creditors or other third parties. Liability might only ensue if that board member: (1) can be seriously blamed for having conducted a wrongful act on the company's behalf towards a third party; (2) is subject to liability pursuant to certain specific statutory grounds or (3) is penalised pursuant to criminal or administrative law. A parent company or its directors may, under certain circumstances, also be liable for the debts of a subsidiary. In an important case at the end of 2015 concerning a takeover of a listed company, both the management board members and the supervisory board members were held liable, the latter for inadequate supervision.³⁰

If a company is declared bankrupt, special rules – including certain evidentiary presumptions – apply. Under these rules, each management board member is personally liable for debts that cannot be satisfied from the assets of the bankruptcy estate if the management board was guilty of clear mismanagement during the three-year period preceding the bankruptcy and it is likely that this was an important cause of the bankruptcy. Under Article 2:138(2) of the DCC, the failure of the management board to comply with its accounting obligations and its obligation to file the annual accounts constitutes an instance of clear mismanagement and a presumption that the mismanagement was an important cause of the bankruptcy. Persons who have co-determined the company's policy can also be held liable under these rules. Beyond the situations described above, clear mismanagement constitutes conduct that is seriously irresponsible, reckless or rash; the trustee in bankruptcy must show that no reasonably thinking board member would have acted in this way under the same circumstances. Supervisory board members are not immune in this respect. In two major bankruptcies of listed companies in 2013, both the management board members and the supervisory board members were held liable, the latter for inadequate supervision. Subsequently, in another large bankruptcy in 2015, the Enterprise Division of the Amsterdam Court of Appeal also held the management board members and supervisory board members liable, ruling that they were responsible for mismanagement.³¹

In an important ruling in 2016, the Dutch Supreme Court ruled that if, in the light of what is generally accepted in society, a tortious act committed by the founder of a private

28 *Fairstar*, 30 September 2015.

29 *Poot-ABP*, 2 December 1994.

30 *Dockwise/Fairstar*, September 2015.

31 *Landis*, 19 June 2013, *Van der Moolen*, 15 February 2013 and *Meavita*, November 2015.

foundation (*stichting particulier fonds*: a specific variant of the legal form of a foundation) is to be considered an act of the private foundation, the private foundation can be held liable for the act, resulting in a tort liability of the private foundation.³²

Standardisation of rules for all legal entities

As at early 2014, draft legislation has been drawn up with the aim of standardising the rules on the responsibilities of management board members and supervisory board members for all the different types of legal entities. This also applies to the rules on conflicts of interest and on liability. The new legislation will not result in any substantive changes for companies with a share capital. A draft bill was presented to parliament in 2016 and is expected to be implemented no later than July 2017.

III DISCLOSURE

Listed companies are subject to various disclosure obligations. The general rules on financial reporting can be found in Book 2 of the DCC, while the FSA contains additional rules applicable to listed companies. The Corporate Governance Code also lays down several specific financial disclosure obligations for listed companies.

The DCC contains rules with regard to the composition of the annual accounts and management report, the auditor's opinion (see below), the adoption of the annual accounts and the publication requirement. Listed companies are required to send their annual accounts to the AFM after adoption. If the AFM believes that annual accounts do not comply with the relevant rules, it may initiate special 'annual accounts proceedings' before the Enterprise Chamber of the Amsterdam Court of Appeal. Shareholders and employees may also initiate such proceedings. In these proceedings, the Court may order the company to amend the annual accounts and management report in accordance with its instructions.

The transparency requirements can, in general terms, be divided into two categories: *ad hoc* disclosure obligations and periodic disclosure obligations.

i Ad hoc

The main example in this first category is the obligation to disclose as soon as possible inside information that directly concerns the issuer.³³ Disclosure may be delayed if the following conditions are met: (1) the immediate disclosure is likely to prejudice the legitimate interests of the issuer or emission allowance market participant; (2) the delay of disclosure is not likely to mislead the public; and (3) the issuer is able to ensure the confidentiality of that information. When the issuer has delayed the disclosure of inside information it shall, immediately after the information is disclosed to the public, (1) inform the competent authority that the disclosure of the information was delayed, and (2) provide a written explanation of how the conditions set out above were met. Member States may provide that the written explanation (2) is to be provided only upon request of the competent authority. The Netherlands have 'opted in' for the requirement of a written explanation to be given only upon request of the

32 *Resort of the World/Maple Leaf*, 7 October 2016.

33 Section 17 Regulation 596/2014 of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 004/72/EC (MAR).

competent authority. Financial institutions (or credit institutions) have additional grounds for delaying public disclosure of inside information where disclosure would risk undermining the financial stability of the issuer and of the financial system, the delay is in the public interest, confidentiality can be ensured, and the regulator consents.³⁴

ii Periodic

The periodic disclosure obligations consist mainly of the annual and half-yearly financial reporting requirements.³⁵

In addition, shareholders of listed companies are required to notify the AFM if their holdings of voting rights or capital in listed companies reach, exceed or fall below particular thresholds.³⁶ Gross short positions in excess of a certain threshold (3 per cent) must also be disclosed; this obligation is intended to give an insight into the shareholder's true economic interest and, at the same time, to shed light on 'empty voting'.³⁷ Moreover, since 1 January 2013 shareholders have been obliged to disclose the loss or acquisition of predominant control (30 per cent shareholding or voting rights), as a result of the mandatory bid regime arising from European legislation. The issuer is required to disclose certain information as well, such as changes in its issued capital or in the number of voting rights on its shares. Management and supervisory board members of listed companies are also required to notify the AFM of their holdings of shares or voting rights in the company and of any transactions in these shares or changes in the voting rights.

With regard to the auditing of financial disclosure, there has been a new European development. This significant change entered into force with effect from 1 January 2017: statutory auditors are required to enact an extensive, supplementary control statement for the audit committee of the board of directors.³⁸ This forms part of a shift in responsibilities to the audit committee. Audit committees have to explain how the audit contributed to the integrity of the financial reporting, what the audit committee's role has been in the process, and bear responsibility for the selection procedure regarding the auditor.

The Corporate Governance Code also contains provisions on the auditing of the financial reports and the position of the internal audit function and the external auditor. These provisions cover subjects such as the role, appointment, remuneration and assessment of the functioning of the external auditor, as well as the relationship and communication of the external auditor with the management board, supervisory board and audit committee. In the new Code, the above-mentioned developments were taken on board, although the Committee responsible deliberately excluded elements of the EU framework that already apply by law or that will do so in the near future.

34 Section 17(5) MAR.

35 Section 5:25c et seq. of the FSA.

36 Section 5:38-44 of the FSA. The Netherlands used the Member State option to maintain a lower threshold (3 per cent as opposed to 5 per cent in the Directive), see the previous footnote.

37 The absence of any economic interest with the party legally entitled to exercise the voting right at the general meeting of shareholders.

38 Audit Firms (Supervision) Decree.

IV CORPORATE RESPONSIBILITY

The Netherlands has traditionally followed the stakeholder model, under which management and supervisory board members are required to take into account the interests of all stakeholders when making decisions and performing their duties. According to its preamble, the Corporate Governance Code is based on the principle that a company is a long-term alliance between the various parties involved in the company, such as employees, shareholders and other investors, suppliers, customers, the public sector and public interest groups. In the consultation for the new Code, the Corporate Governance Code Monitoring Committee explained that corporate social responsibility is not an isolated goal, but forms an integral part of the company strategy geared towards long-term value creation, which is a matter for the management board members and supervisory board members collectively. Next to the focus on carefully weighing up the interests of all stakeholders, this also includes a focus on non-financial issues that are relevant to the enterprise. This is also reflected in the ‘in-control’ statement, which concerns more than financial reporting risks. It is also in line with the current trend towards ‘integrated reporting’. This social undertone is not surprising given that the Corporate Governance Code was drawn up in response to accounting scandals in the United States and Europe, and was intended to restore confidence in management and the financial market parties. The Code, therefore, requires the management board to draw up a view and strategy on long-term value creation setting out, *inter alia*, any aspects relevant to the company, such as the environment, social and employee-related matters, the chain within which the enterprise operates, respect for human rights, and fighting corruption and bribery.³⁹ The management board must engage the supervisory board early on in formulating the strategy. Thereafter, the supervisory board must supervise the manner in which the management board implements the long-term value creation strategy. A more detailed explanation of its view on long-term value creation and the strategy for its realisation, as well as describing which contributions were made to long-term value creation in the past financial year must be published in the management report. It should report on both the short-term and long-term developments.

On an international level, the call for more social responsibility has led to a new European Directive regarding the disclosure of non-financial information, which was implemented in the Netherlands in December 2016.⁴⁰ This Directive requires large public-interest entities – in short: listed companies, banks and insurers – to include in their management reports a non-financial statement containing certain CSR-related information.

We maintain that where socially responsible entrepreneurship initially appeared to be restricted to a small group of idealists, companies now seem to be increasingly aware of its importance also for commercial considerations.

i Risk management

Not surprisingly, post-crisis governance reforms focus on risk management. In the revised 2015 BIS Corporate Governance Principles for banks this is evident, but these are part of a broader trend towards an increased focus on risk and risk governance within financial institutions. Risk governance is also one of the pillars of CRR/CRD IV, the European project

³⁹ Best Practice 1.1.1 of the Corporate Governance Code 2016.

⁴⁰ Directive 2014/95/EU amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

that as at 1 January 2014 raised the Basel III agreements to the level of legislation. In the Netherlands this subject is also prominent on the political and public agenda even apart from the implementation of the European rules just mentioned, as follows from the 2015 Dutch Banking Code.

As a result of the financial crisis, risk management has also gained prominence in the Corporate Governance Code. Moreover, the new Code contains several best practices to further strengthen risk management and disclosure related to risk. The position of the internal auditor and the role of the audit committee regarding staffing, work plan and functioning of the internal auditor are strengthened. Furthermore, the chief financial officer, the internal auditor and the external auditor should attend the audit committee meetings, unless the audit committee determines otherwise. Regarding risk disclosure, the scope of the in-control statement is widened to the functioning of internal risk control in general (not only regarding financial reporting risks) and to require the management board to state that in the 12-month period ahead the continuity of the company is safeguarded.

In practice, the Code also turns out to have a knock-on effect on other sectors. Often the rules of the Code are used by non-listed companies, serving as a model for codes of conduct in all sorts of sectors, including semi-public sectors such as healthcare and education. In addition, Article 2:391 of the DCC requires the management board to describe in the management report the main risks to which the enterprise is exposed. If necessary, to properly understand the results or position of the company and its group companies, the management report should also contain an analysis of both financial and non-financial performance indicators, including environmental and employment-related issues.

ii Client focus

The ‘client-focus’ principle forms part of the Banking Code and is regarded as a necessary precondition for the continuity of the undertaking. While, with respect to 2010, the Banking Code Monitoring Committee still reported that banks were wrestling with how to put the client-focus principle into practice and bring about the related changes in culture, later it sounded a more optimistic note. In its latest report (January 2017) it credits the sector for improving internal processes and listing themes such as the customers’ interests being central, and for having developed a ‘trust monitor’ that enables effective communication on progress relating to client focus towards society. Complementary to the new Banking Code, the Dutch Banking Association introduced a ‘social statute’ setting out the sector’s core values, a banking oath and disciplinary measures, in which the importance of client focus is stressed.

Alongside the efforts of the sector itself, both the Dutch Central Bank and the AFM, within their respective areas of competence, continuously monitor progress on client focus and press for further change.

iii Remuneration

According to the Corporate Governance Code the purpose of the remuneration structure should be to focus on long-term value creation for the company and its affiliated enterprise. The remuneration must ‘not encourage management board members to act in their own interests nor to take risks that are not in keeping with the strategy formulated and the risk appetite that has been established’.⁴¹ Each of the Codes contains a section on remuneration

41 Principle 3.1 of the Corporate Governance Code 2016.

policy. Many of the detailed provisions regarding both fixed and variable remuneration components have been omitted in the latest version of both Codes. However, three important new provisions have been added to the new Corporate Governance Code to provide further substance to the guidelines regarding remuneration policy. Management board members must give the remuneration committee input regarding their own remuneration. In addition, the remuneration of supervisory board members must be in line with time spent. Finally, severance pay is limited to one year's salary and may not be awarded if the management board member terminates the agreement early or is guilty of seriously culpable or negligent conduct.

Both Codes, particularly the Corporate Governance Code, had extensive and complex remuneration provisions. Since various new pieces of legislation regarding remuneration have been introduced in the past few years, the monitoring committees of both Codes no longer saw the need for such detailed provisions in the Codes. In this regard, the legislator has adopted the former Banking Code standard in relation to the variable remuneration of management board members of banks (a maximum of 100 per cent of the fixed salary) and subjected it to stricter conditions: if breached, the rate of a newly introduced bank tax will be increased by 10 per cent.⁴² The Dutch government, moreover, introduced as of February 2015 a maximum variable remuneration within the whole of the financial sector of 20 per cent of the fixed salary.⁴³ This regime was intended as a transitional arrangement awaiting implementation of the CRD IV Directive, in which as a rule bonuses are subject to a cap of 100 per cent of the fixed annual salary. As of 1 January 2016, the rules implementing CRD IV entered into force.

For financial companies as well as Dutch public limited companies, legislation providing for the power to claw back bonuses from management board members entered into force on 1 January 2014.⁴⁴ This power had already formed part of the codes of conduct, but its scope was narrower. The relevant Act was the subject of extensive parliamentary debate because of a controversial provision requiring listed companies, in merger and takeover situations, to deduct from a management board member's salary any increase in the value of the company's shares following the merger or takeover; a management board member with shares in the company is therefore precluded from profiting from the transaction. The – understandable – rationale behind this provision is to eliminate personal gain as the driving force behind the decision-making in such situations. More recently, 'say on pay' has been at issue, partly in the context of the revision of the Shareholders Directive (see Section V.i, *infra*) and in part following the submission of a bill to introduce a say-on-pay right for the works council. Of course, although the discussion specifically focuses on remuneration, it is in fact a general behavioural and cultural change that is expected. Expectations are also high in politics in this respect concerning the moral and ethical declaration contained in the Banking Code enacted in early 2013. Initially, the oath concerned management board members and supervisory board members, but as of 1 April 2015 a larger group is subject to the oath by law.

42 Banking Tax Act (Bulletin of Acts and Decrees 2012, 325); the Act entered into force on 1 October 2012.

43 Bulletin of Acts and Decrees 2015, 45.

44 The Clawback Act (Bulletin of Acts and Decrees 2013, 563).

V SHAREHOLDERS

i Shareholder rights and powers

The general meeting of shareholders has important powers within the company, such as the power to amend the articles of association, dissolve the company, approve a merger, adopt the annual accounts and appoint supervisory board members. In addition to these specific powers, Article 2:107 of the DCC assigns all residual powers (i.e., those not assigned to the management board or other corporate bodies) to the general meeting of shareholders. The general meeting of shareholders of a Dutch public limited liability company (NV) is not, however, entitled to give the management board binding instructions regarding the manner in which the board carries out its duties. Under the influence of the corporate governance debate, the position of shareholders was strengthened in the early years of this century. Since 2004, management board decisions resulting in an important change in the company's identity or character have required the approval of the general meeting of shareholders.⁴⁵ This applies, for example, to decisions to transfer the enterprise or almost the entire enterprise, enter into or terminate a significant long-term cooperation, or acquire or divest a significant holding. In 2007, the Supreme Court rendered a judgment interpreting Article 2:107a of the DCC restrictively. The Court held that this provision only applies to decisions that are so fundamental that they change the nature of share ownership, in the sense that the shareholder will, as a result of the decision, in effect have provided capital to and hold an interest in a substantially different enterprise.⁴⁶

Another important shareholder right introduced in 2004 is the right to have items placed on the agenda of a general meeting.⁴⁷ Originally the threshold was 1 per cent; with effect from 1 July 2013 it has been raised to 3 per cent. With the implementation of the Shareholder Rights Directive in July 2010, this right has been strengthened. Until then, the company could refuse such a request on the basis of a compelling interest. The consequences in practice of the right to have an item placed on the agenda of a general meeting are discussed further in Section V.iv, below.

At European level as well, at the turn of the century the focus was on promoting greater shareholder participation in corporate governance. This was expressed in the first Shareholder Rights Directive,⁴⁸ which grants shareholders in listed companies various rights aimed at facilitating voting (including cross-border), such as e-voting and proxy voting, which under Dutch law mostly existed already. The Directive also provides for the system – meanwhile mandatory in listed companies⁴⁹ – of record dates, under which only shareholders registered on a particular date (approximately four weeks) before the general meeting are entitled to vote at that meeting. Most importantly, the introduction of a record date eliminates the need for share blocking, which discourages institutional investors from voting because it requires them to suspend their investment activity in respect of the blocked shares during the relevant period. As Eumedion, the interest group representing institutional investors, already concluded, this in connection with the extended period for convening general meetings of shareholders (42 days) seems to have contributed to increased shareholder participation.

45 Article 2:107a of the DCC.

46 *ABN-AMRO*, 13 July 2007.

47 Article 2:114a of the DCC was introduced by means of the Corporate Governance Act; see Section V.iv, *infra*.

48 Directive 2007/36/EC.

49 Article 2:119(2) of the DCC.

Currently the Shareholders Directive is under revision. Specific objectives are to (1) increase the level and quality of engagement of asset owners and asset managers with their investee companies; (2) create a better link between pay and performance of company directors; (3) enhance transparency and shareholder oversight on related-party transactions; (4) ensure reliability and quality of advice of proxy advisers; (5) facilitate transmission of cross-border information (including voting) across the investment chain in particular through shareholder identification. At the end of 2016, an agreement was reached in informal trilogue, bringing together representatives of the European Parliament, the Council and the Commission. It is as yet uncertain whether or when formal adoption by the European Parliament and the Council will take place.

ii Equality of voting rights

The most fundamental right of a shareholder is the right to vote at meetings. In principle, Dutch corporate law adheres to the principle of equality of voting rights: all shares carry equal rights and obligations in proportion to their nominal value and all shareholders whose circumstances are equal must be treated in the same manner.⁵⁰ The articles of association may, however, provide otherwise. The principle of one share, one vote also applies.⁵¹ There are, however, important exceptions to these principles, a few of which are mentioned below.

The first exception is the use of 'loyalty shares', to which extra voting rights or extra dividends are attached as a reward for long-term shareholders. The Supreme Court has held that the distribution of loyalty dividends is permitted.⁵² In the political arena, there have been various calls for the enactment of statutory rules on loyalty shares. In 2012, after consulting with experts and interested parties, the government decided to refrain from proposing new legislation for the time being. It was concluded that the advantages of these shares are too uncertain and their limited marketability is a definite drawback. Legal commentators have also pointed out that a long-term shareholder is not necessarily an involved shareholder, participating actively in the company's governance. Such a shareholder would nevertheless profit from the extra dividends or voting rights. An important merger for corporate practice of two companies (Fiat Industrial and CNH Global) into a Dutch NV indicates that the enactment of statutory rules on this issue is unnecessary. The Dutch NV introduced loyalty shares with extra voting rights, based on the French model. In the context of the phased IPO of the nationalised bank ABN-AMRO (November 2015) loyalty shares have been contemplated, but for a number of reasons, including the fact that this would have been the first IPO to include such shares, the government decided against it. A second exception to the principle of equality of voting rights is the issuance of protective preference shares: listed companies may protect themselves against hostile takeovers or shareholder activism by issuing preference shares to an independent foundation set up in advance for this purpose (see Section V.v, *infra*). A third exception to the principle of equality of voting rights is financial preference shares, which are used as a financing instrument. In respect of these shares, too, there is a disproportionate relationship between the voting rights acquired and the capital invested. With respect to the issuance of financing preference shares, the

50 Article 2:92 of the DCC.

51 Article 2:118(2) of the DCC.

52 *DSM*, 14 December 2007.

Corporate Governance Code provides that the voting rights attached to such shares must be based on the fair value of the capital contribution.⁵³ This represents an attempt to return to the one-share, one-vote principle.

iii Shareholders' duties and responsibilities

Under Dutch law, shareholders – unlike management and supervisory boards – are in principle not required to be guided by the interests of the company and its affiliated enterprise. Shareholders may therefore in principle give priority to their own interests, with due regard for the principles of reasonableness and fairness. Based on these principles, however, larger shareholders are considered to have a certain responsibility towards other parties. The Corporate Governance Code's preamble states: 'The greater the interest which the shareholder has in a company, the greater is his or her responsibility to the company, the minority shareholders and other stakeholders.' Institutional investors in particular are therefore being called upon to accept greater responsibility.

In this regard, the Corporate Governance Code seeks to increase the transparency of voting behaviour. Institutional investors must publish their voting policy on their website and report annually on how that policy has been executed in the preceding year. They must also report quarterly to the general meeting of shareholders on how they have exercised their voting rights.⁵⁴ Furthermore, Eumedion adopted a set of 'Best Practices for Engaged Share-ownership' in June 2011, which, *inter alia*, call on institutional investors to inform clients of conflicts of interest if, in relation to a particular matter, the investors have divergent roles that could affect their voting behaviour.⁵⁵ According to its latest monitoring report regarding compliance with the best practices (December 2016), the concept of responsible and engaged share ownership has become common practice. A large majority of institutional investors applies a voting and engagement policy and reports on this (93 per cent). Compliance with the best practice of identifying conflicts of interest is improving (from 41 per cent in 2013 to 70 per cent).

At the European level, similar developments are taking place. In late December 2012, the European Commission adopted the Corporate Governance Action Plan, containing various initiatives to increase the engagement of shareholders with the corporate governance of undertakings. In this regard, the ESMA drew up guidelines at the end of 2013 to clarify the concept of 'acting in concert' in the Directive on Takeover Bids (see Section V.v, *infra*).⁵⁶ In addition, the European Commission is of the opinion that institutional investors should be more transparent about their voting policies, as this would lead to better investment decisions and could also facilitate dialogue with the relevant company. In this context, the unclear role of proxy advisers is seen as a problem area. These issues are dealt with in the proposed revision of the Shareholders Directive (see Section V.i, *supra*).

iv Shareholder activism

In practice, the shareholder rights described in Section V.i, above, have also been actively exercised by hedge funds, most notably the right to have an item placed on the agenda

53 Best Practice 4.3.4 of the Corporate Governance Code 2016.

54 Best Practice 4.3.6 of the Corporate Governance Code 2016.

55 Eumedion has announced in its monitoring report of 2016, that these principles will be revised in 2017.

56 This statement was updated in June 2014.

of a general meeting.⁵⁷ Although the aim of the new rights was to increase shareholder participation and strengthen the monitoring of management boards, the actions of hedge funds have also revealed a dark side to participation. In particular, the focus on short-term profits has had adverse effects in some cases. The notable example of this was the role of hedge fund the Children's Investment Fund (TCI) in the acquisition of ABN-AMRO – one of the largest banks in the Netherlands (2007). TCI, which held only about 2 per cent of the shares, pressed the ABN-AMRO management to sell all or part of the bank and distribute the proceeds as a bonus dividend. TCI managed to have this proposal placed on the agenda of the general meeting and it was ultimately adopted. In the end, this led to the acquisition of ABN-AMRO by three foreign banks.

This transaction in connection with a number of situations in which activist investors targeted companies with similar proposals caused both government and parliament to reconsider the desirability of shareholder activism. In May 2007, the Corporate Governance Code Monitoring Committee recommended certain legislative changes intended to counteract the short-term orientation of activist shareholders. To achieve a sustainable relationship between a company and its shareholders the Monitoring Committee felt that shareholder conduct ought to become more transparent and dialogue between the parties ought to be encouraged. The Corporate Governance Act, which entered into force on 1 July 2013, reflects this train of thought. The idea behind the Act is to enable the management board, through the introduction of disclosure obligations, to learn the identity and intentions of its shareholders at an early stage, so that it can enter into a dialogue with them. The minimum threshold for the obligation to disclose substantial holdings of capital or voting rights in listed companies has therefore been reduced from 5 per cent to 3 per cent.⁵⁸ In addition, the threshold for the right of shareholders to have items placed on the agenda for a general meeting has been substantially raised, from a capital interest of 1 per cent to a capital interest of 3 per cent; the alternative threshold in the case of an interest of €50 million for listed companies has been cancelled. Finally, the Act contains a mechanism enabling a listed company to identify its 'ultimate investors'.

The issues of empty voting or securities lending, both of which have appeared to be important instruments for activists, have not been directly provided for in the Act. Hedge funds can use these devices to influence decision-making in the general meeting of shareholders, without bearing any economic risk. The system of record dates provided for in the Shareholder Rights Directive (see Section V.i, *supra*) is intended to discourage this practice. Furthermore, shareholders of listed companies are not only obliged to disclose their long positions in excess of a certain threshold, but also their gross short positions (see Section III, *supra*) and should, when exercising the right to place an item on the agenda disclose their full economic interests (both long and short). As a result, the shareholder's true motives for placing an item on the agenda should be revealed, which is supposed to discourage the practice of empty voting as well.

In limiting the right to have items placed on the agenda the Corporate Governance Code goes further than the Act.⁵⁹ The Code provides that a shareholder of a listed company

57 To put things into perspective: Eumedion estimates that in the Netherlands between 2005 and 2011 in total 40 shareholder proposals (not just hedge funds) were submitted, against around 7,500 management proposals.

58 See Section III, *supra*.

59 Best Practices 4.1.5 and 4.1.6 of the Corporate Governance Code 2016.

may exercise this right only after having consulted the management board about this. If the item to be placed on the agenda may possibly result in a change in the company's strategy, the management board must be given a period of a maximum of 180 days to respond (the response time). The management board should use this period to confer with the relevant shareholder. The statutory period for such requests, however, is 60 days before the meeting – even for items relating to the company's strategy – and may therefore clash with the response time. A couple of years ago the Enterprise Chamber issued an important ruling on the relationship between the code provision and the statutory provision. The court held that the response time is an elaboration of the statutory principles of reasonableness and fairness that shareholders are required to adhere to in their relations with the company, and must therefore be respected by an activist large shareholder.⁶⁰ According to the court, the response time may only be disregarded on compelling grounds.

The trend towards limiting shareholder rights can also be discerned in Dutch case law. For example, the Supreme Court, in the summer of 2010, held that it is up to the management board to determine corporate strategy. Decisions of this nature need not be submitted to the shareholders for approval or consultation, not even on the grounds of reasonableness and fairness or non-statutory governance rules.⁶¹ This judgment limits the possibility for shareholders to demand strategic changes. This is echoed in a more recent judgment, in which a large investor was denied the right to add a strategic item to the agenda.⁶²

v Takeover defences and other protective measures

In Dutch practice, various (structural and *ad hoc*) defensive measures have been developed against the threat of hostile takeovers, shareholder activism, etc., among others:

- a the incorporation of a protective foundation with a call option to acquire preferred shares;
- b a binding nomination right for the company's board or another body regarding the appointment of directors;
- c a proposal right for the board or another body in respect of certain resolutions of the general meeting of shareholders;
- d imposing an ownership limitation on shareholders; and
- e listing of depositary receipts instead of shares.

The most common takeover defence is the incorporation of a protective foundation with a call option to acquire preferred shares. The shares, which are issued when a threat materialises, change the balance of control within the general meeting of shareholders and make it possible to pass certain resolutions desired by management or in some cases block certain undesired resolutions. Because preference shares are purchased for an amount less than their real value, the foundation acquires substantial control for little invested capital. The Supreme Court permits the issuance of protective preference shares provided they are necessary with a view to the continuity of the enterprise, and are adequate and proportional. The construction must be temporary in nature and intended to promote further dialogue.⁶³ In the autumn of 2013, the Dutch telecom company KPN successfully staved off a hostile takeover bid by the Mexican company América Móvil with the help of such a foundation. In the wake of the

60 *Cryo-Save*, 6 September 2013.

61 *ASMI*, 9 July 2010.

62 *Fugro*, 17 March 2015.

63 *RNA*, 18 April 2003.

bid, politicians again considered the question of whether the Netherlands is not too liberal and whether there should not be more possibilities for government intervention in takeovers of companies that serve a strategic public interest. A draft bill is expected introducing the requirement for a declaration of non-objection for takeovers in strategic sectors, such as vital telecom infrastructure.

Recently, interest in takeover and activism defences has been renewed, in part because of past experiences with activist shareholders and partly because of the increase in the number of IPOs; introduction of defensive measures going concern remains rare. As a part of this trend, the relisting of the nationalised bank ABN-AMRO was coupled with solid protection by means of listing depositary receipts instead of shares; in 2016 the nationalised insurance company ASR was listed with protection in the form of preference shares. Takeover defences under Dutch law are also popular with US and other companies for which Dutch takeover law and practice often is one of the reasons to incorporate or reincorporate in the Netherlands, whereas its (main) listing remains in the United States or elsewhere.

The above-mentioned trend regarding takeover defences has also been observed in the context of the review of the Code. However, the Committee responsible for the review holds the view that this is a corporate law issue that is to be dealt with primarily in law.⁶⁴

Shareholder and voting rights plans, and similar measures

As mentioned before, Dutch law accepts a number of deviations from the one-share-one-vote principle (Section V.ii, *supra*). Instruments that are typically used as a defensive tool are dual class-structures, ownership limitations and – to a lesser extent – loyalty shares. The listing of depositary receipts instead of the shares themselves is not allowed as a defensive measure under the Corporate Governance Code⁶⁵ and its use by listed companies is slowly declining; it is expected that the relisting of ABN-AMRO (see above), where the government opted for this form of protection mainly because of the complications connected with the more customary preference shares structure will remain an exception.

White-knight defence

White-knight defences only occur occasionally in the Netherlands, probably because of the availability of preferable alternatives.

Staggered boards

Directors are typically appointed and re-appointed on the basis of a rotation scheme, as required under the Corporate Governance Code.⁶⁶ The concept of staggered boards, as far as we are aware, is not applied by Dutch listed companies.

vi Contact with shareholders

To avoid confrontations with the general meeting of shareholders, management boards may try to align corporate policy somewhat with the desires of shareholders and to seek out their opinions in advance. Although the general meeting of shareholders has a statutory right to obtain information, based on which it is accepted that shareholders have the right to

64 Compliance report 2014 (published 11 February 2016) (in Dutch).

65 Principle 4.4 of the Corporate Governance Code 2016.

66 Best Practice 2.2.4 of the Corporate Governance Code 2016.

ask questions at a general meeting, it is unclear from the relevant DCC provisions whether the management board can itself take the initiative to discuss its intentions with individual shareholders outside a meeting. In practice, such one-on-one meetings do take place. According to best practice provision 4.2.2 of the Corporate Governance Code, the company should formulate a policy on bilateral contacts with shareholders and publish this policy on its website. It is important that particular shareholders are not favoured and given more information than others, however, as this would violate the principle that shareholders in the same circumstances must be treated equally. It goes without saying that price-sensitive information may not be disclosed. The fear of violating the market abuse rules causes some shareholders and companies to be hesitant about participating in one-on-ones.

Shareholders among themselves may, in addition, be afraid of being regarded as parties ‘acting in concert’, because under the provisions of the Directive on Takeover Bids⁶⁷ such parties are obliged to make an offer for the listed shares of a company if they collectively acquire dominant control (30 per cent or more of the voting rights in that company’s general meeting of shareholders). What exactly is meant by ‘acting in concert’ is not very clear in practice and may represent an obstacle in the path of cooperation among shareholders. For this reason, at the end of 2013 the European securities markets regulator ESMA drew up a white list of activities on which shareholders can cooperate without being presumed to be acting in concert, and which was updated in 2014. However, if shareholders engaging in an activity on the white list in fact turn out to be cooperating with the aim of acquiring control over the company, they will be regarded as persons acting in concert and may have to make a mandatory bid. The sensitive subject of cooperation with regard to board appointments has been acknowledged, but was nevertheless left off the white list.

VI OUTLOOK

Several issues are currently at the forefront of corporate governance in the Netherlands. At the end of 2016, the Justice Minister sent a letter to parliament as a follow-up on the memo from 2014 on the modernisation of corporate law. On a side note, the said Minister resigned his position in January 2017 and was succeeded by a fellow party member. The coming election may also influence the ambitions that were expressed in this letter. Nonetheless, the letter states firstly that several new laws, which have entered into force since then, are currently under evaluation and might be amended in the future. One of the laws that is under evaluation is the price-gain Clawback Act (see Section IV.iii, *supra*). Under this Act, companies are obliged to withhold from a director’s remuneration any share price gains earned by the director on his or her shareholdings in the company as a result of certain triggering corporate events. This rule is a ‘sunset clause’ and will automatically expire on 1 July 2017. Research suggests that the rule is ineffective and the then Justice Minister therefore committed to present a legislative proposal in 2017 to amend it. The Act on Management and Supervision and the Act on Amending the Right of Inquiry are still currently under evaluation.

With regards to potential new legislation, the letter specifies two ambitions. Firstly, the modernisation of the law regarding the public limited company, which will simplify this entity and make it more flexible. In this respect, it is also proposed to dematerialise all bearer shares so these securities will be suitable for book-entry transfer only. Furthermore, a proposal for new legislation regarding partnerships will be presented in 2017.

67 Directive 2004/25/EC.

On a more general note, the letter addressed the position of minority shareholders and the potential need for extending restructuring options. Concerning the latter, the former Minister proposed organising one or more experts meetings to examine whether legislation regarding cross-border conversion or demerger is in order. At the time, the Minister considered the position of minority shareholders sufficiently secure.

In general, more attention is being paid to transparency. The fight against tax evasion and avoidance, money laundering, corruption and the financing of terrorism has led to new legislation in the Netherlands, as well as in Europe. In that respect, the Fourth Anti-Money Laundering Directive, which has to be implemented by 26 June 2017, requires every Member State to introduce a public register of ultimate beneficial owners. On a national level, a bill was presented at the beginning of 2017 to introduce a (less accessible) central register for shareholders of Dutch public listed companies and limited companies. Moreover, the aforementioned proposal for the dematerialisation of bearer shares will also contribute to greater transparency.

In the courts of law, higher demands are being made upon the careful decision-making processes within boards, while at the same time there seems to be a tendency to hold management board members and supervisory board members liable earlier in cases of failing management.

A new Banking Code Monitoring Committee was appointed in late 2014. Furthermore, the Banking Code itself has been revised, specifically to reduce legislative overlaps and inconsistencies and to focus attention on desired changes in behaviour and culture. In February 2016, the long-awaited review of the Corporate Governance Code began, mostly because the most recent previous update was in 2008 and a lot has changed since then. This resulted in the introduction of a revised Code at the end of 2016. With this in mind, it seems fair to say that corporate governance is a hot topic in the Netherlands. The goal remains to create a proper balance between the interests of the various stakeholders within an enterprise, without losing sight of the interests of society as a whole. In the end, a model will have to be found whereby risky conduct is discouraged and public confidence in the management boards of banks and companies is restored.

NIGERIA

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I OVERVIEW OF GOVERNANCE REGIME

i Legal and institutional framework

The Nigerian corporate governance (NCG) regime is characterised by a combination of statutory framework and subsidiary legislation enacted by the relevant regulatory authorities. These laws can be divided into two categories: the general laws and the sector-specific laws. While the general laws govern every entity incorporated in Nigeria, the sector-specific laws govern only companies that operate within the specific sector or industry.

The general laws are:

- a the Companies and Allied Matters Act (CAMA),² and the regulatory authority charged with responsibility of administering the CAMA is the Corporate Affairs Commission (CAC),³
- b the Investments and Securities Act 2007 (ISA), which also established the Securities and Exchange Commission (SEC) as its regulatory authority; and
- c the Financial Reporting Council of Nigeria Act 2011 (the FRCN Act),⁴ administered by the Financial Reporting Council of Nigeria (FRCN).

The sector-specific laws include among others, the Banks and Other Financial Institutions Act (BOFIA) and the Insurance Act (IA).⁵

The CAMA is the main statute delimiting the general framework for the NCG regime. It lays out the various types and forms of entities that can be incorporated, including private companies, which may be limited by shares or by guarantee, unlimited companies, and public companies limited by shares. The CAMA also outlines the structure, powers and duties of the various organs of a corporate entity as well as the systems of governance and management of the company, and management qualifications. On the other hand, the ISA sets out the statutory framework for regulation and operation of the Nigerian securities market. It outlines the operational rules for securities market operators, participants and stakeholders, and liquidity requirements, among other things.

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2 Cap. C20 Laws of the Federation of Nigeria 2004.

3 Notably, however, the CAMA is at present undergoing an amendment process and this chapter will also examine some of the key proposed amendments to the CAMA.

4 No. 6, 2011.

5 Cap. I17 Laws of the Federation of Nigeria 2004.

The BOFIA is the principal statute that regulates the banking sector. It recognises the supervisory role of the Central Bank of Nigeria as enumerated under the Central Bank of Nigeria Act 2007. It states the conditions for the grant of a banking licence and revocation or variation of the same. Furthermore, the principal pieces of legislation governing insurance activities are the National Insurance Commission Act and the IA. The National Insurance Commission is empowered to make regulations and issue guidelines to insurance companies from time to time, while the IA applies to insurance businesses and regulates insurers, with the exception of insurance businesses carried on by friendly societies and by companies, bodies or persons established outside Nigeria, engaged solely in reinsurance transactions with an insurer authorised under the IA.

The NCG space has a number of corporate governance codes applicable to publicly listed companies and for sector-specific companies. The resultant effect of this is that in certain instances there is over-regulation, depending on the industry in which a company operates. For the purpose of this review, the focus is mainly on (1) the Securities and Exchange Commission Code of Corporate Governance for Public Companies 2011 (the SEC Code); and (2) the Code of Corporate Governance for Banks and Discount Houses, and the Guidelines for Whistle-Blowing 2014 (the Bank Code). However, there are also a number of corporate governance codes applicable to other sectors of the economy. These are: (1) the Nigerian Communications Commission Code of Corporate Governance for the Telecommunications Industry 2014, which applies to the telecommunications industry; (2) the National Insurance Commission Code of Good Corporate Governance for the Insurance Industry 2009, which applies to the insurance industry; and (3) the Pension Commission Code of Corporate Governance for Licensed Pension Operators 2008, which applies to the pension industry.

For corporate governance practitioners, the growth and advancement of Nigeria's corporate governance has been slow but steady. Following the corporate scandals in 2008–2009, which practically brought the banking sector to a halt, the regulators seem to perceive corporate governance as the single most important solution to bring sanity in all areas of commerce and capitalism.

II CORPORATE LEADERSHIP

The NCG structure is bipartite, such that a company acts through the members in the general meeting and the board of directors (the Board). The Board is primarily charged with the responsibility of managing the company, with further powers reserved for the members in general meeting. The interface between the board structure and practice and the role of directors is described in detail below.

i Board structure and practices

Nigerian companies operate a one-tier board structure where all the directors sit and make decisions as a single organ except where the functions of the Board have been delegated to a committee of the Board or to the managing director.

Every company is by the provisions of the CAMA required to have a minimum of two directors on its Board and, where at any time the number of directors falls below two, the company is mandated to appoint another director within one month of the reduction in the statutory number of directors or refrain from carrying on business after the expiration of the said period. International best practices dictate that the Board should be of sufficient size

relative to the scale and complexity of the company's operations and composed in such a way as to ensure diversity of experience without compromising independence, compatibility, integrity and availability of members to attend meetings.

In addition, the SEC Code provides that there should be, at the minimum, an independent director on the Board whose shareholding, directly or indirectly does not exceed 0.1 per cent of the company's paid up capital and who should be free of any relationship with the company or its management that may impair, or appear to impair, the director's ability to make independent judgements. The Bank Code provides that banks should have at least two independent directors, while discount houses should have at least one independent director.

Legal responsibility of the Board

Generally, the primary responsibility of ensuring good corporate governance in the company rests with the Board, as it sets the 'tone at the top' on governance issues. The Board is mandated to ensure that the company carries on its business in accordance with its articles and memorandum of association, in conformity with the law and in observance of the highest ethical standards.

The Board is also accountable and responsible for the performance and affairs of the company; it defines its strategic goals and ensures that its human and financial resources are effectively deployed to attain those goals. The principal objective of the Board is to ensure that the company is properly managed to protect and enhance shareholder value, as well as to meet the company's obligations to its other constituencies (i.e., employees, suppliers, customers and stakeholders). The Board may exercise any of its functions through board committees consisting of such members of the Board as it deems fit or, from time to time, appoint one or more of its number to the office of managing director and may delegate any of its powers to the appointed committee or managing director.⁶

Chairperson's control of the Board

The chairperson's primary responsibility is to ensure the effective operation of the Board such that it works towards achieving the company's strategic objectives. The chairperson should not be involved in the day-to-day operations of the company. The day-to-day running of the company should be the primary responsibility of the chief executive officer (CEO) and the management team. For all public companies, the positions of chairperson of the Board and CEO are mandatorily required to be separated and held by different individuals. The purpose of this is to avoid an over-concentration of powers in one individual that may rob the Board of the required checks and balances in the discharge of its duties.

ii Directors

Although the law requires a mixture of both non-executive and executive directors, the numbers of non-executive directors (NEDs) are expected to be higher than the executive directors (EDs). There is however, no division in the performance of their functions on the Board. NEDs are expected to be key members of the Board as they are required to bring independent judgement as well as scrutiny to the proposals and actions of the management and EDs, especially on issues of strategy, performance evaluation and key appointments. EDs are employees of the company who typically: (1) report for duty at the company's offices;

6 *Hastons v. ACB Plc* [2002] 12 NWLR (Pt. 782) 623.

(2) earn salaries; and (3) usually have a contract of employment regulating their powers and functions. On the other hand, the NEDs are not employees of the company, as they do not earn salaries and do not have a contract of employment regulating their functions and powers. They are appointed pursuant to the provisions of the CAMA. The EDs give regular reports on the affairs of the company to the NEDs and act upon the mandate given by the Board at board meetings.

Duties of directors

Directors are regarded as trustees of the company and thus stand in a fiduciary position in relation to the company. By virtue of their position, they are to exercise their powers and discharge their duties in good faith. They are required to act in the best interest of the company as a whole, including the interest of employees of the company; exercise their powers strictly for the purpose specified and not for a collateral advantage; prevent the fetter of their discretion; and avoid conflicts of interest.

Appointment, nomination and term of office of directors

When a company is newly incorporated, the first directors are typically appointed by the promoters of the company. Subsequently, shareholders appoint directors at the general meeting upon the nomination of the Board. The CAMA regulates the term of office of directors by providing for the retirement and rotation of directors and this rule applies in the absence of any provision in the articles excluding its application. All directors are to retire at the first annual general meeting (AGM) of the company and subsequently one-third of the directors shall retire yearly. In determining the retiring directors, the rule is first in, first out, under which the directors who have been longest in office will be made to retire. However, a director may be appointed as a life director, in which case the rule of retirement and rotation will not apply.

The Bank Code provides that the CEO of banks and discount houses shall have a maximum tenure of 10 years and that the CEO shall not be eligible for reappointment in that bank or any of its subsidiaries.

Conflicts of interest of directors

Directors are under a duty to avoid conflict between their personal interests and their duties as directors. A director should not make secret profit or use corporate information to gain an advantage. This responsibility continues even after the director has resigned or been removed by the company. In instances where a director's duty may conflict with his or her personal interest, this can be managed by: (1) disclosure to the Board; or (2) abstaining from voting or taking decisions on such matters.⁷ In the event of uncertainty, the SEC Code provides that the concerned director should discuss the matter with the chairperson of the Board, or the company secretary, for advice and guidance.

Proceedings of directors

Although the CAMA does not stipulate the number of times directors of a company may meet for the purpose of dispatching their business, the SEC Code provides that directors should meet a minimum of four times a year. Every director is required to attend at least

⁷ Section 280 of the CAMA.

two-thirds of all board meetings. Attendance is a prerequisite for the renomination of a director unless there are cogent reasons for non-attendance, and of which the Board must notify the shareholders at the AGM. Board meetings are presided over by the chairperson and if he or she is not present within one hour after the time appointed for the meeting, the directors shall elect one of their number to be chairperson of that meeting.⁸

III DISCLOSURE

i Disclosure by the company

Financial reporting and disclosure obligations in Nigeria are principally governed by the CAMA, which is the primary legislation, and other subsidiary pieces of legislation, typically sectoral corporate governance codes. In addition, public companies and companies listed on the Nigerian Stock Exchange (NSE) have to comply with the SEC Code and The NSE Rulebook 2015 (the NSE Rules). Every company is required by the CAMA to prepare annual financial statements, and has a duty to present the same before the company in general meeting. This may be within 18 months after the incorporation of the company, and then yearly subsequently.⁹

By law, a copy of the company's financial statements must be sent to every member of the company (whether or not entitled to receive notice of the general meeting); every debenture holder of the company (whether or not so entitled); and all other persons other than members and debenture holders, being persons so entitled, not less than 21 days before the date of the meeting at which they are to be presented. The financial statements must comply with the form provided by the CAMA and the FRCN Act. There are certain key sections that the financial statement must include and they are as follows:

- a* a statement of accounting policies;
- b* the balance sheet as at the last day of the year;
- c* a profit and loss account;¹⁰
- d* notes of the accounts;
- e* the auditors' reports;
- f* the directors' report;
- g* a statement of the source and application of funds;
- h* a value-added statement for the year;
- i* a five-year financial summary; and
- j* in the case of a holding company, the group financial statements.

As seen above, the directors' report is among the matters to be contained in the financial statement and it provides: (1) a fair view of the development of the business of the company and its subsidiaries during the year; (2) the names of directors; and (3) the financial activities of the company and its subsidiaries, among other things. In the past few years, companies have started reporting on their corporate governance activities in the annual report.

Under the SEC Code, the obligation to disclose goes beyond financial disclosure and extends to social disclosure. The Board is enjoined to report annually on the nature and extent of its corporate social responsibility, social, ethical, safety, anti-corruption policies,

8 Ibid.

9 See Section 345(1) of the CAMA.

10 In the case of a company not trading for profit, an income and expenditure account for the year.

health and environmental policies and practices. This obligation includes disclosure of the company's business principles and efforts towards implementation of same; the nature and extent of employment equity and gender policies and practices; information on number and diversity of staff, training initiatives, employee development and the associated financial investment; disclosure on the conditions and opportunities created for physically challenged persons or disadvantaged individuals; and disclosure on the company's policies on corruption and related issues.

ii Disclosure by the directors and shareholders

Directors also have obligations to disclose their interests in a company including their interest in shares or debentures, interest in contracts and conflicts of interest. The SEC Code requires companies to disclose in their annual report details of shares held directly or indirectly by a director.

A shareholder who holds 10 per cent of the voting rights in a company has an obligation to disclose the same to the company within 14 days of his or her becoming aware. Such a shareholder also has a corresponding duty to the company when he or she ceases to be a substantial shareholder. However, this all turns on his or her knowledge. By virtue of Rule 397 of the Securities and Exchange Commission Rules and Regulations 2013, the registrar of a publicly listed company is under an obligation to provide the SEC with information on any transaction that brings the beneficial ownership of shares in a company to 5 per cent or more. The NSE Rules also require the prior approval of the NSE to effect a transfer of controlling block of shares (generally referred to as a block divestment) in a listed company.¹¹ It is not clear what 'block divestment' means under the NSE Rules, as no definition is given. However, from the preprinted form to be submitted to the NSE when requesting the NSE's approval for block divestment, it appears that the transfer of 5 per cent or more of the shares of a publicly listed company or of 100 million units or more will amount to a block divestment.

IV CORPORATE RESPONSIBILITY

There has been an interesting movement in the corporate responsibility sphere in Nigeria – driven mostly by regulation. A number of corporate governance codes have provisions that require companies to report on their corporate social responsibility (CSR) activities to employees, stakeholders and the wider society. Interestingly, some companies carry out their charitable activities under the umbrella of CSR, while other companies are strategically evolving and are crafting their CSR policy as a strategic aspect of business, leading to the development of their host communities and ultimately economic growth and development.

The SEC Code provides that a company's annual report should contain a corporate governance report that includes the company's sustainability policies and programmes covering issues such as corruption, community service, environmental protection, HIV/AIDS and general corporate social responsibility issues. The Bank Code also provides that banks shall demonstrate a good sense of CSR to their stakeholders.

11 Rule 16.1 of the Issuer's Rules contained in Part II of the NSE Rulebook 2015.

i Whistle-blowing

The SEC Code provides that companies should have a whistle-blowing policy that should be known to employees, shareholders, contractors and the general public. The Board has the responsibility of implementing this policy. The company's whistle-blowing mechanism should ensure whistle-blower protection and should include a means of communication that could be used to anonymously report unethical practices. The company is also to have a designated senior-level officer assigned with the task of reviewing reported cases and providing the chairperson of the audit committee with a summary of reported cases, cases investigated, the process of investigation and the results of the investigations.¹² Compared with the SEC Code, the Bank Code, which is applicable to banks and other financial institutions, covers a broader spectrum on the scope, procedure and protection of whistle-blowers. It tasks the head of internal audit with a supervisory role over the policy, and with the duty to: (1) review reported cases and recommend appropriate action to the managing director or CEO and, where issues affect executive management, refer the issues to the Board; and (2) provide the chairperson of the Board audit committee with a summary of cases reported and the results of the investigations. This development has had a profound effect as a good number of Nigerian companies have a whistle-blowing policy.

V SHAREHOLDERS

i Shareholder rights and powers

The rights of shareholders in a company include the right to receive annual reports and accounts; the right to attend and vote at general meetings; the right to share profits; the right to propose a resolution to be voted on at the AGM if the shareholder holds at least 10 per cent of the company's voting share capital; and the right to require the directors of the company to call an extraordinary general meeting if the shareholders hold at least 10 per cent of the paid-up voting share capital.

The SEC Code further prescribes that the rights of shareholders of a company should be protected and specifically provides that the Board should ensure that all shareholders are treated equally. In furtherance of this, no shareholder, however large his or her shareholding, should be given preferential treatment or superior access to information or other materials. The Board is also charged with the responsibility of ensuring that minority shareholders are treated fairly at all times and equally protected from abusive actions of controlling shareholders. Despite the foregoing, shareholders with dominant or large shareholdings still have the propensity to influence the board by virtue of their shareholding regardless of whether the company is private or public.

There are a number of decisions statutorily reserved for shareholders, some of which include: the appointment and removal of subsequent auditors, the appointment and removal of directors, the appointment of liquidators in voluntary winding up, the declaration of dividend upon the recommendation of the board (however, in this case, the shareholders at a general meeting can decrease but cannot increase the dividend), the fixing of the remuneration of directors and the power to requisition an extraordinary general meeting. Shareholders also have the power to appoint, remove and reappoint directors in a general meeting. This power is exclusive to the shareholders in general meeting. This gives dominant shareholders some

12 Article 32.4 of the SEC Code of Corporate Governance for Public Companies.

level of control over the company, as, with the cooperation of management, they are able to sponsor their directors. However, these directors would need to pass regulatory scrutiny in heavily regulated sectors like the banks and insurance companies, as well as the SEC if they are publicly listed companies.

Under the ISA, following a takeover bid, a dissenting shareholder may apply to the court to fix a fair value for his or her shares. Thereafter, he or she is bound by the order of the court. In reaching an assessment as to the fair value of the shares, the court has the discretion to appoint one or more independent valuers to assist the court in reaching a decision.

Under Nigerian law, there is no special treatment for long-term shareholders, such as extra votes or extra dividends. However, shareholders may by their shareholders' agreement enter into a private contract to regulate their affairs on such issues as voting, dividends and the number of directors each shareholder may have on the Board. However, except where a new shareholder enters into a deed of adherence, or similar agreement, such a special treatment would not be binding on the shareholder.

ii Shareholders' duties and responsibilities

Although shareholders of a company generally look out for their interests and are concerned with getting the highest return on their investment in the company, the SEC Code emphasises that shareholders of public companies should play a key role in good corporate governance and states that institutional shareholders and other shareholders with large holdings should demand compliance with the principles and provisions of the SEC Code.

It appears that Nigerian institutional investors are typically not as aggressive as their global counterparts in their engagement with the management of companies and the regulators.¹³

VI OUTLOOK

The NCG space has in the past year (2016) seen a number of interesting developments. Notable among these are the following:

- a* the release of a National Code of Corporate Governance by the FRCN for the private, public and non-profit sectors (the FRCN Codes);
- b* the listing on the Premium Board of the NSE; and
- c* the proposed amendment of the CAMA.

Firstly, the FRCN Codes, particularly the private sector code, were shadowed by strong criticism from stakeholders in the Nigerian business landscape, and this brought pressure on the federal government of Nigeria (FGN) to take immediate and unprecedented steps to assuage widespread concerns by suspending their implementation. The criticisms arose largely because the FRCN Codes by their provisions: (1) seek to supersede other corporate governance codes that regulate other sectors; (2) attempt to provide a one-size-fits-all code that fails to recognise the nuances of operating in various economic sectors; (3) are inconsistent with the

¹³ For a discussion on Nigerian institutional investors, see 'An Awakening for the Institutional Investors in Nigeria: A Clarion Call to Action', published in *Thisday* (16 June 2015). The article can be accessed online at www.pressreader.com/nigeria/thisday/20150616/282587376608641/TextView.

provisions of the CAMA, which lays down minimum corporate governance standards; and (4) are mandatory in their application and, in sum, overreach the purview of the statutory mandate of the FRCN.

The suspension brought to a halt the changes that the FRCN Codes were set to make to the NCG sphere. However, the FGN reconstituted the board of the FRCN in January 2017, but it cannot be said yet what direction the new board will take in influencing the NCG sphere.

Secondly, the Premium Board is the listing board for an elite group of issuers that meet the NSE's most stringent corporate governance and listing standards. It is a platform for showcasing companies who are industry leaders in their sectors. Companies listed on the Premium Board adhere to international best practices on corporate governance and meet the NSE's highest standards of capitalisation and liquidity. To be eligible for premium listing, a company must submit itself for an evaluation under the NSE's Corporate Governance Rating System (CGRS) and score a minimum rating of 70 per cent. The CGRS rates all listed companies in Nigeria on their corporate governance and integrity practices. Some of the objectives of the CGRS are to improve corporate governance and business culture in Nigeria, as well as provide an incentive for companies committed to good corporate governance to distinguish themselves from their peers.

Lastly, the review of the CAMA undertaken by the CAC has led to the birth of a draft bill for the repeal of the CAMA 2004, and the enactment of the new CAMA would have a positive impact on the NCG space.

The CAMA, being the principal piece of substantive legislation that governs corporate entities in Nigeria, contains a number of basic corporate governance provisions that the draft bill seeks to amend. These include the following.

i Amendment of the composition of audit committees

The draft bill provides that the audit committee of a company shall comprise seven shareholders who are not directors of the company. This is a departure from the CAMA, which provides that a company's audit committee should comprise an equal number of directors and shareholders, the total number not exceeding six. This amendment thus gives the duty of ensuring accountability and compliance with reporting standards by the company's auditors to the shareholders, with the exclusion of any directors.

ii Introduction of a new section on corporate responsibility for financial reports

The draft bill provides that the managing director and internal auditor of a company shall certify that each auditors' report contains only true statements of material fact and that the financial information included in the report fairly represents, in all material respects, the financial condition of the company. It mandates the managing director and internal auditor of a company to certify in the auditors' report that: (1) the officer who signed the report has reviewed the report; (2) the report does not contain any untrue statement of material fact or omission of a material fact; and (3) the officer who signed the report is responsible for establishing and maintaining internal controls to ensure that material information relating to the company and its subsidiaries is made known to the officer by other officers of the companies, particularly during the period in which the report is being prepared, among other things.

However, these and other amendments that the draft bill seeks to make to the CAMA are presently of no effect, as the bill is still in its draft form and is yet to be passed by the National Assembly. The progress of this draft bill will be closely followed and monitored by stakeholders as NCG continues to make significant strides.

NORWAY

*Gudmund Knudsen and Erik Langseth*¹

I OVERVIEW OF GOVERNANCE REGIME

i Sources of law and other regulations

Norwegian public limited companies are governed by the Public Companies Act, which is on important areas (e.g., information requirements, investor protection and accounting) supplemented by other mandatory laws such as the Securities Trading Act, the Stock Exchange Act and the Accounting Act. Companies listed in Oslo are also subject to the continuing obligations of listed companies as adopted by Oslo Stock Exchange.

In addition, important guidelines for corporate governance in listed companies have been established in the Norwegian Code of Practice for Corporate Governance (NCCG). The NCCG provides Norwegian listed companies with guidelines for governing the relationship between the shareholders, the board of directors and executive management more comprehensively than applicable legislation. The NCCG consists of 15 recommended principles of corporate governance, each of which is coupled with explanatory commentaries.

Several provisions of the Public Companies Act have been introduced or amended owing to EU regulations, including Directive 2007/36/EC on shareholder rights. This directive was implemented in Norway in 2009 and applies to listed companies only. The purpose of the directive is generally to improve the shareholders' opportunities to exercise influence in listed companies.

ii Enforcement

A shareholder who believes that a resolution by the general meeting violates mandatory law or the company's articles of association, can take legal action to have the resolution rendered void. An illegally adopted resolution or other forms of non-compliance with mandatory laws can also give rise to claims for compensation.

The NCCG is, on the other side, not directly legally binding. Nevertheless, the NCCG has to some extent gained legal anchoring through the Accounting Act, which requires that listed companies account for their principles and practice of corporate governance in their annual directors' report on a 'comply or explain' basis. This requirement is also established in the continuing obligations of listed companies published by the Oslo Stock Exchange. In addition, companies applying for listing on the Oslo Stock Exchange must report on

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the company's corporate-governance principles in their listing application. By connecting the NCCG to mandatory legislation and stock exchange regulations, the NCCG has been established as guidelines with which companies are generally expected to comply.

II CORPORATE LEADERSHIP

i Governance regime

The Norwegian governance regime draws a fundamental line between a company's management and its owners. The shareholders exercise the highest authority in the company through the general meeting and may, through the general meeting, decide on any matter provided that it has not expressly been made subject to the exclusive authority of another corporate body (e.g., the board of directors).

A company's management is divided into two corporate bodies: a board of directors (consisting in practice only of non-executive directors) having the overall responsibility for the management of the company and a CEO, who is in charge of day-to-day management.

A special feature of the Norwegian governance model is the obligation to appoint a corporate assembly in companies with more than 200 employees. The principal tasks of the corporate assembly consist of board elections and, following a recommendation from the board of directors, to resolve on matters regarding significant investments in relation to the company's resources, and any rationalisation or alteration of the company's operations that may cause extensive changes or a re-allocation of the company's work force. The Public Companies Act does, however, allow the company to agree with a majority of its employees (or unions representing two-thirds of the employees) that a corporate assembly should not be established in exchange for extended employee representation on the company's board of directors (see below). It is common practice to enter into such agreements.

Another fundamental characteristic of the Norwegian governance regime is the rules in Norwegian companies' legislation that grant company's employees the right to elect members to the board of directors and the corporate assembly. The main rule regarding employee representation is that one-third of the members of the board of directors or one-third of the members of the corporate assembly or both are elected by and among the employees. The employee representatives act as ordinary members of the board or corporate assembly and have the same authority and responsibility as the members elected by the general meeting.

ii Board structure and practices

Size and composition of the board of directors

The board of directors must consist of at least three members (five in companies with a corporate assembly). In practice, the boards of Norwegian listed companies tend to consist of between six and 10 directors, of which one-third is elected by and among the employees.

As regards the composition of the board of directors, at least half of the directors must be resident within the EEA and citizens of an EEA country. Since 2006, Norwegian companies' legislation has also contained requirements relating to gender representation on the board of directors of public limited companies. These rules provide that each gender must, at a minimum, be represented by approximately 40 per cent of the total number of directors elected by the general meeting. According to the Public Companies Act, the CEO cannot be a director.

The Oslo Stock Exchange Listing Rules contains further requirements for listed companies. Pursuant to these rules, at least two of the shareholder-elected directors must

be independent of the company's executive management, material business contacts and the company's 'larger' shareholders (meaning shareholders who own more than 10 per cent of the company's voting capital or share capital). No members of executive management may be represented on the board, unless warranted by special circumstances. Finally, all directors must be fit and proper and have satisfactory knowledge of the rules applicable to listed companies on the Oslo Stock Exchange.

Further guidelines and recommendations regarding the composition of the board of directors are set out in the NCCG relating to, *inter alia*, independence and expertise of the directors.

The chair of the board of directors

The chair of the board is the leader of the board of directors and carries a particular responsibility for ensuring that the work of the board is well organised and that it functions effectively. The chair normally has the casting vote in the event of a parity of votes on the board. The chair shall ensure that matters of 'current interest' are presented to the board. This rule indirectly implies that the chair has a duty to keep him or herself continuously up to date on material matters regarding the company.

Responsibilities of the board

The board of directors has the principal responsibility for the management of the company and for supervising the company's day-to-day management and activities in general. This includes ensuring that the company's activities are soundly organised, drawing up plans and budgets for the activities of the company, staying informed of the company's financial position and ensuring that its activities, accounts and asset management are subject to adequate control.

The principal task of the board of directors, as well as of the other managing corporate bodies (i.e., the CEO and the corporate assembly), is to promote the company's commercial interest, facilitate value creation and, as a consequence thereof, safeguard the shareholders' general interest in gains and dividends on the capital invested in the company. However, the managing bodies of a Norwegian company are also entitled – and sometimes obliged – to consider non-shareholder interests (e.g., the interests of the company's employees, creditors and contract parties), as well as the company's obligations towards society and the environment. The common view is that the board of directors of Norwegian companies must to some extent have a broader perspective than the sole economic interest of the shareholders. This particular point is reflected in the NCCG, which recommends that the board of directors 'should define the company's basic corporate values and formulate ethical guidelines and guidelines for corporate social responsibility in accordance with these values'.

The liability of directors is several and not joint, meaning that each individual director may be held responsible for his or her actions or inactions as a director on the board.

Board committees

The Public Companies Act requires that listed companies of a certain size appoint an audit committee (Section III, *infra*). Apart from this requirement, the Public Companies Act neither requires nor prohibits the establishment of specialised board committees.

The NCCG further recommends that the board of directors of listed companies consider appointing a remuneration committee consisting of independent directors, to help ensure thorough and independent preparation of matters relating to executive compensation. Many

listed companies also choose to appoint other specialised board committees dealing with particular matters of interest (e.g., corporate social responsibility and social responsibility, HR and workplace environment issues, and so forth).

However, it should be noted that, to the extent board committees are established, such committees cannot be granted authority that is vested in specified corporate bodies according to law. Thus, the principal responsibility for tasks delegated by the board of directors to a board committee will always remain with the board and its individual directors. The work being carried out by a board committee must therefore only be viewed as preparatory or advisory for the board's discussions.

Remuneration of directors and the CEO

Except in cases where the company has a corporate assembly, the remuneration of the directors shall be determined by the general meeting. The Public Companies Act does not contain rules or guidelines with respect to the size of the remuneration to the directors, but further guidelines are provided in the NCCG, which states that the 'remuneration of the board of directors should reflect the board's responsibility, expertise, time commitment and the complexity of the company's activities' and that the 'remuneration [. . .] should not be linked to the company's performance'. The NCCG also states that share options should not be granted to directors. The size of the remuneration paid to directors in Norwegian companies varies in practice, but historically has been seen as modest when compared with other industrial countries.

The remuneration of the CEO is determined by the board of directors. The board of directors is obligated to produce an annual statement setting out guidelines for the determination of salaries and other remuneration to the company's executive personnel, including the CEO, for the next financial year. This statement is subject to the consideration of the annual general meeting each year.

iii Directors

Election of directors

The directors are elected by the general meeting, which also determines whether deputy directors shall be elected. In companies with a corporate assembly, this body is responsible for electing the directors. A decision to remove directors may be taken by the same corporate body authorised to elect the directors, which means that removal of directors is normally resolved by the general meeting. A characteristic feature of the Norwegian corporate law is that a majority of the shareholders, acting through the general meeting, may replace one or several directors at any time during his or her term without cause. This grants the majority shareholders authority to determine and alter the composition of the board of directors at any time. 'Staggered boards', where directors cannot be removed until the end of their term, are not permitted according to Norwegian law. An important caveat is that directors who are elected by the employees cannot be removed by the general meeting, but may only be replaced pursuant to a decision by the employees.

The NCCG recommends that the task of proposing eligible candidates for the board of directors, as well as proposing the directors' remuneration, is prepared by a nomination committee. This recommendation is followed by a majority of the Norwegian listed companies, even though there is no legal requirement to appoint a nomination committee. Whether or not a company shall have a nomination committee is usually (but not necessarily) governed by the company's articles of association.

The starting point of the Public Companies Act is that the directors are elected for a period of two years, provided the company's articles of association do not state otherwise. The term cannot, however, exceed four years. The NCCG recommends that directors are not elected for a period of more than two years.

CEO

All Norwegian public limited companies must have one or several CEOs. In practice, Norwegian listed companies have only one CEO. The CEO is normally appointed and dismissed by the board of directors.

The CEO is in charge of the day-to-day operations of the company and responsible for executing the board's resolutions and addressing external relations. The authority of the CEO is generally limited with respect to matters of an unusual nature or major importance to the company. The CEO is subordinate and reports to the board of directors while the board, in turn, has a duty to supervise the CEO. The board of directors may also instruct the CEO on the day-to-day operations of the company.

III DISCLOSURE

i Internal control and financial reporting

The Public Companies Act requires that listed companies of a certain size appoint an audit committee to advise on and prepare certain matters for the board of directors. At least one of the members of the audit committee must be independent of the company's operations and have qualifications from accounting or auditing.

Listed companies are subject to a financial reporting scheme as set out in the Securities Trading Act, Securities Trading Regulation and the Continuing Obligations of the Oslo Stock Exchange. This entails, among other things, that all listed companies must publish semi-annual and annual financial reports to the market within certain deadlines. The financial reports must be prepared in accordance with recognised accounting standards, such as IFRS or US GAAP. The company must ensure that no unauthorised persons gain access to accounting information before any such financial report is published.

ii Reporting on corporate governance

The NCCG is based on a principle of 'comply or explain' and is thus not directly legally binding upon its target companies. However, pursuant to the Accounting Act, listed companies are required to account for their principles and practice of corporate governance in their annual directors' report. This requirement is also established in the continuing obligations of listed companies. In addition, companies applying for listing on the Oslo Stock Exchange must report on the company's corporate-governance principles in their listing application or in an appendix to this.

iii Audit

All public limited companies are required to appoint an authorised auditor. The auditor is elected by the general meeting and serves as auditor until replaced.

The primary task of the auditor is to verify that the company's annual report including its annual accounts is in accordance with applicable legislation. The auditor shall also verify that the company has undertaken satisfactory management of its assets and that proper control mechanisms are in place.

The auditor shall have at least one annual meeting with the board of directors without the CEO being present. In listed companies, the auditor shall liaise with the audit committee, and give the committee a description of the main elements of the audit.

The audit is an important part of the shareholders' monitoring of the board of directors' management of the company. The auditor shall present a report concerning the audit to the general meeting. In the event the auditor finds circumstances that may give rise to liability on the part of a member of the board of directors, a member of the corporate assembly or the CEO, the auditor must make a note of this in the report.

The auditor shall attend any general meeting where the matters to be dealt with are of such a character that the auditor's attendance is deemed necessary. Otherwise, the auditor has, according to law, a right (but no obligation) to be present at the general meeting. However, the NCCG recommends that the auditor attends all general meetings of the company.

IV CORPORATE RESPONSIBILITY

As mentioned above, the Public Companies Act confers the ultimate responsibility for the management of the company on the board of directors. The board shall also keep itself informed on the company's financial position and ensure that the operations, accounts and asset management are subject to adequate control. In performing its duties, the board shall initiate such investigations as it finds necessary, as well as those investigations that may be required by one or more of the directors.

The responsibility of the board of directors is also addressed in the NCCG, which makes it clear that it is also the board's responsibility to define and perform internal controls with respect to the company's corporate values, ethical guidelines and guidelines for corporate social responsibility. It is common for listed companies to appoint a special risk committee to the board of directors to monitor risks and report any issues on an ongoing basis.

V SHAREHOLDERS

i Shareholder rights and powers

Norwegian companies' legislation is based on a majority principle that grants controlling influence to the shareholders controlling the majority of votes at the general meeting. This majority principle provides for a secure and flexible governance system in which an important element is the majority shareholder's control over the company's board of directors. However, an important feature of the Norwegian governance model is the balancing of the majority principle against a set of rules relating to minority protection. These rules limit the majority's authority over individual shareholders (or minority groups of shareholders) and equip the minority shareholders with legal tools to enforce the limitations to the majority's authority.

ii Shareholders' duties and responsibilities

General

The shareholders exercise supreme authority in the company through the general meeting in which they can instruct and control other corporate bodies, including the board of directors and its composition. The general meeting can also, as a main rule, reverse resolutions adopted by other corporate bodies and directly resolve on all company matters to the extent there are no third parties (e.g., contracting parties) who have rights as regards the company that prevent the general meeting from making decisions.

The general meeting is obliged to resolve on matters that are expressly made subject to its authority pursuant to the Public Companies Act, such as adoption of the annual accounts, approval of the board's statement on remuneration to executive personnel and election of directors to the board. Matters concerning the company's capital are also generally subject to the general meeting's authority (i.e., increases and reductions in share capital, mergers, demergers and dividend distributions).

Protection of minority rights

The Public Companies Act has several provisions that balance the majority principle against the interests of the minority shareholders. These minority-protection provisions reflect the fundamental principle of equality in Norwegian company legislation.

The minority-protection rules consists of provisions of various nature, such as general provisions concerning, among other things, abuse of authority, conflict of interests and related-party transactions, as well as provisions regarding majority requirements and procedural requirements for certain resolutions made by the general meeting.

General provision against abuse of authority

The main material limitation on the majority's authority over the other shareholders is set out in the general anti-abuse provisions in sections 5-21 and 6-28 of the Public Companies Act. These provisions prohibit the shareholders, the directors and the CEO from adopting any resolution that may provide certain shareholders or others with an unreasonable advantage at the expense of the other shareholders or the company. Further, these provisions prohibit the board of directors and the CEO from effecting resolutions made by superior corporate bodies that would violate mandatory laws or the company's articles of association.

For listed companies, the anti-abuse provision in the Public Companies Act is supplemented by a provision on equal treatment in the Securities Trading Act and in the Continuing Obligations of the Oslo Stock Exchange.

The anti-abuse provisions are limited in scope to 'unreasonable' abuse of majority power that results in unequal treatment. This implies that unequal treatment *per se* is not prohibited, and that majority shareholders as well as the board and the CEO can pass resolutions that provide for *de facto* unequal treatment as long as there is a good and valid reason for passing such a resolution.

iii Shareholder activism

The Public Companies Act opens up for various methods of exercising shareholder activism in Norwegian companies, such as:

- a A right for shareholders holding more than 5 per cent of the share capital of the company to demand that an extraordinary general meeting is held to discuss any specific matter.

- b* A right to request that the district court initiates an investigation of the company if a proposal to investigate the company's 'establishment, management or certain specified matters regarding the management or the accounts' is supported by at least 10 per cent of the share capital represented at the general meeting.
- c* A right for shareholders who own at least 5 per cent of the share capital to request that the district court resolves a dividend that is higher than that approved by the general meeting, thus giving minority shareholders a protection against being 'starved out' of the company by a dominant shareholder who is keeping the dividend distributions 'unreasonably low'.
- d* An unconditional right for all shareholders to be present (either personally or by proxy) at the company's general meetings.
- e* A right for all shareholders to have specified matters addressed by the general meeting.

The Public Companies Act also provides each shareholder with a right to information, including a right to receive the annual accounts, the board's statement and the auditors' statement and the statement from the corporate assembly. At the general meeting, each shareholder can also demand information regarding circumstances that may be significant for the approval of the annual accounts and the annual report, matters that are presented to the general meeting and information on the company's economic situation. The shareholders' right to information is far-reaching and can only be denied to the extent the information demanded cannot be provided without disproportionate harm to the company.

Proxy advisers

With respect to the actual voting at the general meeting, a practice of using 'proxy advisers' has been increasingly adopted during the past decade, most commonly by institutional shareholders. The proxy advisers are professional analysts who provide advice on how the shareholders should exercise their voting powers at the general meeting. The advice can either be provided based on the shareholders' expressed ownership principles, or be of a more general nature. The proxy advisers help the shareholders stay up to date on their investments by taking on the task of analysing the consequences of the matters that are presented to the general meeting. However, critics are concerned that extensive use of proxy advisers causes unwanted harmonisation of the governance of Norwegian companies, which does not always take into consideration the specific needs of a company's business and operations.

Proxy battles, shareholder campaigns, etc.

Prominent proxy battles and shareholder campaigns in relation to Norwegian companies listed on Oslo Stock Exchange are rarely seen. Occasionally such campaigns and battles ensue in the context of a hostile takeover bid, or more recently in relation to companies in financial distress, where creditors of a distressed company may try to influence shareholders and management to agree to a particular proposal for the financial restructuring of the company.

iv Takeover defences

Takeover defences in the form of 'poison pills' and similar measures are rarely seen in the Norwegian market.

As a starting point, the Securities Trading Act, the NCCG and the Listing Rules of Oslo Stock Exchange builds on a principle that the shares of a listed company should be freely transferable and carry equal rights in the company, and that it should be up to

the shareholders – not the board of directors – to consider any bid made for the shares of the company by a third party. Consequently, Section 6-17 of the Securities Trading Act restricts the board's ability to take defensive measures against a third party tender offer for the company's shares, including by issuing new shares, selling or buying significant assets, purchasing own shares and resolving mergers. These prohibitions can, however, be set aside by a vote of the shareholders in a general meeting.

The NCCG goes even further and states, among other things, that the board of directors should publicly announce how it will act in the event of a tender offer for the company's shares, and that the company should not take any measures to prevent such an offer from being made. In the event that the board has been authorised by the shareholders to take defensive measures in such a situation, the NCCG recommends that the authorisation should only be acted on if it has been given after the relevant offer has become publicly known.

Hostile takeovers are rare in the Norwegian market, but there have been examples of such transactions in recent years where the board of the target company has implemented a variety of defensive measures to secure a more competitive offer.

As an alternative to active, defensive measures against tender offers, it is possible to implement 'structural defences' in the form of voting restrictions, multiple share classes and similar means. The Oslo Stock Exchange has historically been reluctant to accept the listing of companies with such structural defence mechanisms, but there have been several examples in recent years of companies with restrictions on voting rights or dual share classes having been accepted for listing. It is difficult to say whether these cases are rare exceptions to the main rule or if they can be seen as precedents and indications of a less restrictive approach being taken by the Oslo Stock Exchange in recent years and going forward.

Contact between management and shareholders outside the general meeting

Outside the general meeting, the shareholders do not have formal authority to govern the company or to instruct the board of directors or to influence company affairs. This does not, however, prevent the shareholders and management from having contact outside the general meeting when it comes to matters unrelated to the exercise of the shareholders' legal authority. Conversely, such contact is rather common in companies with one dominant shareholder and is often also seen in companies with dispersed ownership, as the main shareholders will have a need to be kept informed and up-to-date on important matters related to the company's operations and development. In addition, main shareholders may also wish to give their input regarding the company's operations to management, and management may need to discuss matters with the main shareholders to avoid falling out of step with them on important matters regarding the company. In matters in respect of which the general meeting has the final authority, the management will usually have discussed the matter with the main shareholders before it is presented to the general meeting. It is, however, important to note that if a shareholder receives inside information the shareholder will become an 'insider' pursuant to the Securities Trading Act. This means, among other things, that the shareholder will be prohibited from trading in the shares and will be obliged not to disclose the information. A shareholder with inside information must also be added to the company's list of insiders.

The extent and substance of the contact between management and the shareholders vary to a great extent from one company to another. In any case, it is important that informal contact between management and the company's shareholders is kept within certain limits to make clear that it is the company's management (i.e., board of directors and CEO) that

has the responsibility and authority to manage the company's operations. Contact with the shareholders should thus principally be of an informative nature and, to the extent the shareholders present comments or proposals to the management, they cannot be of an instructive character. It is also important to ensure that the contact between management and the main shareholders does not violate the other shareholders' rights in the company and that the contact is kept within the framework of, among other things, the principle of equal treatment of shareholders. To this end, the board and management must be particularly cautious not to disclose information to the main or dominant shareholders without providing the same to the minority shareholders.

VI OUTLOOK

The Norwegian corporate governance structure has been rather stable for some time, and legislative amendments that will materially affect the corporate governance regime are not expected.

A general remark is that the Norwegian governance model is broadly drafted and rather flexible and thus caters for many different ownership models. This means that it can be suitable for both companies with a dominant shareholder and companies with dispersed ownership.

In recent years, the actions of directors and management of publicly listed companies in Norway have become subject to increased scrutiny by regulators and the general public, in particular as allegations of corruption and unlawful business practices have been made against several large Norwegian corporations. Statistics also show that director liability lawsuits by aggrieved shareholders and third parties have increased in recent years, prompting an increased focus on directors' responsibilities and potential liability in general.

POLAND

Andrzej Wierciński, Anna Wojciechowska and Anna Wyrzykowska¹

I OVERVIEW OF GOVERNANCE REGIME

i Legal framework: sources of law

In Poland, general corporate governance rules applicable to companies, including listed companies, are laid down in the Commercial Companies Code of 2000 (CCC), which replaced the former Commercial Code of 1934. The CCC sets out the general duties and powers of the various corporate bodies, as well as rules on representation, conflicts of interest and the liability of management board members.

As regards listed companies, further rules are contained in the following acts:

- a* the Act on Public Offering and Conditions for Introducing Financial Instruments to the Organised Trading System and Public Companies, which includes rules regarding takeover offers and general duties of listed companies;
- b* the Act on Trading in Financial Instruments, which contains provisions on disclosure of non-public information that could affect the market in respect of a listed company's shares and the prohibition on insider trading;
- c* the Accounting Act, which contains rules regarding financial reporting and disclosure; and
- d* the National Court Register Act, which contains rules on filings with the public register of companies.

Compliance with the above rules can, if necessary, be enforced through the courts and, with respect to the capital market regulations, by the Financial Supervision Authority. The significant role of registry courts in respect of the National Court Register goes far beyond the mere authority to maintain the public registers. Under certain circumstances, the registry courts may decide to dissolve a company (although this is very rare in practice).

ii Legal framework: best practice relating to the governance of listed companies

Alongside the above statutory rules, companies listed on the Warsaw Stock Exchange (WSE) are also expected to follow corporate governance rules adopted by the WSE. The very first formal document containing these rules was adopted by the WSE in early 2000 and entered into force in 2002. Since then, it has been revised regularly and adapted to the needs of

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the growing Polish capital market. The most recently adopted Best Practice of WSE Listed Companies 2016 (the Best Practice Code) came into force last year. These rules apply on a voluntary basis (i.e., as soft law).

In contrast to the version that was in force in the years 2008–2015, the latest Best Practice Code uses a legislative approach adopted in the UK Corporate Governance Code (formerly the Combined Code) and repeated in the EU model of corporate governance rules, consisting of general principles followed by detailed guidelines. The absence of such general principles in the earlier Best Practice Code was heavily criticised. In particular, it was emphasised that without general principles the Best Practice Code was essentially just a manual providing a set of technical rules. Apart from seeking to protect shareholders' interests, the current version permits the rules to be better understood and properly applied, which serves the interests of all members of a company's governing bodies.²

Compliance with the Best Practice Code is monitored by the WSE, and listed companies have certain disclosure obligations in this regard, based on the 'comply or explain' model.

There are separate best practice rules that apply to companies listed on NewConnect, a stock exchange for smaller companies that is generally subject to less stringent rules and oversight.

Financial institutions are also obliged to implement the current Corporate Governance Rules for Supervised Institutions, issued by the Financial Supervision Authority, and which have been in force since 2014.

II CORPORATE LEADERSHIP

In Poland, only joint-stock companies can be listed. The relevant regulations of the CCC provide for a mandatory two-tier board structure for joint-stock companies that consists of a management board and a supervisory board.

i Board structure and practices, and directors

Composition, appointment and dismissal

Management board

The management board of a company must have at least one member (with no applicable maximum number of members unless otherwise specified in the articles of association). Only individuals can be members. In particular, another company may not be appointed to the management board.

If a fixed or a minimum number of management board members is provided in the articles of association and that number of members is not appointed, even temporarily, then the ability of the management board to validly represent the company may be compromised. To avoid any such issues, most companies have articles of association specifying that the management board consists of one or more members.

The competence to appoint, remove or suspend a management board member is vested in the supervisory board, unless the articles of association of the relevant company provide otherwise (e.g., by stipulating that the management board members are appointed

2 A Opalski in A Opalski, ed., *Kodeks spółek handlowych: Tom IIIA: Spółka akcyjna* (2016), p. 81–82.

by way of a shareholders' resolution or by conferring rights on a certain shareholder to make nominations). Management board members may always be removed or suspended by the shareholders at a general meeting.

Following the latest amendment to the CCC, which entered into force on 1 January 2017, the articles of association or a resolution of a general meeting may stipulate certain criteria that should be met by a management board candidate, or may provide a detailed qualification procedure.

There is the possibility to temporarily appoint one member of the supervisory board to the management board. Such an appointment (which is an exception to the general division of functions between company bodies and the non-compatibility rule described below) is only allowed for up to three months and is only used in exceptional circumstances (e.g., after resignation of a management board member and before appointment of a new candidate).

The Best Practice Code provides that management board members should be of high quality and experienced, and the overall composition of the board should ensure diversity as regards matters such as gender, age, education and professional background.

Generally, no minimum term applies to the appointment of management board members, although a single term of office cannot exceed five years. Reappointment for a subsequent term cannot be made earlier than one year before the end of the current term of office. If the articles of association do not provide any specific term of office, the mandate of a management board member automatically expires, at the latest, on the date of the general meeting approving the financial statements for the final full financial year of service of the relevant management board member. Similarly, if a term of office is specified in the articles of association, the mandate of a management board member expires upon approval of the financial statements for the final full financial year of that term. Recently, the Supreme Court ruled that, for these purposes, the final full financial year is the final financial year that commenced during the term of office.³ The ruling brought an end to debate in the legal doctrine with regard to that aspect of the interpretation of the regulation. This is an important development because miscalculation of the expiry of mandates of management board members could have significant consequences. In particular, a management board member without a valid mandate cannot validly represent the company and, as such, the effectiveness of any acts undertaken by a management board member after the expiry of the mandate could potentially be brought into question, sometimes years later.

The articles of association may provide for a joint term of office of the management board members. In such cases, the mandates of all members generally expire at the same time, even if a particular management board member was appointed during the term of office.

A management board member may generally be removed without reason at the discretion of the general meeting or other nominating body. However, the articles of association may limit this right to circumstances in which there are valid reasons for removal.

Supervisory board

The supervisory board of a listed company must consist of at least five members, and there is no maximum unless otherwise specified in the articles of association. Because of the division of functions between the management board and the supervisory board, it is not possible for

³ Resolution of the Supreme Court dated 24 November 2016, III CZP 72/16; although it concerns members of the supervisory board, the ruling is also relevant to management board members because of the similar statutory regulations in respect of terms of office.

a management board member to be a supervisory board member at the same time. The same restrictions apply to a commercial proxy, a liquidator, a manager of a branch office of the company and certain other persons employed by the company.

Members of the supervisory board are generally appointed and dismissed by way of resolutions at a general meeting. Irrespective of the appointment rules specified in the articles of association, the regulations of the CCC provide a special appointment procedure designed to protect the interests of minority shareholders. Shareholders representing at least one-fifth of the share capital may request that the election of the supervisory board at a general meeting take place by voting in separate groups. Shareholders may create groups by division of the total number of shares represented at the general meeting by the number of supervisory board members to be appointed. Each group may then elect one supervisory board member.

The recommendations of the Best Practice Code regarding the composition of the management board and diversity are equally applicable to the supervisory board. Additionally, at least two members have to fulfil the independence criteria described in the Commission Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. Neither an employee of the company, a subsidiary or an affiliated company, nor a person holding at least 5 per cent of the shares in the company, can be regarded as independent for these purposes.

The rules regarding the term of office and expiry of the mandate of a supervisory board member are the same as for the management board members as described above.

Legal responsibilities and representation

Management board

The competence to represent a company in relation to third parties generally lies with the company's management board. Specifically, management board members are entitled to represent the company in relation to third parties in all judicial and extrajudicial matters. The representation rules specified in the articles of association may provide for either joint or individual representation. The rules on joint representation may provide that the company can be represented by a management board member acting jointly with a commercial proxy. The notion of commercial proxy in Poland is similar to that of '*Prokura*' in Germany.

As a general rule, each management board member is responsible for the day-to-day management of the company.

The competence of the management board to manage the company's business may, to a certain extent, be limited. In particular, it may be subject to a list of reserved matters for which the consent of the supervisory board or the shareholders by way of resolution at a general meeting is required. In such situations, the supervisory board role is strengthened or the shareholders in general meeting are more involved in crucial decisions concerning management of the company. However, exceptionally detailed or exhaustive catalogues of reserved matters for the supervisory board may not be permissible because, in practice, the need for the approval of the supervisory board may be tantamount to it giving binding instructions to the management board, which is prohibited.

In the course of performing their duties, the management board members are obliged to act with due care necessitated by the professional nature of their activity. In 2012, the Court of Appeal in Poznan emphasised⁴ that a management board decision can be made based on

⁴ Judgment of the Court of Appeal in Poznan – I Civil Division dated 11 October 2012, I ACa 336/12.

analyses prepared by the company's employees or opinions of external persons who have the required special knowledge. However, simply entrusting other persons with an issue is not on its own sufficient to fulfil the obligations of due care of a management board member. In particular, the responsibility for decision-making cannot be shifted to a subordinate.

The management board members have fiduciary duties towards the company and are obliged to act in the interests of the company. Following a resolution of the Supreme Court in 2009, it is clear that the interests of the company are not independent and abstract from the interests of the shareholders, but the interests of the shareholders should be taken as a whole.⁵

Supervisory board

The supervisory board exercises ongoing supervision of all the company's activities. For that purpose, the supervisory board members may inspect all the company's documentation and request information from the management board and the company's employees.

The specific responsibilities of the supervisory board include, in particular, evaluating annual financial statements, annual management board reports and motions from management concerning decisions on the company's profits or losses. The supervisory board provides the shareholders with an annual written report on the results of the evaluation. The basic scope of supervisory board responsibilities may be extended and include, among other things, reserved matters for which management is obliged to get supervisory board approval.

The powers of the supervisory board also include suspending (but only for significant reasons) an individual or all management board members from their duties and temporarily appointing supervisory board members to the management board (for a period no longer than three months) to perform the duties of management board members who were dismissed, who resigned or who are incapable of performing their duties for other reasons. The supervisory board is not entitled to issue binding instructions to a management board member and the supervisory board members cannot represent the company in relation to third parties, except in relation to agreements or disputes with the management board members.

Supervisory board and management board

Delegation of board responsibilities

The supervisory board members generally act jointly. Indeed, the regulations of the CCC explicitly apply a collectivity principle to the activities of the supervisory board. In accordance with this principle, a supervisory board member cannot act individually without the prior authorisation of the entire supervisory board. However, the supervisory board may delegate an individual supervisory board member to undertake certain specific supervision activities.

As a general rule, and unlike the supervisory board members, each management board member is responsible for the day-to-day management of the company. The management board is entitled to issue its own by-laws regulating its internal operation, unless the authority to issue the by-laws is granted under the articles of association to the supervisory board or to the shareholders in a general meeting.

The by-laws may provide for the delegation of certain areas of the company's operations to individual management board members. However, the delegation of functions within the management board does not relieve the other management board members of their responsibility for those functions. Management board members are obliged to control each

5 Resolution of the Supreme Court – Civil Chamber dated 22 October 2009, III CZP 63/09.

other and prevent a negative outcome for the company (horizontal control). According to the Best Practice Code, such an internal division of responsibilities should be clear and unambiguous and published on the company's websites.

Roles of the chairman

There is the possibility to appoint one of the management board members as the president of the management board. However, unless provided otherwise in any management board by-laws or the articles of association, no particular duties or powers apply to the president. As such, this function is not necessarily the same as or comparable to the position of a CEO or president of a US corporation.

In the case of a supervisory board, there is often a chairman and a deputy chairman. Unless explicitly granted additional powers (e.g., a decisive vote if there is no majority on a supervisory board decision), the main power of the chairman is basically to open general meetings. Usually, the chairman has administrative functions with respect to the supervisory board, such as preparing agendas for and chairing its meetings.

Remuneration

The shareholders should determine the general remuneration policy of the company including, among other things, caps and remuneration systems, as well as any rights of the management board members to participate in the company's profit. However, the specific remuneration of the management board members is usually determined by the supervisory board.

According to the Best Practice Code, the level of remuneration of management and supervisory board members and key managers of the company should be sufficient for the acquisition, retention and motivation of persons with the qualities and range of competence generally required by the company, as well as being adequate with regard to the specific tasks and any additional functions discharged by the relevant individual.

III DISCLOSURE

According to accounting rules, a listed company is obliged to include a separate statement on corporate governance in its annual management board report. These statements are subject to review by an external auditor. Matters referred to in the Best Practice Code and marked with 'R' are recommendations for disclosure in these statements. Instances of non-compliance with matters marked with 'Z' fall under the comply or explain principle. Specifically, a listed company has to report cases of non-compliance with matters marked with 'Z', whether permanent or incidental, including information on the reasons for non-compliance and the steps to be undertaken to ensure future compliance. The report has to be published on the company's websites, as well as by the same method employed for ongoing reporting and disclosure. The report has to be published immediately after the non-compliance occurred. Similarly, a report has to be published immediately if the company decides not to apply a relevant recommendation. The Best Practice Code requires that a company explicitly explain the reasons for any non-compliance.

As emphasised by commentators,⁶ it cannot be excluded that in certain cases a failure to report non-compliance with a particular recommendation of the Best Practice Code may

6 K Oplustil in Mirosław Stec, ed., *Law on Financial Instruments 2016* (1st edn), pp. 932–933.

infringe the obligation to disclose confidential information provided in Article 17 of the Market Abuse Regulation (MAR),⁷ which means that such an infringement may potentially be subject to criminal, administrative and civil liability. A failure to report non-compliance with the recommendation to disclose transactions with a shareholder representing 5 per cent of the votes in the company or an affiliated company without supervisory board consent is an example of a situation in which such liability might apply.

IV CORPORATE RESPONSIBILITY

i Risk management and compliance

Polish listed companies are not obliged to adopt any risk management regulations, nor to appoint a risk officer or establish a risk committee. Polish law is quite traditional in this respect, making management board members liable for their decisions that exceed the 'permitted risk doctrine'. Responsibilities are usually divided among management board members. According to the Best Practice Code, which is not binding, the internal division of responsibilities for individual areas of the company's activity among management board members should be clear and transparent, and a chart describing that division should be available on the company's website.⁸

However, at the same time, according to the Best Practice Code, a company should maintain efficient internal control, risk management and compliance systems, and an efficient internal audit function adequate to the size of the company and the type and scale of its activity.⁹ Responsibility for the implementation and maintenance of the above rests with the management board. The staff working in particular units responsible for risk management, internal audit and compliance should report directly to the president or another member of the management board, and should be allowed to report directly to the supervisory board or the audit committee. The supervisory board, which is obligatory in joint-stock companies, is generally responsible for exercising supervision over the company's activity. However, listed companies are also required to appoint an audit committee. A supervisory board composed of no more than five members may itself perform the tasks of the audit committee. Otherwise, the audit committee should consist of at least three members appointed by the supervisory board to monitor:

- a* the financial reporting process;
- b* the effectiveness of internal control systems, internal audit systems and risk management;
- c* the performance of financial audit; and
- d* the independence of the auditor and the entity authorised to audit financial statements.¹⁰

Polish law does not provide for any specific whistle-blowing regulations for listed companies. Obviously, auditors responsible for examining company's financial statements and books play

7 Regulation (EU) 596/2014 of the European Parliament and the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

8 Principle No. II.Z.1.

9 Ibidem, Part III.

10 See Article 86 item 7 of the Act on financial experts and their organisation and entities permitted to examine the financial statements and the public surveillance from 7 May 2009.

an important gatekeeping role. Nonetheless, there is a general trend towards implementing internal whistle-blowing systems in line with the compliance regulations introduced by corporations internally. At present, almost every listed company has such internal procedures in place or is in the process of adopting the same.

The implementation of internal compliance and risk management regulations is also becoming increasingly common in the market because of new laws that allow the imposition of very high penalties on corporations and their managers, while at the same time extending their corporate liability. For instance, EU Regulation 2016/679 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data allows corporations to be penalised for infringements with administrative fines of up to €20 million, or, in the case of an undertaking, up to 4 per cent of the total worldwide annual turnover of the preceding financial year, whichever is higher;¹¹ and the MAR,¹² which, in certain circumstances described therein, allows the imposition on legal persons of a penalty of €15 million or 15 per cent of the total annual turnover of the legal person according to the most recent available accounts approved by the management body. In certain cases, EU regulations are transposed into Polish law; for example, in relation to liability in cases of unintentional infringement of competition and consumer protection law, which may be penalised with an administrative fine of up to 10 per cent of the turnover achieved in the financial year preceding the year in which the fine is imposed.¹³

The visible practice of implementation of risk management and internal compliance regulations is a sign that the tone from a top (i.e., ethical business standards set by top management) is slowly but steadily breaking through to Polish corporate society. However, as usual, reality is different from theory, since it is created by managers who are not always appointed as a result of a contest.

ii Corporate social responsibility

We observe a general tendency for higher expectations among corporations: increasingly more businesses and their top management focus not only on gaining financial profit, but also on supporting values and goals promoted and supported worldwide. An example of these values and goals is described in the UN 2030 Agenda for Sustainable Development, raising such issues as, for example, affordable, decent work and economic growth, and partnerships between governments, the private sector and civil society. A more detailed example of cooperation between private and public sector and their joint cooperation is the Paris Agreement on climate change adopted during the UN conference held in 2015 in Paris.

These trends are also visible from the Polish perspective and Polish corporations are expected to live up to a set of general social, economic and climate expectations. However, no general corporate responsibility rules are implemented in this respect, especially in corporate law. What is being introduced internally for all company's employees, managers and members of supervisory boards are certain ethical and business conduct standards.

11 Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

12 See footnote 7.

13 Protection of Competition and Consumers Act dated 16 February 2007.

V SHAREHOLDERS

i Shareholder rights and powers

Equality of voting rights

A company may issue either registered or bearer shares.¹⁴ By definition, a listed company is a company in which at least one share is dematerialised.¹⁵ Only bearer shares may be dematerialised. Except for silent shares (non-voting shares) only registered shares may be preference shares.

As a rule, the preference may concern in particular:

- a* the voting right;
- b* the right to dividend; or
- c* the distribution of the company's assets in the event of its liquidation.

A single share may carry no more than two votes. In the event that such a share is changed into a bearer share or disposed of in breach of certain reserved conditions, the privilege expires. While the voting preference does not apply to listed companies,¹⁶ before the CCC was adopted listed companies were also allowed to issue preference shares, and therefore they may still exist in the Polish market.

The powers of shareholders to influence the board

The general meeting and the supervisory board may not give binding instructions to the management board concerning the running of the company's affairs.¹⁷ (This regulation is limited only to internal relations within the company, since, from the point of view of outside relationships, the right of management board members to represent the company may not be restricted with a legal effect with respect to third parties.)¹⁸

The above reflects the principles governing joint-stock companies, such as the principle of separation of capital from management and the principle of the presumption of competence of the management board. This also supports the principle that liability is related to those who make decisions.¹⁹ The discussed regulation does not preclude the right of the general meeting or the supervisory board to give non-binding guidelines and advice (i.e., suggestions on taking a position or other recommendations). However, the board's failure to comply with such guidelines does not render board members liable for damages and should not constitute a valid reason to dismiss a board member if the articles of association limit the right of dismissal only to valid reasons.²⁰ In practice, articles of association rarely make such provision, and therefore board members must take into account that they can be dismissed in such cases. Furthermore, there is a general rule that, in relationships with the company, members of the management board shall be subject to restrictions set forth in the CCC,

¹⁴ Article 334 Section 1 of the CCC.

¹⁵ Article 4(20) Act on Public Offering and Conditions for Introducing Financial Instruments to the Organised Trading System and Public Companies.

¹⁶ Article 351 Section 2 of the CCC.

¹⁷ Article 3751 of the CCC.

¹⁸ Article 372 Section 2 of the CCC.

¹⁹ S Sołtysiński, A Szajkowski, A Szumański, J Szwaja, *Kodeks spółek handlowych: Tom III: Spółka akcyjna: Komentarz do artykułów 301-490* (3rd edn, Warsaw, 2013).

²⁰ Ibidem.

articles of association, management board by-laws and resolutions of the supervisory board and the general meeting.²¹ Thus, the general meeting may actually influence the management board if competence for this is included in the articles of association.

It is noted, however, that the above-mentioned right is reserved for the shareholders' meeting and not individual shareholders. The rights of individual shareholders are limited to the right to information, and not the right to influence the board.

Decisions reserved to shareholders and subject to shareholder approval

Pursuant to the CCC, the shareholders' consent is required for the following:

- a* examination and approval of a management board report on the company's operations, financial statements for the previous financial year, and granting a vote of approval to members of the company's bodies for the discharge of their duties;
- b* decisions concerning claims for redressing damage inflicted upon formation of the company or exercising management or supervision;
- c* disposal or lease of the enterprise or an organised part thereof, and establishment of a limited right *in rem* thereon;
- d* acquisition and disposal of real property, perpetual usufruct, or an interest in real property, unless the articles of association provide otherwise;
- e* issue of convertible bonds or senior bonds and issue of subscription warrants;
- f* acquisition of own shares and authorisation to acquire the same under the circumstances set forth in the CCC; and
- g* conclusion of a management contract between the company and its subsidiary.²²

Also contracts for the acquisition of any assets for the benefit of the company (including acquisition of property from the controlling company or from a subsidiary company or co-operative), for a price higher than one-tenth of the paid-up share capital, from the company's founder or shareholder, or for a subsidiary company or co-operative from the company's founder or shareholder, executed prior to the lapse of two years from the company registration, require a resolution of the general meeting. The foregoing does not apply to the acquisition of assets on the basis of the provisions of law concerning public procurement, liquidation, bankruptcy and execution proceedings, and to the acquisition of securities and commodities on the regulated market.²³

The articles of association may specify other matters reserved to the competence of the shareholders' meeting. While the absence of a shareholders' resolution required by the articles of association does not make a particular action invalid, neither does it preclude the liability of members of the management board towards the company for violation of the articles of association. Furthermore, the absence of a shareholders' resolution required by the provisions of the CCC (which may be granted two months after the action at the latest) does entail the invalidity of an action.

21 Article 375 of the CCC.

22 Article 393 Section 1 of the CCC.

23 Article 394 Section 1, 2 and 4 of the CCC.

Rights of dissenting shareholders

The CCC and other regulations applicable to listed companies provide for the principle of majority rule. Nonetheless, minority shareholders are to some extent protected and are vested with rights aimed at guaranteeing them a certain influence in company matters.

For instance, at the request of a shareholder or shareholders in a public company holding at least 5 per cent of the total vote, the general meeting may resolve to mandate an expert to review, at the company's expense, a specific issue relating to the company's incorporation or the conduct of its business (a special-purpose auditor). To this end, the shareholders may request that an extraordinary general meeting be convened or that the adoption of such a resolution be placed on the agenda of the next general meeting. The management board and the supervisory board of the public company shall provide the special-purpose auditor with the documents specified in the resolution of the general meeting or in the court's decision to appoint the special-purpose auditor, and shall also provide all the explanations necessary for the performance of the review.²⁴

Furthermore, minority shareholders have the right to appoint members of the supervisory board by a vote in separate groups, which may be executed at the request of shareholders representing at least one-fifth of the share capital, even if the company's articles of association provide for a different manner of appointing the supervisory board.²⁵ As a result of the aforementioned regulation, the minority shareholders representing at least 20 per cent of votes may have their representative appointed to the supervisory board.

Facilities for long-term shareholders

Polish law does not provide for any specific facilities (such as extra votes or extra dividend) for long-term shareholders, except for the option to obtain preference shares incorporating a right to dividend on advantageous terms compared with other shareholders. For example, shares carrying special dividend rights may entitle the holder to a dividend that exceeds by no more than one half the dividend to be distributed to holders of non-preference shares. Shares carrying special dividend rights do not enjoy priority of satisfaction over other shares and may be deprived of voting rights (non-voting shares).²⁶

ii Shareholders' duties and responsibilities***Controlling shareholders' duties and liability***

Polish law does not impose any special requirements on controlling shareholders apart from the obligation (which applies to all shareholders) to notify the Financial Supervision Authority and the company about reaching or exceeding a particular percentage of the total votes in a company or a change in the share of votes held in excess of 10 per cent of the total votes by at least:

- a 2 per cent of the total votes in a public company the shares of which have been admitted to trading on the official stock exchange listings; and

24 Articles 84–86 Act on Public Offering and Conditions for Introducing Financial Instruments to the Organised Trading System and Public Companies.

25 Article 385 Section 3 and 9 of the CCC.

26 Article 353 Section 1-3 of the CCC.

- b 5 per cent of the total votes in a public company the shares of which are admitted to trading on another regulated market, or a change in the share of votes held in excess of 33 per cent of the total votes by at least 1 per cent of the total votes.

Furthermore, the majority shareholder is obliged to purchase shares of the minority shareholders under the buyout procedure.²⁷ A shareholder or shareholders representing not more than 5 per cent of the share capital may demand that the agenda of the next general meeting include the issue of adoption of a resolution on compulsory buyout of their shares by no more than five shareholders holding, in aggregate, no less than 95 per cent of the share capital, where each of them holds no less than 5 per cent of the share capital (majority shareholders).

Institutional investors' duties and best practice

Neither the CCC nor the Act on Public Offering and Conditions for Introducing Financial Instruments to the Organised Trading System and Public Companies provides for any regulation specifically relating to institutional investors. Nor is there any specific best practice code for such investors or other shareholders other than the Best Practice Code.

According to the Best Practice Code, the general meeting should deliberate with respect to the rights of shareholders and make sure that the resolutions do not infringe upon legitimate interests of various groups of shareholders. Moreover, the shareholders participating in the general meeting are obliged to exercise their powers in a manner not prejudicial to good practice.

iii Shareholder activism

Say on pay

There is no general rule that the company's shareholders have the right to vote on the remuneration of executives. Save as otherwise provided in the company's articles of association, according to the general rules provided in the CCC, the supervisory board sets the remuneration of management board members employed under employment contracts or other contracts, and the general meeting may authorise the supervisory board to establish that the remuneration of members of the management board shall also include the right to participate, in a specified manner, in the company's annual profit allocated for distribution among the shareholders. Obviously, the company's articles of association may provide that the rules of the remuneration are determined by the shareholders.

The Best Practice Code specifies only that companies have a remuneration policy at least for management board members and key managers. The remuneration policy should specify, in particular, the form, structure and method of determining the remuneration of members of the company's bodies and its key managers.

Derivative actions

Under Polish law, if the company fails to file a statement of claim for redressing damage within one year from the disclosure of the act resulting in the damage caused to the company,

27 Article 418(1) of the CCC.

each shareholder or person otherwise entitled to participate in profit or in distribution of assets may file a statement of claim for redressing the damage suffered by the company (*actio pro socio*).²⁸

Furthermore, a shareholder has the right to file a statement of claim to repeal or declare a resolution of the general meeting invalid if:

- a the shareholder voted against the resolution and, upon the adoption thereof, requested that his or her objection be recorded in the minutes; the voting requirement does not apply to shareholders holding a non-voting share;
- b the shareholder was prevented from participating in the general meeting without a sound reason; and
- c the shareholder was absent from the general meeting, only in the event of a defective convening of the general meeting or adoption of a resolution on a matter not included in the agenda.

Any resolution of the general meeting that is in conflict with the provisions of the articles of association or good practice and detrimental to the company's interest or aimed at harming a shareholder may be appealed against by filing a statement of claim against the company to repeal the resolution. A statement of claim against the company to declare a resolution of the general meeting invalid may be filed if the resolution was adopted in breach of the law. Both proceedings may only be commenced within statutory periods.

Proxy battles

Polish law does not set out any regulations that would prohibit shareholders from joining forces and gathering enough shareholder proxies to win a corporate vote. It is a strategy that often accompanies takeovers.

Formally, the right to appoint a proxy at the general meeting and the number of proxies cannot be limited. A proxy exercises all rights of the shareholder at the general meeting unless the power of attorney provides otherwise. A proxy may grant a further power of attorney if the power of attorney so provides. A proxy may represent more than one shareholder and vote differently under the shares held by each shareholder. A shareholder holding shares registered on a collective account may appoint separate proxies to exercise the rights attached to the shares registered on this account. A shareholder holding shares registered on multiple securities accounts may appoint separate proxies to exercise the rights attached to the shares registered on each account.

The provisions on the exercise of voting right by proxy apply to the exercise of voting right through another representative.²⁹

Shareholder campaigns

There are no regulations or established market practice regarding shareholder campaigns.

28 Article of the 486 Section 1 of the CCC.

29 Article 412 Section 1-7 of the CCC.

iv Takeover defences

Shareholder and voting rights plans, white-knight defence and other measures

The Takeover Directive 2004/25/EC has not been fully transposed to Polish national legislation, and therefore there are no explicit provisions governing the admissibility of reactive defensive measures that could be undertaken by the management board. It is clear that the shareholders taking over a company are guided exclusively by their own interests rather than the interests of the company, which might be better judged by its management board, representing the next shareholders' interests, as well as the interests of other persons associated with it (i.e., company stakeholders, such as banks, creditors, employees and the state).

Members of the management board generally do not support takeovers since they are likely to lose their positions in the aftermath of the takeover. Therefore, through the prism of their own interests, they opt for taking defensive measures *ad hoc*. Unfortunately, Polish law does not regulate (neither authorises, nor prohibits, nor requires) the admissibility of reactive defensive measures by the management without the authorisation of the general meeting. Consequently, in principle, and if they are not prohibited by law, defensive measures are allowed and their exercise depends on the will of the management board members and the actual position of the management board in the company. From a broader perspective, however, it seems that the taking of defensive measures by the management board, and thus exerting influence on the shareholding structure, does not fall within the competence of the management board under the CCC at all.

The regulation aimed at protecting companies against takeovers stipulates an obligation to announce a takeover bid for the sale or exchange of shares. The purpose of the announcement is to allow other shareholders to exit the company or to reduce their involvement therein and consequently to have one of the investors acquire a stake resulting in the acquisition (change) of control of the company. If the shareholder taking over the company fails to make the announcement and, at the same time, exceeds a certain threshold of the total votes in the company, that shareholder cannot exercise the voting rights attached to the shares. Furthermore, the Financial Supervision Authority may impose a penalty of up to 1 million zloty on the entity that failed to make the announcement.³⁰

Staggered boards

The rules for appointment and dismissal of members of the company's bodies should be described in the articles of association subject to the provisions of the CCC. In the absence of any statutory provision, it would seem that the company's articles of association may provide for staggered boards. However, according to the statutory rule, the members of the company's bodies may always be revoked by the general meeting. Therefore, staggered boards are not a sufficient solution for takeover defences under Polish law.

³⁰ Article 97 Section 1 item (5) and (5a) of the Act on Public Offering and Conditions for Introducing Financial Instruments to Organised Trading, and Public Companies.

v Contact with shareholders

Mandatory and best practice reporting to all shareholders

The mandatory provisions applicable under Polish law focus on the shareholders' right to information. Compared with the right to information in limited liability companies, this right is limited in joint-stock companies since, together with the right of supervision, it is vested with the supervisory board, which should be appointed within the company.

The main source of information for the shareholders is reports, which the company is obliged to publish immediately, or at least no later than 24 hours after the occurrence of or upon becoming aware of a reportable event. Furthermore, pursuant to the provisions of the CCC, in the course of the general meeting, the management board is obliged to provide a shareholder, at the latter's request, with information concerning the company, if this is justified for the purpose of evaluating an issue included in the agenda. The management board may refuse to provide information if it could inflict damage on the company, an affiliate company or a subsidiary company or co-operative, in particular through the disclosure of technical, commercial or organisational secrets of the business enterprise. A management board member may refuse to provide information if providing it could constitute grounds for criminal, civil or administrative liability of the member. A reply is deemed given if relevant information is available on the company's website in a place designated for replies to shareholders' questions.

For important reasons the management board may provide information in writing outside a general meeting. The management board is obliged to provide information within no more than two weeks from a request being submitted during a general meeting. If a shareholder submits a request for information concerning the company outside a general meeting, the management board may provide the information to the shareholder in writing. In the documents submitted to the next general meeting, the management board is obliged to disclose in writing information provided to a shareholder outside a general meeting together with the date on which the information was provided and the person to whom it was provided. Information submitted to the next general meeting does not have to include information made public and provided during a general meeting.

A shareholder who was refused the requested information in the course of the general meeting and who requested that his or her objection be recorded in the minutes, may apply to the registration court requesting that the management board be obliged to provide the information.³¹

According to the Best Practice Code, companies should ensure adequate communications with investors and analysts by pursuing a transparent and effective disclosure policy. To this end, they should ensure easy and non-discriminatory access to disclosed information using diverse tools of communication. The Best Practice Code specifies all the information that should be published on the company's website.³² Furthermore, if a shareholder requests information concerning the company, the company's management is obliged to respond to the shareholder no later than within 30 days, or notify him or her of its refusal

31 Articles 428 and 429 of the CCC.

32 Principles No. I.Z.1.1–I.Z.1.21.

to provide the information, if the management board made this decision on the basis of Article 428 Section 2 and Section 3 of the CCC.³³ All responses should be published on the company's website.³⁴

Selective meetings and communications: circumstances in which meetings can take place with individual shareholders

The Best Practice Code recommends that companies should allow investors and analysts to ask questions and receive explanations – subject to prohibitions defined in the applicable legislation – on topics of their interest. This recommendation may be implemented through open meetings with investors and analysts or in any other format allowed by a company.³⁵

It must be underlined that the principle of equality of shareholders should be observed with respect to meetings and the provision of information to shareholders. Issuers of securities admitted to trading on the regulated market are obliged to ensure equal treatment of the holders of securities of the same type in the same circumstances. The foregoing shall not prevent the issuer from redeeming debt securities earlier, pursuant to the legislation of the country where the issuer's registered office is established, in cases where derogation from the original conditions of issue is necessary in accordance with social priorities.³⁶

Issue of information to shareholders in advance of shareholders' meetings

Companies should use best efforts, including taking all steps well in advance as necessary to prepare a periodic report, to allow investors to review their financial results as soon as possible after the end of a reporting period.³⁷

Resolutions of the general meeting should allow for a sufficient period between decisions causing specific corporate events and the date of determination of the rights of shareholders pursuant to the corresponding events.³⁸

As a rule, a periodic report should be published at least 26 days before the general meeting.³⁹

VI OUTLOOK

With the Polish national economy constantly growing, it is clear that the public market will evolve. However, because of changes in law and, particularly, the adoption of the MAR, it is quite possible that we may see more delistings than IPOs. The main barriers to the development of the Polish capital market are: a limited inflow of capital, the lack of understanding of the market, risk aversion and choosing banks for savings. These are the

33 See the chapter on mandatory and best practice reporting to all shareholders.

34 Principle No. IV.Z.13.

35 Recommendation No. I.R.3.

36 Article 20 of the Act on Public Offering and Conditions for Introducing Financial Instruments to Organised Trading, and Public Companies.

37 Recommendation No. I.R.4.

38 Principle No. IV.Z.14.

39 Section 100.3 of the Ordinance of the Minister of Finance on current and periodic information provided by issuers of securities and conditions for recognising as equivalent information required under the law of a non-member state.

reasons why stock market specialists and advisers underline how important it is to strive for support and education of listed companies, and to tighten requirements for 'small stock' companies (i.e., NewConnect, small companies stock; and Catalyst, bonds stock).

The corporate market and the listed companies market will also probably be influenced by a substantial change to Polish corporate law planned for this year (i.e., the introduction of the Polish simplified joint-stock company, which is supposed to be similar to the French *société par actions simplifiée* or the Slovak *jednoduchá spoločnosť na akcie*). The initiative for this regulation came from the idea of creating a new simplified and inexpensive tool for start-up investments. However, even at this stage of work on the new regulation, it is emphasised that it must not be the only goal of the new company structure, which is also supposed to serve other, larger enterprises. The advantages offered by the simplified functioning of the simplified joint-stock company and its financing might attract more investors than the public stock market, where companies and their managers may be penalised with huge administrative fines, such as those provided for in the MAR.

Nonetheless, regardless of the above, we have recently seen a trend for an increasing number of IPOs.

PORTUGAL

*Francisco Brito e Abreu and Joana Torres Ereio*¹

I OVERVIEW OF GOVERNANCE REGIME

i Sources and recent developments

The corporate governance rules applicable to Portuguese listed companies – like those in EU Member States in general – derive from various sources: laws and regulations binding on companies, and corporate governance codes establishing sets of recommendations and best practices.

The main legal sources of corporate governance rules in Portugal are the Portuguese Commercial Companies Code, enacted by Decree-Law No. 262/86, of 2 September, as amended (CSC), which sets out the general legal framework governing companies, including, in particular, rules applicable to corporate bodies, shareholders' general meetings, shareholders' rights and obligations; and the Portuguese Securities Code, enacted by Decree-Law No. 486/99, of 13 November, as amended (CVMob), which is applicable to companies with capital open to investment by the public (among others, listed companies), setting out, in particular, specific information rules and transparency duties rules on the attribution of voting rights and shareholders' general meetings, and, in certain matters, to companies in general.

As far as Portuguese corporate governance soft law is concerned, significant changes took place in 2013. The Portuguese Securities Market Commission (CMVM)² approved a new Corporate Governance Code (the 2013 CMVM Code), replacing the Code that had been in force since 2010.³ The first private-initiative corporate governance code was also approved in 2013: the Code of the Portuguese Corporate Governance Institute (IPCG), a private association engaged in the investigation and promotion of corporate governance principles (this private-initiative code was updated in early 2014).⁴

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2 The CMVM was established in April 1991 and entrusted with the task of supervising and regulating securities and other financial instruments markets, as well as the activities of those operating in those markets. The CMVM is an independent public institution, with administrative and financial autonomy.

3 An English version of this code is available at www.cmvm.pt/en/Legislacao/National_legislation/Recommendations/Documents/Final.trad.Cod.Gov.Soc.09.10.2013.MM.pdf. The first Portuguese corporate governance set of recommendations was produced by the CMVM in 1999. Since this date, the recommendations of the CMVM have been modified approximately every two years, which shows how corporate governance has been constantly evolving.

4 A Portuguese version of this code is available at www.ecgi.org/codes/documents/code_portugal_jan2014_pt.pdf.

Currently, another significant change in the Portuguese corporate governance framework is under way, as the two above-mentioned corporate governance codes currently in force are expected to be unified in a new corporate governance code issued by the IPCG. A draft of this code is currently under scrutiny by the corporate bodies of the IPCG and is expected to be published soon.

Despite their non-binding nature, listed companies are obliged to adopt one of the codes and declare, in their annual corporate governance report,⁵ to what extent the chosen corporate governance code is observed and, if that is the case, the reasons for not complying with any of its provisions (statement of compliance)⁶ – the ‘comply or explain’ rule. As for non-listed companies, which are not bound by these rules, these codes serve, to some extent, as guidelines on corporate governance best practice and therefore have a significant role at the decision-making level of directors and shareholders.

Regarding regulations about corporate governance, CMVM Regulation No. 4/2013, which revoked CMVM Regulation No. 1/2010 and governs (and includes a draft of) the annual report on corporate governance, entered into force on 1 January 2014. This CMVM Regulation introduced more flexibility in terms of the choice of a corporate governance code for listed companies. In fact, it establishes that listed companies shall adopt the CMVM Code or another corporate governance code produced by a competent entity and states that the choice is to be justified in the annual corporate governance report (while Regulation No. 1/2010 established several requisites that other corporate governance codes had to comply with). On the other hand, and even though the number of recommendations was reduced, information duties increased under Regulation No. 4/2013.

Specific types of companies are also subject to sectoral corporate governance rules – for instance, the corporate governance framework of state-sector companies is established in Decree-Law No. 133/2013, of 3 October (as amended), which enacted the State-Sector Companies Legal Framework.

In addition to the above, some Portuguese listed companies have their own corporate governance codes or manuals, which set out internal corporate governance guidelines.⁷

ii Enforcement

Portuguese listed companies’ compliance with corporate governance rules is confirmed through each company’s annual corporate governance report on two levels.

At an internal level, the company’s supervisory corporate body must certify the completeness of that report, in light of the provisions of the CVMob and CMVM Regulation No. 4/2013.

5 The annual report on corporate governance matters forms part of companies’ annual accounts and is prepared pursuant to Article 245-A of the CVMob and CMVM Regulation No. 4/2013. This report is made available to investors and public in general, both at the CMVM’s website (www.cmvm.pt) and on the website of each listed company.

6 This results from Article 1 of CMVM Regulation No. 4/2013. The falsity, incorrectness or incompleteness of this declaration may lead to administrative and civil liability of the company or its directors, or both.

7 This is the case with EDP, whose corporate governance manual is available at www.edp.pt/en/aedp/governosocietario/ManualdeGovernoSocietario/Corporate%20Governance%20Manual/Manual_Governo_Societario_EN_Out12.pdf.

At a regulatory level, the content of the annual corporate governance reports is monitored by the CMVM, which, in its capacity as the securities market regulator, often asks listed companies for clarifications and additional information in connection with the reports.

In addition to this, the CMVM prepares an annual report regarding compliance with corporate governance rules by a significant number of listed companies (the CMVM Report),⁸ both at market-wide and individual levels.

II CORPORATE LEADERSHIP

i Board structure and practices

Alternative corporate governance structures

Following a major legislative reform to the CSC implemented in 2006,⁹ Portuguese companies may now adopt one of three corporate governance structures (with the possibility of changing to another structure following incorporation).

First, companies may adopt the ‘Latin model’, which is the corporate governance structure most commonly used in Portugal and implemented by the majority of both unlisted and listed public limited companies,¹⁰ including some of those listed in the Portuguese Stock Index,¹¹ for example, Galp Energia (oil and gas sector), Sonae SGPS (food industry and distribution sectors), NOS (telecommunications and entertainment sector), The Navigator Company (formerly Portucel) (pulp and paper sector), BPI (banking sector), Mota Engil (construction sector) and Semapa (pulp and paper, concrete and aggregates sectors). Espírito Santo Saúde (health sector), which was publicly listed in February 2014, also uses the Latin model.

Companies that adopt this model have a board of directors (or a sole director)¹² and a supervisory body (a sole auditor or a supervisory board).¹³

Second, companies may adopt the ‘German model’, where they will have an executive board of directors (or an executive sole director)¹⁴ responsible, in general, for managing and representing the company (though with fewer powers than the board of directors under the Latin model); a general and supervisory board, the main function of which is to supervise the directors’ activity, although it also has powers that would typically be exercised by the shareholders’ general meeting, such as deciding on the appointment and dismissal of

8 The most recent CMVM Report is for 2014 and is available at www.cmvm.pt/pt/EstatisticasEstudosEPublicacoes/Publicacoes/governosocietadescotadas/Documents/Relat%C3%B3rio%20Governo%20Sociedades%202014.pdf (the 2014 CMVM Report).

9 This legal reform was enacted by Decree-Law No. 76-A/2006, of 29 March.

10 According to the 2014 CMVM Report, 72 per cent of the 43 analysed companies adopted this model (page 9).

11 That is, the PSI-20, which encompasses the 20 companies with the largest market capitalisation trading on Euronext Lisbon, Portugal’s main stock exchange. Currently this index is formed by 17 companies.

12 Sole directors are permitted in companies whose share capital does not exceed €200,000.

13 Companies are in general allowed to choose between a sole auditor and a supervisory board. However, several categories of companies, such as listed companies, credit institutions and companies that exceed two of the three following thresholds (recently updated by Law No. 148/2015, of 9 September, effective as of 1 January 2016) in two subsequent years and that are not fully held by other companies that adopted this model are obliged to have a supervisory board and a chartered accountant: (1) balance sheet of €20 million; (2) total net turnover of €40 million; and (3) an average number of 250 employees during the fiscal year.

14 Sole executive directors are also allowed if the company’s share capital does not exceed €200,000.

directors (unless these functions are attributed to the shareholders' general meeting in the articles of association), and may even have to authorise directors to carry out certain acts, if so is established in the company's articles of association, and finally a chartered accountant.

In addition, in listed companies and those meeting the criteria pointed out in footnote No. 14, the general and supervisory board must include a financial committee with significant powers in the supervision of financial and accounting matters.

This model is used by EDP (energy sector), which is included in the PSI-20.

Third, companies may choose to implement the 'Anglo-Saxon model', in which case they will have a board of directors and a chartered accountant. Under this model, the board of directors is divided into an executive committee, composed of at least one or two members and responsible for managing the company, and an audit committee composed of at least three members and in charge of, in particular, supervising the activity of the company's management and chartered accountant, and the compliance with the law and with the company's articles of association. The audit committee may not exercise executive functions.

This corporate governance structure is usually adopted by larger companies, as is the case for a significant number of PSI-20 companies, such as REN (energy grid sector), BCP (banking sector), Altri (paper and pulp sector), CTT (one of the recently privatised companies, engaged in the postal services sector) and Jerónimo Martins (food industry and distribution sector).

Composition of the board

Boards of directors (including executive boards of directors under the German model) must be composed of at least two members (there is no maximum number of members), as established in the relevant articles of association.¹⁵

Each board of directors shall have a chairman, who may either be appointed by the shareholders' general meeting at which the directors are appointed, or elected by the directors themselves. The chairman holds the casting vote whenever the board is composed of an even number of members and in all other cases set forth in the company's articles of association.

On 5 January 2017, the Council of Ministers approved Draft Law No. 52/XIII, according to which, as of 1 January 2018 and 1 January 2020, boards of directors (and, if applicable, executive committees) and supervisory boards of listed companies shall be composed, respectively, of at least 20 per cent and 33.3 per cent of persons of each gender (this second threshold applying for state-sector companies as of 1 January 2018). According to this Draft Law, a breach of this rule by listed companies entails that the appointment of directors is merely provisional until the breach is remedied. Should it not be remedied within 90 days, a penalty corresponding to one month of the global remuneration of the members of the board of directors or of the supervisory board, as applicable, is due, this value doubling for each semester of non-remedied breach. However, the Draft Law has still to be ratified by the President of the Republic, meaning that it may still be amended before entering into force.

15 Since 2006 companies have not been required to have an odd number of members in their boards of directors.

Representation and authority to bind the company

Boards of directors have full and exclusive powers to represent the companies for which they are appointed (without prejudice to the appointment of attorneys for a specific act or category of acts and to the authority of the general and supervisory board to represent the company in its relations with the directors under the German model).

These representation powers are exercised jointly by the directors, meaning that a company is bound by the acts carried out (or ratified) by the majority of its directors (or, pursuant to the CSC, by fewer directors, as established in the articles of association), provided that they sign the relevant documentation (when applicable) and indicate their capacity as directors.

Regarding certain matters, representation powers may also be exercised by one or more managing directors or members of an executive committee (see the following section).

In some cases, the execution of a managerial act must be preceded by a resolution of the board of directors approving the act. However, acts following under the scope of the company's corporate purpose do not require a prior resolution of the board, unless the articles of association establish otherwise.

Delegation

The CSC allows the board of directors both to delegate certain management matters to one or some of its members, provided that the company's articles of association do not prohibit delegation, and to delegate the ordinary management of the company to one or more directors (managing directors) or to an executive committee, provided that such delegation is permitted under the company's articles of association.

In both cases, the board of directors must approve the delegation of powers, which may not relate to certain matters listed in the CSC (for instance, the granting of guarantees by the company and share capital increases). Also, this delegation does not exclude the authority of the board of directors to decide on the delegated matters, nor does it annul the liability of the remaining directors for acts carried out by the managing directors or executive committee.

The delegation of board powers is expressly permitted in companies that have implemented the Latin and the Anglo-Saxon corporate governance models but is not referred to in the legal provisions governing the German model. Hence, scholars tend to sustain that delegation of management powers is not permitted under this structure.

The delegation of management matters to an executive committee in companies following the Latin corporate governance model (which, as referred to above, is the most frequent) is used in most of the Portuguese listed companies.¹⁶

CEO and chairman

It is possible, both for companies following the Latin model and that have an executive committee and for companies that follow the Anglo-Saxon model, to have a chairman and a CEO – the chairman corresponds to the chairman of the board of directors and the CEO to the chairman of the executive committee.

¹⁶ According to the 2014 CMVM Report, 28 of the 43 listed companies scrutinised had an executive committee (page 14).

No legal or regulatory provision prevents the same person from performing both offices and a significant number of listed companies do indeed combine the two positions in the same person,¹⁷ including some PSI-20 companies.¹⁸

Remuneration

Pursuant to the CSC, the remuneration of directors in companies following the Latin and Anglo-Saxon governance models is determined either by the shareholders' general meeting or by a remuneration committee appointed by it. Under the German model, directors' remuneration is decided either by the general and supervisory board or by a committee appointed by it or, if the articles of association so establish, by the shareholders' general meeting or by a remuneration committee appointed by it.

The CSC further establishes that, in either case, directors' remuneration must be determined taking into consideration the functions performed by each director and the company's financial situation and that it may either be fixed or partially variable, depending on the company's annual distributable profits. However, the maximum percentage of annual profits used for this purpose must be specified in the company's articles of association.¹⁹

In this respect, the 2013 CMVM Code recommends, in particular, that (1) all members of the remuneration committee (or its equivalent) be independent from the executive directors and that at least one of its members has knowledge and experience in remuneration matters; (2) the remuneration committee not comprise any person or entity that renders or has rendered, in the previous three years, services to any structure under the management or to the management itself or that has any relationship with the company or with any of the company's consultants; (3) the remuneration of non-executive directors not include any variable component subject to the company's performance or value; (4) a significant part of the variable remuneration be deferred for at least three years and received only if the company maintains a good performance throughout that period; (5) directors not enter into any agreements with the company or with third parties aimed at mitigating the risk of their variable remuneration.

In smaller companies, remuneration of corporate bodies is usually determined by the shareholders' general meeting, while in larger companies this is normally decided by a committee appointed specifically for that purpose.

17 According to the 2014 CMVM Report, in 28 per cent of the listed companies analysed that followed the Latin Model and had an executive committee, the chairman and CEO posts were held by the same person (page 15).

18 This is the case, for instance, with CTT.

19 According to the 2014 CMVM Report, fixed remunerations represented 76 per cent of the total remuneration of listed companies' directors (against 24 per cent in the case of variable remuneration). Of the listed companies analysed 37.2 per cent contributed to pension plans or subscribed pension funds for the benefit of their directors (pages 21 and 34).

Say on pay

Pursuant to Law No. 28/2009 of 19 June (as amended), the management body (or the remuneration committee, if one exists) of public interest companies²⁰ shall submit to the annual shareholders' general meeting a declaration regarding the remuneration of the members of its management and supervisory corporate bodies.²¹

This declaration shall include information regarding, in particular, (1) the mechanism enabling the alignment of directors' interests with the company's interests; (2) the criteria for defining the variable component of their remuneration; (3) the possibility of the variable part of the remuneration, if any, being paid, fully or partially, after the clearance of the accounts regarding the entire term of office; and (4) the mechanisms to limit the variable remuneration if the annual results show a significant deterioration in the company's performance over the previous financial year or the same is expected in the ongoing financial year.

In addition, these companies must disclose their remuneration policies in their annual accounts – in the case of listed companies, this shall be included in their annual corporate governance report.

ii Directors

Legal duties

Under the CSC, there are two general duties that must be observed by directors in the performance of their management activities: the duty of care and the duty of loyalty.

Pursuant to their duty of care, directors must carry out the company's management with the diligence, dedication, skill and knowledge of the company's business considered appropriate to their functions in the company. In this regard, the law defines a standard: a director must act as a diligent and responsible businessman (prudent businessman).

Although the CSC does not clarify what this general duty includes, it is understood that it includes specific duties such as the duties to (1) monitor the company's activity and economic performance and to control the activities of its employees and officers; (2) remain fully informed, at all times, of the company's status; (3) adequately and promptly execute the necessary management acts, based on proper information; and (4) make reasonable and rational decisions avoiding unmeasured risks that could jeopardise the company's assets.

Directors are also bound to a duty of loyalty, according to which they must act to the exclusive benefit of the company, considering the interests of shareholders and other stakeholders (in particular, employees, clients and creditors) without acting with the intent to obtain benefits for themselves or for third parties while performing their management duties.

It is understood that this general duty entails that directors, in particular, (1) may only enter into agreements with the company where permitted by law and certain requirements have been met (specifically, there are certain agreements that the company is prevented from entering into with its directors, such as the granting of credit or guarantees to secure the directors' obligations; as regards other agreements, the same must, as a general rule, be

20 Pursuant to Law 148/2015 of 9 September, listed companies, credit institutions, investment funds, pension funds, private equity companies and funds, and holding companies in the insurance sector, among others, are considered public interest companies.

21 CMVM Regulation No. 4/2013 extends this obligation, establishing that the annual corporate governance report shall also include a reference to remuneration received by the directors from companies controlled or fully owned by or that control or fully own the company or that are controlled by the same entity controlling the company.

previously approved by the company's board of directors and be subject to a favourable opinion from the supervision body); (2) may not carry out any activity that conflicts with the company's activity without authorisation obtained at the shareholders' general meeting; (3) may not vote on resolutions of the board of directors when they are affected by a conflict of interest with the company; and (4) may not use the company's assets or know-how to their own benefit and must maintain the confidentiality of all information relating to the company.

In addition to these general duties, the CSC subjects directors to specific duties, such as the duty to carry out the company's activities within its corporate purpose (as set forth in the company's articles of association), the duty to convene the shareholders' meeting when so required by the law and the duty not to execute decisions taken by the board of directors that are null and void.

Further to these duties, sectoral laws and regulations also set forth duties to be complied with by directors while performing their management functions.

In addition, both the company's articles of association and management agreements entered into between the company and the directors may also establish additional duties to be observed by directors.

Liability

In the event of a breach of any of their duties, directors may be held civilly, administratively and criminally liable for damage they cause, and they may also be dismissed with just cause by the company.

Directors are civilly liable towards the company, its creditors and shareholders and third parties, on a joint and several basis.

However, their liability may be excluded if the damage results from a decision of the board of directors and the relevant director has not taken part in the relevant meeting or voted against the winning proposal and has issued a formal statement of his or her refusal.

Directors' liability towards the company is based on the damage suffered by the latter as a result of any action or omission in breach of their duties, unless they prove that they acted or omitted to act without fault (their fault is presumed).

Pursuant to the CSC, directors' liability towards the company may be excluded in the following cases:

- a* if the director proves that he or she acted in a duly informed manner, free from any personal interest and according to business rationality criteria (the business judgement rule); and
- b* if the director's relevant act or omission was carried out pursuant to a shareholders' decision (even if the decision is not valid).

Directors are also liable towards the company's creditors if the company's assets become insufficient to fully satisfy the latter's credits as a result of an act or omission carried out by the directors at fault and if said act or omission constitutes a breach of those specific provisions in law or in the company's articles of association aimed at protecting the company's creditors. In that event, the directors' fault is not presumed and hence creditors bear the corresponding burden of proof, and liability is not excluded if the directors' behaviour is based on a shareholders' decision.

Directors are also directly liable towards the company's shareholders (as individuals) and third parties for any damage directly caused to them as a result of the directors' actions or omissions in breach of their duties. Directors shall not be liable if their action or omission has been executed pursuant to a shareholders' decision (even if invalid).

Moreover, the breach of duties by directors may entail their criminal liability (if the offences at stake are expressly set out in the Portuguese criminal legislation) as well as their liability under the applicable tax, labour and insolvency legal provisions.

Furthermore, in the event of a serious breach of their duties, directors may also be dismissed with just cause by the company's shareholders' general meeting.

Appointment formalities

Directors may be appointed either in the company's articles of incorporation (as regards the initial term of office) or by the shareholders' general meeting – in which case, the formalities of shareholders' general meetings need to be complied with, in particular, summoning²² and information²³ formalities.

As a general rule, no special requirements are needed for an individual to be appointed as a director.

In particular, directors do not have to be shareholders and may either be Portuguese or foreign natural persons;²⁴ it is possible to appoint a legal person as director, but in such cases that legal person shall indicate a natural person to perform the office in his or her own name (even though the appointed legal person remains jointly and severally liable for any damage caused by the designated natural person).

Despite this general rule, the CSC provides specific requirements regarding directors of listed companies and of companies that meet the criteria indicated in footnote 14, *supra* that follow the Anglo-Saxon model.²⁵ In these cases, the CSC requires that at least one member of the audit committee hold a degree compatible with his or her functions, expertise in audit or accounting and be independent. In listed companies that trade shares on regulated markets and that follow this model, the majority of the members of the audit committee need to be independent.

22 As a general rule and pursuant to the CSC, shareholders' general meetings need to be summoned with a prior notice of at least one month (in listed companies, the CVMob establishes minimum prior notice of 21 days), even though shareholders may adopt resolutions without any prior formalities provided that some requisites are met (in particular, provided that all shareholders are present or duly represented, which is not feasible for listed companies but is quite common for small-medium unlisted companies).

23 Certain elements need to be provided to the shareholders at the company's registered office in the 15-day period prior to each shareholders' general meeting. For instance, if the agenda of the meeting includes the appointment of corporate bodies, the company shall make available, in particular, the names of the persons proposed to be appointed, their professional qualifications, the list of the activities carried out in the past five years and the number of shares held by them in the company's share capital.

24 To be registered as a director of a Portuguese company, foreign persons need to previously obtain a Portuguese taxpayer number. Non-EU citizens also have to appoint a tax representative.

25 Both the CSC and specific legislation governing public interest companies also require that the members of supervisory corporate bodies and the chairman and secretary of the shareholders' general meeting comply with certain independence, incompatibility and knowledge requirements.

The 2013 CMVM Code establishes general recommendations in this regard, recommending that every listed company has an adequate number of independent directors among the non-executive directors (bearing in mind the corporate governance model adopted by the company, its dimension, shareholding structure and free float).²⁶

According to the CSC, a person is considered independent if he or she is not linked to any group of specific interests in the company and is not affected by any situation that may affect his or her capacity for unbiased analysis and decision-making, in particular, but not limited to, owing to: being a holder of or acting in the name or on behalf of a holder of qualified shareholdings of at least 2 per cent of the company's share capital; or having been reappointed for three or more terms of office, either on a consecutive or intermittent basis.

The 2013 CMVM Code adds the following as situations that may impair one's independence:

- a* having been an employee at the company or at a company controlled or fully owned by or that controls or fully owns it, within the previous three years;
- b* having, within the previous three years, provided services or established a significant commercial relationship with the company or with a company controlled or fully owned by or that controls or fully owns it, either directly or as a shareholder, director or officer;
- c* being paid by the company or by a company controlled or fully owned by or that controls or fully owns it in excess of the remuneration arising from the exercise of his or her functions as a director;
- d* cohabiting with or being married to, a relative or related in direct line or in indirect line up to the third degree (inclusive) of directors or natural persons who directly or indirectly hold a qualifying holding in the company; or
- e* being or representing a qualifying shareholder.

The two main specificities under the CSC regarding independent members of corporate bodies are that they may only be dismissed with just cause and their remuneration is mandatorily fixed.

Even though compliance with guidelines on directors' independence is increasing, independence remains one of the areas where fewer companies comply with the CMVM's recommendations (and where the percentage of inadequate explanations on the non-compliance is higher).²⁷

26 Once more, this corporate governance code is more flexible than the one approved by the CMVM in 2010, which required that, in all cases, at least a quarter of the non-executive directors was independent.

27 According to the 2014 CMVM Report, independent directors represented on average 34 per cent of non-executive directors (page 10). Also, according to a report prepared by Católica Lisbon Business & Economics and the Association of Portuguese Listed Companies (AEM) in 2014, with reference to the annual corporate governance reports submitted in 2013 (available at www.cgov.pt/images/stories/ficheiros/relatorio_catolica_lisbon_aem_governo_das_sociedades_em_portugal_2014.pdf; the 2013 Católica/AEM Report), the recommendations on directors' incompatibility and independence were still some of the least followed among Portuguese listed companies – in particular, only 59 per cent (against 38.1 per cent in 2012) of these companies followed the recommendation establishing that, among the non-executive directors, there shall be an adequate number of independent directors (page 24). The remaining recommendations on these matters were observed by most Portuguese listed companies.

Term of office

The articles of association must establish the duration of the directors' term of office, which shall not exceed four calendar years and may be renewed.²⁸

Once their term of office expires, and unless they resign or are dismissed or a new member of the board is judicially appointed, directors remain in office until their substitutes are appointed.

Conflicts of interest

Based on the general duty of loyalty under the CSC (please see above), directors are required to abstain from voting on resolutions regarding matters in which they have, directly or indirectly, a conflict of interest with the company, as well as to disclose to the chairman of the board any potential conflict of interest or other reasons of incompatibility pertaining to their office.

As regards transactions between companies (and companies controlled or fully owned by or that control or fully own them) and directors, the CSC prevents companies from granting loans to directors, granting guarantees as security of their obligations, making payments on their behalf and making remuneration advancements exceeding one month of remuneration.

The CSC also requires that other agreements between companies and their directors be previously approved by the board of directors (in which the director at stake is prevented from voting) and subject to a favourable opinion from the supervision body. These rules do not apply if the transaction falls under the scope of the normal business of the company and does not attribute any special benefit to the director.

III DISCLOSURE

i Financial reporting and accountability

Directors of Portuguese companies are required to annually prepare and submit to the shareholders' general meeting for approval the company's annual accounts,²⁹ the annual management report and other related documents.

In 2009, additional requirements were implemented in the CSC regarding transparency and disclosure, as companies were required to indicate in their annual accounts the nature, commercial purpose and financial impact of any transactions not reflected in their balance sheets whenever the risks or benefits resulting from those transactions are relevant and the disclosure of those risks or benefits is necessary to assess the company's financial situation. In addition, it became necessary to disclose the total amounts of professional fees invoiced by the chartered accountant regarding the annual statutory audit and the professional fees invoiced by it in respect of reliability guarantee, tax consulting and other services. Further, it also became necessary to identify all related-party transactions, indicating the specific

28 Pursuant to the 2014 CMVM Report, in 2014 the articles of association of 58.1 per cent of the listed companies under scrutiny set forth the directors' term of office as three years. This report also shows that directors had been performing their functions for an average of 6.3 years and that 5 per cent of the directors had been serving as directors for at least 20 years (page 11).

29 Companies' annual accounts are publicly accessible at www.portaldaempresa.pt/CVE/IES/ServicosIES.aspx.

amount of each transaction, the nature of the relationship with the related party and other details necessary to assess the company's financial situation, whenever those transactions are considered relevant and have not been carried out in normal market conditions.

Likewise, the 2013 CMVM Code recommends that transactions between the company and shareholders with qualifying holdings (or entities related to the same) are carried out in normal market conditions.³⁰

Also, pursuant to the CSC, the management annual report shall contain a faithful and clear description of the performance and situation of the company and indicate the main risks and difficulties it is facing. This report shall also identify the authorisations given by the board for transactions between the company and its directors and the shareholdings held by its main shareholders and members of its corporate bodies.

Lastly, the 2013 CMVM Code establishes recommendations according to which all information necessary to be informed of the evolution and economic, financial and governance situation of listed companies shall be made available (both in Portuguese and English) on the companies' websites and that each company shall have an investor relations office, which shall be in permanent contact with the market.

ii Auditors' role and incompatibilities

Auditors are required to be present in all listed companies, regardless of the corporate governance model adopted, and their main role is to verify that the company's financial statements present fairly in all material respects its financial position. In light of this analysis, they prepare an annual report with their main findings and conclusions.

Auditors are also responsible for verifying, in particular, whether the company's books and accounting records are in good order and if the accounting principles and criteria used by the company lead to a correct evaluation of its assets and results.³¹

Auditors must be chartered accountants or chartered accountant companies, a profession supervised by the Chartered Accountants Association (OROC), which exercises some functions considered by law to be of public interest.

The Chartered Accountants Act³² sets forth certain requisites to access the profession, for example, it is necessary to have a degree in auditing, accounting, law, economics or management, and to have passed the admission examination to the OROC.

In addition, Law 148/2015 of 9 September established some additional requirements that auditors of public interest companies need to meet.

Furthermore, the CSC establishes a list of incompatibilities that, if verified, prevent auditors from holding a post in a given company – for instance, persons receiving private benefits from the company or who perform functions in a competing company cannot be appointed as auditors (similarly, their posts will be automatically terminated if any of the incompatibilities set forth in the CSC is subsequently verified).

30 The 2010 Code approved by the CMVM included identical recommendations on this matter.

31 Pursuant to the CMVM 2013 Code, auditors shall verify the application of the systems and policies regarding remunerations of corporate bodies, the effectiveness and functioning of internal control mechanisms and communicate any irregularities to the supervision body (the same recommendation was also set forth in the 2010 Code).

32 English version available at www.oroc.pt/fotos/editor2/Tecnico/2010/estatutosEN.pdf.

IV CORPORATE RESPONSIBILITY

i Risk management

Pursuant to the 2013 CMVM Code, the board of directors or the general and supervisory board, depending on the adopted structure, shall set goals regarding risk management and create risk control systems to guarantee that the risks effectively borne by the company are consistent with those goals. This code also sets out that the supervisory body shall evaluate the functioning of the internal control and risk management systems and propose the necessary adjustments.³³

Additionally, sectoral legislation and regulations require certain companies to create risk management mechanisms (for instance, the CVMob sets out such requisites regarding financial intermediaries).

In line with this, most of the Portuguese listed companies have internal risk control systems and internal audit units.³⁴

ii Compliance policies and whistle-blowing

According to the 2013 CMVM Code, the audit committee, the general and supervisory board and the supervisory board (depending on the adopted corporate governance structure) shall assess the internal compliance systems and receive the reports prepared by the compliance services at least when these reports concern the company's annual financial statements, the identification and resolving of conflicts of interest and the detection of possible illegalities.

The 2010 CMVM Corporate Governance Code also recommended that listed companies adopt whistle-blowing policies and indicate the main aspects of those policies in their annual corporate governance reports. These recommendations were not maintained in the 2013 CMVM Code. However, it would be hasty to conclude that these recommendations could or should simply be disregarded by companies.³⁵

Also, sectoral legislation and regulations specifically require certain companies to implement compliance or whistle-blowing mechanisms or both.

Regarding whistle-blowing policies, it is essential to bear in mind data protection issues. The Portuguese Data Protection Agency (CNPd) has strict requirements that must be observed by companies while implementing whistle-blowing mechanisms.³⁶

V SHAREHOLDERS

i Shareholder rights and powers

Equality of voting rights

The general rule in Portuguese corporate law is that each share corresponds to one vote and that all shares attribute equal voting rights to their shareholders.

Nevertheless, the CSC allows companies to establish two departures from this principle (not to mention the possibility of issuing preferred shares with no voting rights, which are

33 Similar recommendations were established in the CMVM 2010 Code.

34 Pursuant to the 2014 CMVM Report, 90.6 per cent and 62.7 per cent of Portuguese listed companies had, respectively, internal risk control systems and internal audit units (page 19).

35 According to the 2014 CMVM Report, 81.3 per cent of Portuguese listed companies declared that they had implemented whistle-blowing policies (page 19).

36 Refer to Resolution No. 765/2009 of the CNPD.

also expressly permitted under the CSC and confer no voting rights at all on their holders). On the one hand, a company's articles of association may establish that a certain number of votes only entitle the shareholder to one vote, which is common in large companies.³⁷ On the other, the articles of association may establish that shareholders have a maximum number of votes (meaning that the votes above the fixed threshold would not be taken into consideration).

This notwithstanding, the current trend, consistent with the recommendations of the 2013 CMVM Code, is to abolish these limits.³⁸

In any case, there are differences between the CMVM 2010 and 2013 recommendations in this regard. In particular, the CMVM 2010 established that companies should ensure the proportionality between the voting rights and the percentage of share capital held by each shareholder, preferentially, by means of provisions in their articles of association attributing one vote to each share held. The CMVM 2010 Code further set forth that proportionality would not be met in companies that established any of the two deviations referred to above and that no restrictions should be created for postal votes and, when permitted, electronic votes.

The 2013 Code seems more permissive, as it merely establishes that companies should urge their shareholders to participate and vote in the shareholders' general meetings,³⁹ in particular, by not setting an unreasonable minimum number of shares necessary to have one vote and by implementing the necessary mechanisms allowing the shareholders to vote by correspondence and by electronic means.

Decisions reserved to shareholders

The CSC sets a clear distinction between the powers of shareholders and directors.

In public limited companies,⁴⁰ shareholders are specifically competent to pass resolutions on the matters attributed to them by law and the company's articles of association. Moreover, they have both a residual competence and an extraordinary competence.

Within the competence specifically attributed to them by law, shareholders are the body responsible for deciding, for instance, on the approval of the company's annual accounts, the

37 In any case and pursuant to the CSC, shareholders may form groups to jointly have the minimum number of shares necessary to vote, in which case they shall appoint a common representative to participate in the shareholders' general meeting in their name.

38 Pursuant to the 2014 CMVM Report, there were 11 companies where more than one share was necessary to have one vote, the same number as in 2013 and 2011; previously, the figure in 2011 had confirmed a downward trend in this regard (in 2010 there were 13, in 2009 there were 15 and in 2008 there were 25 companies with this regime) (page 7).

39 Pursuant to the 2012 CMVM Report, the average percentage of share capital present at the shareholders' general meetings taking place in 2012 was 75.7 per cent (page 41). No information is provided on this point either in the 2013 CMVM Report or in the 2014 CMVM Report.

40 *Sociedades anónimas* – as opposed to private limited companies, *sociedades por quotas*, which are traditionally used for smaller and family companies.

distribution of dividends,⁴¹ any modification to the company's articles of association,⁴² the merger, demerger or conversion into a different type of company, the winding-up of the company and the appointment and dismissal of directors.⁴³

Under their residual competence, shareholders have authority to decide on matters not entrusted to other corporate bodies.

Finally, shareholders' extraordinary competence entitles them to decide on management matters, provided that their intervention is required by the management body.

In fact, management decisions in public limited companies are, as a general rule, taken by the board of directors. For instance, directors have authority to prepare the company's annual accounts (which are subsequently submitted to the shareholders' general meeting) and to decide on the acquisition, transfer and creation of encumbrances over real estate assets and shares in other companies' share capital, the granting of guarantees by the company, important modifications to the company's organisation, etc.

Rights of dissenting shareholders

In the event that specific important resolutions are approved at the shareholders' general meeting and one or more shareholders vote against the winning proposal, the dissenting shareholders have the right to withdraw from the company and receive the price of their shares.

This is the case, for instance, if the other shareholders approve a change of the company's registered office to another country, a merger with another company (in some types of mergers, provided that the withdrawal right is set forth in the company's articles of association) and the conversion into another company type (provided that this right is established in the company's articles of association).

Shareholding structure

Ownership of Portuguese listed companies is usually very concentrated, with several cases of block holders and family shareholders.

In fact, according to the most recent available data, 55.8 per cent of listed companies had controlling shareholders, holding an average of 67.1 per cent of the share capital.⁴⁴

41 Except for any advancement of profits resolved by the board, as allowed under the CSC provided that certain specific requisites are met.

42 Except for the change of the company's registered office within the national territory and share capital increases, which, if not prohibited or allowed by the company's articles of association, respectively, may also be approved by the board of directors (for share capital increases certain requisites set out in the CSC must also be met).

43 However, in the event of a definitive absence of a director, directors may co-opt a new director to replace the absent one, by means of a resolution of the board of directors (except in companies adopting the German model). The co-optation needs nevertheless to be ratified by the first shareholders' general meeting taking place after that resolution has been passed by the board. Also, in companies that have implemented the German model, the power to appoint and dismiss directors belongs in principle to the general and supervisory board.

44 Information included in the 2014 CMVM Report (page 3). The 2013 CMVM Report also showed that most of the qualifying shareholdings were held by qualifying investors (page 5), but this information is not provided by the 2014 CMVM Report. Pursuant to the CVMob, a holding is considered qualifying whenever it reaches 2 per cent or more of the voting rights corresponding to the company's share capital. Among others, credit institutions, insurance companies, investment funds, pension funds, private equity companies and funds, as well as legal entities that, according to their most recent individual financial

ii Shareholders' duties and responsibilities

In addition to the general obligations to which all shareholders are bound (in particular, the obligations to pay up the shares subscribed in the company's incorporation and share capital increases), shareholders of listed companies are subject to additional information obligations according to which they must inform both the company and the CMVM if they reach or fall below the shareholding thresholds established in the CVMob.⁴⁵

Also, if a controlling shareholder reaches a shareholding of 90 per cent in a company, it must inform the company of the fact (as well as the CMVM in the case of listed companies) and may be obliged to acquire the shares held by the remaining shareholders.

More importantly, the CSC sets out a specific liability framework applicable, in particular, to companies that fully own other companies (or in some cases, own at least 90 per cent of their share capital). Pursuant to this framework, a parent company may be held liable for the obligations of its subsidiary if the latter does not comply with them in the 30-day period granted by the relevant creditor for that purpose. Also, the parent company may be obliged to compensate the annual losses of its subsidiaries once their relationship terminates or if the subsidiaries are declared insolvent.

The CSC also establishes a general framework under which the sole shareholder of a company declared insolvent may be held liable on an unlimited basis for the obligations assumed in the period after it became the sole shareholder, provided that it is evidenced that during that period there was no adequate separation between the company and the shareholders' assets.

iii Takeover defences

Voting caps

As mentioned above, CMVM's general recommendation regarding voting rights is the one-share one-vote rule, even though the 2013 CMVM Code seems to be somehow more permissive on this matter when compared with the 2010 Code.

In any case, and as also mentioned, the CSC does allow articles of association to establish a maximum number of votes per shareholder (acting both in its own name and as representative of another shareholder), meaning that the votes above the fixed threshold are not taken into consideration.⁴⁶

White-knight defence

The white-knight defence is one of the anti-takeover measures expressly admitted by Portuguese law.

In this regard, the CVMob expressly allows management to, after the public offering is known, and with no need of authorisation from the shareholders' general meeting, look for competing bidders, as an exception to the passivity rule (which limits management powers

statements, have a dimension considered significant are considered to be qualifying investors (which will be the case if they meet two of the following thresholds: (1) equity of €2 million; (2) total assets of €20 million; and (3) net turnover of €40 million).

45 According to a study prepared by Riskmetrics in 2009, Portugal was the first Member State to implement disclosure duties for qualifying investors in 2003.

46 According to the 2014 CMVM Report, 16.2 per cent of the listed companies scrutinised had adopted this mechanism and the average maximum percentage of voting rights per shareholder was 20 per cent (page 8).

to ordinary management since the offering is launched). Competing offerings must offer compensation at least 2 per cent higher than the one of the prior offering and may not contain conditions that make it less favourable.

Despite its relevance, this measure may, however, be insufficient, as the initial bidder may revise its initial offering.

Staggered boards

There is no express rule under Portuguese law prohibiting staggered boards.

Hence, provided that this is clearly governed in the articles of association, nothing seems to prevent companies from appointing different groups of directors, with each group serving for a different term of office (however, the duration of directors' terms of office, which may vary from one to four years, needs to coincide).

In any case, staggered boards are not common practice in Portugal (with this mechanism being considered unlawful by some scholars).

VI OUTLOOK

Even though Portuguese companies have, since 2014, had the opportunity to choose between two different corporate governance codes (the 2013 CMVM Code and the first private-initiative corporate governance code, produced by the IPCG), adherence to the IPCG Code was not significant and the CMVM Code continued to be the benchmark reference for most Portuguese listed companies.

Currently, a new IPCG Code (resulting from a merger of the two existing corporate governance codes, with improvements) is expected to be published in 2017, meaning that the IPCG will become the entity issuing the sole corporate governance code applicable to Portuguese companies; the CMVM is, however, expected to maintain its supervisory powers in this area.

Another hot topic in 2017 is the implementation of the regime aimed at guaranteeing improved gender-equality on boards of directors and supervisory boards, with the possibility of the entry into force of Draft Law No. 52/XIII being imminent.

On the basis of the latest reports on the adoption of corporate governance practices by Portuguese companies, levels of compliance have been increasing significantly in recent years,⁴⁷ which suggests that Portuguese companies are on the right track as far as corporate governance is concerned.

⁴⁷ Pursuant to the 2012 CMVM Report, the average compliance with the set of recommendations was 90.7 per cent. In particular, the average compliance with the recommendations on shareholders' general meetings and information increased to 98 per cent (page 48). The recommendations regarding the board of directors were complied with by an average of 89 per cent of the companies, whereas in 2010 the compliance rate was 72 per cent and in 2011 it was 88 per cent (page 53). The recommendations on remuneration matters had a clearly inferior compliance rate (79.2 per cent), despite a significant improvement of 24.2 per cent in comparison with 2010 (page 61). The average level of compliance with the recommendations regarding auditors was 87 per cent, representing a 3 per cent increase compared with 2011 (page 64). Neither the 2013 CMVM Report nor the 2014 CMVM Report provide updated figures on the levels of compliance with each set of recommendations.

The 2013 Católica/AEM Report also emphasised the good performance of Portuguese listed companies as regards compliance with the 2013 CMVM Code (with an average compliance score for listed companies

Notwithstanding the above, taking into consideration both legislative changes and market needs, continued improvements to corporate governance rules are expected, from both the CMVM and other regulatory authorities, such as the Bank of Portugal, and from private players, such as the IPCG.

of 9,124/10,000 points) (page 40). This most recent report also highlights that PSI-20 companies register higher compliance levels than other listed companies, suggesting that greater exposure to the market leads to a greater implementation of corporate governance recommendations.

RUSSIA

*Danil Guryanov, Denis Morozov and Bogdana Shtoma*¹

I OVERVIEW OF GOVERNANCE REGIME

i Legal and institutional framework

The core statute setting forth the general framework for the Russian governance regime is the Russian Civil Code (RCC).² The RCC outlines the basic available corporate forms (including the most commonly used forms: the limited liability company (LLC) and the joint-stock company (JSC)), the structure and powers of the various corporate bodies, the rules on representation, the statutory duties and the matters of civil liability of a company's management and controlling persons, and the procedure for bringing derivative actions. The JSC Law³ and the LLC Law⁴ each expand upon and supplement the RCC provisions. Importantly, the JSC Law also specifies takeover procedures in respect of public JSCs. The provisions of those laws are primarily enforced by shareholders through Russian commercial (or *arbitrazh*) courts.⁵

Another statutory framework is the Securities Market Law.⁶ This lays out the operational rules for all securities market participants in relation to the offering of securities, the marketing of financial products and the disclosure of information. Regulatory and interpretative acts of Russian regulatory and enforcement agencies (such as the Standards for Issuance of Securities⁷ and the Disclosure Rules⁸) expand upon and supplement the provisions of the Securities Market Law.

Both public and non-public corporations active in certain highly regulated sectors of the Russian economy (such as banks, insurers, non-state pension funds and professional securities market participants) are bound by industry-specific legislation. This legislation specifies management qualification and reputation requirements, liquidity and financial stability standards, risk management and compliance procedures, and in certain cases, specific

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2 Civil Code of the Russian Federation (Part 1) (Federal Law No. 51-FZ dated 30 November 1994).

3 Federal Law No. 208-FZ On Joint-Stock Companies dated 26 December 1995.

4 Federal Law No. 14-FZ On Limited Liability Companies dated 8 February 1998.

5 For ease of reference Russian *arbitrazh* courts are referred to as 'commercial courts' in this chapter.

6 Federal Law No. 39-FZ On the Securities Market dated 22 April 1996.

7 Regulation No. 428-P On Securities Issuance Standards, the Procedure of State Registration of Issuance (Additional Issuance) of Securities, the Procedure of State Registration of Securities Issuance Reports and the Registration of Securities Prospectuses approved by the Central Bank of the Russian Federation on 11 August 2014.

8 Regulations on Disclosure of Information by the Issuers of Securities No. 454-P approved by the Central Bank of Russia on 30 December 2014.

requirements in relation to the structure of the governing bodies of the regulated company. Industry-specific legislation is primarily enforced by Russian regulators. The Russian Central Bank (CBR) is the key regulator, which is in charge of the listed companies' regime and generally responsible for the prudential regulation and supervision of Russia's financial services industry.

Best practice provisions for listed companies are set out in the Corporate Governance Code (CGC)⁹ and the listing rules of licensed stock-exchanges.¹⁰ Listed companies are expected to comply with the CGC or disclose and explain non-compliance in their annual reports. Companies must comply with the listing rules requirements to obtain and maintain premium or standard listings (rather than mere quotations) at the stock exchange. Best practice provisions for certain regulated companies are determined and enforced by self-regulatory organisations (SROs) in each sector. For example, the law on self-regulation of financial markets¹¹ requires the SROs for professional security markets participants to agree with the CBR the corporate governance standards for their members, which will then be mandatory.

ii Corporate governance regime – latest developments

Virtually non-existent in the early 1990s following Russia's abrupt transition to a market economy and privatisation, corporate governance standards have gained more significance over the years and became one of the top policy issues in 2010, when the Russian government launched an initiative to transform Moscow into an international financial centre and channel investments in Russian assets from foreign jurisdictions onshore.

Of all the steps taken to achieve this ambitious goal, those intended to improve the quality of capital markets' infrastructure and financial services' regulatory framework were the most successful. For example, the government has successfully completed the reforms of netting and clearing arrangements on organised markets, stock exchanges and custodian activities; self-regulation of financial markets; facilitated the access of foreign investors to Russian markets through international clearing systems; and implemented measures against the abuse of inside information and market manipulation. In a further attempt to improve the stability of the financial services industry, the Russian government has begun to regulate it more closely. Since concentrating the regulatory functions for that sector under the auspices of the CBR in 2013, the CBR has been waging a large-scale campaign against financial institutions and their management involved in bad faith or suspicious transactions or practices detrimental to their clients (for example, money laundering, asset dissipation and write-offs, misstatement of financial reports, excessive risk assumption). According to the CBR's official statistics, as at 27 January 2017 there were more than 30 cases pending before Russian courts on personal liability of the management and controlling persons of insolvent credit organisations.¹² The CBR's continued efforts on removing financially unstable and non-compliant participants from the financial services market have recently received commendation and public support from the highest-level Russian officials.

9 Corporate Governance Code, published in the Official Journal of the Bank of Russia No. 40 (1518) (18 April 2014).

10 Each stock exchange develops a set of rules for access to public trading in securities that in turn are based on the benchmark approved by the regulators.

11 Federal Law No. 223-FZ On Self-Regulatory Organisations on Financial Markets dated 13 July 2015.

12 <http://cbr.ru/credit/likvidbase/LikvidBase.aspx>.

As part of broader reforms of Russian civil law, in 2014, the RCC was amended to distinguish between public and non-public companies (with non-public companies having significantly greater flexibility in their governance arrangements). A company is deemed to be public if it has registered prospectus in respect of its shares or instruments convertible into shares and has entered into a listing agreement with a licensed stock exchange.¹³

In its further corporate governance reforms, the government concentrated on the two principal conflict areas common in virtually any corporate governance regime. Those are the conflicts between (1) the interests of the majority and minority shareholders and (2) the shareholders in general and the management of the company. In assessing how regulation of the first of those conflict areas was addressed, it is important to remember that the Russian economy is characterised by a high concentration of ownership and control, in both public and non-public companies, and a very significant government footprint (with the government holding controlling stakes in key players in banking, energy, transport, machinery, telecoms and various other sectors).¹⁴ The majority shareholders are often perceived by Russian policymakers as being in the business for the long run, and taking a strategic interest in its development. While recognising the importance of attracting financial investors into Russian businesses, policymakers often see financial investors as having a more speculative interest in obtaining a short-term return on their investment. The key concern of Russian policymakers in respect of minority shareholder protection matters was, therefore, to avoid the overextension of the powers of the minority shareholders, and so to prevent a significant rise in shareholder activism by short-term speculative investors (or their nominees to the supervisory board, now that they have been entitled to bring derivative actions) to the detriment of the company's long-term stability and development. To try to find the balance between the various conflicting interests in this area, the government retained very low thresholds for shareholders to bring derivative actions (1 per cent for derivative actions concerning management liability or to challenge some *ultra vires* transactions of management). At the same time, to limit the room for potential abuse of the right to bring the derivative actions, a more complicated procedure for bringing those actions was introduced to the JSC Law. This procedure requires the claimant shareholder or the claimant supervisory board member to notify all the shareholders in the company of its intention to bring a derivative action (by submitting the notice to the company, which then forwards it to the shareholders), and contemplates a cut-off time for all shareholders to join derivative actions initiated by a shareholder or by a supervisory board member. Shareholders who do not join the action lose their right to bring any action in connection with the same matter in the future. On the other hand, Russian corporate law

13 This definition was introduced in 2015. However, immediately following the 2014 reform of the RCC, a different definition of a public company applied, which allowed a company simply to opt to acquire public status without arranging for the public trading of its shares. Simultaneously with the introduction of new requirements for acquiring public status, for those companies that had previously opted in favour of public status but do not satisfy the new criteria, the law established a transition period up to 2020, during which those companies should either apply for termination of their public status or register a prospectus for their shares or securities convertible into shares.

14 OECD, 'OECD Economic surveys: Russian Federation: January 2014: Overview', page 9 (www.oecd.org/eco/surveys/Overview_RUSIA_2013.pdf).

was supplemented with a concept of liability of controlling persons¹⁵ of the corporation to enhance both the accountability of such controlling persons and the protection of minority shareholders against controlling persons' bad-faith actions.

In addressing the second set of conflicting interests of various stakeholders in a corporation, the government concentrated on closing the previous regulatory loopholes, which, until recently, provided very limited legal instruments for shareholder and supervisory board oversight of the exercise by management of their widely formulated powers.

To enhance the accountability of the management of both public and non-public companies, the RCC expressly set out an overriding duty of the members of governing bodies of companies and their controlling persons: to act in the company's best interests reasonably and in good faith, subject to an obligation to indemnify the company for damages resulting from a breach of that duty. To improve the quality of board oversight, the Russian government significantly expanded the powers and information rights of supervisory boards and, therefore, their independence from management. Most importantly, supervisory board members have been given the power to bring derivative actions.

The government is continuing its efforts on finding an appropriate degree of balance between the interests of various stakeholders in Russian corporations. There are a number of legislative initiatives proposed by Russian ministries seeking to address sensitive issues such as the information rights of shareholders and supervisory board members, the takeover rules in relation to public companies, the exercise of the internal control and risk management function in public corporations, etc. These proposed amendments are now mostly at the consultative stage of the legislative process.

II CORPORATE LEADERSHIP

i Board structure and practices

Russian law provides for a two-tier board structure in public companies, including a supervisory board (also referred to as the board of directors) and the executive bodies. The two-tier structure is also mandatory for non-public companies that have more than 50 shareholders or that are subject to a specific regulatory regime (e.g., credit institutions).

The executive bodies of a company include the CEO (or several joint CEOs) and the management board. The formation of a management board is optional, except for those companies that are subject to special regulatory regimes (such as credit institutions).

Supervisory board and management board

Functions and formation

The function of the supervisory board and the management board is to supervise and advise the CEO (or the joint CEOs) and limit his or her or their discretion on matters that are crucial for the stability and sustainable development of the company. The supervisory board and the management board are not responsible for the day-to-day management of the company and, therefore, do not have authority to enter binding contracts with third parties on behalf of the company.

15 A controlling person of a company is a person having actual ability to determine how the affairs of the company are run (in particular by giving instructions to the members of the governing bodies of the company).

The supervisory board is responsible for determining the company's long-term strategy and deciding on matters that affect key aspects of that strategy (for example, the acquisition or disposal of major assets or the entry into a joint venture). Supervisory board members are usually nominated by the shareholders and rarely include representatives of the company's management – in particular, there is a statutory limitation on the representation of members of the management board on the supervisory board.¹⁶ Additionally, the CEO, if elected to the supervisory board, may not serve as its chairman. The supervisory board may not delegate matters within its competence to the management board or the CEO (joint CEOs).

The information rights granted to the supervisory board were reinforced in 2014. Despite these improvements, the scope of information rights is not broad enough to ensure an appropriate level of transparency. For example, some Russian listed companies are only holding companies, while the key assets of the group are held by their operational subsidiaries. Russian law views these subsidiaries as separate legal entities (rather than as part of a single economic unit) and, therefore, supervisory board members (and shareholders of the holding company) are not entitled to request information about the activities of key subsidiaries bypassing the management of the holding company (however, an obligation of the management of the holding company to request and share information on the key subsidiaries if requested by the shareholders or supervisory board members of the holding company may be set out in the company's internal regulations). However, as mentioned above, a draft law was recently proposed to fill in this gap and to grant supervisory board members access to the documents, books and records of the company on whose board they serve and its subsidiaries. The draft law also proposes to subject the management of the company to administrative liability for failure to provide this information upon the supervisory board members' request.

The management board usually includes the company's senior management and is subordinate to the supervisory board. Its primary function is to advise the CEO on the implementation of the strategy approved by the supervisory board and the most important matters of the company's day-to-day activities. The CEO is vested with the office of the chairman of the management board by operation of law.

The minimum competence of the supervisory board is specified by the RCC and the JSC Law. The competence of the management board is determined wholly by the company's charter.¹⁷

Decision-making procedures

With few exceptions, the law does not regulate the decision-making procedures of the supervisory board or the management board, so that shareholders are free to specify the relevant procedures in the charter. The CGC urges the procedures for the supervisory board to be set out in a way that allows the supervisory board members to have appropriate time to prepare for meetings of the supervisory board and to engage in meaningful discussions on the matters in question. The CGC also recommends that important matters are decided by supermajority or unanimous voting.

16 The members of the management board may not fill more than 25 per cent of the seats on the supervisory board.

17 The charter is the analogue of the memorandum and articles in Western jurisdictions.

Committees

There is no statutory requirement for the supervisory boards of listed companies to form specialised committees, although one of the recent sets of legislative amendments put forward by the government (which has not yet been approved by the parliament) proposed the introduction of specific provisions requiring the formation of an audit committee of the supervisory board in public corporations and implementation of risk management and internal control functions in public corporations in general. The formation of supervisory board committees is recommended in the CGC, which specifically refers to an audit committee, compensation committee and human resources (HR) committee. The CGC urges that each of these committees, either entirely (audit and compensation) or predominantly (HR), comprise independent directors.¹⁸ The supervisory board is urged to form other committees that are necessary based on the scale of the company's business (e.g., a strategy committee, corporate governance committee, or ethics committee may be appropriate).

While the formation of committees is, pending the adoption of the proposed amendments relating to audit committees and the implementation of internal control functions in the public companies, generally discretionary, the stock exchange rules may require that certain committees are formed for a company to be included in certain quotation lists. For example, the MOEX Rules¹⁹ require that companies with securities included in the first quotation level have audit, compensation and HR committees and that companies with securities included in the second quotation level have an audit committee.

CEO (or joint CEOs)

The CEO (or joint CEOs) (referred to in law as the 'sole executive body') has the duty of managing the company (with assistance from, and supervision by, the supervisory board and the management board). The CEO is held accountable by Russian law for the company's overall compliance with applicable law. The CEO is vested with power to enter binding contracts with third parties on behalf of the company. Additionally, the CEO may issue powers of attorney to other individuals or legal entities to allow them to represent the company.

18 There is not a statutory definition of an independent director. However, the regulations on related-party transactions in effect from 1 January 2017 provide a number of additional criteria that the members of the supervisory board of a public company need to satisfy to be able to participate in the approval of company related-party transactions. While the law does not expressly use the term 'independent directors' when setting out those criteria, they aim to enhance the independence of the supervisory board members approving potentially sensitive transactions in which management or the controlling persons of the company have a personal interest. Namely, the supervisory board member in question shall not and shall not have been within one year prior to the date the related-related party transaction is approved by the supervisory board: (1) the CEO of the company, a member of the management board, or otherwise involved in the management of the activities of the company; (2) related to a person holding a managerial position in the company; or (3) a *de facto* controlling person of the company. In accordance with the CGC, an independent director should mean any person who has the required professional skills and expertise and is sufficiently able to have his or her own position and make objective and *bona fide* judgements, free from the influence of the company's executive bodies, any individual group of its shareholders or other stakeholders. It should be noted that, under normal circumstances, a candidate (or an elected director) may not be deemed to be independent if he or she is associated with the company, any of its substantial shareholders, material trading partners or competitors, or the government.

19 Listing Rules of Public Joint-Stock Company 'Moscow Exchange MICEX-RTS' adopted by the board of directors on 28 November 2016 and registered by the CBR on 21 December 2016 (<http://fs.moex.com/files/257>).

The scope of powers of each of the joint CEOs may differ depending on the provisions of the company's charter. The powers vested in the office of the CEO by applicable law and the charter (in particular, the representative powers) may be performed by each of them individually and independently from each other or by all (or some) of them acting jointly. The functions of the CEO may alternatively be performed by a specialised management company on the basis of a management services agreement with the company.

Any action of the CEOs that is taken without due authorisation from the supervisory board, the management board and, in certain cases, the general shareholders' meeting (GSM), may be open to challenge by shareholders or supervisory board members and be a basis for the CEOs to be liable to the company.

ii Directors

Appointment and removal

Supervisory board

Supervisory board members of a public JSC are elected annually by the GSM (meaning that the maximum term is one year). Members may be re-elected for an unlimited number of terms. The supervisory board in a public JSC is elected by cumulative voting. Each shareholder receives a number of votes equal to the product of the number of shares held by the shareholder by the number of seats on the supervisory board, and may distribute these votes among the nominees as desired. The supervisory board is then comprised of the candidates who receive the largest number of votes. The cumulative voting is an important element of minority protection system in Russia, allowing minority shareholders to be represented on the supervisory board, which would not have been possible, had those matters been decided upon by simple or qualified majority of votes.

As a general rule the GSM may dismiss the supervisory board (as a group rather than any member individually) at any time prior to the expiration of its term of office.

Management board/CEO (or joint CEOs)

Statute does not prescribe the term or procedure for the appointment of members of the executive bodies. In view of this, the matter is governed by the company's charter.

Independence, expertise and reputation

The professional suitability of supervisory board members and executive body members is becoming increasingly important in Russia. Under Russian law, no person disqualified by a court for an administrative or criminal offence (for example, the falsification of financial and accounting reports, money laundering, or insider trading) can serve as a CEO or a member of the management or the supervisory boards of a public or non-public company for the term of their disqualification.

There are further reputational and qualification requirements for supervisory board members and executive body members of regulated companies. For example, a CEO of a bank must have a law or economics degree and relevant managerial experience of at least one year. Similarly, a person who heads a financial organisation during a period in which its licence is withdrawn cannot serve as the CEO of an insurance company for three years from the date the licence was withdrawn.

In the absence of limitations in the charter, supervisory board members are generally free to simultaneously hold managerial and supervisory positions in other companies. The

approach is entirely different for the executive body members, which require an express authorisation from the supervisory board to be able to combine more than one office. Additionally, there are certain specific restrictions for regulated companies. For example, the CEO of a bank cannot simultaneously hold the CEO or chief accountant position in another bank, insurance company, non-state pension fund and certain other financial organisations (or their affiliates).

Remuneration of directors and senior management

Membership of the supervisory board does not result in employment by the company *per se*. In view of this, the basic position is that membership of the supervisory board is unpaid. However, the GSM may decide to remunerate or compensate the supervisory board members.

Executive body members are company employees and their salary is stipulated in their employment contracts. The CEO is responsible for implementing the company's employment policies by operation of law and, therefore, whether the executive bodies' compensation package (or that of any other key employees) requires special approval from the supervisory board or the GSM depends on the provisions of the charter. In practice, the compensation of key managers is usually made subject to the consent of the supervisory board.

In accordance with Russian employment law, there is no upper limit on the amount of severance payments to the CEO of a non-state-owned company – it all depends on the terms of the CEO's employment agreed with the company. However, following a high-profile case in 2013 where courts invalidated a multimillion dollar severance payment to the former CEO of a state-controlled and significantly leveraged telecoms major, the severance payments to CEOs of state-controlled companies were capped at the level of three months' salary.

Conflicts of interest

Russian law contains the principle that supervisory board members and executive body members should act in the absence of conflicts of interest. To enforce this principle, supervisory board members and executive body members are required to provide to the company the information necessary to determine whether a transaction undertaken by the company qualifies as a 'related-party transaction' – that is, a transaction in which an executive body member or supervisory board member or a controlling person²⁰ of the company is interested personally or through companies under their control or their respective relatives.²¹ With effect from 1 January 2017, related-party transactions are not subject to mandatory prior approval by the supervisory board or the GSM. Instead, the management of the company is under an obligation to notify the supervisory board and, in certain circumstances, the shareholders of the intention to proceed with a related-party transaction. The supervisory board members and more than 1 per cent of shareholders in the company are then entitled to request that the transaction be postponed until the approval of a competent management body of the company is obtained. If no such request is made, the management is free to proceed with the

20 The definition of a controlling person for the purposes of related-party transactions includes the persons holding directly or indirectly a controlling stake in the capital of the company, the persons vested with power to appoint its CEO or to elect more than 50 per cent of supervisory board members, or both.

21 The information undertakings imposed on those persons by the JSC Law are expanded and supplemented by the regulations of the CBR.

transaction; however, the management may request an approval from the competent bodies of the company even in the absence of a request from the supervisory board members or the shareholders (e.g., to enhance the legitimacy of the transaction).

A transaction made or approved in the presence of a conflict of interest (unless it was properly disclosed and the interested persons refrained from participating in the approval process) and resulting in a loss to the company may trigger an obligation for the conflicted persons to indemnify the company for that loss. This obligation can be enforced through a derivative action by the supervisory board members or shareholders.

Following a number of high-profile cases involving major credit institutions becoming insolvent as a result of significant financing having been extended to persons connected with management and major shareholders, the CBR has sought to put an end to such practices. In particular, the CBR has introduced and continues consistently to enforce more rigid standards on the level of risk that can be assumed by a bank with respect to a single borrower and its affiliates and on the value of transactions with the bank's connected persons. Another example of the regulation aimed at elimination of a conflict of interest is a statutory prohibition for a non-state pension fund to become a shareholder of the management company that manages its assets.

Liability

Internal liability

In the event that the supervisory board members, or executive body or a company's controlling persons are in breach of their duties to the company, they are under an obligation to indemnify the company (rather than its shareholders) for the damage (both direct loss and loss of profit) resulting from the breach. There is a statutory restriction on the ability to limit management's liability in relation to bad faith (all companies) and unreasonable conduct (public companies) and the liability of controlling persons. There are several exemptions from liability – for example, if the action in question, although detrimental to the company, qualifies as a reasonable commercial risk.

The CEO is not exculpated from liability merely because he or she obtained all requisite corporate approvals for an action – if the action caused damage to the company and none of the exemptions from liability apply, all persons who voted in favour of that action (or abstained from participation in the voting in bad faith) may be held jointly and severally liable. In assessing the scope of liability of the members of the supervisory board and the management board, courts will take into account the scope of their information rights and, in certain cases, their dependency on the CEO in terms of the information required for their decision making.

As executive body members are in an employment relationship with the company, they can be sanctioned in accordance with employment law for any breach of their duties to the company.

External liability

The general position under Russian law is that executive body members, supervisory board members and the company's controlling persons are not liable to parties who contract with the company for the company's debts. However, there are several exemptions to this principle.

One exception is that management and the controlling persons are liable in the event that the company is declared insolvent. The controlling persons of the company²² are subject to secondary liability to the company's creditors if the insolvency is the result of their actions or omissions. In the case of the controlling persons, there is a presumption in favour of liability if the creditors' interests have been prejudiced as a result of a transaction made by, in favour or with the approval of, the controlling person. In the case of the CEO, the presumption also applies if the accounting documents are misleading, omitted or missing, which complicates the course of the insolvency proceedings.

Another exception is set out in the Securities Market Law, which provides that any person who has signed or approved a prospectus (i.e., the CEO, the chief accountant and the supervisory board members) is subject to secondary liability for losses caused to investors as a result of inaccurate, misleading or incomplete information being contained in the prospectus.

III DISCLOSURE

The JSC Law and the Securities Market Law are the key statutes establishing disclosure obligations. The JSC Law requires all public companies (including those public companies that have not arranged for the registration of a prospectus or listing of their securities) to disclose annual reports, annual accounts (including auditor's opinion), lists of affiliates and corporate documents. The composition of the annual accounts is set out in the Accounting Law²³ and the requirements for the auditor's opinion are set out in the Auditors Law.²⁴ In general, the auditor is required to be independent from the company and its major shareholders. The annual report and the annual accounts are subject to review and approval by the internal audit commission, the supervisory board and the external auditor before they are submitted to the GSM for approval.

The Securities Market Law sets out wider disclosure obligations that are triggered by the company registering a prospectus of its securities. The registration of a prospectus is not tantamount to the admission of securities to trading on an organised market. The prospectus requirements apply in most cases where securities are issued to a large number of subscribers through an open subscription (even without the involvement of stock exchange infrastructure). As a result, the disclosure obligations apply to public companies (other than those that only opted for public status without offering their securities to the public). The disclosure obligations may also apply to non-public companies (such as LLCs and non-public JSCs) that have issued securities (such as bonds)²⁵ to the public and that were required to register a prospectus. The Disclosure Rules provide further detail to supplement the Securities Market Law.

22 The definition of a controlling person for the purposes of insolvency laws, includes the CEO (or joint CEOs), the persons holding a controlling stake in the capital of the company, the persons vested with representative authority on behalf of the company and the persons exercising *de facto* control over its activities.

23 Federal law No. 402-FZ On Accounting dated 6 December 2011.

24 Federal Law No. 307-FZ On Audit Activity dated 30 December 2008.

25 Non-public companies may not issue shares and instruments convertible into shares to the public – this right belongs to public companies only.

The Securities Market Law disclosure requirements can be classified as periodic and one-off disclosure obligations. The periodic disclosure obligations include the publication of quarterly reports, which primarily include quarterly financial statements. One-off disclosures relate to 'material facts'. Material facts are price-sensitive information concerning the reporting company – which may, for example, include information about: meetings of the supervisory board or the GSM; changes of control of the company; or information on the acquisition by a single shareholder or a group of shareholders of a stake exceeding 5, 10, 15, 20, 25, 30, 50, 75 or 95 per cent of voting shares in the company.

A complex procedure applies if a reporting company wishes to terminate (or become exempt) from its disclosure obligations. This procedure involves a super-majority vote by the shareholders and a special authorisation from the CBR. The reporting company is primarily liable to its shareholders for damage caused by untimely, incomplete or misleading disclosure. The management of the reporting company may be subject to administrative or criminal sanctions for any failure to comply with the disclosure regime.

Additional disclosure obligations may apply to regulated companies. Credit institutions are subject to the highest level of transparency. In particular, banks are required to disclose information on their ownership structure, and the qualification and reputation of their management. Additionally, credit institutions are subject to numerous reporting requirements to the CBR (and in particular, are required to disclose to the CBR their annual and quarterly accounts, details of their risk management and risk assessment systems and an outline of the level of risk they have assumed). The CBR urges banks to agree for part of the information submitted to the CBR to be disclosed on the CBR's official website for the public and, in practice, a large number of banks follow this recommendation.

IV CORPORATE RESPONSIBILITY

i General

The CGC defines corporate governance as 'a system of relationships between the executive bodies of a [. . .] company, its board of directors, its shareholders and other stakeholders'. The CGC recommends supervisory boards take into account both financial and non-financial risks affecting a company's activities – including ethical, social, ecological and operational risks – the interests of all external stakeholders – including employees – and applicable social and ecological standards. The CGC also recommends that the annual report contain a section on human resources and social policy, health care and protection, work place safety and social policy.

The obligation of the management to take into account the interests of all of the company's stakeholders is not expressly set out in a specific piece of legislation, but is rather derived from a range of general provisions of legislation. Thus, the obligation to act in the best interests of the company makes it the managers' responsibility to build and maintain an efficient interaction system with key contributors to, and stakeholders in, the company. Additionally, CEOs are held personally responsible by the government for ensuring companies' compliance with applicable laws. Some of those laws establish minimum statutory comfort for the various stakeholders in the company (e.g., its employees, creditors and clients).

For some time, the Russian government has been promoting the idea of companies engaging in corporate social responsibility beyond the minimum benchmark standards. However, the government has failed to provide an appropriate regulatory framework to incentivise companies to engage in charitable activities or other additional social responsibility

measures. Despite this, many major companies tend to assume broad social responsibility undertakings in implementing their internal ethics codes and, on certain occasions, as part of their government-relations strategy.

ii Employees

All Russian companies are subject to social obligations, such as ensuring minimum salary levels for employees, making contributions to social and pension funds for employees, conducting assessments of workplace conditions and introducing additional benefits and regimes if necessary based on these assessments. Companies with a significant number of employees must also employ a minimum percentage of disabled people. Separate benefit regimes are also established for different categories of employees (such as women with family responsibilities and rotational system employees). Breaches of these obligations can result in fines and other kinds of liability for a company.

However, the above is only a benchmark level of comfort for the employees. In practice, companies tend to assume a wider range of social responsibilities and reflect them either in their internal regulations or in the agreements with the employees or trade unions. Those documents usually address issues such as increases to the minimum amount of salary and the period of annual leave, additional allowances for employees under certain circumstances, additional medical and life insurance, employees' discounts for certain services, compensation of travelling costs during employees' holidays, and protection and additional support to former employees and retired employees.

iii Small and medium-sized businesses

The Russian government is seeking to support Russian small and medium-sized businesses (SME). Given the significant footprint that the Russian government has on the Russian economy, one of the support measures proposed by the Russian government is to ensure the access of SMEs to the Russian government and state company procurement systems.

Russian law sets mandatory provisions for state agencies and state-owned companies to purchase a specified amount of goods and services from SMEs. The general rule is that companies that are within the scope of the Procurement Law²⁶ must procure at least 18 per cent (as measured in terms of value) of the total amount of their contracts from SMEs.

To increase transparency of procurement processes, companies must disclose information about their procurement policy, procurement plans and information on tenders in a publicly available information system.

iv Anti-corruption

In an effort to improve the investment climate in Russia and to advance its transition to an international financial centre, the Russian government has launched a number of anti-bribery and corruption initiatives. Commercial bribery is a criminal offence under Russian law and an offender can be sentenced to a period of imprisonment. Although Russian anti-corruption legislation is mainly focused on governmental authorities and state-owned companies, there are still some broadly stated rules requiring companies with no state participation to take measures to prevent corruption. These measures may include adopting a corporate ethics code

26 Federal Law No. 223-FZ On Procurement of Goods and Services by Certain Types of Legal Entities dated 18 July 2011.

and anti-bribery policies, procedures preventing conflicts of interest, or appointing an officer with controlling powers in this area. Internal anti-bribery policies and codes have become common in large Russian companies but remain rare for smaller privately held companies. Companies with significant foreign participation tend to follow the anti-corruption standards applicable to their overseas parent undertakings (e.g., the UK Bribery Act or US Foreign Corrupt Practices Act).

v Currency control and anti-money laundering

Russian financial institutions have a number of supervisory functions in relation to currency control and anti-money laundering (AML). Russian residents are required to collect all foreign currency export proceeds in their bank accounts in Russia ('mandatory repatriation of currency proceeds'). The purpose of this regulation is to prevent capital flight from Russia. Controlling functions are mainly delegated to Russian banks. When making overseas contracts, Russian residents must report this to their bank and open a transaction passport outlining basic information about the contract, including the amount and time frames for delivery and payments. Subsequently all payments under the relevant transaction should be made through the passport bank (unless the passport bank is replaced, in which case payments should be made through the new passport bank).

The AML laws require that companies operating with money – banks and other credit institutions, securities market participants, insurance companies, investment fund management companies, realtors, pawnshops and others – to monitor and, if necessary, report their clients' transactions the value of which exceeds the threshold set out in law. Reporting obligations are triggered irrespective of the value of the transaction if it qualifies as a 'suspicious' transaction. 'Suspicious' transactions include extraordinary transactions with no clear commercial purpose, transactions not consistent with the client's business, and other transactions that raise a reasonable suspicion of money laundering or financing of terrorism.

vi Compliance

To ensure their stability and protect their clients, credit institutions and professional participants of securities markets are required to maintain an internal compliance function. Other companies are not required to organise a compliance function; however, in practice, this function is usually fulfilled by various departments within the relevant company's corporate structure. As mentioned above, specific regulation of the implementation of the internal control and risk management function in public companies has recently been proposed.

The requirement for credit institutions and professional participants to organise a compliance function is enforced predominantly by the CBR. Credit institutions should also refer to the principles of the Basel Committee on Banking Supervision's 'Compliance and the compliance function in banks' of 2005.

Russian law requires that the internal compliance policies of credit institutions and professional participants specify, *inter alia*, the structure of the compliance function, its activities, main responsibilities, allocation of duties and internal compliance procedures (such as compliance risk assessment and coordination). The compliance function in these institutions must be carried out on a regular basis.

V SHAREHOLDERS

i Shareholder rights and powers

Russian policymakers have adopted a restrictive approach towards the powers of the GSM in public companies. The scope of these powers is determined by the JSC Law only and may not be extended (but, conversely, may be further limited in favour of the supervisory board) by the charter. Unlike some jurisdictions, where residual powers falling outside the competence of other governing bodies are attributed to the GSM, in Russia such residual powers would be assumed by the CEOs. It is, therefore, the supervisory board (and not the GSM) that plays a key role in the system of oversight over the managerial activities in a public company.

Still, the GSM is vested with important powers within the company (in particular, the power to amend its charter, to elect the supervisory board members, to approve dissolution or reorganisation of the company, its exemption from the disclosure obligations²⁷ or major acquisition or disposals involving more than 50 per cent of the balance sheet value of its assets). The matters attributed to the competence of the GSM by the JSC Law, are, therefore, limited to those that are likely to result in a fundamental change to the nature of the business of the company or the composition of its assets and the balance of powers between the various governing bodies set out in the charter.

As stated above, the regulation is more flexible for non-public companies (i.e., non-public JSCs and LLCs). For example, the competence of the GSM in a non-public company may be extended compared to the one set forth by the statute (making, in the absence of a statutory requirement, the formation of the supervisory board and the management board redundant).

The key statutory rights of the shareholders include (1) their rights on participation in the management of the company (i.e., voting rights, information rights and rights to put items on the agenda of the GSM); (2) their economic rights (i.e., rights to receive dividends and other distributions from the company); (3) the rights to protect the interests of the company (i.e., the right to bring derivative actions); and (4) the rights to protect the shareholder's own interests (in particular, the rights for the dissenting shareholder to put its shares to the company in a limited number of circumstances). The rights of the holders of the preference shares are determined either by the charter or the preference shares issuance documents.

Russian law establishes the following ownership thresholds for the exercise of the management rights by the shareholders of public companies. The right to request the convocation of the GSM is granted to the shareholders individually or collectively holding at least 10 per cent of voting shares in the company, the right to put an item on the agenda – to the holders of at least 2 per cent of the voting shares. The list of shareholders entitled to vote at the GSM is set up as at the record date (which, subject to a few exceptions, may not be more than 25 days prior to the date of the GSM). In the event of the transfer of the shares following the record date, the shareholder appearing on the register will have to grant a voting power of attorney to the transferee or vote at the GSM in accordance with the instructions of the transferee.

Equality of voting rights

Russian law establishes the principle of equality of voting rights: all ordinary shares and all preference shares of a single issue provide equal rights in proportion to their nominal value. For the ordinary shares the JSC Law sets forth the 'one share – one vote' principle.

²⁷ See Section III, *supra*.

The voting rights are usually carried by ordinary shares only. The preference shares in public JSCs become voting in certain exceptional circumstances only (most commonly in the event of non-payment of dividends in respect of the non-voting preference shares or if the GSM is to consider winding up the company). The non-public JSCs may issue voting preference shares granting voting rights on all or some of the matters on the agenda of the GSM. The LLCs do not issue shares and, as a general rule provide a percent of votes determined as the ratio between the nominal value of the participatory interests held by the shareholder and the aggregate amount of the charter capital of the LLC. Disproportionate voting arrangements may be set out in the charter of an LLC or a non-public JSC (but not a public JSC).

Rights of dissenting shareholders

Apart from the general protections available to all shareholders, the law contains specific protections for shareholders who attended a GSM and voted against a resolution or did not participate in the relevant GSM (dissenting shareholders).

A dissenting shareholder can challenge such a resolution of the GSM. If, pursuant to the resolution, the company entered into a transaction, the dissenting shareholder can also challenge the transaction. For the resolution or transaction to be invalidated, the dissenting shareholder needs to establish grounds for its invalidity (most commonly, the transaction having been made without proper authorisation from the competent governing bodies of the company, the lack of proper authorisation having been known to the other party and the transaction in question being prejudicial to the interests of the company).

Additionally, the law permits dissenting shareholders of JSCs to request that the company buys out all or a part of their shareholding, if the resolution in question concerns the following fundamental matters:

- a* reorganisation of the company;
- b* approval of a major transaction of the company with a value exceeding 50 per cent of the company's asset value;
- c* introduction of amendments to the company's charter that restrict the rights of the dissenting shareholders; or
- d* delisting of the company's shares.

ii Shareholders' duties and responsibilities

The most important statutory obligations of shareholders include:

- a* the obligation to participate in the formation of capital and assets of the company (by way of paying up their share in the charter capital in the course of the company's incorporation and, if explicitly provided by the charter, by making other mandatory contributions to the capital or assets of the company (or both));
- b* the obligation to refrain from disclosing confidential information relating to the activities of the company;
- c* the obligation to participate in the adoption of decisions required for the company to continue in existence (where such participation is necessary); and
- d* the obligation to refrain from knowingly causing damage to the company and otherwise significantly complicating or rendering impossible the pursuit of the company's fundamental goals.

Subject to the obligations above, the shareholders are generally free to act in their own discretion and in their own interests. A higher standard of conduct is set forth for the

controlling persons of a company. As stated above, the RCC has recently been amended to impose on them a duty to act reasonably and in good faith in the best interests of the company. Therefore, as is the case with managers, controlling persons who cause damage to the company may be liable to reimburse the company for the damage.

iii Shareholder activism

Say on pay

The GSM is the competent body to decide on the timing and amount of the distribution of dividends to shareholders. However, the supervisory board, assessing the results of the company's activity for the relevant period and its financial status, may issue a recommendation to the GSM on the amount of dividends (in which case the GSM cannot decide to distribute a larger amount) or a recommendation not to distribute the dividends at all (in which case the GSM cannot decide otherwise).

As best practice, the CGC recommends that companies adopt an internal dividend policy, and that they explain to shareholders the reasons for any change to, or deviation from, that policy. Until recently, most Russian companies did not have a dividend policy or any dividend distribution principles. The situation changed in the mid-2000s when major listed companies, including those controlled by the state, adopted codes of corporate governance and dividend policies.²⁸

Derivative actions

Shareholders can sue members of the executive bodies and the supervisory board, as well as persons exercising *de facto* control over the company, for damage caused to the company by those persons. Guidance for assessing the unreasonable and bad faith behaviour of managers is provided in the Resolution of the Supreme Commercial Court of the Russian Federation No. 62 of 30 July 2013 (the Resolution).

The Resolution clarified that the obligation to act reasonably and in good faith shall be construed to mean that the managers must take necessary and sufficient actions for the achievement of the company's objectives, including the due performance by the company of any public liabilities imposed by applicable law (such as the payment of taxes). The Resolution gives a number of examples where managers are presumed to be acting in bad faith and unreasonably and where transactions are considered to be evidently unfavourable to the company.

The Resolution was passed prior to the RCC being amended to impose duty to act in the interests of the company reasonably and in good faith. It is sensible to assume that the guidance in the Resolution is equally applicable to the liability of controlling persons.

Proxy battles and proxy solicitation

As noted in Section I, the share capital of Russian companies, including listed companies, is typically concentrated in the hands of one or a few large shareholders, who can procure decisions at the GSM. Therefore, unlike in some Western jurisdictions, the issue of proxy fights and proxy solicitation is not typical in Russia. In view of this, there are no special regulations in this respect.

28 O Belenkaya, E Novikova, 'Dividend policy of Russian companies and its impact on the market price of shares', *Securities Market*, No. 12 (2003).

Shareholder campaigns

Large shareholder campaigns are not very common in Russia, however there have been some notable cases. Recent examples of shareholder activism include the campaigns of Alexey Navalny, a minority shareholder in 20 Russian companies, including the state-owned Rosneft, Gazprom, Transneft and VTB. Navalny has filed numerous lawsuits and petitions to regulatory authorities in relation to non-transparent transaction structures, suspicious expenses and failure to provide information to him as a shareholder.

Contact with shareholders

Mandatory and best practice reporting to all shareholders

Shareholders have a general right to access information and documents concerning the company's activities. Both the JSC Law and the LLC Law list the information that is available to all shareholders and set out the procedure for accessing this information. Access to certain documents of JSCs, such as the company's accounts and minutes of its management board, is open only to a shareholder or shareholders collectively holding not less than 25 per cent of voting shares. As mentioned above, a set of legislative amendments has been proposed by the government on the information rights of shareholders and supervisory board members. Those amendments contemplate the extension of the scope of the information rights of supervisory board members and impose a number of restrictions on the information rights of minority shareholders. The rationale behind the amendments is to protect companies against the risk of greenmailing by minority shareholders. Most importantly, the government proposed to increase the minimum ownership threshold for requesting the documents and information that the company is not required to disclose to the public by operation of law and to grant the company a right to deny the provision of particularly commercially sensitive information in the absence of an appropriate justification for the request for documents and information. Significant minority shareholders (holding more than 10 per cent and 25 per cent of voting shares) may be exempt from some of those restrictions. These amendments have not yet been submitted to the parliament and, if and when approved by the parliament, may be in a significantly different form from the existing draft. However, the fact that those amendments have been proposed for public discussion may be a sign that the trend going forward will be for continued reinforcement of the powers of the supervisory boards as the main supervisory body in a corporation, as opposed to the GSM and shareholders individually.

The CGC recommends that companies develop and implement an information policy enabling them to efficiently exchange information with shareholders, investors and other stakeholders. The interaction with shareholders should be facilitated by setting up a company website and posting useful information there, and organising regular presentations and meetings with management.

The JSC Law requires that shareholders be provided with physical access to documents and information relating to the agenda of the forthcoming GSM at least 20 days before the date of the GSM (certain specific matters require more advanced notice). Shareholders can also request copies of the relevant documents. The company has seven business days to prepare the copies or a longer period if the shareholder requests a substantial amount of information (more than 10 documents or more than 200 pages). The relevant material may be published on the company's website only if this is expressly permitted by the charter.

There is room for improvement of the information provision policies of many large companies, including state-controlled companies.²⁹ In practice, shareholders may face problems obtaining a comprehensive set of materials for the GSM within a reasonable time frame. This is especially relevant for foreign shareholders controlling shares in Russian companies through a long chain of depositaries.

The CGC states that companies should provide shareholders with an opportunity to coordinate their actions in relation to the GSM. However, in practice, no specific steps are ordinarily taken to ensure that shareholders can share their views on the agenda before the GSM.

VI OUTLOOK

Since 2010, the Russian government's programme on the transformation of Moscow into an international financial centre has been the key driving force behind corporate governance reforms in Russia. One of the key ideas behind that initiative was to make the Russian jurisdiction more attractive to international financial investors and give a boost to domestic capital markets. In parallel, the government intended the non-state pension funds to play an important role in increasing the liquidity levels of domestic markets by channelling the monies under their management to Russian publicly traded companies.

However, following the political crisis in Ukraine, Russia becoming subject to an EU and US sanctions regime significantly reduced the interest of international investors in the Russian market and in Russian assets in general. The government's plans concerning the role of pension funds as a key liquidity source on the Russian market were significantly revised because of the resulting budgetary difficulties and the consequent changes to the basic elements of the Russian pensions system.

Despite these unfortunate developments, corporate governance remains one of the most important policy issues. Key discussion platforms on the subject (for example, the OECD Russia Corporate Governance Roundtable) also remain operational, not least because Russian policymakers and companies themselves have realised the importance of good corporate governance, irrespective of the level of interest of foreign investors in the Russian jurisdiction.

The key area of focus for Russian legislators remains balancing the contrasting interests of various internal stakeholders. While the Russian governance system is characterised by highly concentrated ownership, which is usually associated with higher levels of oversight and control over the actions of management, this oversight and control, while indeed exercised by controlling shareholders, was not backed by appropriate legal instruments until recently.

Russian policymakers continue their work on further enhancing management accountability. One of the suggested innovations (which have not yet been approved by the parliament) relates to the treatment of quasi-treasury shares. While treasury shares owned by a company itself are non-voting and are not counted towards a quorum, there is no similar limitation for shares in the company held by its subsidiaries. Therefore, as has been

29 Alexander Shevchuk, 'The main problems of corporate governance in Russia and the possibility of resolving such problems through the application of the Corporate Governance Code and associated regulatory mechanisms' in 'OECD Russia Corporate Governance Roundtable: Meeting Documents' (May 2013), pp. 9–10.

the case in numerous high-profile shareholders' conflicts surrounding prominent Russian companies, the control by management of a significant quasi-treasury stake results in an excessive entrenchment of the management.

The concepts of accountability of management and controlling persons remain of even greater importance in the financial services sector. With the general trend for clearing the sector of corrupt and bad-faith participants, suitability criteria for management and its liability for actions detrimental to the clients of financial services firms may be expected to remain one of the key matters of public concern.

Protection of minority shareholders in the process of takeovers is another hot topic. The debate over legislative amendments concerning takeover regimes is still ongoing. One of the key proposed changes to the takeover regime concerns the indirect change of control over public companies. The takeover rules at this stage are triggered only through the change of ownership of a significant stake in the company itself. The change of control over a significant shareholder does not trigger the takeover rules and has on numerous occasions been used to avoid the implementation of the minority protection measures contemplated by the law.

In summary, the government is continuing its work on improving the Russian governance regime with a view to reaching a balance of interests between the various interested parties, despite the unfavourable political and economic circumstances. Hopefully, those efforts will receive an additional boost if and when the international sanctions against Russia are lifted.

SPAIN

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I OVERVIEW OF GOVERNANCE REGIME

i Introduction

Corporate governance of listed companies in Spain is primarily regulated by the standard compulsory corporate legislation and by a corporate governance code, the recommendations of which are generally addressed to listed companies and may be followed voluntarily. Although these two sets of rules and recommendations are structured differently, there is no strict separation between them, as legal rules have been enacted following recommendations on corporate governance given by the prevailing corporate governance codes, which, in turn, use concepts and structures provided for by the legislation.

The applicable corporate legislation is mainly composed of the Companies Law, approved by Royal Legislative Decree 1/2010, of 2 July (the Companies Law 2010), which sets out the rules for all limited liability companies, including a section with specific rules for listed companies. A major amendment of the Companies Law 2010 came into force on 24 December 2014. This amendment implemented the proposal issued by an *ad hoc* expert committee appointed by the government in 2013 and had a significant impact on matters such as the following:

- a* the rights and obligations of directors, including directors' liability;
- b* directors' remuneration;
- c* the composition and functioning of the board and its committees;
- d* shareholders' rights; and
- e* shareholders' meetings.

A number of the new legal provisions merely enacted pre-existing recommendations, which thus became mandatory.

As to the voluntary corporate governance codes, the first corporate governance code (the Olivencia Code) was drafted by the Olivencia Committee in 1998 as a response to a demand by the markets and the economic agents to increase efficiency, agility, accountability and transparency in the governance of listed companies, as well as to ensure a more effective protection of shareholders. The Olivencia Code – the recommendations of which were limited to the scope of the functions of the board of directors – was very much influenced by the developments that had originated in the Anglo-Saxon world and that had spread to different countries. Nevertheless, it adapted these developments to the peculiarities of the Spanish economy, where the process of the privatisation of public companies determined an

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increase in the number of shareholders and an awareness of the need for adequate safeguards for their position. Although its recommendations were not generally followed by Spanish listed companies, for the first time in the Spanish market the Olivencia Code highlighted the debate regarding the composition, practices and functioning of boards of directors, led to a thorough analysis of the Spanish market in terms of listed companies, shareholding structure and board behaviour, and created the basis for the growth of the corporate governance practices over the coming years with the introduction of new concepts, such as that of independent directors and the disclosure of conflicts of interest.

A second wave of corporate governance reforms came in 2003 with the creation of the Aldama Committee and the production of a new corporate governance code, which not only focused on the role of the board but also on the functioning of general shareholders' meetings and the rendering of services by outside professionals, such as auditors or investment banks. This was completed by the enactment of compulsory legislation relating to some of the most important recommendations included in the Olivencia Code, which, until that date, were not generally followed by Spanish companies (such as a detailed regulation of the fiduciary duties of directors as regards conflicts of interest, including the duty to abstain and refrain from participating in board discussions relating to a subject for which a conflict of interest exists).

In 2006 the National Securities Market Commission (CNMV) approved a corporate governance code (the Unified Code), which was a harmonisation and review of the recommendations and principles previously stated by both the Olivencia and the Aldama Committees. It adopted modern trends in corporate governance, stated by different entities and institutions such as the Organisation for Economic Co-operation and Development, the Basel Committee on Banking Supervision and the European Commission, and it took into account the comments and proposals put forward by economic operators and institutions.

In February 2015 the Unified Code was replaced by yet another new corporate governance code (the Corporate Governance Code) approved by the CNMV and adapted to the reform of the Companies Law 2010 that took place in 2014. It contains 25 principles and 64 recommendations, which listed companies may follow when preparing their annual corporate governance reports. The recommendations range from those relating to general shareholders' meetings to those referring to the board or its directors, including board composition and functions, selection, appointment and removal of directors, remuneration and internal committees of the board (executive committee, audit committee and remuneration and nomination committees). Some new recommendations on corporate social responsibility were introduced in 2015, while others contained in the Unified Code are no longer present in the Corporate Governance Code as they are now mandatory provisions. Although its recommendations are voluntary, every listed company, whatever its size, market capitalisation and nature, must explain its level of compliance with the provisions of the Corporate Governance Code on a yearly basis.

ii Legislation and supervision

The Corporate Governance Code shares the international standards that characterise the recommendations on good governance practices. According to the Companies Law 2010, recommendations are given on a 'comply or explain' basis. It is up to companies to decide whether or not to follow corporate governance recommendations, but in the event that a recommendation is not followed, a reasoned explanation must be given.

In this regard, all listed companies and entities issuing listed securities are obliged to prepare an annual corporate governance report – a document to be produced in a format pre-established by the CNMV² in which the relevant company or entity must include a substantial amount of information relating to:

- a* the ownership structure, including shareholders with significant stakes and the existing relationships between them, the stakes held by members of the board, the treasury shares of the company and any shareholders' agreements in place;
- b* any restrictions on the transfer of securities or on voting rights;
- c* the structure of the board of directors, including information on its composition, functioning rules, existing committees, remuneration, relationship with significant shareholders, procedures for the selection of directors, and measures in place to seek a balanced representation of women and men on the boards of companies;
- d* related-party transactions with shareholders, directors and managers, including intra-group transactions;
- e* risk-control systems, including tax-related risks;
- f* information on the functioning of the general shareholders' meeting;
- g* evaluation and assessment of the level of compliance with the Corporate Governance Code recommendations or, where applicable, an explanation of any deviations; and
- h* the main characteristics of the internal control and risk management systems in connection with the process of disclosing financial information.

According to the most recent data available, which relates to the 2014 and 2015 fiscal years, the degree of compliance with the recommendations of the Corporate Governance Code by companies listed on the IBEX 35 index is remarkably high: 88.4 per cent of the recommendations were complied with in 2015 (93.8 per cent of the Unified Code³ recommendations in 2014). Although somewhat reduced, this ratio also remains high if all companies listed in Spain (and not only the 35 largest ones listed on the IBEX 35) are considered. Of the Corporate Governance Code recommendations, 81.8 per cent (85.4 per cent in 2014) were followed by the 137 companies that were listed in Spain in 2015, while there was partial compliance with 8.8 per cent of the recommendations (6.3 per cent in 2014). Thirty-seven listed companies complied with more than 90 per cent of the recommendations and two claimed to have complied with all of them. Only two listed companies registered a compliance level of under 50 per cent. With 2015 being the first year after the enactment of the Corporate Governance Code, the degree of compliance with those recommendations that were not formerly included in the Unified Code is lower than the current average degree of compliance: only 70.5 per cent of the new recommendations were complied with in 2015.

Despite this, it has been noted – particularly in relation to non-IBEX 35 companies – that the quality of the information given to explain the deviations needs to be improved, and on many occasions compliance with the recommendations is more in form than in essence. In this regard, the CNMV published in July 2016 a technical guide on good practices for the

2 The current format is contained in CNMV Circular 5/2013 of 12 June, as amended by CNMV Circular 7/2015 of 22 December.

3 For fiscal year 2014, reference is made to the degree of compliance with the recommendations of the Unified Code and not to those of the Corporate Governance Code, as the latter were not yet in force. This probably accounts for a large part of the difference in compliance ratios.

application of the ‘complain or explain’ principle, which aims to help improve the quality of the explanations provided in cases of non-compliance. The CNMV states in the guide that companies should conduct an annual *ex ante* analysis of the recommendations that will not be followed and the reasons for not doing so, instead of conducting a routine *ex post* analysis at the end of the year.

In any case, the evaluation of the degree of compliance of the recommendations and the explanations given by the relevant companies is left to the markets and to the CNMV. In this regard, the CNMV has powers to request additional explanations from any issuer regarding its corporate governance practice and the information on its practice included in the annual corporate governance report, including the publication of amendments and the imposition of fines or other sanctions in the case of breaches of applicable law.

Finally, as previously mentioned, a number of prior recommendations are now mandatory legal provisions and therefore all listed companies (and in some cases even non-listed companies) are obligated to comply with them.

II CORPORATE LEADERSHIP

i Board structure and practices

Spanish legislation (namely the Companies Law 2010) provides for a standard one-tier board structure for public companies. Listed companies must have a board of directors, with this structure being mandatory. Very often, however, powers are delegated by the board to an executive committee, or to one or more executive directors or CEOs, that in fact assume the ordinary management of the company. Only European companies incorporated in Spain can opt for a two-tier board, where directors assume the management of the company and the supervisory body controls their performance, but such companies are not at all common in Spain and, currently, none of them are listed.

Composition of the board

The board must have at least three members, which can be individuals or entities. The Corporate Governance Code recommends, in the interests of maximum effectiveness and participation, that the board should have no fewer than five and no more than 15 members. It is also recommended that companies should strike a balance between executive and external directors.

External directors can be of two different types: proprietary (those representing or appointed by holders of significant or controlling stakes in the company) and independent (those with no links or relationships with the company, its managers or its significant or controlling shareholders), although a third category may exist consisting of those who are neither proprietary nor independent directors.

The Companies Law 2010 includes detailed definitions of the various types of directors. The definitions are mandatory.

External directors should account for an ample majority of the board, while executive directors should be the minimum number that is practical while taking into account the complexity of the corporate group and the ownership interests they control. Under the Corporate Governance Code, whereas the proprietary members should represent the significant shareholders in a proportion generally no greater than the capital that they represent, the number of independent directors should be at least half of all board members. Exceptionally,

in companies with low market capitalisation and in those in which an individual shareholder, or various acting in concert, control more than 30 per cent of the share capital, the number of independent directors should be at least one third of all board members

Sector-specific eligibility requirements apply to directors of certain types of companies, particularly: (1) credit institutions and investment firms pursuant to Law 10/2014 of 26 June (the Solvency Legislation) and its implementing regulations, especially Royal Decree 84/2015 of 13 February and Bank of Spain Circular 2/2016 of 2 February, (2) insurance and reinsurance entities, pursuant to Law 20/2015 of 14 July and its implementing regulation (Royal Decree 1060/2015 of 20 November), and (3) collective investment managers and depositaries, pursuant to Royal Decree 1082/2012 of 13 July (as amended by Royal Decree 83/2015 of 13 February). The Solvency Legislation implements the CRD IV/CRR IV⁴ package in Spain and the specific rules on corporate governance contained therein (the Solvency Legislation). It is aligned with the guidelines of the European Banking Authority of 22 November 2012 (EBA/GL/2012/06), currently in the process of being updated, and the Basel III Accord, adopted by the Basel Committee on Banking Supervision.⁵

Separation of the roles of CEO and chair

The chair of the board of a public company has the power to call meetings, draw up agendas and chair board meetings and, unless the articles of association state otherwise, also shareholders' meetings. The chair must play an active role in promoting directors' participation in board meetings, ensuring that directors receive sufficient information, fostering debate and active involvement in the meetings while safeguarding each director's own judgement (the Companies Law 2010).

According to the law and the Corporate Governance Code, companies can decide how to determine the specific powers of the chair, and no specific rule or recommendation is provided on the separation of the chair and CEO positions. Therefore, the chair might also be the CEO of the company. However, when this is the case (or where the chair holds executive functions), such a concentration of powers must be counterbalanced by appointing a senior or lead independent director who will be responsible for requesting the holding of board meetings, including new points on the board agenda, coordinating and convening external directors and supervising the evaluation of the chair by the board. Until the latest reform this was merely a recommendation of the Unified Code, but it is now a mandatory legal provision.

Unlike boards in other European jurisdictions, Spanish boards have predominantly seen CEOs combining these roles with that of chair. Possibly owing to the influence wielded by proxy agencies and the evolution of these roles in other European jurisdictions, in recent times the percentage of CEOs also carrying out the chair's tasks has decreased among Spanish

4 The Directive and Regulation intended to implement the Basel III solvency framework in the European Union: (1) Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (CRD IV); and (2) Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 (CRR IV).

5 In July 2015, the Basel Committee published the revised 'Corporate governance principles for banks', which contain new guidelines related not only to the composition of the board, but also to other features of corporate governance of credit institutions, such as internal audit and governance of group structures.

companies.⁶ Besides, where one person holds both positions, in many cases this has come with the vesting of additional balancing powers in one of the independent directors, even before this was mandatory. While we anticipate that this trend will probably continue to grow during the coming years and that we will see more companies splitting the roles of chair and CEO, we believe that no standard rules can be formulated in this area.

For instance, there is no clear empirical evidence that the separation of roles positively affects share prices or companies' performance. The separation of roles may increase confusion and duplication of tasks within the board (especially in a system where it has not been the prevailing structure for years). It may also cause some inefficiencies in decision-making processes and generally increase costs. Lastly, depending on the moment at which the separation occurs, it may disrupt the positive performance of the company, as it may demoralise the existing CEO and create animosities within the board. While we believe that there cannot be any standard rule for companies on whether to combine the roles of chair and CEO, a decision to split the two roles in a board must be made after a careful analysis of the situation of the relevant company. It would be more reasonable to agree these matters at the time of the succession of the CEO or at any other time when change is really needed at the company.

Note, however, that the Solvency Legislation specifically provides that the chair of the board of directors of a credit institution or investment firm cannot act as CEO unless the institution justifies an exception that is authorised by its institutional supervisor (i.e., the Bank of Spain or the CNMV).

Committees

It is standard that in addition to a managing director holding powers delegated from the board, Spanish listed companies have an executive committee with similar powers that works, in practice, as a reduced board. In some companies, the function of the executive committee is to hold meetings more regularly than the board (weekly or fortnightly), while the board as a whole meets with a reduced frequency (once a month). Notwithstanding this reduced frequency, the Corporate Governance Code recommends that the board is kept fully informed of the discussions and decisions adopted by the executive committee and that, in terms of the qualification of directors (independent, proprietary and executive), the structure of this committee replicates that of the board.

In addition, the Companies Law 2010 requires that an audit committee and a nomination and remuneration committee (or two separate nomination and remuneration committees) be created within the board of every listed company. Each committee must be formed by members of the board, all of whom must be external directors. The majority of the members of the audit committee must be independent and the committee must be presided over by one of the independent directors. The role of the audit committee is mainly of an advisory nature and concerns the supervision of auditing practices, the relationship with external and internal auditors, devoting special attention to the independence of external auditors, the oversight of risk management policies and the review of the financial information that the company has to make public. At least one of its members must have accounting or auditing knowledge and, furthermore, all members of the audit committee must, as a whole, have the appropriate technical knowledge of the sector in which the company operates.

⁶ In the period 2009–2014, the overall percentage of listed companies whose CEO was also chair of the board diminished from 58.3 per cent to 48.22 per cent. More recent statistics are not publicly available.

The nomination and remuneration committee has advisory powers in matters such as the selection of candidates for the board, the right to formulate proposals (or inform the proposals made by the board) relating to the appointment of directors and the right to propose (or inform the proposals of the board on) remuneration policies.

The creation of a nomination and remuneration committee has only become mandatory for listed companies following the latest reform of the Companies Law 2010. However, as a formerly recommendation of the Unified Code it was generally followed by most of the larger Spain-listed companies.

Finally, according to the Solvency Legislation, credit institutions and investment firms must create a remuneration committee and a nomination committee, and may be required by the Bank of Spain or the CNMV, as applicable, to set up a risk committee, if appropriate considering the size of the institution, its organisation, and the nature, scale and complexity of its activities.

ii Directors

The involvement of external directors in the board's practice is essential, since they normally account for the majority of the members of the managing body, and, as previously mentioned, there are rules limiting the presence of executive directors (or even proprietary directors) in specific board committees.

According to the law, boards as a whole have the duty of defining company strategy, which includes active and decisive participation by outside directors. Other topics that require approval by the board in full include the investment and financial policy, the structure of the group, the corporate governance policy, the remuneration and evaluation of senior officers, risk management, the tax policy, the dividends policy, decisions on the appointment or removal of senior officers, directors' remuneration, financial information to be disclosed, and strategic and related-party transactions when these are not subject to the shareholders' vote.

External and, particularly, independent directors also play a significant role in the committees of the board, which have the power to approve and submit specific proposals to the board, evaluation reports or opinions on the proposals to be made by the board. In this regard, the nomination and remuneration committee proposes to the board the decisions on the appointment of independent directors, the remuneration for directors and senior officers, the individual remuneration and contractual conditions of executive directors and the standard conditions for senior officer employment contracts.

Appointment and term of office

Directors of Spanish listed companies may be appointed for a term of up to four years. Before the latest reform of the Companies Law 2010, the maximum term was six years and, while there was a growing trend to amend the articles of association to reduce the term to five, four or even three years, many companies appointed directors for six years. New appointments will have to comply with the four-year limitation, but directors already in office can complete their current tenure.

According to the current legislation, no director can qualify as an independent director if he or she has held office in the same company for a continuous period of more than 12 years. The recommendations and voting policies of the major proxy advisers, which support shorter term limits – such as three and even one year – than those provided by law, may also contribute towards increasing the rotation levels of all types of directors.

Liability of directors

The liability of directors stems directly from the fiduciary duties imposed on them by law and, if applicable, by the articles of association. Specifically, the law states that directors have two basic duties: to act diligently, with the standard of diligence befitting an orderly businessperson (duty of care); and to act loyally, in the company's best interest (duty of loyalty). If either duty is breached, directors may be held liable for any harm caused to the company, its shareholders or third parties, provided that they have acted wilfully or negligently.

The most recent reform of the Companies Law 2010 brought about significant changes to the liability regime. Most importantly, it enacted the business judgement rule, well-known in several US states and other jurisdictions but until then alien to the Spanish legal system. The law now states that the duty of care is fulfilled when a strategic or business decision is made by directors acting in good faith, with sufficient information and following an appropriate decision-making process – provided, however, that no company director has a personal interest in the relevant decision. When these requirements are met, the decision will not be second-guessed by a reviewing court.

All directors, whether executive or external, face the same liability regime. This regime is based on a presumption that all members of the management body are jointly and severally liable. However, the applicable standard of diligence is qualified by the nature of their position and the specific responsibilities entrusted to them. For example, a CEO is likely to be judged more strictly than an external director who has no presence in any committee and no specific role on the board.

All directors are vested with equal and complete information rights regarding the company. Frequently, company executives are invited to join board meetings to explain specific issues and reinforce directors' knowledge and awareness of business and company structures.

Directors' remuneration

Directors' remuneration is no doubt one of the trending topics of corporate governance and has been the subject of much debate and legal change in recent years.

Law 2/2011 of 4 March on sustainable economy (the SE Law) first made the pre-existing recommendations on the 'say on pay' practice mandatory. Since 2012, boards of directors of listed companies have been obligated to prepare and submit annual reports on the remuneration of their members to the advisory vote of the general shareholders' meetings, as a separate item on the agenda. Currently, the report must include, in the standard format established by the CNMV:⁷

- a* complete, clear and comprehensible information about the remuneration policy approved by the board for the current year;
- b* an overall summary on how the remuneration policy was applied during the financial year; and
- c* detail on individual remuneration accrued by directors.

According to the most recent data available, which relate to the 2015 fiscal year, IBEX 35 companies generally use a wider range of criteria than smaller listed companies to establish the fixed part of their directors' remuneration. Every IBEX 35 company and

⁷ The current format is contained in CNMV Circular 4/2013 of 12 June, as recently amended by CNMV Circular 7/2015 of 22 December.

82 per cent of all other listed companies (85 per cent in 2014) had approved variable retribution plans for executive directors. Forty per cent of IBEX 35 companies and 41 per cent of all other listed companies obtained, at their general shareholders' meetings, a favourable vote of over 95 per cent on their annual remuneration report.

The reform of the Companies Law 2010 brought about further changes. In addition to the remuneration report, company boards are now required to approve and submit a policy on directors' remuneration for approval by the general shareholders' meeting, at least every three years. Each company policy will set out for each year at least: (1) the aggregate compensation awarded to the board as a whole for the performance of non-executive duties; and (2) with respect to executive directors, the amount of fixed remuneration, the parameters for variable remuneration and the main terms and conditions of their executive contracts, including duration, severance payments, exclusivity and post-employment obligations, including non-compete and paid leave arrangements. The board will then be entitled to decide on each director's remuneration pursuant to the policy as approved by the general shareholders' meeting. The shareholders' vote on the policy is no longer advisory but binding. In addition, if, in any given year, the remuneration report is rejected by the shareholders on the advisory vote, the remuneration policy for the following year will need to be put to a vote prior to its implementation even if the approved policy currently in place is less than three years old or otherwise in force. In practice, although a remuneration policy is valid for up to three years, the shareholders may shorten its duration by voting against the remuneration report at any subsequent meeting.

The Solvency Legislation also provides for specific rules intended to increase transparency on the remuneration policies of financial institutions and investment firms and the consistency thereof with the promotion of sound and effective risk management. For this purpose, the Solvency Legislation has reinforced the Bank of Spain's and the CNMV's roles in the implementation and supervision of remuneration policies and the corporate governance rules of the entities subject to their respective supervisory authorities. In particular, the Bank of Spain is vested with powers to require financial institutions to limit variable components of their remuneration system, establish criteria for variable remuneration to be reduced in the event of losses and require credit institutions and their groups to limit variable remuneration by reference to a percentage of their turnover, to preserve a solid capital basis. The supervisory powers of the Bank of Spain in respect of remuneration and remuneration policies are regulated in detail by Royal Decree 84/2015 of 13 February, as implemented by Bank of Spain Circular 2/2016 of 2 February, including the ability to set criteria in relation to the various concepts and policies mentioned in the Solvency Law. The Solvency Legislation further establishes limitations on variable remuneration that apply to all credit institutions (state-supported or otherwise) in line with the Guidelines on Remuneration Policies published by the Committee of European Banking Supervisors as of 10 December 2010.⁸ Pursuant to these provisions, the variable component of the remuneration of staff whose activities have a material impact on the institution's risk profile cannot exceed 100 per cent of the fixed component. Exceptionally, and subject to a stringent procedure, the shareholders' meeting can decide to extend this limit to 200 per cent with a two-thirds majority vote. Furthermore, Royal Decree-Law 2/2012 of 3 February on the recapitalisation of the financial sector sets out specific restrictions for

8 In December 2015, the European Banking Authority published an updated set of Guidelines on sound remuneration policies, which entered into force on 1 January 2017 and replaced the CEBS Guidelines on Remuneration Policies and Practices, which have now been repealed.

financial institutions that benefit from state aid. These restrictions affect both the amount of the remuneration and its variable components, as well as the pension benefits associated with them, the latter two items being reduced to zero in certain cases.

Similar limitations to those established therein for credit institutions apply to investment firms pursuant to Royal Legislative Decree 4/2015 of 23 October, on securities markets as implemented by Royal Decree 217/2008 of 15 February, as amended by Royal Decree 358/2015 of 8 May. In addition, in 2014 the CNMV adopted the guidelines on remuneration policies and practices approved by the European Securities and Markets Authority (ESMA/2013/606), mainly intended to ensure compliance with the Markets in Financial Instruments Directive conduct of business and conflicts of interest requirements.

III DISCLOSURE

As indicated in Section I, *supra*, all listed companies and entities issuing listed securities are obliged to prepare an annual corporate governance report – a document to be produced in a format pre-established by the CNMV. The annual corporate governance report is prepared and approved by the board of directors and must be delivered to the CNMV and published on the company's website no later than the date on which the annual general shareholders' meeting is called. CNMV Circular 3/2015 of 23 June 2015 regulates the specific legal and technical requirements of the information to be published in the websites of listed companies. In addition, the corporate governance report must also be included as a separate section in the directors' report relating to the annual accounts. Required among the contents of the corporate governance report is an evaluation and assessment of the level of compliance with the Corporate Governance Code recommendations or, where this is the case, an explanation for any deviations from the recommendations.

Listed companies must also disclose an annual report on directors' remuneration (see Section II, *supra*) and submit it to the advisory vote of the general shareholders' meeting.

Furthermore, directors of listed companies must present a liability statement together with the annual accounts and the mid-year accounts. This statement must generally confirm that the relevant accounts being made public have been prepared in accordance with applicable accounting principles, and reflect a fair view of the financial situation of the company and its consolidated group, its net worth and results.

Finally, whenever a one-on-one or selective meeting takes place between directors and shareholders, the information provided to shareholders must be disclosed to the public in the same manner as price-sensitive information. Regularly conducting these meetings is not standard practice in Spain, except for larger companies in the IBEX 35 index, in which foreign shareholders are predominant and for which corporate governance is, in certain respects, more in line with international market standards.

Some non-listed entities must also disclose an annual corporate governance report and an annual report on directors' remuneration. This is the case of saving banks and banking foundations, pursuant to Law 26/2013 of 27 December. Order ECC/2575/2015 of 30 November regulates the content and disclosure conditions of these reports for the former and Bank of Spain Circular 6/2015 of 17 November does the same for the latter.

IV CORPORATE RESPONSIBILITY

Following international and European developments, the impact of the financial crisis has led, in Spain, to a review of corporate governance practices in the fields of risk management and control, an area where companies should anticipate a more precise regulatory framework in the future.

A working group created by the CNMV delivered in June 2010 a report on internal control of the financial information of listed companies, providing guidelines for the preparation of the description of the internal control system on financial information and for the tasks that should be carried out by the audit committee to supervise the system's performance. In particular, one of the recommendations among those set out by the working group was that the limited review by the external auditor of the system governing internal control over financial reporting should aim to ensure that the information included in the corporate governance report is both accurate and consistent with the findings of the external auditor during its auditing and limited review work.

In its report, the working group defines a body of general principles and good practices for internal control, with the aim of helping listed companies to design, implement, run and monitor their systems of internal control over financial reporting. In addition, the report also includes guidance for companies regarding disclosures on internal control over financial reporting. Accordingly, the form for the annual corporate governance report, as updated by the CNMV in 2015, requires entities to disclose detailed information on their systems for risk management and internal control over financial reporting. The entities must further state whether this information has been reviewed by the external auditor and, if so, must also disclose the auditor's report.

Furthermore, legislation has been enacted in the past, through modification of the Audit Law, to reinforce the powers of audit committees and the role of external directors within them, and to foster the efficacy of the systems of internal control and management of risk, as well as of the process of elaboration and disclosure of financial information of companies.⁹ In particular, the committee must produce an annual report on the independence of the external auditors, taking into account the provision of any services other than auditing services. The composition of the audit committee is dealt with above in Section II, *supra*.

As regards corporate responsibility, in the previous decade an increasingly significant number of Spanish listed companies undertook to approve internal policies on the matter and issue annual reports on their implementation. These reports, which were voluntary in all respects and – until recently – were not the subject matter of any specific legal provisions, have become common practice in listed companies and show an upward trend in the undertaking of commitments with stakeholders. Since 2011, corporate responsibility has been dealt with in the SE Law. Pursuant to this law, public companies may (but are under no obligation to) issue an annual report on corporate responsibility based on certain international standards, such as transparency of management, good corporate governance and commitment to the environment. Any such report must state whether it has been verified by third parties.

⁹ A newly amended and consolidated Audit Law was enacted by Law 22/2015 of 20 July to implement Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014. The new law, which entered into force on 17 June 2016, further emphasises the role of audit committees.

Reports issued by companies employing over 1,000 individuals must be submitted to the National Council for Corporate Responsibility for monitoring purposes. Under the SE Law, any company may also request acknowledgment as a socially responsible company.

V SHAREHOLDERS

The shareholding structure of Spanish listed companies is somewhat concentrated. In 2015, 25.5 per cent (24.8 per cent in 2014) of listed companies reported that one person owned the majority of voting rights or exercised, or could exercise, control over the company. The average free-float percentage increased to 43.4 per cent (43.9 per cent in 2014). In 107 out of 137 listed companies, free float exceeded 25 per cent, in five companies (seven in 2014) it was less than 5 per cent. In 2015, the concentration level was only slightly lower among companies in the IBEX 35 index (e.g., in 20 per cent of those companies (also 20 per cent in 2014), one person owned the majority of voting rights or exercised, or could exercise, control over the company).¹⁰ There are, however, a few exceptions among Spanish listed companies where there are no major shareholders.

This shareholding structure partly explains why the shareholder activism movement that has swept through the American and European markets during the past decade has not been so active in Spain. To date, the Spanish market has not seen significant shareholder action (and certainly not action driven by hedge funds), except in very specific cases linked to disputes over the control of target companies, normally in the context of tender offers or minority shareholders fighting against the management of specific companies.

Possibly the same circumstance accounts for the relative lack of specific takeover defences provided for either by the law or the internal rules of Spanish listed companies. Staggered boards do not exist, since the authority of the shareholders to dismiss and replace directors at any time is one of the cornerstones of Spanish corporate architecture. ‘Golden shares’ and other tools based on asymmetric voting rights are banned too. This is because another basic rule of public limited companies states that all shares must vest voting rights that are proportional to their nominal value. Historically, the most frequent defence was to include provisions in the articles of association limiting the maximum number of votes – typically around 10 per cent of all outstanding voting rights – that could be cast by any one shareholder, together, if applicable, with its affiliates and any other shareholders with which it was concerted, irrespective of the actual ownership percentage. This type of provision too was temporarily banned by an amendment of the Companies Law 2010 approved in 2011.¹¹ As a result of a subsequent amendment, effective from June 2012, it is now valid again, provided that the relevant provision is deemed repealed if, in the context of a takeover bid, the bidder acquires 70 per cent or more of the target’s voting rights (unless the bidder itself is not subject to, or has not adopted, equivalent neutralisation measures). Although some companies still include limitations of this type in their articles of association, they have become rare. This is a consequence not only of the mentioned succession of legislative changes, which has noticeably weakened them as an effective takeover defence; but also of the increasing pressure exerted by some shareholders and proxy advisers in line with current trends.

¹⁰ Latest available data.

¹¹ By virtue of Law 25/2011 of 1 August, implementing Directive 2007/36/EC of the European Parliament and of the Council, of 11 July 2007, on the exercise of certain rights of shareholders in listed companies.

Shareholder communication is gaining increasing importance, especially among the largest Spanish companies, which are also those with the lower shareholding concentration level and where foreign shareholders are predominant. These companies have normally been among the first to observe say on pay practices (prior to their being mandatory) and regularly conduct one-on-one and selective meetings with shareholders.

A review of shareholders' rights in Spain would not be complete without reference to the shareholders' electronic forum and shareholders' associations. The Companies Law 2010 provides for: (1) the obligation of listed companies to include a duly protected shareholders' electronic forum on their website, accessible by individual shareholders and any voluntary associations established thereby, designed to furnish information prior to general meetings; and (2) the admissibility of incorporation of associations of shareholders for any given listed company aimed at the exercise of their rights and the defence of their common interests.

The forum may include motions to be incorporated on the agenda announced in the meeting notice (provided that the requesting party holds at least three per cent of the share capital), requests for support for such motions, initiatives to gain a sufficient percentage to exercise any minority right established by law (normally restricted to holders of a three per cent interest or more), as well as offers or requests for proxy voting. As to the shareholders' associations, these must be registered at a special registry yet to be created with the CNMV. To date, no such associations have been created. The rules establishing the general regulations, originally enacted in July 2010, were further detailed by the latest reform of the Companies Law 2010, but are yet to be implemented.

VI OUTLOOK

In general terms, the recommendations formerly contained in the Unified Code have been increasingly followed by listed companies, as shown by the annual corporate governance reports published by the CNMV every year. Taking into account that 2015 was the first year of application of the Corporate Governance Code, the degree of compliance is significant. Traditionally, some of the least followed recommendations have been those relating to the approval and disclosure of directors' remuneration. Nevertheless, pursuant to the Companies Law 2010, since 2011, listed companies have had to comply with increasingly demanding provisions on the matter, including former recommendations that have become binding legislation. The review of the Unified Code put more pressure on listed companies to abide by more stringent corporate governance practices. At the same time, these companies have faced and will continue facing stricter scrutiny on remuneration practices through the submission of the remuneration policy to a shareholder vote, at least, every three years. In this respect, recommendations on the application of *malus* and clawback clauses for remuneration arrangements, already provided for under financial entities regulation, will probably gain ground in non-regulated sectors as well. We also expect that the return of international investment to the Spanish economy will increase both pressure on boards and the influence of proxy advisers and institutional investors.

Meanwhile, boards should work on achieving greater diversity in terms of expertise, age, gender and background. We also expect boards to focus on engaging with shareholders and stakeholders and to proactively prepare for the growing demands of corporate governance activists to secure support from long-term investors if required.

SWEDEN

*Björn Kristiansson, Sanna Böris and Per Samuelsson*¹

I OVERVIEW OF GOVERNANCE REGIME

Corporate governance in Swedish stock exchange listed companies is regulated by a combination of written rules and generally accepted practices. The framework includes the Swedish Companies Act and the Swedish Annual Accounts Act, supported by the Swedish Corporate Governance Code (the Code) and the rules of the regulated markets on which shares are admitted to trading, as well as recommendations and statements from the Swedish Financial Reporting board and statements by the Swedish Securities Council on what constitutes good practice in the Swedish securities market.

Enforcement of regulations applicable to listed companies – the Swedish stock exchange’s Issuer Rules, the Code (under the comply or explain regime) and the statements from the Swedish Financial Reporting Board and the Swedish Securities Council – may be carried out by the Stock Exchange through disciplinary procedures. In addition, the law may be enforced through actions in local courts.

Ownership structure on the Swedish stock market differs significantly from that in countries such as the United Kingdom or the United States. While the majority of listed companies in those countries have a very diverse ownership structure, ownership in Sweden is often concentrated to single or small numbers of major shareholders, as is the case in many other continental European countries. In around half of listed companies, these shareholders strengthen their positions further through holdings of shares with greater voting rights. They often play an active ownership role and take particular responsibility for the company, for example, by sitting on the board of directors. A particular characteristic of Swedish corporate governance is the engagement of shareholders in the nomination processes for boards of directors and auditors, which they exercise through their participation in companies’ nomination committees. Nomination committees are not regulated by the Companies Act, but by the Code. A Swedish nomination committee is not a sub-committee of the board, but a body of the shareholders’ meeting made up of members who are appointed by the company’s owners.

Swedish society takes a positive view of major shareholders taking particular responsibility for companies by using seats on boards of directors to actively influence governance. At the same time, major holdings in companies must not be misused to the

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detriment of the company or the other shareholders. The Companies Act therefore contains a number of provisions that offer protection to minority shareholders, such as requiring qualified majorities for a range of decisions at shareholders' meetings.

International institutional investors have recently requested individual voting on boards of directors, even though such a procedure is normally superfluous and time-consuming in a Swedish setting with the Swedish nomination committee system.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure

A Swedish limited liability company is organised as a unitary structure in line with the Anglo-Saxon one-tier model. The shareholders' meeting, acting as the company's supreme decision-making body, *inter alia*, elects a board, which in turn appoints a managing director. The shareholders' meeting, the board and the managing director together with the auditors comprise the four corporate bodies recognised by the Swedish Companies Act and the former three are in descending order subordinated in relation to each other. The auditors, whose main responsibility is to keep the accounts in order, are however independent in relation to the others. Thus, under the Swedish corporate governance structure there is no two-tier model with a supervisory board overseeing the administration of the company as traditionally can be found in continental Europe.

Composition of the board

In general, the board in Swedish listed companies includes five to 10 members and primarily consists of non-executive directors. According to the Code, a majority of the directors of the board elected by the shareholders' meeting must be independent from the company and its executive management. A minimum of two of these directors must also be independent from the company's major shareholders. In addition to this, the Code stipulates that no more than one board member elected by the shareholders' meeting may be part of the executive management of the company. Thus, boards of listed companies normally consist of non-executive directors only.

Recurrently, the low percentage of female board members comes under review and within the public debate there are those who argue that legislation is required to balance the gender ratio between female and male board directors. Under the Code, the board shall have a composition appropriate to the company's operations, phase of development and other relevant circumstances. The board members elected by the shareholders' meeting shall collectively exhibit diversity and breadth of qualifications, experience and background. Moreover, the company is also to strive for gender balance on the board.

In 2006, the Ministry of Justice had introduced a proposal for a provision, under which at least 40 per cent of boards of listed companies would be required to be comprised of female directors and, in 2015, the Minister of Justice stated that the parliament may be required to amend the law to reach the goal of more gender-balanced boards. It was further stated by the secretary that a bill would be presented to the parliament within a year in the event that companies did not have female representation of at least 40 per cent before that point in time, and during the autumn of 2016, a legislative proposal to this effect was presented

by the government. However, the proposal did not have sufficient support in parliament and, therefore, at this time, there is no legal requirement as regards female representation on boards of directors.

Representation

In general, under the Swedish Companies Act, the right to represent and sign on behalf of the company in all matters is vested in the board as a whole. If a managing director has been appointed, he or she has the right to sign on behalf of the company as regards the day-to-day operations. In addition to this, the board may authorise a board member, the managing director or any other person to represent the company by way of special company signature. In practice, the managing director or the chairman, each alone, as well as two board members or another special signatory are typically entitled to represent and sign on behalf of the company.

Legal responsibilities of the board and the chairman of the board

According to the Swedish Companies Act, the principal duties of the board comprise of the responsibility for the organisation of the company and the management of the company's affairs. Furthermore, the board is also to ensure that the company's organisation is structured in such a manner that accounting, management of funds, and the company's finances in general are monitored in a satisfactory manner. In addition to this, board members as well as the managing director have an overall duty in all matters to act in accordance with the interests of the company. The chairman of the board has no specific duties or powers other than a responsibility for convening the board and leading the work of the board.

Another key task of the board is to appoint and dismiss the managing director. Whereas the board is responsible for the overall management of the company's affairs, the managing director shall attend to the management of the day-to-day operations pursuant to guidelines and instructions issued by the board.

Thus, the board in Swedish companies has an extensive decision-making authority but it also has its limitations, primarily by way of the legal provisions giving the shareholders' meeting exclusive powers as regards specific matters (e.g., share issues, amendments to the articles of association and election of board members and auditors).

Remuneration of directors and compensation from shareholders

The board remuneration is resolved upon by the annual general meeting and the board decides the remuneration for the executive management. According to the Code, the remuneration and other terms of employment are to be designed with the aim of ensuring that the company has access to the competence required at a cost appropriate to the company, and that they have the intended effects for the company's operation.

The basic rule is that directors receive their remuneration from the company concerned. There are, however, no rules directly prohibiting a director from also accepting compensation from a shareholder who has nominated him or her. In practice, the director may, for example, be employed by the nominating shareholder. In some cases, a director, being employed by the nominating shareholder, waives his or her remuneration from the company. Such arrangements should be factored in when determining whether the rules regarding disqualification of a director to decide on specific matters involving such a nominating shareholder are applicable. If a board member receives compensation from a shareholder, he or she is not deemed independent from that shareholder.

ii Directors

Legal duties

Board members have a fiduciary duty to act in good faith and in the best interest of the company, which entails a duty to act in the interest of all shareholders. For that reason, the board may for instance not consider an activist proposal under any different standard of care compared to other board decisions and individual shareholders may not be given an unfair advantage compared to the other shareholders in the company. However, the board may cooperate with an activist as long as the board does not breach the duty of equal treatment of all shareholders.

Provided that it is not in conflict with the Swedish Companies Act or the applicable articles of association, the board is also obliged to follow any specific instruction decided by the shareholders' meeting.

Liability of directors

According to the Swedish Companies Act, a board member as well as a managing director may be liable for damages to the company, the shareholders and third parties (e.g., creditors). If he or she, in the performance of his or her duties, intentionally or negligently causes damage to the company, he or she shall compensate the damage. Liability towards a shareholder or a third party may, however, only arise when damage is caused as a consequence of a violation of the Swedish Companies Act, the applicable annual reports legislation or the articles of association. The board may delegate specific tasks to individual members or other employees but is not able to avoid liability for the company's organisation or the duty to ensure satisfactory control of the finances of the company.

Further, members of the board and the managing director may also be held liable under general principles on tort and, if applicable, the Swedish Tort Liability act. As for the board, there is no collective liability *per se* and an *in casu* judgment must be made as regards each claim and each director. Moreover, a Swedish company is not itself capable of committing a crime, which implies that it is the natural person who commits the crime who ultimately will be held responsible.

Appointment, nomination and term of office

Under the Swedish Companies Act, the board is elected by the shareholders' meeting. In listed companies, director nomination is done by the nomination committee, which in Sweden is not a board committee, but a committee set by the general meeting and which includes the largest owners. The Code stipulates that a company shall have a nomination committee, which, *inter alia*, shall nominate candidates to the board. The general meeting elects the members of the nomination committee and thus large shareholders generally have great influence over the composition of the committee. However, at least one of the members shall be independent in relation to the company's largest shareholder or group of shareholders that cooperate regarding the management of the company.

Any shareholder may, however, nominate directors for election to the board and have the nomination included in the notice to attend the general meeting, as long as the proposal is presented to the board within the time frame stipulated in the Swedish Companies Act and otherwise complies with the applicable provisions in the aforementioned Act. Furthermore, if the matter of election of members of the board is already on the agenda of the general meeting a shareholder has the right to propose a candidate as late as at the meeting itself.

The nomination committee shall safeguard the interest of all shareholders in its nomination of candidates. The nomination committee's proposal is presented in the notice to attend the general meeting. The board is elected by a majority vote, unless the articles of association stipulates otherwise. The market practice in Sweden has been to elect the members of the board by a single vote. This is not required by law and some international investors in Sweden have shown tendencies to start raising demands on listed companies to switch to separate voting for each member of the board. Lately, large international institutional investors have also been campaigning for individual board election and transparency of voting at the general meeting.

Staggered boards are non-existing (each board member is elected annually, and there is no way of preventing a new owner from replacing the board immediately).

III DISCLOSURE

The primary rules relating to communications made by listed companies concern disclosure duties and equal treatment of shareholders. Transparency and disclosure are key aspects of Swedish corporate governance in listed companies. The EU Market Abuse Regulation (MAR), the Swedish Securities Markets Act and the stock exchange's Rule Book for Issuers (the Rule Book) set forth the basis for listed companies' disclosure obligations. Under the MAR, listed companies are obliged to publish as soon as possible all information of a precise nature that has not been made public, relating, directly or indirectly, to the issuer's financial instruments and that, if it were made public, would be likely to have a significant effect on those financial instruments or on the price of related derivative financial instruments (i.e., inside information). Additionally and in accordance with the Swedish Securities Markets Act and the Rule Book, listed companies are obliged to disclose information related to financial reports, issues of securities, changes in board, management and auditors, share-based incentive programmes, closely related-party transactions and business acquisitions and divestitures, irrespective of whether the information constitutes inside information. The purpose of the disclosure obligations is to provide sufficiently comprehensive, relevant, clear and not misleading information to the market. To promote proper disclosures, listed companies are recommended to prepare a written disclosure policy, in which the guidelines and procedures applied in the company's communications with the capital markets and investors are specified.

As a main rule, inside information shall be disclosed as soon as possible although companies, provided that certain conditions are fulfilled, may delay the disclosure. To be allowed to delay the disclosure of inside information to the public, the following conditions must be met according to the MAR, (1) immediate disclosure is likely to prejudice the legitimate interests of the company, (2) the delay of disclosure is not likely to mislead the public, and (3) the company is able to ensure the confidentiality of that information. When this information is subsequently publicly disclosed, the company must submit a written explanation to the Swedish Financial Supervisory Authority (SFSA) specifying that the disclosed information was delayed and explain how the aforementioned conditions were met.

Generally, selective disclosure of inside information constitutes a violation of the MAR, which will result in sanctions for the company. Such disclosure may also constitute a criminal offence for the person making the disclosure under the MAR and the EU Market Abuse Directive. In special situations, for example, ahead of a rights issue where the company wants to secure commitments from its largest shareholders, selective disclosure, pursuant to the market sounding rules of the MAR, may, however, be permitted. When delaying disclosure,

listed companies are under the obligation to maintain insider registers of directors, employees and other persons with access to inside information as well as of other parties and advisers in separate projects that involve inside information.

In accordance with the Swedish Annual Accounts Act and the Code, listed companies shall disclose a yearly corporate governance statement in which the company shall present information on its corporate governance functions and state its compliance with the Code. If the company chooses to deviate from a certain provision of the Code, it must state its reasons for doing so (the 'comply or explain' principle). Moreover, a corporate governance report shall include a description on internal controls and risk management regarding the financial reporting and how the yearly evaluation of the board has been conducted and reported.

The MAR contains a requirement that all disclosed inside information is made public on the company's website and stored there for at least five years. The same applies, according to the Rule Book, to all information communicated by the company to the market. There are no other rules governing the media platform to be used as distribution channels; however, social media platforms are rarely used for shareholder activity-related matters. In addition, since the purpose of the disclosure duties is to make sure that the information is disclosed to the market simultaneously on a non-discriminatory basis, in practice, the companies must use an information distributor for this purpose.

Financial reporting and accountability

Listed companies shall prepare annual financial statements and, as a general rule, interim reports for the first three, six and nine months of the financial year. The consolidated financial statements shall be prepared in compliance with IFRS. Companies are entitled to disclose a lighter-form interim management statement instead of an interim report for the first three and nine months of the financial year. According to the amended Transparency Directive,² published in November 2013, listed companies are no longer obliged to publish quarterly financial information. However, Member States may require greater disclosure on certain conditions, and in Sweden the obligation to publish quarterly information remains. The stock exchange has set out guidance for preparing interim management statements. A company may, however, deviate from the guidance completely or on certain points, if the company disclose the reporting or statement format the company have chosen instead, and the reasons for doing so, on its website.

The annual financial statements shall be published within four months from the end of the financial year and three weeks before the annual general meeting. Quarterly reports or interim management statements shall be published within two months from the end of the reporting period.

According to the Swedish Securities Markets Act and the Rule Book, the SFSA may impose independently of the stock exchange a penalty payment for any failure to comply with the ongoing disclosure obligation, disclosure of periodic information and publication and storage of regulated information. All financial reports shall be made available on the company's website for a minimum of 10 years.

2 Directive 2013/50/EU of 22 October 2013 amending Directive 2004/109/EC.

Auditors

Listed companies must appoint at least one authorised auditor or audit firm. Listed companies may not appoint the same main responsible auditor for more than seven consecutive years or the same audit firm for more than 10 consecutive years. Provided that a renewal process in accordance with the EU Audit Regulation³ takes place, listed non-financial companies may, however, appoint the same audit firm for another 10-year-period (i.e., for a total of 20 years). The company's statutory auditor is appointed by the shareholders' meeting to examine the company's annual accounts and accounting practices and to review the board's and the managing director's management of the company. Auditors of Swedish companies are therefore given their assignment by, and are obliged to report to, the owners, and they must not allow their work to be governed or influenced by the board or the executive management. Auditors present their reports to the owners at the annual general meeting in the annual audit report.

Furthermore, the Swedish Companies Act sets out that the company, as a general rule, shall establish an audit committee. The audit committee shall, without it affecting the responsibilities of the board, monitor the financial reporting of the company, monitor the efficiency of the company's internal controls, internal auditing and risk management, keep abreast of the audit of the annual accounts and consolidated accounts, review and monitor the impartiality and independence of the auditor and pay close attention if the auditor provides the company with services besides audit services for the company, and assist in the preparation of proposals for the decision of the shareholders' meeting decision on election of auditors.

IV CORPORATE RESPONSIBILITY

i Framework and recent development

Under the Code, which outlines the main responsibilities of the board in relation to internal control and risk management, one of the principal tasks of the board is to ensure that there is an appropriate system for follow-up and control of the company's operation and the risks to the company that are associated with its operations. The Code further stipulates that the board is also to ensure that there is a satisfactory process for monitoring the company's compliance with laws and other regulations relevant to the company's operations, as well as the application of internal guidelines.

Following numerous corporate scandals in Sweden and abroad over recent years, the media as well as the public and authorities are, to a somewhat increasing extent, scrutinising corporations and their management and directors. In particular, different incentive programmes for senior executive, bonuses, other benefits and so forth, but also questionable risk management have been subject to an increased focus, which has led to public debate. In recent years there have been a few high-profile criminal proceedings against company officials. Most of them have been brought against the executive management, but there a few example of cases where the board directors also have been charged.

On 1 December 2016, amendments were made to the Swedish Annual Accounts Act, as a result of the implementation in Sweden of the EU Directive on non-financial reporting. The amendments entail that certain larger companies, companies that are of public interest

³ Regulation (EU) No. 537/2014 of 16 April 2014.

and parent companies of large groups shall draw up a sustainability report that shall include information necessary to understand the company's development, performance and position and the consequences of its business, including information related to the environment, social matters, staff, respect for human rights and work counteracting corruption. These companies must also report on the diversity policy that applies to the composition of the board of directors.

ii Recent high-profile cases

One of the most discussed cases recently has been the criminal procedures involving HQ Bank and its top executive management as well as a number of its board directors, but at the end of 2016, all criminal charges were dismissed by the court. Parallel to the criminal proceedings, however, there is also a civil suit brought by the shareholders against, *inter alia*, several of the directors of HQ AB and HQ Bank, which is expected to be settled during 2017. According to the claimants, the board has been aware of a systematic overvaluation of the trading portfolio but neglected to act accordingly. Furthermore, the respondents are said, *inter alia*, to have neglected their duty to ensure that the bank had appropriate risk management, staffing and organisation. The outcome of the criminal case as well as the civil case is likely to have a significant impact on future similar claims and also in general on the way Swedish directors operate.

V SHAREHOLDERS

i Shareholders' rights and powers

Shareholders exercise their rights and powers by participating in general meetings. Shareholders most significant rights include voting rights in general meetings, right to have a matter dealt with by a general meeting and the right to ask questions at a general meeting.

The annual general meeting convenes once a year, within six months of the end of the financial year. In between the annual general meetings, extraordinary general meetings may be convened either by the board, if it so deems necessary, or by shareholders holding at least 10 per cent of the outstanding shares in the company. Under Swedish law, there are no special facilities for long-term shareholders.

Matters to be brought by the general meeting

Any shareholder who wishes to have a matter addressed at a general meeting may submit a written request thereof to the board. The matter must be addressed at the general meeting if the request from the shareholder is received by the board no later than seven weeks prior to the general meeting or at a later date if the request is submitted in due time for the matter to be included in the notice to attend the general meeting. The proposed matter must concern an issue relevant to the company, which falls within the competence of the general meeting.

There are certain matters that fall under the exclusive competence of the general meeting. The Swedish Companies Act and the company's articles of association regulate this. Matters falling within the competence of the board or the managing director of the company may be decided upon by the general meeting if the shareholders unanimously support the matter and the Swedish Companies Act does not prescribe otherwise.

Matters, which fall under the exclusive competence of the general meeting, include election of board members and their remuneration, election of the auditor of the company and any amendments to the company's articles of association, as well as decisions relating to

the shares or share capital of the company and certain corporate restructuring matters, such as mergers and demergers. Share repurchases or share issues shall be brought by the general meeting, however, the general meeting may authorise the board to decide on a repurchase of the company's own shares or share issue. The authorisation regarding share repurchase must specify the price range for the repurchase and with regard to a share issue, the maximum number of shares to be issued. Decisions regarding dividend distributions are also reserved for shareholders; however, the dividend distribution may not exceed the proposal made by the board, except where such an obligation exists in accordance with the articles of association or where the distribution was resolved upon at the request of a minority holding at least 10 per cent of the shares in the company. Shareholders holding at least 10 per cent of the shares in the company are always entitled to request the payment of a dividend corresponding to half of the profits of the financial year, although not more than 5 per cent of the equity of the company.

Decision-making at the general meeting

Each shareholder has the right to participate in a general meeting. The articles of association may prescribe that, to participate at a general meeting, a shareholder must notify the company thereof not later than the date specified in the notice to attend the general meeting. The main rule is that all shares carry equal rights, however, the articles of association may prescribe otherwise.

Resolutions at a general meeting usually require a simple majority to be passed. There are, however, certain matters that require a qualified majority of both the votes cast and represented at the general meeting. A majority is purported as qualified if it is supported by at least two-thirds of the votes cast and shares represented at the meeting.

Below is an enumeration of certain matters, which require a qualified majority vote:

- a* amendment of the articles of association;
- b* directed share issue;
- c* issuing option rights and other special rights entitling to shares;
- d* acquisition and redemption of own shares;
- e* directed acquisitions of own shares;
- f* mergers and demergers; and
- g* a decision to enter into liquidation or terminate a liquidation procedure.

Sweden does not have a proxy voting system (or similar system), instead all voting is done at the general meeting (either by the shareholder in person or by anyone with a written power of attorney).

Objection to a decision by the general meeting

In the event that a resolution of a general meeting has not been adopted in due order or otherwise contravenes the Swedish Companies Act, the applicable annual reports legislation or the articles of association, a shareholder, the board, a member of the board or the managing director may bring proceedings against the company before a court of general jurisdiction to set aside or amend the resolution. Such proceedings may also be brought by a person whom the board has unduly refused to enter as a shareholder in the share register.

An action to have a general meeting's resolution declared void must be commenced within three months from the date of the resolution. Where proceedings are not commenced within that period, the right to commence proceedings shall be forfeited. Proceedings may

commence at a later time provided that the resolution is such that it cannot be adopted without the unanimous consent of all shareholders, consent to the resolution is required of all or certain shareholders and no such consent has been granted, or notice to attend the general meeting has not been given or significant parts of the provisions governing notice to attend the general meeting have not been complied with.

ii Shareholders' duties and responsibilities

Protection of minority rights

An important protection mechanism for the minority shareholders of a company is the principle of equal treatment. The principle is established in the Swedish Companies Act and is thus applicable to both listed and unlisted companies. The principle entails that shares of the same class have the same rights, unless otherwise specified in the articles of association. A dividend that results in a difference in the payout per share is therefore in conflict with the principle of equal treatment. The same would apply to any other asset transfers that differentiate between shareholders of the same class of shares. In cases where a minority shareholder is unfairly treated in relation to a majority shareholder (for example, if the company enters into an unfavourable agreement with a majority shareholder), the minority shareholder will not be able to rely on the principle of equal treatment to invalidate the transaction, because in that situation all shareholders are affected equally. However, in such cases minority shareholders are protected by other provisions of the Swedish Companies Act. For example, the Swedish Companies Act states that the general meeting may not adopt any resolution that is likely to provide an undue advantage to a shareholder or another person to the disadvantage of the company or another shareholder. The board, or any other representative of the company, is also prohibited from performing any legal acts or other measures that are likely to provide an undue advantage to a shareholder or another person to the disadvantage of the company or any other shareholder. If a minority shareholder manages to show that it has been unfairly treated the transaction may be invalidated and the minority shareholder may receive damages. The transaction will not be regarded as unfair should the majority shareholder be able to show that the transaction was entered into in the normal course of business.

Some important minority shareholders' rights include the possibility for owners of not less than 10 per cent of all shares in the company (owned by one shareholder alone or by a number of shareholders in conjunction) to demand in writing that the company's board convene an extraordinary general meeting to address a specified matter. If the request is correctly made, the board is obliged to convene the meeting and must issue a notice to attend the meeting within two weeks of receipt of the demand. A 'specified matter' means an issue relevant to the company that can be decided upon at the extraordinary general meeting. For that reason, it is not possible for minority shareholders to demand that an extraordinary general meeting is convened just for the opportunity to ask questions of the members of the board or the management. However, a minority that needs to ask questions of the board could initiate its right to appoint an extra auditor or a special examiner and demand that an extraordinary general meeting is held to decide on the matter. During the meeting, the right to ask questions can be utilised as a first step to meet the information requests of the minority. If the board satisfies the minority's needs in this regard, the need to appoint an extra auditor or special examiner may no longer be necessary.

A minority shareholder may also propose that an extra auditor appointed by the Swedish Companies Registration Office shall participate in the audit of the company together with

the company's ordinary auditors. The proposal shall be submitted to a general meeting at which election of auditors is to take place or at which a proposal set forth in the notice to attend the general meeting is to be addressed. If the proposal is supported by owners of at least 10 per cent of all shares in the company or at least one-third of the shares represented at the meeting and a shareholder then submit a request to the Companies Registration Office, the Companies Registration Office shall appoint an extra auditor. As a general rule, it is the person whom the minority has proposed as extra auditor who shall be appointed.

The extra auditor has the same privileges and obligations as the company's ordinary auditor and shall participate in the auditing of the company together with the ordinary auditor. Thus, the extra auditor shall examine the company's annual report and the company's bookkeeping, as well as the board's and the managing director's management of the company. Both the ordinary auditor and the extra auditor shall perform its function independent of the company and its management.

It should be noted that the ordinary auditor, as well as the extra auditor, have a duty of confidentiality and may not, without due authorisation, disclose to an individual shareholder or any third party any information concerning the company's affairs learned by the auditor in the performance of his or her duties, if the disclosure could damage the company. It is therefore mainly through the disclosure of the auditor's report and other accounting documents in close proximity to the annual general meeting that the minority shareholders of the company receive information concerning the company's financial situation. The auditor report shall be presented to the company's board no later than three weeks prior to the annual general meeting. Accounting documents and the auditor's report, in listed companies, shall then be made available for the shareholders during a period of not less than three weeks immediately prior to the annual general meeting.

Further, a minority shareholder may submit a proposal for an examination through a special examiner. A special examiner's assignment is to review the company's management and accounts during a specific period in the past or certain measures or circumstances within the company. A proposal for an examination through a special examiner shall be submitted at an ordinary general meeting or at the general meeting at which the matter is to be addressed. Where the proposal is supported by owners of at least 10 per cent of all shares in the company or at least one-third of the shares represented at the general meeting, the Swedish Companies Registration Office shall, upon request by a shareholder, appoint one or more special examiners. The special examiner shall submit a report regarding his or her examination. The report shall be made available and sent to the shareholders.

Controlling shareholders and institutional investors

In almost all Swedish listed companies, there is a controlling shareholder (or shareholders), who may have retained control through shares with greater voting power, such as certain family or privately controlled investment companies. Together, Swedish institutional shareholders have large stakes in many listed Swedish companies. In specific cases, they try to team up and then exert great influence.

There are no particular duties for controlling shareholders or institutional investors in Swedish legislation and self-regulation, except for the general obligation to launch a takeover bid when a shareholder's ownership exceeds a certain level (30 per cent or 50 per cent of the voting rights in the company) and the obligation to redeem the remaining outstanding shares when the shareholding exceeds 90 per cent of all the shares and voting rights in the company.

A shareholder does not owe the same fiduciary duties towards the company as the board, and is not required to act positively in the interest of the company. However, a shareholder should compensate for damage that he or she causes to the company, a shareholder or another person as a consequence of participating intentionally or through gross negligence, in any violation of the Swedish Companies Act, the applicable annual reports legislation or the company's articles of association.

iii Shareholder activism

Shareholder activism has been fairly moderate in Sweden. However, there is a growing tendency, especially among institutional investors, to take a more active role. Swedish institutional shareholders play an important role in Swedish listed companies. Together they have large stakes in many listed Swedish companies. In specific cases, they try to team up and then exert great influence. In their daily 'activism' they try to influence through direct dialogue with the board and by taking part in the nomination committees.

Activist shareholders normally gain a position through the acquisition of a corner in a company (in many cases together with foreign activist fund). However, we have seen very few activist investors in Swedish companies.

Say on pay

The Code stipulates that a company shall have a nomination committee, which, *inter alia*, shall nominate candidates to the board and propose the remuneration payable to the board and committee work. The proposal shall be put forth at the annual general meeting. In addition, the Swedish Companies Act require the Annual General Meeting to resolve on principles for remuneration to management, to which the board must adhere when setting the remuneration for the CEO and other management staff.

Derivative action

Derivative actions on behalf of the company may be brought where a minority of owners of not less than 10 per cent of all shares in the company have, at a general meeting, supported a resolution to bring such a claim or, with respect to a member of the board or the managing director, have voted against a resolution regarding discharge from liability. If shareholders holding at least 10 per cent of the shares in the company vote against a resolution regarding discharge of liability, a claim of damages may be brought against the board and the managing director despite the fact that the rest of the shareholders have voted for discharge.

Where the general meeting has adopted a resolution to grant discharge from liability or not to commence an action for damages (without 10 per cent of the shareholders having voted against the resolution), or the period for the commencement of an action has expired, an action may nevertheless be brought where, in the annual report or the auditor's report or otherwise, from a material aspect correct and complete information was not provided to the general meeting regarding the resolution or the measure on which the proceedings were based.

iv Takeover defences

The Swedish corporate governance framework is significantly guided by the principle of equal treatment and a strong requirement on the board to always act in the best interest of

the company and its shareholders. The board may not promote shareholders' initiatives that conflict with these rules and principles. For that reason, target boards are prevented from taking defensive measures and the Swedish takeover rules are prone to takeovers.

Staggered boards do not exist (each board member is elected annually, and there is no way of preventing a new owner from making an immediate board replacement). Poison pills, stitching, etc. are not allowed under Swedish law.

Contact with shareholders

As set out in Section III, above, Swedish companies have a duty to disclose all inside information as soon as possible. Shareholders also receive information on all matters proposed to be decided upon by the general meeting. The notice to a general meeting shall be published and made available to the shareholders no later than three or four weeks (depending on the type of general meeting) prior to the general meeting and shall include information on the decisions proposed to be taken. Shareholders also have the right to ask questions at the general meeting, and in practice often do so in connection with the managing director's presentation of the results of the company.

The company may generally contact individual shareholders as long as the contact is in the interests of the company and in accordance with the principle of equal treatment of all shareholders (i.e., the contact may not be aimed at giving one shareholder undue benefit at the expense of other shareholders or the company). Certain situations where the company engages in discussions with a major shareholder can be in the interests of all shareholders; these may include, for example, planned share issues or other corporate restructurings. In such instances the rules regarding market soundings in the MAR are applicable and the company would have to have met all the conditions stipulated in the MAR (e.g., confidentiality arrangements would have to be duly put in place, and the shareholder in question would be prevented from trading in the securities of the company upon receiving insider information).

Large shareholders acting together will have to observe the rules relating to acting in concert, which may trigger an obligation to launch a mandatory takeover bid if the joint holding of shareholders acting in concert were to exceed 30 per cent of the votes.

VI OUTLOOK

The updated Shareholders Rights Directive will necessitate changes to legislation and the Code, but these changes will probably not have any major impact on the Swedish corporate governance system.

SWITZERLAND

*Rolf Watter and Katja Roth Pellanda*¹

I OVERVIEW OF GOVERNANCE REGIME

The main source of law for Swiss governance rules is the company law contained in Article 620 et seq. of the Swiss Code of Obligations (CO). In the course of the rather fundamental reform of 1991, corporate governance rules, in particular those relating to the improvement of shareholders' protection, became law. A further governance debate was triggered at the beginning of the previous decade, in 2000/2001, *inter alia*, as a consequence of the Swissair Ltd bankruptcy. One of its outcomes was the issuance of the Swiss Code of Best Practice for Corporate Governance (SCBP) by Economiesuisse,² first enacted in 2002 and revised in 2007 and 2014.³ It contains a range of guidelines and recommendations for boards of directors of listed companies (the board or boards) on how to organise themselves. Notwithstanding its rather far-reaching impact, it is not mandatory and represents a code of best practice, leaving leeway for specific adaptations and modifications by individual companies. On 1 July 2002, the Corporate Governance Directive issued by SIX Swiss Exchange Ltd (DCG) entered into force; it was revised in 2008 and 2014.⁴ The DCG 'has the objective of obliging issuers to make available to investors in a suitable form certain key information with regard to corporate governance practices within their company'. It applies to companies whose equity securities are listed on the SIX Swiss Exchange Ltd (SIX) and is largely based on the principle of 'comply or explain'. The enforcement of the DCG lies within the responsibility of the SIX.

A rather fundamental revision of the company law is currently under review by the legislature. One of its main goals is to further strengthen corporate governance rules, in particular relating to shareholders' rights and board and management compensation. While a part of this revision (i.e., the accounting provisions) entered into force on 1 January 2013, the governance provisions are still controversially debated. A preliminary draft⁵ of the revised CO (the Preliminary Draft) has undergone a public consultation, which concluded on 15 March 2015; the results of this process were published in autumn 2015.

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2 Economiesuisse is the largest umbrella organisation representing the Swiss economy (www.economiesuisse.ch/en/pages/default.aspx).

3 Available at www.economiesuisse.ch/en/Documents/swisscode_e_web.pdf.

4 Available at www.six-exchange-regulation.com/admission_manual/06_16-DCG_en.pdf. See also the DCG commentary available at www.six-exchange-regulation.com/download/admission/regulation/guidelines/swx_guideline_20070820-1_comm_en.pdf.

5 Available at www.admin.ch/ch/d/gg/pc/documents/2499/OR-Aktienrechte_Entwurf_de.pdf.

A major part of the revision is the implementation of the ‘Ordinance against Excessive Compensation in Listed Companies’ (the Ordinance) into formal law. The Ordinance is the result of a far-reaching popular initiative for a constitutional amendment in the area of compensation, colloquially called the ‘Minder initiative against fat-cat salaries’ (the Minder initiative),⁶ which was adopted in 2013 by a popular vote with a strong majority of 68 per cent. The transitional provision of the constitutional amendment provided that, until the statutory provisions come into force, the Swiss Federal Council had to issue implementing provisions within one year;⁷ this was done through the Ordinance, which applies to companies limited by shares with their domicile in Switzerland and their shares listed in Switzerland or abroad.⁸ The Ordinance obliges such companies to annually submit the top management’s compensation to the shareholders for a binding vote and contains far-reaching rules on corporate governance with direct effects on boards, executive management, shareholders, pension funds and independent proxies. It also outlaws certain payments, such as certain golden handshakes (but allows a new manager to be indemnified for losses suffered with the former employer) and severance payments. Moreover, the Ordinance implements the principle required by the Minder initiative that certain contraventions to the Ordinance are sanctioned by imprisonment of up to three years and a fine of up to the equivalent of six years’ annual compensation. All offences have to be prosecuted *ex officio*.

On 23 November 2016, the Swiss Federal Council submitted to the Swiss parliament a revision of the Preliminary Draft (the Revised Draft). The most important changes by the Federal Council to the Preliminary Draft are: (1) no ban on prospective shareholder voting on variable compensation but a duty to hold a consultative vote on the compensation report; (2) no duty to set the relationship between fixed and variable compensation in the articles of association; (3) no duty to establish and operate an electronic shareholder forum; and (4) no right for shareholders to institute legal proceedings at the expense of the company. The guidelines on gender representation at senior executive level remain in place but the Federal Council has lowered this requirement to 20 per cent, whereas the level for boards of directors remains at 30 per cent. If a company fails to meet these gender guidelines, it will have to disclose the reasons for its non-compliance, as well as current and planned actions to meet the targets.

Unlike the Minder initiative, the ‘1:12 initiative’ was rejected by the Swiss voters in November 2013 by a large majority of 65 per cent. This initiative aimed at introducing a salary cap of 12 times the lowest salary within a company. The outcomes of the Minder and 1:12 initiatives show that Swiss voters require a tight corporate governance regime in respect of compensation but desire no governmental intervention regarding the amount of absolute level of compensation.

II CORPORATE LEADERSHIP

According to the CO, the board is the executive body of a company limited by shares (i.e., the one-tier board system is the default rule).⁹ The board is therefore responsible for the management of the company and represents the company in relation to third parties. The

6 Available at www.admin.ch/ch/d/ff/2006/8755.pdf.

7 See Article 197 X of the Federal Constitution.

8 Article 1 I of the Ordinance.

9 See Article 716 II of the CO.

board may carry out any legal acts consistent with the company's purpose clause¹⁰ and may pass resolutions on all matters not reserved to the general meeting of shareholders (the shareholders' meeting) by law or by the articles of association.¹¹ The relationship between the shareholders' meeting and the board is generally described as a relationship of parity rather than a hierarchy: both bodies have distinct responsibilities and competence by law.¹² But Swiss law permits shareholders to dismiss board members in a general meeting at any time.

However, the legal default concept of the board directly managing the company no longer corresponds to the reality of today's medium-sized to large companies, and in particular of listed companies. As Swiss company law is very flexible, different governance structures are possible, as will be explained below.

i Board structure and practices

In terms of board structure, Swiss company law allows the board to delegate significant parts of its responsibilities to the senior management. However, certain responsibilities cannot be transferred and are considered inalienable duties of the full board.¹³ Depending on the size and the needs of the company, the board may therefore assume the entire responsibility for management (this system is adopted predominantly by smaller non-listed companies) or it may delegate all transferable responsibilities to one or several board members or the senior management, subject to an authorisation by the shareholders in the articles of association and the establishment of organisational regulations by the board.¹⁴ Thus, it is possible to create a two-tier structure, which is what listed companies typically do and is what the SCBP recommends, by requesting a majority of non-executive board members. Such a two-tier structure is mandatory for banks and insurance companies.

A board must consist of at least one individual.¹⁵ In reality, most companies have several board members. Where there are different classes of shares, the articles of association must stipulate that the holders of each share class are entitled to elect at least one representative to the board.¹⁶

The board is responsible for the representation of the company towards third parties. Unless the articles of association or the organisational regulations stipulate otherwise, all the members of the board have an individual authority to represent the company.¹⁷ It is, however, common practice, at least in medium-sized to large companies, that only joint signatory power, of any two board members, is granted. The board may also delegate the authority of representation to members of management or to other employees. At least one member of the board, or two board members in cases of joint signatory power, must always be authorised to represent the company and at least one authorised representative, either a board or a management member, must be domiciled in Switzerland.¹⁸

10 Article 718a I of the CO.

11 Article 716 I of the CO.

12 See, *inter alia*, the decision of the Swiss Federal Supreme Court BGE 100 II 384, consideration 2.a).

13 Article 716a I of the CO.

14 Article 716b I of the CO; Article 6 of the Ordinance.

15 See Article 707 I of the CO.

16 Article 709 I of the CO.

17 Article 718 I of the CO.

18 Article 718 II, III and IV of the CO.

The CO provides the following catalogue of non-transferable and inalienable duties that cannot be delegated to the management (but for which the management often does the preparatory work):¹⁹

- a* determination of the strategy and the definition of the means to implement it (e.g., budget process, establishment of a business plan, issuance of all necessary directives and establishment of a risk control and management system);
- b* determination of the organisation (e.g., decision on the governance structure of the board and management and the organisation of the business along business lines);
- c* structuring of the accounting system, the financial controls and the financial planning (including monitoring the liquidity of the company);
- d* appointment, removal and succession planning of the members of the management team and the persons authorised to sign on behalf of the company (the appointment of the top executive management must remain with the board, whereas the appointment of the lower hierarchical levels may be delegated);
- e* supervision of management (including, *inter alia*, the implementation of a state-of-the-art internal control system and clear reporting lines), in particular with respect to compliance with the law, the articles of association and the directives issued by the board;
- f* preparation of the annual report consisting of the financial statements (which have to include, *inter alia*, the significant shareholders and their shareholdings)²⁰ and a narrative business report;
- g* preparation of the shareholders' meeting (which has to be held within six months after the end of each business year)²¹ and the implementation of its resolutions; and
- h* notification of the court in the event that the company is over-indebted.

The Ordinance requires the board to prepare a compensation report that replaces the disclosure of board and senior management remuneration in the notes to the statutory financial statement.²² The preparation of the compensation report is also a non-transferable and inalienable duty of the board.²³ The Revised Draft requires companies with a prospective vote on variable compensation for the board and senior management to have an advisory vote on the compensation report.

Where there are several board members, the organisation of the board requires the nomination of a chair and of a secretary, but the latter does not have to be a board member.²⁴ The chair was customarily appointed by the board; however, the articles of association could also provide for a direct appointment by the shareholders' meeting.²⁵ Now, the Ordinance provides that, in listed companies, the shareholders' meeting has to elect and dismiss him or her.²⁶ The role of the chair is not defined in detail by Swiss company law and few duties are explicitly assigned. In reality, the chair's function is key to the proper functioning of the entire

19 Article 716a of the CO.

20 Article 663c of the CO.

21 Article 699 II of the CO.

22 Article 13 I of the Ordinance.

23 Article 5 of the Ordinance.

24 Article 712 I of the CO.

25 Article 712 II of the CO.

26 Article 4 I and III in connection with Article 29 I of the Ordinance; boards could also suspend a chairman but then have to call a shareholders' meeting (Article 726 of the CO).

board and to an adequate working relationship between the board and the management. The chair, *inter alia*, (1) keeps direct contact with the senior management (typically represented by the CEO), (2) communicates and engages with important shareholders and stakeholders (in general together with the CEO), (3) organises and conducts the board meetings and sets their agendas, (4) is, together with or subsidiarily to the CEO, the outside ‘face’ of the company, and (5) takes the lead in crisis situations. The chair has a deciding vote if not prohibited by the articles of association. Cumulative voting within the board is not possible under Swiss law.

The question of combining the roles of the chair and the CEO in the same person has been the subject of significant debate in Switzerland. Although not explicitly excluded by the SCBP, the majority opinion nowadays, voiced in particular by proxy advisers, is that such a concentration of power does not represent best practice. However, a certain tradition of these combined roles exists,²⁷ which is in general justified by efficient communication and faster decision-making that might be particularly important in crisis situations. The SCBP provides that, as a principle, ‘a balance between direction and control should apply to the top of the company’ and if the board decides that the roles of the chair and the CEO are combined, adequate control mechanisms should be implemented, including the appointment of an experienced non-executive board member as independent lead director. One of the roles of an independent lead director is to convene and chair meetings of the board without the chair when necessary.

The board is required when fulfilling its tasks to observe the duty of care and loyalty, the duty of confidentiality and the duty to treat shareholders equally.²⁸ The principle of equal treatment of shareholders does not require the board to provide identical treatment to all shareholders; it must, however, make sure that shareholders are treated equally in comparable circumstances. This principle is of particular significance in relation to the communication with and information provided to shareholders. Therefore, Swiss company law provides for relative rather than absolute equality, meaning large shareholders might under certain circumstances receive more information than small investors. Whereas company law specifically takes into consideration the circumstances of the specific case, capital market law and stock exchange regulations, namely rules prohibiting insider dealing and *ad hoc* publicity rules, provide for a stricter understanding of a ‘level playing field’ and aim to ensure that price-sensitive information is disseminated on an equal basis; but even there, large (institutional) shareholders often get more information than retail shareholders, which is permissible as long as this information is not price-sensitive or is mitigated by confidentiality undertakings and contractual agreements not to trade on information received.

The organisational flexibility of the board is rather far-reaching; it may allow for executive and non-executive board members, committees, delegation of management duties, etc. Furthermore, the CO provides for the possibility of assigning responsibility for preparing and implementing resolutions of the board, or monitoring transactions, to board committees or individual board members. As a matter of principle and according to the SCBP, the overall responsibility for non-transferable and inalienable duties delegated to committees or third parties remains with the board. In all instances, appropriate reporting to the (full) board has to be ascertained. Under the previous law the creation and revocation of board committees was in the sole discretion of the board. Article 7 of the Ordinance now provides that the

27 The CEO is in seven out of 20 SMI companies a member of the board.

28 Article 717 of the CO.

members of the compensation committee, who need to be members of the board, have to be elected by the shareholders' meeting. Even though the wording of the Ordinance does not explicitly state that a compensation committee is required for listed companies, there is, according to legal scholars, an affirmative duty to establish one. This view is confirmed by Article 733 I of the Revised Draft, which states that the shareholders' meeting has to elect a compensation committee. The basic principles of the duties and responsibilities of the compensation committee have to be determined by the articles of association and, therefore, by the shareholders; still, details may be stipulated in the organisational regulations (i.e., by the board). The SCBP also recommends the creation of an audit and a nomination committee. It is recommended that the audit committee should consist of non-executive, preferably independent members only, and that a majority of its members should be financially literate, whereas a majority of the members of the compensation committee should consist of non-executive and independent members. No independence requirements are provided by the SCBP for the nomination committee. Other committees, such as a finance committee, a strategy committee, a risk committee, an independent committee consisting of independent board members and established for special situations where a conflict of interests arises (for example, in the event of going private or takeover situations), or other *ad hoc* committees may be constituted when needed for an efficient functioning of the board.

ii Directors

While the law provides in general that the members of the board need to be elected by the shareholders' meeting for a term of office of three years unless the articles of association state otherwise,²⁹ the members of the board of listed companies have to be elected individually and on an annual basis.³⁰ Boards can therefore not fill vacancies by themselves. Further, staggered boards are not possible for listed companies.

In general, no formal requirements have to be met for being nominated to a board but certain rules apply to banks and insurance companies. Swiss company law requires neither special knowledge nor qualifications (e.g., in strategic, financial or accounting matters); currently, there are also no gender requirements. However, this is likely to change in the future with the proposed introduction of a gender quota for the board of listed companies as part of the current revision.³¹ Compared with quotas implemented and proposed in other jurisdictions (e.g., Norway and Germany), the proposed revision is less intrusive as it would only foresee a comply or explain approach.

Regarding the independence of board members, there are, in principle, no specific requirements. However, Articles 717 and 754 of the CO indirectly require a composition of the board that ensures that risks will be recognised and wrong business decisions avoided. Therefore, boards and shareholders are well advised only to propose and nominate members who do have the necessary skills. Candidates to a board should ensure that they have enough time, knowledge and experience to meaningfully contribute to the board, as well as a basic understanding of the legal framework and the business of the company. Furthermore, the articles of association may contain certain qualifications and conditions, such as an age or a term limit; no such restrictions are provided by law, but many articles of association provide for them (typically around 70 years of age and a 12-year maximum term).

29 Article 710 I of the CO.

30 Article 3 of the Ordinance.

31 Article 734f of the Revised Draft.

Each board member may generally resign at any time without giving any reason to the shareholders or the remaining board members. The corollary to such a right is the right of the shareholders' meeting to remove a board member at any time.³² However, if a board member steps down at an inconvenient time, he or she is liable for damages arising from the resignation.

Many boards, even of listed companies, consist of non-executive, outside members only; the SCBP recommends that, as a rule, the majority of the board should be composed of non-executive members. Non-executive, outside members have, as a matter of principle, the same information rights as executive members formally involved in the management. The involvement of non-executive, outside board members in the company's affairs outside formal board meetings (e.g., direct contacts with senior or lower management and on-site visits of subsidiaries) very much depends on the rules set by the board and the chair.

The board members, as well as senior management, may be held liable for any losses or damages arising from wilful or negligent violation of their duties. This accountability not only applies to formally appointed persons, but also to *de facto* directors (i.e., anyone, including shareholders or banks, who takes decisions or materially influences corporate high-level decision-making without being formally appointed). The plaintiff may be any individual shareholder, the company itself or, in the case of the company's bankruptcy, any creditor. Liability presupposes: (1) damage suffered by the company or the plaintiff; (2) a breach of a duty defined by the law, the articles of association, the organisational regulations or other internal directives by the defendants; (3) acting intentionally or negligently; and (4) a proximate causation of the breach of duty to the loss sustained.³³ In connection with the required breach of duty the Swiss Federal Supreme Court now expressly acknowledges that courts have to exercise restraint in the retrospective review of business decisions and only examine whether a business decision was reached in a sound manner; the Court requires that the business decision was taken in a flawless decision-making process, made on the basis of appropriate information and free from conflicts of interest.³⁴ Compliance with these requirements can, therefore, significantly reduce the liability risk for board members as well as senior management. In the legal literature, these court decisions are regarded as recognition of the 'business judgement rule' as a principle of Swiss corporate law.

As a matter of law, there is joint and several liability of all board members; an individual board member is, however, exempt from liability provided that there has been no fault at all on his or her side.³⁵ Individual allocation of the damage caused to shareholders, the company or, in the case of bankruptcy, to a creditor, is a matter of subsequent recourse claims among the board members. Very often when a claim is filed, there is a tension between the basic requirement of the board members to stand together and to take a uniform position when sued by an outsider and the desire of each board member not to compromise his or her position for the subsequent recourse proceedings. With regard to the burden of proof, Swiss courts typically require that once a breach of duties is established, the board member exonerates himself or herself with respect to fault. If the board lawfully delegated a part or all of the management duties, the liability of the board is limited to the required care in

32 See Article 705 I of the CO.

33 See Article 754 et seq. of the CO.

34 Decision of the Swiss Federal Supreme Court BGE 139 III 24, consideration 3.2.

35 Article 759 I of the CO.

selecting, instructing and supervising the senior managers.³⁶ Moreover, if the shareholders' meeting took the decision to discharge the board members and senior management, the latter cannot be held liable by the company and the shareholders approving the resolution. Discharge is, however, of limited relevance, since it is only valid if it relates to facts and omissions known to the shareholders at the time of the discharge decision.³⁷

In practice, shareholders' actions against board members are rare outside bankruptcy, but rather frequent if a company becomes insolvent. Recently, claims have also been brought forward in the context of hostile takeovers and even more so in going-private situations. One of the main reasons for the reluctance of shareholders to pursue legal action against board members is the financial risk associated with it. The Revised Draft does not facilitate the possibility of shareholders bringing lawsuits, as initially proposed in the Preliminary Draft.³⁸

Actions by a company itself against current or former board members happen more often nowadays, but are still rare; however, when making its decision whether to file a claim, a board should weigh the chances of success (and the possible monetary reward, taking also into account any asset protection moves that defendants are likely to make) against all the risks, which include the following:

- a* the financial risk of losing the case (which in Switzerland leads to a duty to indemnify the winning defendant for his or her costs and to the payment of the court costs);
- b* future (negative) media coverage;
- c* consequences for future hiring (i.e., negative consequences if a company is seen to 'go after' its own people);
- d* the danger that management might become risk-averse;
- e* the fact that such proceedings may potentially last several years (as happened, for example, in the *Swissair* case) and the fact that pursuing claims will be time consuming for the current management, as not all work – and certainly not all decision-making – can be delegated to (outside) lawyers; and
- f* negative impact on future cost and availability of directors' and officers' insurance (D&O insurance).

The board should consider the medium to long-term interests of the company to be paramount in any decision, rather than how its decision may be perceived by the public, which often wants to see punishment for misconduct. Generally successful liability claims against boards are still the exception rather than the rule. Most claims end with out-of-court settlements, typically financed by D&O insurance; basically, all larger companies buy coverage for potential liability claims because a number of corporate failures or crisis situations in the past 10 years (Swissair Ltd, UBS Ltd, etc.) has sharply increased awareness of the liability issue.

According to the Swiss Federal Supreme Court the above-mentioned duty to safeguard the interests of the company in good faith requires that the board ensures by appropriate measures that the interests of the company are duly considered if a risk of a conflict of interests arises;³⁹ but conflicts of interest are not specifically regulated by the current law. The SCBP, however, recommends that, as far as possible, conflicts of interest should be avoided. Should a conflict arise, the board member concerned must inform the chair who, in turn,

36 Article 754 I of the CO.

37 Article 758 of the CO.

38 Article 697j et seq. of the Preliminary Draft.

39 Decision of the Swiss Federal Supreme Court 4A_462/2009 dated 16 March 2010, consideration 6.3.

requests a decision by the full board (generally without the participation of the individual concerned). Most scholars and the SCBP recommend that the individual concerned should fully abstain from the decision-making (i.e., board discussions and voting) relating to the conflict. Our point of view is that such decisions should generally be made by way of a double vote (i.e., votes with and without the relevant individual should take place, with a decision requiring in principle two positive votes). This avoids the individuals concerned withholding information and escaping liability. Other possible measures to address conflicts are ‘dealing at arm’s length’ and third-party fairness opinions. Moreover, in specific situations (such as a takeover or going-private transaction) it may be advisable to establish an independent board committee consisting of board members who have neither a financial interest in the transaction nor any other potential conflict. The independent board committee represents the board in all matters relevant to the transaction and prepares the decision-making by the full board; a separate decision by the independent board committee to recommend the transaction is advisable as well. Such a process allows liability claims (and reputational risk) to be avoided in conflict-of-interest situations.

Agreements between the company and a board member or a member of senior management are not *per se* excluded, but the requirement of ‘dealing at arm’s length’ must be rigorously applied, and contracts above 1,000 Swiss francs need to be in writing. In addition, it may be advisable to provide for a special approval by the non-conflicted board members or, in small companies, by a shareholders’ meeting. The current revision of company legislation includes a new provision dealing with conflicts of interest of board members and senior management,⁴⁰ which essentially turns the recommendations of the SCBP into law. In addition to this, the Ordinance requires that the articles of association include the number of permissible activities of the members of the board, senior management and members of an advisory board (if any) on administrative boards or executive bodies outside their own group.⁴¹ Since the Ordinance provides no maximum number of permissible activities outside the company, the limit selected by the companies ranges from as few as five to as many as 50 positions for a board member. The corresponding limits for the senior management are considerably lower in most companies, and never exceed the limits for the board members.

III DISCLOSURE

For each financial year, the board must prepare financial statements (consolidated if required) and, under certain circumstances, a management report (Article 957 et seq. of the CO). A new law on accounting rules entered into force on 1 January 2013 and applies from 2015 (2016 for consolidated accounts). According to the new rules, the accounting standard no longer depends on the legal form of a company but will generally be applicable to all entities according to certain size criteria. For legal entities with revenues of less than 500,000 Swiss francs, it is sufficient to prepare an income statement and account for expenditures on a cash basis and a statement of assets and liabilities. Specific accounting and valuation rules apply to all legal entities with an annual turnover above 500,000 Swiss francs;⁴² however, even these new rules generally do not assure a true and fair view of the company’s financial position, as the board can still create (and within limits dissolve) hidden reserves. Listed companies, large

40 Revised Draft Article 717a of the CO.

41 Article 12 I Paragraph 1 of the Ordinance.

42 Article 957 of the CO.

cooperatives (with at least 2,000 members) and foundations subject to an ordinary audit must prepare financial statements in accordance with generally accepted accounting standards such as Swiss GAAP, IFRS or US GAAP, which require the company to present a true and fair view of its financial situation. The auditors have to comply with strict independence requirements; more specifically, the auditors must be independent of the board members and major shareholders, and may not engage in activities for the company outside the audit work that would endanger their independence. In addition, the Federal Act on the Admission and Supervision of Auditors requires that a supervisory authority ensures that audit services are performed only by sufficiently qualified specialists.

Listed companies are subject to more far-reaching disclosure obligations governed by stock exchange regulations (e.g., the DCG), must comply with certain accounting standards and must, for example, publish half-year interim statements. As far as the DCG is concerned, failure to disclose certain information must be justified in the annual report (comply or explain). In addition, listed companies must comply with disclosure requirements regarding compensation. Nowadays, the board has to prepare a written compensation report on an annual basis, which has to be audited; it must disclose all compensation, loans and credits to the members of the board, the senior management and the advisory board (if any).⁴³ The new disclosure requirements under the Ordinance regarding compensation are very similar to the ones under the previous law.

Finally, and as mentioned above, significant shareholders and their participation have to be disclosed in the notes to the balance sheet. *Ad hoc* publicity requirements for listed companies and disclosure requirements for important shareholders if their holding crosses certain thresholds (3, 5, 10, 15, 20, 25, 33.3, 50 or 66.6 per cent of voting rights) complement their framework of disclosure requirements.⁴⁴

IV RISK MANAGEMENT

An effective and efficient risk management is required by the law and the SCBP. The board is responsible for setting up an appropriate risk management framework and appropriate systems for internal control and risk management tailored to the size, complexity and risk profile of the business of the company; risk management should cover both financial and operational risks. In addition, the board has to continuously (typically each year, unless extraordinary situations arise) assess the risk situation of the company. In the management report, it must be confirmed that the risk assessment has taken place. Swiss company law does not require the establishment of a specific risk committee at board level. The SCBP, however, recommends an internal audit function that should report to the audit committee or, as the case may be, to the chair.

Compliance with the law is an integral part of the risk framework of each company; its significance is increasing because of ever-stricter regulation and enforcement of certain rules and regulations (e.g., in relation to the fight against corruption). As already mentioned, one of the non-transferable and inalienable duties of the board is the supervision of senior management, in particular with regard to compliance.⁴⁵

43 Article 13 et seq. of the Ordinance.

44 Article 120 I of the FMSA.

45 Article 716a I Paragraph 5 of the CO.

Currently, there is no formal whistle-blowing legislation in force, but on 20 November 2013 the Swiss Federal Council adopted a proposal for the implementation of better protection for employees against wrongful termination by an employer if the employee discloses alleged dishonest or illegal activities in the company.⁴⁶ There is still a certain resistance in many Swiss companies to stipulating rules on whistle-blowing. Larger multinational companies, however, normally have procedures promoting and protecting whistle-blowing.

V CORPORATE RESPONSIBILITY

Corporate social responsibility (CSR) is still a relatively new concept in Switzerland, even though some components of CSR already form part of the law. Requirements generally cover a call for sustainable management and a responsible use of the resources of the company; employee protection is provided for by the CO, the Employment Act and the Gender Equality Act. Moreover, there is extensive legislation regarding the protection of the environment. Even though CSR is, as a matter of law and fact, already part of social and corporate reality, tensions between measures and decisions promoting long-term profitable growth of the company on the one hand and CSR rules on the other hand may still exist and have to be appropriately resolved by the board, which is the guardian of the company's interests. Generally, Swiss company law does allow a board to take into account both the interests of shareholders (which typically means maximising shareholder returns over the medium term) as well as the interests of the company with all its stakeholders (employees, customers, suppliers and, further, the community and the environment at large). This means, for example, that if a board decision does not maximise value but can be justified by the legitimate interests of stakeholders, board members cannot be held liable for it.

VI SHAREHOLDERS

i Shareholder rights and powers

The financial rights of shareholders basically consist of the right to receive dividends provided that the shareholders approve them, and liquidation proceeds if the company is dissolved. Dividends may only be distributed from the disposable balance sheet profit on the stand-alone accounts of the top company of a group and from specific reserves held for this purpose (both being generally referred to as 'free reserves').⁴⁷ For tax reasons, dividends have been substituted in many companies by either payments out of surplus or reductions in the nominal value of shares as such payments are withholding tax-free.

In terms of non-financial rights, participation and protection rights have to be distinguished. Every share carries one vote and every shareholder has at least one vote. The articles of association may impose restrictions on the number of votes each shareholder may cast.⁴⁸ It is not allowed to create shares with multiple voting rights; it is, however, possible to have different classes of shares with different nominal values (and thus different dividend rights, which are always proportional to nominal value) with each share carrying one vote, which leads to voting power not being correlated to the shareholder's financial investment.

46 The draft is available at www.admin.ch/opc/de/federal-gazette/2013/9589.pdf.

47 Article 675 II of the CO.

48 Article 692 II of the CO.

Certain quorum requirements set by the law or provided for in the articles of association have the effect of protecting minority shareholders, as they will *de facto* have veto rights on certain decisions if the quorum is appropriately set.

A shareholders' meeting may be called by one or several shareholders representing at least 10 per cent of the share capital; this amount may be lowered in the articles of association. Shareholders representing shares with a nominal value of at least 1 million Swiss francs may set an item on the agenda of the shareholders' meeting;⁴⁹ often, this threshold is lowered in larger companies in their articles of association.

Shareholders have to be provided with the annual report, the compensation report and the audit opinion; in addition, each shareholder may request specific information necessary for the exercise of his or her rights at the shareholders' meeting. If this information is refused by the board, the shareholder may request a special audit ordered by a judge.⁵⁰ However, this is a rather burdensome, difficult and time-consuming procedure. To facilitate the exercise of minority shareholders' rights, the Revised Draft lowers several thresholds and hurdles, such as: (1) lowering the percentage of the share capital or voting rights required for shareholders to request a shareholders' meeting from 10 per cent to 5 per cent; (2) changing the amount of the share capital or voting rights required for the right of shareholders to ask for an item to be put on the agenda from shares with a total nominal value of at least 1 million Swiss francs to 0.5 per cent of the share capital or voting rights; (3) invitations to shareholders' meetings must include a brief explanation of each motion of the board of directors (also indicating the respective shareholders requesting the items); and (4) shareholders meetings can be held at several locations or as online meetings.⁵¹

A further protection element is afforded by the subscription rights of existing shareholders in the case of a capital increase, which protect them from dilution: these rights may only be withdrawn by a qualified shareholders' decision in specific situations.⁵² In the case of issuance of convertible or similar bonds, existing shareholders have a priority right to purchase these instruments, which, in certain cases, may also be limited by a decision of the shareholders.

Article 95 III of the Federal Constitution and the Ordinance strengthen shareholders' powers in listed companies in different ways. As mentioned above, the shareholders, *inter alia*, have to elect the chairman of the board as well as the members of the compensation committee. One of the most contentious issues in Swiss corporate law in the past has been the allocation of responsibilities between the shareholders' meeting on the one hand and the board on the other hand, in particular in relation to the determination of compensation to be paid to the board and to the senior management. In this respect, the Minder initiative and its implementing provisions strengthen shareholders' powers in listed companies by providing a binding 'say-on-pay' vote for the compensation of the board, the executive management and the advisory board (if any) and by the prohibition of certain compensation forms such as severance payments. Other compensations, such as a new-hire compensation, severance payments due under employment law (e.g., during a termination period even if there is gardening leave) as well as compensation at fair market value for non-compete clauses of a reasonable duration are still allowed, provided that (except for non-compete payments) they

49 Article 699 III of the CO.

50 Article 697 of the CO.

51 See Articles 699 Paragraph 3, 699b, 700, 701a Paragraph 2, and 701d of the Revised Draft.

52 Article 704 I Paragraph 6 of the CO.

are approved by the shareholders' meeting or have a basis in the articles of association. Such a basis is also necessary for the grant of loans and pension benefits outside the occupational pension system and for performance-related remuneration and participation plans. Furthermore, the Ordinance provides for a maximum duration for fixed-term contracts (no longer than one year) with the members of the board and senior management, as well as a maximum termination period of one year for contracts with no fixed term.⁵³

The Revised Draft provides legal certainty and makes only minor changes to the Ordinance. The following amendments are, however, noteworthy: (1) clarification that sign-on bonuses may only be paid if they compensate for actual losses of benefits granted by an executive's former employer; (2) compensation for post-contractual non-compete undertakings may only amount to the average annual compensation over the past three years and must be commercially justified, but no time limit is imposed; (3) companies with a prospective vote on variable compensation must hold an advisory vote on the compensation report; and (4) the compensation report must disclose all other companies in which the members of the board of directors or the executive management hold offices (including publication of the names of the member, function and company).⁵⁴

ii Shareholders' duties and responsibilities

Obligations on shareholders (other than to pay in full for the shares upon their issuance) are prohibited under Swiss company law.⁵⁵ Moreover, there is no duty of loyalty for shareholders. There are, however, duties and obligations for shareholders in listed companies, such as disclosure requirements regarding qualified participation as set out in Article 120 of the FMSA.

iii Shareholder activism

Swiss company law provides for a catalogue of specific rights of shareholders to take legal action in the event of an infringement of the law by the board, management or auditors. For example, each shareholder has the right to challenge resolutions of the shareholders' meeting that are in breach of the law or the articles of association;⁵⁶ there is no right to challenge resolutions of the board. However, any resolution passed by the shareholders' meeting or the board violating fundamental rules of company law is void.⁵⁷

Shareholder activism in the area of listed companies has increased significantly in the past few years. Several high-profile battles promoted by activist shareholders' groups have been widely publicised; typically, activist shareholders have tried to change the board composition and appoint members who favoured their strategy. The fact that board members can, as mentioned above, be fired at any time by a shareholders' decision and the need to re-elect board members annually has, of course, helped the activist shareholders. Other demands often include the return of excess cash to shareholders either in the form of dividends or share buy-backs. Effective from 21 January 2013 a code of best practice for institutional investors governing the exercising of participation rights in Swiss listed companies has been enacted.

53 Article 12 I Paragraph 2 of the Ordinance.

54 See Articles 735c Paragraph 3 and 5 and 735 Paragraph 4 of the Revised Draft.

55 Article 680 I of the CO.

56 Article 706 of the CO.

57 Article 706b and 714 of the CO.

The aim of these guidelines is that the institutional investors exercise their participation rights in a more systematic manner and communicate the principles and processes used to their clients.

Compensation of the board and the senior management in listed companies has been high on the agenda of the legislature and the public in the past couple of years. As mentioned before the Minder initiative and its implementing Ordinance require, *inter alia*, that the shareholders annually hold binding separate votes on the aggregate compensation amount for the board, the senior management and the advisory board, thereby quite substantially changing the current structure of parity between the shareholders and the board. The details of the voting on compensation have to be set out in the articles of association, which had to be amended at the latest in the ordinary shareholders' meeting in 2015.⁵⁸ Various models are possible: a vote on a compensation cap, whereby the shareholders state in advance the maximum amount of compensation for the respective governing bodies for the coming year (prospective vote); a vote on the base compensation for the term until the next ordinary shareholders' meeting or for the next financial year (again prospective), combined with a vote on performance-based compensation for the past financial year (retrospective vote). If a prospective vote is chosen, the Ordinance allows that the articles of association provide an additional amount for the hiring of new members of the executive management after the shareholders' meeting has taken place.⁵⁹ A survey among companies listed in Switzerland has shown that more than 90 per cent opted for a prospective model for the board's compensation (and 64 per cent opted for a prospective model for the management team's compensation).

The articles of association can also contain a provision for the course of action to be taken in the event of a negative shareholder vote on the compensation, but the solution chosen must not constrain the decision-making power of the shareholders' meeting. The binding⁶⁰ say-on-pay vote as a non-transferable power of the shareholders' meeting⁶¹ must necessarily take place on an annually basis.⁶² Many large companies had previously introduced a non-binding vote on the compensation system in the articles of association, thereby providing shareholders with an opportunity to express their non-binding view on the compensation system of the company; especially in cases of a purely prospective system, this non-binding vote, which is better aligned to international practice than the binding vote, will probably be maintained.⁶³

Swiss company law does not provide for specific legal regulations on proxy fights. A shareholder has no right to see the share register of the company; therefore, contact with other, in particular smaller, shareholders is difficult. In the course of the current reform, implementation of rules granting access to the share register in certain circumstances have been discussed but ultimately dismissed.

iv Takeover defences

In takeover situations, Swiss company and stock exchange laws disempower the board of the target company (target board) to a certain extent. The target board is not allowed to

58 Article 27 of the Ordinance.

59 Article 12 II Paragraph 5 of the Ordinance.

60 See Article 18 III Paragraph 3 of the Ordinance.

61 Article 2 Paragraph 4 of the Ordinance.

62 Article 18 III Paragraphs 1 and 2 of the Ordinance.

63 Of SMI companies, 95 per cent carried out a non-binding vote on compensation in 2014.

conclude any legal transactions that would significantly alter the assets or liabilities of the company without a resolution of the shareholders' meeting.⁶⁴ However, the target board might convene a shareholder's meeting to have contemplated defensive measures approved (e.g., share repurchase programmes). In such cases, the target board has to give advance notice to the takeover board regarding contemplated defensive measures. Subject to a resolution of the shareholders' meeting, the target board must not sell or purchase assets worth more than 10 per cent of the total assets. The most important duty in the context of takeover situations is that the law requires the target board to submit a report to the shareholders in which its position regarding the offer is explained and planned defence measures and conflicts of interest are disclosed.⁶⁵

'Poison pills' are not permitted under Swiss law; however, Swiss companies may include transfer restrictions that limit the voting rights an acquirer may obtain (i.e., percentage limit in the articles of association) or majority requirements for certain decisions by the shareholder's meeting (e.g., amendment of the articles of association), which have partially a similar effect; these defences have, however, proven only partially effective, as a bidder will usually make it a condition of its offer that a shareholders' meeting of the target abolishes these hurdles – and if the premium is high enough, the target's shareholders are likely to do so. The target board may also search for a white knight but has to grant an unfriendly bidder the same due diligence as it offers a potential white knight.

v Contact with shareholders

The parameters governing disclosure and reporting to the shareholders are set by Swiss company law, by the FMSA and its implementing regulations, and by self-regulation, namely by the SIX; annual and semi-annual reports, *ad hoc* publicity, disclosure of qualified participation of shareholders, etc. constitute further important elements of this framework. Equal treatment of market participants in the case of listed companies is, as explained above, important.

In Switzerland, institutional investors such as pension funds, the social security system and insurance companies are significant shareholders in many companies; very often, however, they do not exercise their voting rights. Various attempts have been made to induce institutional investors to get more involved and to exercise their shareholder rights. In line with this, on 21 January 2013, guidelines for the exercise of participation rights by institutional investors were enacted.⁶⁶ Generally, investor protection and shareholders' advisory organisations have become more important in Switzerland. The Ordinance now contains an obligation for pension funds to exercise their votes in listed companies with respect to motions contained in the invitation to the shareholders' meeting concerning specific matters, such as, for example, the election of board members.⁶⁷ This rule is likely to lead to an increase in the influence and power of investor protection and shareholders' advisory organisations, since pension funds (which are often too small in Switzerland to accurately monitor all companies they have invested in) are likely to delegate their voting rights to them or to follow their recommendations. Furthermore, the Ordinance obliges companies to introduce indirect electronic proxy voting, which means that they need to ensure that powers

64 Article 132 II of the Financial Market Supervision Act (FMSA).

65 Article 132 I of the FMSA.

66 Available at http://swissinvestorscode.ch/wp-content/uploads/Richtlinien_16012013_e.pdf.

67 Article 22 of the Ordinance.

of attorney and instructions may also be given electronically while corporate proxies are currently prohibited. The independent proxy, who must meet the same independence criteria as the auditors, has to be elected on a yearly basis by the shareholders' meeting.⁶⁸

To improve contact with shareholders, the Preliminary Draft obligated listed companies to provide an electronic forum for its shareholders, where agenda items of an upcoming shareholders' meeting could be discussed in advance;⁶⁹ the Revised Draft no longer foresees this possibility.

VII OUTLOOK

As set out at the beginning of this chapter, Swiss company legislation is undergoing a major revision with the Revised Draft. Apart from those planned changes already mentioned, the revision pursues six principal goals:

- a* improving corporate governance;
- b* creating a more flexible capital structure;
- c* modernising the shareholders' meeting (e.g., by introducing electronic voting);
- d* implementing the Ordinance's provision into formal law and proposing related adjustments;
- e* improving coordination of company law with accounting provisions; and
- f* implementing several minor parliamentary initiatives (e.g., gender quotas).

With regard to the improvement of corporate governance, there are three principal objectives:

- a* improving shareholder protection;
- b* improving control mechanisms; and
- c* facilitating better investment decisions by institutional and foreign investors.

Even though the debate on the new Swiss company legislation is extensive, the fundamental principles of Swiss company law will, in all likelihood, be upheld. The revision is, therefore, evolutionary rather than revolutionary in nature. In compensation matters it will, by and large, implement the Ordinance into ordinary law if the Revised Draft is not changed in parliament. Swiss listed companies will thus continue to have the task of following these rules, which are, in certain areas, stricter than the ones their international competitors face, while having to try to attract, reward and retain key talent.

68 See Article 8 et seq. of the Ordinance.

69 See Article 701g of the Preliminary Draft.

TAIWAN

Stephen C Wu, Benjamin Y Li and Derrick C Yang¹

I OVERVIEW OF GOVERNANCE REGIME

All companies incorporated in Taiwan are governed by the Company Act.² The listed companies in Taiwan are further subject to the Securities and Exchange Act (SEA) and ancillary regulations, as well as rules published by the two stock exchanges, the Taiwan Stock Exchange Corporation (TWSE) and the Taipei Exchange (TPEX), which mainly set forth and promote the disclosure requirements to ensure the transparency of the publicly listed and traded companies. In addition, to establish a sound corporate governance regime and to advance the integrity of the securities market, the TWSE and the TPEX jointly adopted the ‘Corporate Governance Best Practice Principles for TWSE/TPEX-Listed Companies’ on 4 October 2002.³

The SEA, enacted on 30 April 1968 and last amended on 7 December 2016, provides a comprehensive framework for securities⁴ regulation in Taiwan. Prior to 2 April 1997, the SEA was enforced by the Securities and Exchange Commission (SEC). Subsequent to the amendment to the Futures Trading Act on 26 March 1997, the SEC was renamed as the Securities and Futures Commission (SFC) on 2 April 1997. On 1 July 2004, following the institutional reorganisation of certain financial regulatory agencies, the SFC became the Securities and Futures Bureau (SFB) under the Financial Supervisory Commission (FSC) of the Executive Yuan (i.e., Taiwan’s administrative branch). In its capacity as the supervisory and regulatory agency for the securities and futures markets, the FSC may request account books, financial statements, documents, or other reference or report materials for inspection, render remedial measures in the event of any non-compliance, and impose administrative fines against SEA violations.

1 Stephen C Wu and Benjamin Y Li are partners and Derrick C Yang is a senior associate at Lee and Li Attorneys-at-Law.

2 As an attempt to deregulate small and mid-sized enterprises and to provide a more flexible corporate structure while strengthening information disclosure and corporate governance mechanisms, a special committee organised by leading scholars, legal practitioners and government officials convened in February 2016 to propose an overhaul amendment of the Company Act, which may include introducing a corporate secretary for record management and compliance purposes, enhancing directors’ duty of care and duty of loyalty as well as relaxing the threshold for initiating a derivative action, etc.

3 The ‘Corporate Governance Best Practice Principles for TWSE/TPEX-Listed Companies’ mainly encompasses the following aspects: (1) establishing an effective corporate governance structure; (2) protecting shareholders’ rights; (3) enhancing the function of boards of directors; (4) empowering the supervisors; (5) recognising the stakeholders’ importance; and (6) improving information transparency.

4 Pursuant to Article 6 of the SEA, securities are defined as including government bonds, shares and bonds publicly issued by a company limited by shares, and other securities approved by the government.

In principle, corporate governance is embodied by a corporate structure that consists of a board of directors, supervisors and the shareholders, and this is applicable to all companies limited by shares. The shareholders, as the beneficial owners of the company, are vested with the rights to elect directors and supervisors as well as approving the proposals prepared by the board. The board holds discretionary powers delegated by the shareholders and oversees the business operations of the company. The supervisors are responsible for overseeing the financial condition of the company, examining and auditing the accounts and financial statements, and supervising the conduct of the directors.

On a more detailed level, for certain public companies⁵ the 11 January 2006 amendment to the SEA (the 2006 Amendment) requires that independent directors occupy at least two seats on the board, which shall be no less than one-fifth of the total number of directors, to ensure the board's function and safeguard the interests of the shareholders. The 2006 Amendment also introduced the audit committee, which replaces the supervisors. Moreover, the 24 November 2010 amendment to the SEA prescribed that all TWSE or TPEX-Listed companies shall establish a remuneration committee to review the company directors' remuneration. As with the role of the corporate secretary adopted in the United States, United Kingdom and Singapore, the 'Corporate Governance Best Practice Principles for TWSE/TPEX-Listed Companies', similarly recommends that public companies designate personnel (with certain qualifications) to oversee or handle corporate registration matters, prepare meeting minutes of the board and shareholders' meetings, and monitor regulatory developments to ensure compliance therewith.

II CORPORATE LEADERSHIP

i Board structure and practices

Structure of the board

Under the Company Act, a company limited by shares is legally required to establish the board to oversee its business operations.⁶ The one-tier board structure is commonly adopted in Taiwan. The board shall comprise no less than three directors. On the other hand, Article 26-3 of the SEA prescribes that the board of a public reporting company shall consist of at least five directors.

The chairman of the board represents the company, while other directors may only do so if authorised by the board. The chairman shall preside over the shareholders' meeting, the meeting of the board of directors, and the meeting of the managing directors, if applicable. The board, functioning through its meetings, is granted a wide range of powers. Except for the matters that shall be effected pursuant to the shareholders' resolutions as required by law

5 According to the FSC's Letter (Ref. No. Jin-Guan-Zheng-Fa-1020053112) dated 31 December 2013, the adoption of independent directors shall apply to financial holding companies, banks, bills corporations, securities investment trust companies, integrated securities firms and listed futures commission merchants, as well as other listed companies that do not belong to the financial industry. For other listed companies that do not belong to the financial industry but have a paid-in capital of NT\$10 billion or less, a grace period for complying with the aforementioned ruling is given to the incumbent directors of said companies.

6 For other types of companies (i.e., limited companies, unlimited companies and unlimited companies with limited liability shareholders), the power and authority of the board will be exercised by the individual managing directors or shareholders.

or the articles of incorporation, the operations of a company are by and large determined by the board's resolutions adopted at the board meetings. The board may also establish internal rules to govern the procedures for specific types of transactions, such as extending loans and providing endorsements or guarantees.

Legal responsibilities of the board

The legal responsibilities of the board include convening the shareholders' meeting, keeping the articles of incorporation, the minutes of the shareholders' meetings, the financial statements and other books for inspection, reporting to the shareholders' meeting, declaring the bankruptcy of the company, announcing or notifying the dissolution of the company, etc.

Except as otherwise provided in the Company Act, the following matters must be resolved and adopted by a majority of the directors present at a meeting representing more than half of the directors of the company (if no higher quorum and vote are stipulated in the articles of incorporation):

- a* appointment and dismissal of external auditors and managers, and determination of their remuneration;
- b* approval of public issuance of the shares of the company;
- c* approval of the amount of capital contribution in kind;
- d* convening the shareholders' meetings;
- e* reporting losses of the company to the shareholders' meeting when the losses reach half of the paid-in capital; declaring bankruptcy when the company's assets are not sufficient to satisfy its indebtedness;
- f* approval of the annual reports and proposals regarding earnings distribution or loss-offsetting for submission to the shareholders' meeting for approval;
- g* approval of a merger or spin-off agreement for submission to the shareholders' meeting for approval; and
- h* amendment of the articles of incorporation for submission to the shareholders' meeting for approval.

Aside from the above, the following matters must be resolved and adopted by a majority vote of the directors present at a board meeting attended by two-thirds or more of the directors (if no higher quorum and vote are stipulated in the articles of incorporation):

- a* approval of a company share buy-back;
- b* approval for entering into a share subscription agreement with its employees whereby the employees may subscribe, within a specific period, for a specific number of shares of the company;
- c* making proposals to the shareholders' meeting to engage in any of the following transactions:
 - entering into, amending, or terminating any contract for the lease of the company's business in whole, or for entrusted business, or for regular joint operation with others;
 - transferring the whole or any essential part of the company's business or assets; or
 - accepting the transfer of another party's whole business or assets that have a great impact on the business operations of the company;
- d* electing the chairman of the board or the managing directors from the directors;
- e* offering corporate bonds;
- f* issuance of new shares; and

g application for reorganisation of the company.

According to the Company Act, the board must comply with relevant laws and regulations, the company's articles of incorporation and resolutions adopted at a shareholders' meeting. While the Company Act is silent on whether the board resolution should be deemed null and void if the aforesaid obligation is breached by the board, a series of court decisions held that the company may not invoke the fact that a resolution is null and void as a defence against a *bona fide* third party. Moreover, according to the Company Act, in the event that such a resolution causes damage to the company, the supervisor as well as any shareholder who has continuously held the shares of the company for one year or longer may request the board to discontinue the act. The board members participating in the passing of such a resolution would be liable to the company for the damage resulting therefrom, except for those who raise objections in writing or whose objection is duly recorded in the meeting minutes.

Delegation of responsibilities

Under the Company Act, the chairman of the board represents the company. If the chairman is on leave or absent or for any reason cannot exercise his or her power and authority, the vice chairman shall act on his or her behalf. In the cases where the company does not have a vice chairman, or the vice chairman likewise cannot exercise his or her power and authority for any cause, the chairman should appoint one of the directors to act on his or her behalf.

With respect to the power and authority of the board, according to the interpretation of the Ministry of Economic Affairs (MOEA),⁷ during the recess of the board of directors, the managing directors may regularly exercise the power and authority of the board if the matters in hand are not specifically required to be resolved by the entire board. The Company Act prescribes that while the managing directors are not mandatory, if the managing directors are elected, the number thereof shall not be less than three and no more than one-third of the total number of directors. Accordingly, the company must have at least nine directors to elect three managing directors to attend to the entrusted corporate affairs.

In this regard, the Corporate Governance Best Practice Principles for TWSE/TPEX-Listed Companies provide that the board of directors of a TWSE/TPEX-Listed company may, taking into account the size of the company and the board, and the nature of the business, set up audit, remuneration, nomination, risk management or any other functional committees and, on the basis of a belief in corporate social responsibility and sustainable operation, set up an environmental protection or other committee, and have that committee stipulated in the articles of incorporation.

Remuneration of directors

According to the Company Act, the remuneration of the directors of the company, if not prescribed in the articles of incorporation, shall be determined by a meeting of shareholders and cannot be ratified. The SEA requires all listed companies to set up a remuneration committee, which consists of at least three members, to periodically review topics surrounding the performance of the company and directors' remuneration. The details in respect of the qualifications of the committee member and the procedures for exercising his or her power

⁷ See MOEA's Letter Ref. No. Sun-04379, dated 12 February 1988.

are set forth in the Regulations Governing the Appointment and Exercise of Powers by the Remuneration Committee of a Company whose Stock is Listed on the Stock Exchange or Traded Over the Counter promulgated by the FSC.

Board and company practice in mergers and acquisitions

According to the Business Mergers and Acquisitions Act (the M&A Act), upon adopting a resolution in respect of mergers and acquisitions, the board shall act in the best interest of the company and exercise the care of a good administrator in attending to relevant affairs. The amendment to the M&A Act, effective from 8 January 2016, requires the board to establish an *ad hoc* committee for reviewing the fairness and reasonableness of the merger or acquisition plan and the transaction contemplated thereby. The *ad hoc* committee shall report their findings to the board and shareholders' meeting, if applicable. For the companies that have established an audit committee in accordance with the SEA, the audit committee shall exercise the functions of the *ad hoc* committee provided above. In addition, the *ad hoc* committee or audit committee shall seek the opinion of an independent expert on the fairness of the share exchange ratio or distribution of cash or other assets to shareholders in the course of conducting its review.

ii Directors

Appointment, nomination, and term of office

The board of directors of a company shall be elected at a shareholders' meeting. When electing the directors, each share carries the number of votes equal to the number of seats to be elected, and a shareholder may cast all the votes for one candidate or divide the votes among several candidates. Accordingly, the minority shareholders are afforded the opportunity to cause certain candidates to be elected as directors by means of a collective action. A shareholders' meeting may resolve to discharge a director at any time by a supermajority vote, provided that the director may claim against the company for any damages resulting from the discharge if he or she is discharged without cause. The term of office of a director shall not exceed three years, but a director is eligible for re-election.

Legal responsibilities of the directors

In the 2001 amendment to the Company Act, the directors' fiduciary duty was formally codified. A director owes the duty to faithfully and loyally conduct the company's business and to exercise the care of a good administrator.

According to the Company Act, a director should also comply with the relevant laws and regulations, the company's articles of incorporation and the resolutions adopted at a shareholders' meeting. If this duty is breached, the director could be held jointly and severally liable with the company to third parties.

For a director who competes with the company (i.e., engaging in a transaction for oneself or any third party's behalf that is within the scope of the company's business), that director shall disclose the important contents of such an action to the shareholders' meeting and obtain its approval (by a resolution adopted by a majority of the shareholders present at a meeting representing two-thirds or more of the total number of its outstanding shares); otherwise, the meeting of shareholders may, by a resolution, recover the profits that the director made from the transaction, unless one year has lapsed since the realisation of the profits.

The Company Act also provides that where a director (or the juristic person he or she represents) has an interest in the agenda and this interested relationship may prejudice the company's interest, the director shall abstain from voting on the agenda. According to a series of court decisions, the 'interested relationship' refers to the situation where the director will acquire rights or be exempted from obligations, or lose rights or assume obligations, as a result of the adoption of the resolution on the agenda in question. 'Prejudice the company's interest' is interpreted as 'being detrimental to the company's interests', which lacks an objective guideline and thus will be subject to a case-by-case review. On the contrary, if the 'self-dealing' (i.e., the director or the juristic person he or she represents is the contracting party to the company) occurs, it is perhaps less ambiguous under the Company Act, and the disinterested supervisors will step in and act for the company in dealings with the interested director.

Shadow director

Under Paragraph 3, Article 8 of the Company Act, amended on 4 January 2012, a non-director of a public reporting company, who (1) *de facto* performs a director's duties, or (2) has *de facto* control over a company's personnel, financial or business operation and can instruct a director to perform his or her duties, shall be deemed a shadow director and shall, likewise, be subject to a director's liabilities. The legislative intent, published by the Legislative Yuan when this Article was passed, provides some guidance on the definition of what constitutes a statutory shadow director and, according to the legislative intent, this Article was introduced to address the corporate governance issues pertaining to controlling shareholders that circumvent directors' liabilities by not acting as directors but manipulating the company's affairs through appointing 'in name only' nominees to the board.

Independent directors

Certain public reporting companies are required to designate and elect at least two independent directors to seats on the board, which shall not be less than one-fifth of the total number of directors, in accordance with the SEA. The professional qualification requirements for an independent director include at least five years' work experience in any of the following fields or positions:

- a* an instructor (or of a higher position) of a department of commerce, law, finance, accounting (or other academic department related to the business needs of the company) in a public or private junior college, college or university;
- b* a judge, public prosecutor, attorney, certified public accountant, or other professional or technical specialist who has passed a national examination and been awarded a certificate in a profession necessary for the business of the company; or
- c* have work experience in commerce, law, finance, accounting or an area otherwise necessary for the business of the company.

During the term of his or her office and two years before his or her election, an independent director shall not, *inter alia*, be:

- a* an employee of the company or any of its affiliates;
- b* a director or supervisor of the company or any of its affiliates (the same does not apply, however, in cases where the person is an independent director of the company, its parent company or any subsidiary in which the company holds, directly or indirectly, more than 50 per cent of the voting shares);

- c* an individual shareholder who holds shares, together with those held by the person's spouse, minor children, or held by the person under others' names, in an aggregate amount of 1 per cent or more of the total number of issued shares of the company or ranking in the top 10 in shareholdings;
- d* a spouse, relative within the second degree of kinship, or lineal relative within the third degree of kinship, of any of the persons in the preceding three subparagraphs;
- e* a director, supervisor, or employee of a corporate shareholder that directly holds 5 per cent or more of the total number of issued shares of the company or that holds shares ranking in the top five in holdings;
- f* a director, supervisor, officer, or shareholder holding 5 per cent or more of the shares, of a specified company or institution that has a financial or business relationship with the company; or
- g* a professional individual or an owner, partner, director, supervisor, or officer of a sole proprietorship, partnership, company, or institution that provides commercial, legal, financial, accounting services or consultation to the company or to any affiliate of the company.

III DISCLOSURE

i Internal control

Since independence is one of the salient features of a supervisor, a supervisor is prohibited from serving as a director, manager or other officer concurrently. A company limited by shares should elect at least one supervisor, who is domiciled in Taiwan, to be responsible for reviewing the financial condition of the company, examining and auditing the accounts and documents, and supervising the conduct of the directors. For a listed company, there should be at least three supervisors, with at least one of them domiciled in Taiwan.

In 2006, audit committees were introduced to the SEA as an alternative to statutory supervisors for public companies. While certain public companies are required to establish an audit committee,⁸ most public reporting companies are allowed to choose whether to adopt an audit committee in lieu of supervisors. The audit committee shall comprise at least three independent directors, at least one of whom shall be an accounting or finance professional. In addition to the duties prescribed for independent directors, the audit committee should also review the internal control system and the company's financial reports (Paragraph 1, Article 14-5 of the SEA).

ii Mandatory disclosure

For a private company, there is no requirement for filing annual financial reports with the authorities other than a tax return. However, public reporting companies are subject to

⁸ According to the FSC's Letter (Ref. No. Jin-Guan-Zheng-Fa-10200531121) dated 31 December 2013, the adoption of an audit committee shall apply to financial holding companies, banks, bills corporations, insurance companies, integrated securities firms of listed companies or the subsidiaries of financial holding companies and other listed companies that do not belong to the financial industry but have paid-in capital of NT\$10 billion or more. As for other listed companies that do not belong to the financial industry but have a paid-in capital of between NT\$2 billion and NT\$10 billion, the adoption of an audit committee shall be applicable as of 1 January 2017, provided that a grace period for complying with the aforesaid ruling is given to the incumbent directors and supervisors of such companies.

disclosure and periodic reporting requirements prescribed under the securities regulations. In a nutshell, a public reporting company is required to upload certain information that is subject to mandatory disclosure onto the website of the Market Observation Post System (MOPS) either on a regular basis (e.g., report about the company's finance-related information on monthly basis), or from time to time under certain circumstances (e.g., material information on occurrences that may affect the shareholders' interest, asset acquisitions or disposals, capital increases, proxy solicitations, etc.). To facilitate sound disclosure, in 2008, the TWSE and the TPEX announced the "Public Company Material Information Disclosure Process" with the aim of helping corporate insiders and the employees of a company better understand the relevant laws and regulations.

IV CORPORATE RESPONSIBILITY

Section 4.3 of the National Action Plan for Anti-Corruption promulgated by the Executive Yuan provides that corporate social responsibility shall be advanced. In this regard, the TWSE and the TPEX have jointly adopted the Ethical Corporate Management Best Practice Principles for TWSE/TPEX-Listed Companies and the Corporate Social Responsibility Best Practice Principles for TWSE/TPEX-Listed Companies (last amended on 28 January 2015 and 28 July, respectively) for listed companies to observe in fostering a corporate culture of ethical management and carrying out corporate social responsibility.

Moreover, the regulations governing the information to be published in the annual reports and offering prospectuses provide that all listed companies are required to disclose performance and achievements in respect of corporate social responsibility, in areas such as the environment, community service, social welfare, consumer rights, human rights and safety and sanitation, in the annual report and prospectus.

V SHAREHOLDERS

i Shareholders' rights and powers

Voting power and shareholders' meeting

Shareholders, being the beneficial owners of a company, enjoy voting rights on the matters prescribed by the Company Act, which include:

- a* election and dismissal of the directors and supervisors;
- b* proposal of agenda items for the regular shareholders' meeting to consider;
- c* determination of remuneration of the directors and supervisors;
- d* modification of the articles of incorporation; and
- e* approval of material transactions.

Generally speaking, each outstanding share is entitled to one vote unless otherwise prescribed by the Company Act (e.g., no voting rights for holders of special shares or for a company that holds its own shares in accordance with the law).

In Taiwan, there are two types of shareholders' meetings: a regular meeting and a special meeting. The regular shareholders' meeting shall be held within six months of the close of each fiscal year to approve (1) the business report, (2) financial statements and (3) the surplus earnings distribution or loss-offsetting proposals prepared by the board. The special

shareholders' meetings can be convened by the board of directors whenever material events occur (e.g., transfer or sale of all or substantially all of the business or assets) or by the supervisor when necessary.

Aside from the above, when a company limited by shares is organised by a single government shareholder or a single juristic person shareholder, the functional duties and power of the shareholders' meeting shall be exercised by the board of directors. The directors and supervisors of the company shall be appointed by the government shareholder or juristic person shareholder. Unless otherwise prescribed by the articles of incorporation, at least half of the directors should constitute the quorum and the matters that should be resolved at a shareholders' meeting should be adopted by a simple majority vote at a board meeting.

Inspection and pre-emptive rights

Under the Company Act, the board of directors shall prepare the business report, the financial statements and the surplus earning distribution or loss-offsetting proposals for the supervisor to audit before the statements and records are submitted to the shareholders' meeting for ratification. The shareholders' meeting may select and appoint inspectors for inspection.

In the event that a company proposes to issue new shares, the company shall notify its current shareholders to subscribe for, with pre-emptive right, the new shares, except those reserved for the employees under the Company Act. The subscription will be made according to the proportion of the shareholders' shareholding. Certain exceptions also apply to public reporting companies under the SEA and ancillary regulations.

Rights of dissenting shareholders

When a company is considering engaging in specific types of transactions (e.g., sale or purchase of all or substantially all of a company's business or assets, spin-off or merger), the board of directors shall submit the proposal to the shareholders' meeting. Any shareholder who dissents in writing or verbally with the record made before or during the meeting may waive the voting right and request that the company buy back his or her or its shares at a fair price, which should be made in writing within 20 days after the adoption of the resolution in question. In cases where no agreement on fair price can be reached between the dissenting shareholder and the company within 60 days after the resolution is adopted, the shareholder may, within 30 days prior to the expiration of the 60-day period, apply to the court for a decision.

ii Shareholders' duties and responsibilities

Article 154 of the Company Act provides that if a shareholder materially abuses the company's status as a legal entity and causes the company to assume certain debts that the company apparently would have difficulty in repaying, the shareholder shall become liable for the debts. This law has been promulgated and effective since June 2013, and there is no settled law or meaningful court decision in the area as to how a shareholder will be deemed to have manipulated its power and fall under this statutory 'piercing the corporate veil' rule. Accordingly, any guidance that the courts may develop on a case-by-case basis shall be considered in future.

iii Shareholder derivative actions

The shareholders may claim against a director by a direct action instituted within 30 days after a resolution to institute the action is passed by the shareholders' meeting. Any shareholder who has been continuously holding 3 per cent or more of the total number of the outstanding shares of the company for over a year may initiate a derivative action seeking the supervisors of the company to institute, for the company, an action against a director of the company. However, if the outcome of the lawsuit is in favour of the director, then the shareholder who commenced the derivative proceedings may be personally liable to indemnify the company for any damage suffered by it therefrom.

To facilitate the shareholders' voting rights, the Company Act provides that the voting rights may be exercised in writing or by way of electronic transmission, provided that the methods for exercising the voting rights are stipulated in the meeting notice of the shareholders' meeting. Listed companies having registered capital of NT\$2 billion or more and 10,000 or more shareholders recorded in the shareholder roster in the most recent lock-up period shall include electronic voting as one of the voting methods for the shareholders.

iv Takeover defences

Shareholder and voting rights plans

Paragraph 1, Article 10 of the M&A Act provides that the shareholders of a company participating in the merger or acquisition under the M&A Act may decide on the methods and related matters regarding the joint exercise of voting rights by a written agreement. However, the validity of the voting agreements entered into by the shareholders, in anticipation of an unqualified transaction as well as for other purposes, remains unsettled.

The Supreme Court, in its judgments (Ref. Nos. 71 Tai-Sun-4500, 72 Tai-Sun-2825 and 96 Tai-Sun-134), ruled that a voting agreement that stipulates provisions that will have a detrimental effect on the interest of minority shareholders should be deemed as null and void for violating the public order and good morals. Nonetheless, this stance has been criticised by scholars for failing to acknowledge the parties' intent as well as potentially eroding private law principles. As the amendment to the Company Act, dated 1 July 2015, introduced a new section designed for closed companies (i.e., non-public offering companies whose shares are held by no more than 50 persons) and the voting agreement entered into between or among the shareholders thereof is explicitly recognised, it remains to be seen as to whether local courts would change their position when adjudicating issues relating to a voting agreement in the future.

Staggered board

Paragraph 1, Article 195 of the Company Act provides that a director's term of office shall not exceed three years, albeit, that a director who has served his or her term is eligible to stand for re-election. In other words, the law is silent on whether a company may adopt a staggered board where only a number of the directors are elected each time. Nonetheless, in practice, the MOEA and local authorities responsible for corporate registration matters require the term of office of all directors in a company to be consistent; otherwise, they may reject the application for registering the directors' term of office on the grounds that this mechanism is not specifically provided by the law. As such, a staggered board has not, as yet, become an effective defence to a takeover bid in Taiwan.

v Contact with shareholders

If contacting shareholders with the intention of garnering their support, proxy solicitation is allowed in accordance with the applicable regulations. In Taiwan, a shareholder may appoint a proxy to attend the shareholders' meeting on the shareholder's behalf by executing a power of attorney printed or issued by the company stating the scope of the power authorised to the proxy. Except for trust enterprises or stock agencies approved by the authority, when a person acts as a proxy for two or more shareholders, the number of votes represented by him or her shall not exceed 3 per cent of the total number of voting shares of the company; otherwise, the number of votes in excess shall not be counted. Moreover, a shareholder may only execute one power of attorney and appoint one proxy only, and shall serve this written proxy to the company no later than five days prior to the date of the shareholders' meeting (Article 177 of the Company Act).

To regulate proxy solicitation in connection with listed companies' shareholders' meetings, the authority has promulgated the Regulations Governing the Use of Proxies for Attendance at Shareholder Meetings of Public Companies in accordance with Article 25-1 of the SEA, which contains the following key provisions:

- a* except for trust enterprises or stock agencies, a proxy solicitor shall be a shareholder holding 50,000 shares or more of the total issued shares, provided that if election of directors or supervisors is on the agenda of a shareholders' meeting, a higher threshold shall apply;
- b* a proxy solicitor shall meet certain qualifications;
- c* no solicitation will be allowed unless a proxy solicitor has submitted to the company the documents regarding proxy solicitation within the time limit (i.e., 38 days before the convention of the annual shareholders' meeting or 23 days before the convention of a special shareholders' meeting);
- d* a shareholder shall personally fill out the name of the proxy solicitor or the proxy on the proxies, unless a trust enterprise or stock agent is engaged to act as a proxy, in which event affixation of seals to the proxies will suffice;
- e* a proxy solicitor shall sign or affix its seal to the solicited proxies and may not assign the proxies to any other person; and
- f* proxies may not be obtained in exchange for money or other benefits, except for distribution of souvenirs at a shareholders' meeting on behalf of the company or where reasonable fees are paid by a proxy solicitor to a person mandated to conduct solicitation.

VI OUTLOOK

On 26 December 2013, the FSC announced the Road Map for Strengthening Corporate Governance in Taiwan, which includes measures such as reinforcing a corporate governance culture, promoting shareholder activism, enhancing the function of the board, disclosing material information in connection with corporate governance and stressing the legal affairs of a company. The TWSE and the TPEX will also participate in promoting this road map for a five-year term. During the term, the FSC will review and make necessary adjustments to this road map on a year-by-year basis, which is expected to serve as a foundation for reshaping corporate governance practice and developing more sustainable corporate management. Meanwhile, the FSC will proceed with amending relevant regulations governing listed companies to achieve the same objectives.

Moreover, to provide listed companies with the opportunity to communicate material information to the public and enable investors to digest material information that might have a significant impact on shareholders' equity or the price of securities of the listed companies, the TWSE, on 15 January 2016, implemented the Trading Halt System, which allows trade to be halted for one day if any of the listed companies intends to convene board meetings to adopt resolutions on any matter set out in Paragraph 1, Article 13-1 of the Taiwan Stock Exchange Corporation Procedures for Verification and Disclosure of Material Information of Companies with Listed Securities, or if the company finds that it is unable to provide a comprehensive explanation regarding media coverage on the aforesaid material information on the same day. In principle, the period for a trading halt is one trading day and the resumption of trading can take place upon providing full disclosure of the reason for halting the trade. The implementation of this mechanism could bring Taiwan a step closer to the international norm.

UNITED KINGDOM

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I OVERVIEW OF GOVERNANCE REGIME

The UK system of corporate governance is generally seen as an effective model that has influenced many other jurisdictions in Europe and Asia. This helps to attract international companies wishing to gain access to a wide pool of investors, who are reassured by the governance obligations placed on issuers regardless of where their key business operations are located. In this chapter we focus on UK-incorporated companies with a premium listing on the Main Market of the London Stock Exchange. Requirements are relaxed to a degree for companies that are only able (or only choose) to obtain a standard listing, or that are not UK-incorporated companies.

The United Kingdom's corporate governance system comprises laws, codes of practice and market guidance. Mandatory and default rules and legal standards derive from common law, from statute (notably the Companies Act 2006 (the Companies Act)) and from regulation (notably the Listing Rules and the Disclosure and Transparency Rules published by the Financial Conduct Authority (FCA), which is a statutory body). Some of these laws and regulations derive from European law, but some are specific to the United Kingdom. The City Code on Takeovers and Mergers (the Takeover Code) also has an important role to play in control transactions, and has statutory force. Each company's constitution, which will also impose governance requirements, has legal effect as a statutory contract.

The most important code of practice is the UK Corporate Governance Code (the Code), which is published and updated periodically by the Financial Reporting Council (FRC), which is also a statutory body. The current edition of the Code was published in 2014. The FRC has recently indicated that no substantial changes are expected until the next scheduled review in 2019. In 2010, the FRC also published the UK Stewardship Code (the Stewardship Code), which applies to the institutional investor community and not to companies directly.

Finally, guidelines from the key supervisory bodies and from the institutional investor community supplement these laws, regulations and codes of practice. The United Kingdom's institutional investor community also regularly publishes and updates guidance on a range of matters, particularly those where a shareholder vote is required.

The bedrock of best practice corporate governance in the United Kingdom is the single board collectively responsible for the long-term success of each company including:

- a* separate chairman and CEO;

¹ Andy Ryde is a partner and Murray Cox is a senior associate at Slaughter and May. The information in this chapter was accurate as of March 2016.

- b* a balance of executive and independent non-executive directors;
- c* strong, independent audit and remuneration committees;
- d* annual evaluation by the board of its performance;
- e* transparency on appointments and remuneration; and
- f* effective rights for shareholders, who are encouraged to engage with the companies in which they invest.

One defining feature of the Code is the ‘comply or explain’ approach: rules for companies with a stock exchange listing (the Listing Rules) require all companies either to comply with the Code or explain why they do not. The Code is issued with an acknowledgement of flexibility; this is in recognition of the principle that no single governance regime would be appropriate, in its entirety, for all companies. This approach does, however, rely on shareholder engagement to challenge non-compliance where appropriate. Nevertheless, in its January 2016 report on recent developments in corporate governance, the FRC noted that over 90 per cent of all FTSE 350 companies (the 350 largest UK-listed companies, by market capitalisation) reported full compliance with the Code, or full compliance with all but one or two provisions. In many cases, non-compliance is due to circumstances rather than deliberate choice. This confirms that the provisions of the Code are widely adopted by companies despite the comply or explain philosophy.

The Code states that an explanation for non-compliance should set out the background, provide a clear rationale that is specific to the company, indicate whether the deviation from the Code’s provisions is limited in time and state what alternative measures the company is taking to deliver on the principles set out in the Code and to mitigate any additional risk.

II CORPORATE LEADERSHIP

i Board structure and practices

The UK system features a unitary board. There is no two-tier structure – executive directors and independent, non-executive directors instead act together as one board. There is no co-determination principle in the United Kingdom requiring seats on the board to be reserved for employee representatives. The company’s powers are exercised by its board acting collectively, with a small number of decisions requiring shareholder approval. In practice, substantial managerial authority is delegated by the board to the company’s executives; the board appoints the executives and exercises an oversight function by approving substantial decisions that do not require shareholder approval. Standing committees of the board typically include at least a nomination committee, audit committee and remuneration committee; but the creation of other standing committees, or *ad hoc* committees to exercise delegated powers, is permitted.

The Code recommends that the board and its committees should have an appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively. Except for smaller companies (being those below the FTSE 350), at least half of the board, excluding the chairman, is required to comprise individuals determined by the board to be independent. A smaller company is required to have at least two independent directors. This way, no individual or small group of individuals can dominate the board’s decision-making. It is the CEO, though, who is responsible for running the company’s business, in consultation with the board.

The criteria for determining whether a director may be regarded as ‘independent’ are set out in the Code. A director will generally not be regarded as independent if he or she has been an employee of the company or group within the past five years; has, or has had within the past three years, a material business relationship with the company; has received or receives additional remuneration from the company apart from a director’s fee, participates in the company’s share option or a performance-related pay scheme, or is a member of the company’s pension scheme; has close family ties with any of the company’s advisers, directors or senior employees; holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; represents a significant shareholder; or has served on the board for more than nine years from the date of their first election.

The Code requires that the board constitute a nomination committee, an audit committee and a remuneration committee. The strength and independence of these committees – whose particular duties are addressed in the Code and in recommended terms of reference published by the Institute of Chartered Secretaries and Administrators (ICSA) – is a key factor in ensuring effective corporate governance, although ultimate responsibility for areas addressed by these committees remains with the board collectively. Some boards also constitute a risk committee that is separate from the audit committee and has responsibility for overseeing risk exposure and future risk strategy.

The Code recommends that the audit committee should comprise at least three (or in the case of smaller companies, two) independent directors, one of whom should have ‘recent and relevant financial experience’. The chairman of the board should not be a member of the audit committee unless the company falls below the FTSE 350, in which case the chairman may be a member (but not chair) of the audit committee, provided he or she was independent on appointment. The nomination committee should comprise a majority of independent directors and be chaired by an independent director. The chairman of the board can be a member of (and chair) the nomination committee. The remuneration committee should comprise at least three (or, in the case of smaller companies, two) independent directors. The chairman of the board may sit on (but not chair) the remuneration committee, provided he or she was independent on appointment.

The separation of chairman and CEO is one of the key ‘checks and balances’ of the UK system. To combine these roles had been permissible under earlier versions of the Code, but it has for some time been recognised that combining the roles increases the likelihood of one individual having unfettered decision-making powers. The Code recommends splitting the role of chairman and CEO, and that the division of responsibilities between the two positions should be clearly established. If the roles of chairman and CEO are combined (or if the CEO succeeds as chairman), this must be publicly justified in accordance with the comply or explain principle, and the company should expect close questioning from institutional investors.

Executive pay

The Code states that levels of remuneration should be sufficient (but not higher than necessary) to attract, retain and motivate directors of the quality required to run the company. A significant proportion of executive directors’ remuneration should be structured to link rewards to corporate and individual performance (but pay for non-executive directors should not include performance-related elements).

Levels of executive remuneration have been heavily criticised by the public and in the media, in the context of both the global financial crisis and the ensuing economic austerity

measures. Shareholders of UK-incorporated, listed companies now have a binding vote on the company's directors' remuneration policy. In broad terms, shareholders are required to approve, at least every three years, a policy setting limits and conditions for directors' remuneration. If payments and awards made by the company to its directors are not consistent with the shareholder-approved policy, they are recoverable from the director in question and the directors responsible for approving the unauthorised payment or award are liable to compensate the company. Shareholders have, in addition, retained their annual advisory (i.e., non-binding) vote on the implementation of the approved policy during the previous year. Companies are also obliged to publish a report on the directors' remuneration in their annual report, including the remuneration policy in the years it is being put forward for approval.

ii Directors

The role of the independent director is seen as essential in providing a balance on the boards of listed companies and the Code and related guidance emphasise the need for independent directors to be suitably experienced, committed and prepared to challenge the executive directors. The latest edition of the Code emphasises the need for the board to establish the correct 'tone from the top'.

The primary function of independent directors, according to the Code, is to scrutinise the performance of management and monitor the reporting of performance. The board should appoint an independent director to be the 'senior independent director', to provide a sounding board for the chairman and to serve as an intermediary for the other directors when necessary. The senior independent director should be available to shareholders if they have concerns that contact through the normal channels of chairman, CEO or other executive directors has failed to resolve a matter, or for which such contact is inappropriate. The FRC's Guidance on Board Effectiveness (2011) further emphasises the critical role of the senior independent director to help resolve significant issues when the board is under periods of stress. Independent directors should hold meetings without the executives present both with the chairman and, at least annually, without the chairman (led by the senior independent director) to appraise the chairman's performance.

In practice, independent directors generally meet with the other directors for board meetings at least eight times per year in addition to attending committee meetings. They should (and often do) have direct access to all staff below board level and all advisers and operations, and receive information at an early stage (before executive directors have made key decisions). The Code provides that, as part of their role as members of a unitary board, independent directors should constructively challenge and help develop proposals on strategy. On the other hand, a 'conscientious and independent standard of judgement, free of involvement in the daily affairs of the company' is seen as an independent director's key contribution to the boardroom. In this regard, the board is required to determine annually whether a director is independent in character and judgement and whether there are relationships or circumstances that are likely to affect the director's judgement.

Independent directors should also monitor the performance of management in meeting agreed goals and objectives, and the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors and in succession planning.

Directors' duties

All directors, both executive and non-executive, owe fiduciary duties and a duty of care and skill to the company. These duties are derived from common law but have now been largely codified under the Companies Act. These statutory duties are:

- a* to act within their powers (i.e., in accordance with the company's constitution);
- b* to promote the success of the company;
- c* to exercise independent judgement;
- d* to exercise reasonable care, skill and diligence;
- e* to avoid conflicts of interest;
- f* not to accept benefits from third parties; and
- g* to declare any interest in a proposed transaction or arrangement with the company.

These statutory duties must still, however, be interpreted and applied in accordance with the pre-existing common law duties. Indeed, in respect of some directors' duties that have not been codified under the Companies Act, the common law rules remain the only relevant law. These include the duties not to fetter their discretion, not to make a secret profit, and to keep the affairs of the company confidential.

UK law has adopted the 'enlightened shareholder approach' to the orientation of its directors' duties. The Companies Act requires directors, when deciding how to exercise the powers of the company, to have regard to:

the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment, the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company.

UK law takes a relatively strict approach to the enforcement of directors' duties. For example, unauthorised self-dealing is not reviewed *ex post* against an 'entire fairness' standard, as it might be in the United States; rather, the transaction is in principle voidable at the instigation of the company without any inquiry into its fairness. Similarly, disgorgement of profits is generally available as a remedy for breach of fiduciary duty, as of right. Breach of duty is in principle actionable only by the company to which the duty is owed, and not by shareholders. While a shareholder may bring a derivative action on behalf of the company in relation to actual or threatened breaches of duty, the UK legal system is not well suited to private enforcement of directors' duties outside formal insolvency proceedings, so litigation by shareholders of a listed company alleging breach of duty by its directors is extremely rare.

In relation to control transactions (i.e., any proposed acquisition of 30 per cent or more of the voting rights), the Takeover Code requires shareholder approval for any action by the directors that may result in any offer (or expected offer) for the company being frustrated, or in shareholders being denied the opportunity to accept or reject the offer on its merits. Viewed in isolation, this prohibition against 'frustrating action' seems draconian; however, potential prejudice to the target company's shareholders is mitigated to a degree by the Takeover Code's relatively intrusive regulation of the terms and timing of any proposed control transaction.

Other legislation imposes criminal and civil liability on directors, including health and workplace safety laws, environmental laws and competition and securities laws.

Appointment, nomination, term of office and succession

The Code provides that there should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. The search for candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender. A nomination committee should lead the process for board appointments and make recommendations to the board. Independent directors should be appointed for specified terms subject to annual re-election. The Code refers to the need to ensure progressive refreshing of the board so that any term beyond six years for an independent director should be subject to particularly stringent review.

The Code states that all directors of FTSE 350 companies should be re-elected annually by shareholders. Directors of other companies should be put up for re-election at intervals of no more than three years. Each director's election is voted on separately, with statute requiring majority rather than plurality voting (i.e., an ordinary majority of shareholders can vote against – and hence block – a director's election). In theory, an ordinary majority of shareholders also has a statutory right under the Companies Act to remove a director at any time and without cause, but regular re-election renders this right largely irrelevant in practice. Consequently, there is no concept of a 'staggered board' under UK law.

The board should satisfy itself that plans are in place for orderly succession of appointments to the board and to senior management, so as to maintain an appropriate balance of skills and experience within the company and on the board and to ensure progressive refreshing of the board.

Gender balance

While diversity in its broadest terms is encouraged, it is clear that in the United Kingdom gender balance on boards is gaining a higher profile. The Davies Review (2011) was an important milestone in this regard, and encouraged companies to set targets for gender balance and to improve disclosure about their diversity policies and progress towards their diversity goals.

While government supported the recommendation of the Davies Review that quotas be rejected in favour of a business-led approach, it has, however, indicated that such quotas could be imposed if progress towards gender balance is not achieved.

The most recent statistics, published in October 2015 as part of a five-year review of the Davies Review, indicate that in 2015, 26.1 per cent of directors on FTSE 100 boards were women (19.6 per cent for FTSE 250 companies). In 2011, there were 152 all-male boards in the FTSE 350; in 2015, there were no all-male boards in the FTSE 100 and only 15 in the FTSE 250.²

2 Women on Boards Review: Five Year Summary (Department of Business, Innovation and Skills, October 2015).

III DISCLOSURE

Listed companies are subject to a wide range of periodic and event-driven disclosure obligations, many of which derive from, or have been harmonised under, EU law, and relate to the following key areas:

- a* financial and operating results of the company, together with certain elements of narrative reporting;
- b* share capital and voting rights;
- c* members of the board and key executives;
- d* directors' remuneration;
- e* price-sensitive information (inside information);
- f* share dealing by insiders and significant shareholders;
- g* governance structure and policies (comply or explain);
- h* significant transactions; and
- i* related-party transactions.

Companies are required to prepare and publish audited annual financial statements (prepared in accordance with international financial reporting standards) and to make these available to shareholders within four months of the financial year end and in time for the annual general meeting. These form part of the company's annual report, which must include elements of narrative reporting along with the audited financial statements. The annual report must include a strategic report in addition to the directors' report, the purpose of which is 'to inform [shareholders] and help them assess how the directors have performed their duty' to promote the success of the company. In addition to 'a balanced and comprehensive analysis of both the development and the performance of the company's business during the financial year, and the position of the company's business at the end of that year', the strategic report must contain a description of the principal risks and uncertainties affecting the company's business, information about the gender split for its directors, managers and employees, trend information and disclosure about certain environmental matters. The Code recommends that it also include a description of the company's business model and strategy.

At the end of 2014, the Competition and Markets Authority issued an order requiring FTSE 350 companies to put their audit engagement out to competitive tender at least every ten years. The provisions of this order reflect more extensive reform of EU law regarding audit requirements, which will take effect in June 2016. These include a maximum engagement period for a single audit firm of 20 years. While not mandatory, most companies publish an unaudited preliminary statement of their annual results before publishing their annual report, partly to satisfy market expectations and also to shorten the period during which insiders are prevented from dealing in the company's securities.

The Listing Rules require the publication of a half-year report within two months of the end of the relevant six-month period, containing a condensed set of (unaudited) financial statements and an interim management report. The interim management report must include details of any important events in the relevant period, the principal risks and uncertainties for the remaining six months and details of related-party transactions. Requirements for more frequent 'interim management statements' were abolished during 2014.

Companies are required to disclose promptly all dealings in their securities (including non-voting securities) by 'persons discharging managerial responsibilities' (PDMRs) and certain connected persons. Companies are also required to take all reasonable steps to ensure that their PDMRs and persons connected with them comply with the Model Code

on dealings in securities, which forms part of the Listing Rules. In general, this prohibits all dealings during defined 'close periods' (in the run-up to the publication of quarterly, half-yearly or annual results) and at any time when a company is in possession of price-sensitive information, subject to certain exceptions. Even when not absolutely prohibited, dealings by PDMRs and their connected persons must be cleared in advance by a director. Dealings are, however, permitted under the terms of an approved trading plan, provided it meets certain requirements.

As well as giving rise to civil liability, insider dealing is also a criminal offence; moreover, it is not restricted to dealings by corporate insiders and advisers but can extend to anyone dealing on the basis of price-sensitive information, regardless of its source. A company with a stock exchange listing is in any event required to disclose all price-sensitive information to the market promptly, subject to certain recognised exceptions (e.g., commercially sensitive negotiations still in progress).

A person acquiring 3 per cent of the voting rights in a company must notify the company, which is in turn required to make prompt disclosure to the market. Disclosure is also required thereafter whenever that person reaches, exceeds or falls below each additional 1 per cent threshold. During any period in which a takeover offer for the company is pending, all dealings by the offeror and persons acting in concert with it are disclosable. Companies are also required to publish their total outstanding voting rights monthly. Finally, Section 793 of the Companies Act enables a company to request certain information from any person suspected by the company of having a beneficial interest in its shares, in default of which the voting rights can be suspended. During 2015, the Supreme Court ruled – in *Eclairs Group Ltd and Glengary Overseas Ltd v. JKK Oil & Gas plc* – that the directors of a listed company had acted for an improper purpose in exercising a power under the company's articles of association to suspend a shareholder's voting rights following an incomplete response to such a request, because the directors had acted with an improper motive.

Pursuant to European Law, any person must make a private notification to the FCA of a net short position it has in relation to shares in a listed company when the position reaches or falls below 0.2 per cent of the issued share capital of the company, and at each additional 0.1 per cent thereafter. Public disclosure is also required where the net short position reaches or falls below 0.2 per cent of the issued share capital of the company and at each additional 0.1 per cent thereafter.

The Listing Rules require 'significant transactions' by a listed company to be disclosed to shareholders. Moreover, Class 1 (i.e., large, measured by reference to profits, assets, gross capital or consideration) transactions require not only disclosure but also shareholder approval by ordinary resolution (i.e., 50 per cent of shares voted, but without a special quorum requirement).

In addition to certain shareholder approval requirements under the Companies Act, the Listing Rules require independent shareholder approval by ordinary resolution for 'related-party transactions', unless they fall within certain exceptions (e.g., small related-party transactions). 'Related parties' include PDMRs and shareholders holding more than 10 per cent of the voting rights, and persons connected with them. The Listing Rules also require a proposal for approval of a related-party transaction to be accompanied by an independent 'fair and reasonable' opinion, typically from an investment bank.

IV CORPORATE RESPONSIBILITY

The need for companies to be held accountable for their actions by shareholders, the government and the general public has gained even greater significance in light of the financial crisis and subsequent recession, and arguably with more moral force than before.

From an internal company perspective, effective corporate responsibility means high standards of risk management, disclosure and transparency, compliance with best practice and effective monitoring. In the United Kingdom, a key principle of the Code requires a board to maintain sound systems for managing risk and internal control. It suggests that the board should review these systems at least annually, and consider how much risk the company can, and should, take. In September 2014, the FRC published its Guidance on Risk Management, Internal Control and Related Financial and Business Reporting, which aims to:

- a* bring together elements of best practice for risk management;
- b* prompt boards to consider how to discharge their responsibilities in relation to the existing and emerging principal risks faced by the company;
- c* reflect sound business practice, whereby risk management and internal controls are embedded in the business process by which a company pursues its objectives; and
- d* highlight related reporting responsibilities.

At the same time, the Code was amended to require an explicit statement in the financial statements about whether the ‘going concern’ basis of accounting has been adopted, and whether there are any material uncertainties about the company’s ability to continue to do so in future. Moreover, companies are now also required to include in their annual report a broader statement about the board’s reasonable expectation as to the company’s viability, based on a robust assessment of the company’s principal risks and current position. Revised auditing standards impose obligations on auditors to review and challenge these statements.

Corporate responsibility also encompasses a company’s duty to its external environment; corporate social responsibility has become a hot topic in recent years, as businesses have responded to the growing demand from governments, shareholders and the general public for companies to ‘give something back’ to the society in which they operate.

Slavery and human trafficking

The Modern Slavery Act 2015 requires large commercial organisations that carry on business in the United Kingdom (including, in principle, non-UK companies) to publish a ‘slavery and human trafficking statement’ for financial years ending on or after 31 March 2016, explaining what action they have taken to ensure that their business and supply chains are slavery free. The statement is required to be approved by the board. Commercial organisations carrying on business in the United Kingdom, and that have a consolidated turnover exceeding £36 million, are within the scope of the regime. It is expected that companies within the scope of the regime will take steps to impose contractual terms on their suppliers, requiring them to comply with slavery and human trafficking policies.

V SHAREHOLDERS

i Shareholder rights and powers

Under the Companies Act, shareholders have the power to challenge a board in several ways. As few as 100 shareholders or shareholders holding as little as 5 per cent of the voting rights

(whichever is less) can requisition a meeting and add any item to the agenda or add any item to the agenda for the company's AGM; moreover, there is no minimum holding period to qualify. In practice, however, boards are relatively responsive to shareholder concerns and such requisitions are rare because each director must submit to annual re-election and because directors are in any event required to obtain shareholder approval for a number of matters, requiring relatively frequent engagement with the company's main shareholders.

Under the Companies Act, shareholders must approve secondary share offerings by ordinary resolution (i.e., 50 per cent of voting shares), and in any event shareholders enjoy statutory pre-emption rights on all secondary share offerings for cash, although they can approve the disapplication of these pre-emption rights by special resolution (i.e., 75 per cent of shares voted). In practice, shareholders typically give directors general authority to issue further shares for cash and on a non-pre-emptive basis within certain guidelines published by institutional investors (e.g., no more than 5 per cent of the company's share capital in any year, and no more than 7.5 per cent on a rolling three-year basis (or an additional 5 per cent in connection with an acquisition or specified capital investment), and then subject to restrictions on the price at which the shares may be issued). Authority to issue further shares is typically renewed at each AGM or sought in relation to a specific transaction where equity funding is required.

Shareholders are also required to approve the terms of share incentive plans and Class 1 transactions (in each case by ordinary resolution), related-party transactions (by ordinary resolution of independent shareholders), as well as any changes to the company's constitution or the rights attaching to their shares (by special resolution). Any proposal to acquire control (defined as 30 per cent or more of the voting rights) of a company subject to the Takeover Code in effect requires an offer to be made to all shareholders on the same terms unless minority shareholders waive this 'mandatory offer' obligation; in the effect is that proposed control transactions are put to an independent shareholder vote. Finally, shareholder approval (by way of ordinary resolution) is required under the Companies Act for loans and other credit transactions, and for 'substantial property transactions', with directors and their connected persons (although in practice the provisions of the Listing Rules cover many more such related-party transactions).

A general shareholder equality principle pervades both UK company law and the Listing Rules. There is a 'one-share, one-vote' norm, and distributions to shareholders (dividends, share repurchases, etc.) are required to be made anonymously 'on market' and on tightly regulated terms unless shareholders waive these requirements. In principle, information must be made available simultaneously to all shareholders, although in practice it is possible to inform key shareholders of significant proposals to take 'soundings' on a confidential basis, although this precludes shareholders from dealing in the company's securities until the information has been made public or ceases to be price-sensitive.

ii Shareholders' duties and responsibilities

English law imposes little in the way of active duties or liabilities on shareholders. For example, a person acquiring 30 per cent or more of the voting rights in a company is required to make an offer to buy out the minorities, unless a majority of the minority shareholders waive the requirement. But, having acquired control, a majority shareholder does not owe any fiduciary duty to the company as such and is free to exercise its voting rights to advance its own interests, except where it is barred from doing so because of its interest in a proposed transaction (e.g., a related-party transaction) and provided it exercises its vote in good faith.

Certain non-binding expectations are placed on investors by institutional guidelines, by the Code and by the Stewardship Code, reflecting the belief that self-interest of investors, and of the companies themselves, is necessary to ensure effective governance. The Stewardship Code for institutional investors encourages them to be more proactive in their role as shareholders. Under the Stewardship Code, institutional investors are required to exercise their votes in respect of all the shares they hold and not to support the board automatically. Institutional investors are expected to disclose on their websites how they have applied the Stewardship Code or, if they have not, to explain why not. It remains to be seen, however, how the Stewardship Code will influence behaviour by asset managers, asset owners and companies themselves.

The Listing Rules contain the concept of a ‘controlling shareholder, who (either alone or together with others ‘acting in concert’ with it, is able to control 30 per cent or more of the voting rights). Affected companies must enter into a ‘relationship agreement’ with their controlling shareholder containing certain mandatory terms intended to ensure that the board will remain independent of improper influence by the controlling shareholder. Companies with a controlling shareholder are also subject to additional disclosure requirements, and certain matters require the approval of shareholders independent of the controlling shareholder.

iii Shareholder activism

While institutional investors have traditionally been reluctant to act as the policemen of the corporate governance regime, an increasing number have recently become more vocal. Where institutional investors do have criticisms, they are more likely to engage in private dialogue with the directors. What distinguishes shareholder ‘activists’ is that they are prepared to air issues publicly to achieve change.

iv Contact with shareholders

A company’s relations with its shareholders are also specifically addressed in the Code by providing for a dialogue with shareholders based on the mutual understanding of objectives and that the board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. The board should keep in touch with shareholder opinion in whatever ways are most practical and efficient, using the AGM to communicate with investors and encourage their participation.

In the context of potential control transactions, the Takeover Code provides that the board must not, without the approval of the shareholders in general meeting, take any action that may result in any offer or *bona fide* possible offer for the company being frustrated, or in shareholders being denied the opportunity to decide the outcome of the offer on its merits. This ‘no frustration’ principle is buttressed by aspects of company law that would, in any event, make it very difficult for the board unilaterally to adopt anything equivalent to a shareholder rights plan, or to issue shares to a white-knight bidder to block a hostile takeover. For better or worse, takeover regulation in the United Kingdom strongly favours the short-term interests of shareholders by depriving the board of anything other than the power to persuade shareholders to reject an unwanted offer.

VI OUTLOOK

2015 has been a relatively calm year on the corporate governance front. Notable developments have included the enactment of the Modern Slavery Act 2015 and certain new requirements regarding statutory audit requirements. As in previous years, the burden of compliance has increased; particularly in the area of non-financial reporting. Looking ahead, 2016 is set to be a year of consolidation and reflection, as the changes in rules and standards wrought by the global financial crisis are bedded down and begin to have effect.

UNITED STATES

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I OVERVIEW OF GOVERNANCE REGIME

The sources of corporate governance law and regulation in the United States are varied and interrelated. From a strictly legal and regulatory perspective, there are four key sources of corporate governance law and regulation: state corporate law (predominantly Delaware, in which over half of all US publicly traded corporations are incorporated); the federal 1933 Securities Act and 1934 Securities Exchange Act and regulations of the Securities and Exchange Commission (SEC) under those Acts; stock exchange listing rules (predominantly the New York Stock Exchange (NYSE) and the NASDAQ); and federal statutes in regard to particular areas of corporate practice (for example, regulations promulgated by the Federal Reserve and other federal and state agencies with respect to banks and other financial institutions, and by other similar regulatory bodies in respect of communications, transportation and other regulated fields). Because of the federal system of US law, different sources of law are not always harmonised and corporations are often subject to different obligations to federal and state governments, regulators at each level of government and demands of other relevant bodies, such as the applicable stock exchange. This mosaic of rules and regulations, and the various authorities and mechanisms by which they are implemented and enforced, make for an environment of frequent change and evolution. But of increasing importance to the US corporate governance regime are the proxy advisory firms (predominantly Institutional Shareholder Services (ISS) and, with lower market share, Glass, Lewis & Co (Glass Lewis)) and the influence those proxy advisers have on the institutional investor community, and the related prevailing and evolving views of the institutional investor community. That community's views have become particularly influential as the shareholder base of the vast majority of US publicly traded corporations consists of an overwhelming majority of institutional shareholders, including index funds, pension funds and mutual funds. As a result, major institutional investors are increasingly developing their own independent views on preferred governance practices.

Securities laws and regulations are civilly enforced by the SEC, and the SEC must also grant clearance to certain important corporate disclosure documents (such as proxy statements and certain securities registration statements). Larger and older corporations with a history of securities law compliance are subject to fewer such pre-clearance requirements and may in certain cases file abbreviated forms of disclosure. Private investors may also bring

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actions under many provisions of the securities laws to recover damages for misstatements or omissions in public statements and in certain other circumstances. The Department of Justice prosecutes criminal violations of federal securities laws and SEC rules.

State law fiduciary duties of directors and officers are predominantly enforced by private actions led by plaintiffs' lawyers. These private actions generally fall into one of two categories: class-action suits on behalf of a particular group of the corporation's shareholders (typically all shareholders who bought or sold during a particular period or all unaffiliated shareholders), and 'derivative' suits purportedly on behalf of the corporation itself. Putative class-action suits must satisfy the criteria under the Federal Rules of Civil Procedure or analogous provisions of state law before being permitted to proceed as a class action, including the numerosness of the class members, the commonality of legal and factual issues between members of the class, the typicality of the claims or defences of the representative parties to the class, and the fairness and adequacy of the representative parties' protection of the class interests. Derivative suits, creatures of state corporate law, provide a mechanism by which shareholder plaintiffs can in theory represent the corporation in suing the corporation's own board of directors or management, sometimes after complying with a 'demand' procedure in which the plaintiff must request that the corporation file suit and be rebuffed. In certain circumstances, especially when it can be shown that the board of directors is for some reason conflicted with respect to the alleged breach of duty, this 'demand' requirement is excused and the shareholder will be permitted to pursue a claim in the corporation's name without further enquiry.

The two primary US stock exchanges, the NYSE and the NASDAQ, each make rules with which corporations must comply as a condition to being listed on these exchanges. These listing rules address all aspects of corporate governance, including topics such as director independence, the composition of various board committees, requirements to submit certain matters to a vote of shareholders, regulation of dual-class stock structures and other special voting rights, publication of and topics covered by corporate governance guidelines, and even requirements related to the corporation's public website. These rules are enforced by the threat of public reprimand from the exchanges, temporary suspension of trading for repeat offences and permanent delisting for perennially or egregiously non-compliant companies.

While proxy advisory firms are not a source of law, their guidelines now figure significantly in the corporate governance landscape. ISS is estimated to control approximately 61 per cent of the proxy advisory market, with Glass Lewis, another proxy advisory firm, estimated to control approximately 36 per cent. These advisory firms exert pressure on corporations to conform to governance standards they promulgate by issuing director election voting recommendations to each publicly traded corporation's shareholders based on the corporation's compliance with the advisory firm's published standards. Perhaps because of the problem of 'rational apathy' – that is, because an individual shareholder bears all of the costs of becoming an informed voter but shares the benefits with all other shareholders, shareholders have little incentive to inform themselves – proxy advisory firms wield outsized influence on corporate elections, especially among institutional investors such as pension funds.² One study found that a recommendation from ISS to withhold a favourable vote in an uncontested director election correlates with a 20.9 per cent decline in favourable voting.³

2 See Michael J Segal, Trevor S Norwitz and Sabastian V Niles, 'SEC Commissioner Critiques Reliance on Proxy Advisory Firms', *Bank and Corporate Governance Law Reporter*, Volume 51, Number 1 (2013).

3 Stephen Choi, Jill Fisch and Marcel Kahan, 'The Power of Proxy Advisors: Myth or Reality?', *Emory Law Journal*, Volume 59 (2010), pp. 869, 886–7.

In addition, a 2013 study sponsored by Stanford University found companies were altering their compensation programmes to comply with proxy advisory firms' ever-evolving policies.⁴ The US Congress, US Department of Labor and the SEC have raised questions regarding fiduciary responsibility in the context of the outsourcing of proxy voting decisions to proxy advisory firms. In 2014, the SEC issued regulatory guidance concerning the fiduciary duties of investment advisers when voting proxies and relying on proxy advisory firms, particularly as to the investment adviser's duty to oversee such firms and ensure conflicts of interests are being properly addressed, and adopt reasonably designed protocols to ensure the proxies are voted in their clients' best interests. Significantly, certain major institutional investors, such as BlackRock Inc (which invests over \$5.1 trillion in client assets) and the Vanguard Group (which invests over \$3.6 trillion in client assets) have indicated that they intend to reach proxy voting decisions on the basis of their own internal guidelines, independent of proxy advisory firms, and have sought to engage directly and pragmatically with companies. These major institutions are uniquely positioned to use their influence to recalibrate the system to reduce reliance on proxy advisory firms.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), signed into law in July 2010, was passed in response to corporate governance practices perceived by some to have contributed to the 2008–10 economic crisis. The Dodd-Frank Act requires additional disclosure in corporate proxies, non-binding shareholder votes on various questions of corporate governance (notably, related to executive compensation) and contemplates greater access for shareholder-proposed director nominees to the company proxy.

II CORPORATE LEADERSHIP

Under Delaware law, 'The business and affairs of every corporation [...] shall be managed by or under the direction of a board of directors'.⁵ The corporation law of all other US states similarly assigns corporate managerial power to the board of directors.

i Board structure and practices

Boards of directors customarily organise committees to carry out specific functions without the presence of the entire board. State law generally permits most of the functions of the board of directors to be delegated to committees⁶ and generally permits directors to rely on information, opinions, reports or statements presented to the board by its committees.⁷ Boards are specifically required by federal securities law to have an audit committee with certain prescribed functions relating to the retention, compensation and oversight of the company's independent auditor. Federal securities law and NYSE and NASDAQ listing rules also require listed companies to maintain compensation and nominating or corporate governance committees. Boards will often voluntarily establish additional committees – for example, a company in the technology sector might establish a technology committee comprising directors with the most applicable expertise to stay abreast of technological developments,

4 David F Larcker, Allan L McCall and Gaizka Ormazabal, 'Outsourcing Shareholder Voting to Proxy Advisory Firms', Rock Center for Corporate Governance at Stanford University Working Paper No. 119 (2013).

5 Delaware General Corporation Law, Section 141(a).

6 See, e.g., Delaware General Corporation Law, Section 141(c)(2).

7 See, e.g., Delaware General Corporation Law, Section 141(e).

and a company that has important relationships with labour unions might choose to establish a labour relations committee. By custom, many companies have established a risk committee (actually required of certain financial institutions by the Dodd-Frank Act), an executive committee, a finance committee, a public policy committee, or some subset thereof. Boards may also establish *ad hoc* committees in response to discrete or emergent developments.

A panoply of regulations and disclosure requirements affect the composition of the board of directors. Federal securities laws require all of the directors who serve on audit, compensation and nominating committees to be independent from the management of the company, and NYSE and NASDAQ listing rules require a majority of the board of directors to be independent. Companies are required to disclose the experience, qualifications or skills of each director nominee that led the board to nominate that person to serve as a director. A company must also disclose whether and how its nominating committee considers diversity in identifying director nominees, and must make extensive disclosure about the nominating committee and how it functions.

Just over half of large corporations in the United States have a common CEO and chair of the board of directors. Companies that have one person serving as both chair and CEO typically have a lead director with additional rights, responsibilities and compensation. In 2016, about 48 per cent of companies listed on the S&P 500 index had separate chairs and CEOs, up from 29 per cent in 2005. ISS generally recommends a vote in favour of shareholder proposals requiring an independent chair, taking into consideration the company's current board leadership structure (including whether the company maintains a strong lead director position), governance structure and practices (including overall board independence) and the company's performance. In 2016, shareholders brought proposals at 47 companies to require an independent chair. These proposals enjoyed an average level of support of 27 per cent. Companies are also required to describe in their annual meeting proxy statements the leadership structure of the board of directors, such as whether the same person serves as chair and CEO, and to explain why the company has determined that its leadership structure is appropriate. To date, the governance trend is towards ensuring an independent board leadership structure through a lead independent director, as opposed to separating the CEO and chair functions in all companies.

Corporations are generally permitted by state corporate law to have classified, or 'staggered', boards of directors, in which roughly one-third of the directors are elected each year for three-year terms, but classified boards have become substantially less common in recent years. With a classified board, shareholders can replace a majority of the directors only in two election cycles, so a classified board can promote the continuity and stability of a corporation's long-term strategy, reduce a corporation's vulnerability to abusive takeover tactics, and ensure that the institutional experience of the board of directors will not be swept away in a single lopsided election. On the other hand, classified boards historically have not halted well-priced, all-cash takeover bids. The percentage of S&P 500 companies with staggered boards has steadily declined, to approximately 11 per cent in 2016, down from approximately 17 per cent in 2012 and 53 per cent in 2005. Shareholder proposals to declassify boards of directors enjoy strong support from shareholders – shareholders voted on such proposals at 19 companies in 2016, and the proposals averaged approximately 79 per cent shareholder support. (Shareholders voted on 58 management-initiated proposals to declassify boards in 2016, and these averaged 98 per cent shareholder support.) However, corporations are more likely to implement a classified board in connection with an initial public offering (IPO). Despite an ISS policy of recommending a 'withhold' vote for directors

at the first public company annual meeting of a corporation that implements a classified board in connection with an IPO, in 2016, 68 per cent of IPO corporations implemented a classified board in connection with the offering. Notwithstanding the trend towards removing classified boards, a 2013 empirical study confirmed that classified boards can enhance shareholder value.⁸

Delaware law currently permits corporations to choose whether and how to afford access to the company's proxy statement to insurgent director nominees, but new rules promulgated by the SEC in 2010, which were later struck down in 2011 by court order in a successful legal challenge, would have permitted shareholders without control intent to nominate up to a maximum of 25 per cent of the company's entire board. The rules required that shareholders or shareholder groups had held both investment and voting power of at least 3 per cent of the voting power of a company's securities continuously for at least three years. While these mandatory proxy access rules were overturned and did not go into effect, the SEC has implemented other rules that enhance the ability of shareholders to propose company-specific forms of proxy access, and the interest in proxy access as a 'democratisation' of corporate governance and voting has garnered increased strength. In late 2014, a group of pension funds announced a broad campaign to install proxy access at over 75 US publicly traded companies of diverse market capitalisations and across a variety of industry sectors. In 2016, shareholders at 84 companies voted on proposals to grant shareholders proxy access, and the proposals averaged 50 per cent shareholder support. These shareholder proxy access proposals typically seek to permit shareholders to nominate between 20 and 25 per cent of the company's entire board. Many companies are also either proactively revising by-laws to permit proxy access or submitting management-initiated proxy access proposals for shareholder consideration. In 2016, shareholders voted on 21 management-initiated proxy access proposals, and these averaged 87 per cent shareholder support. In addition, a report by the EY Center for Board Matters at Ernst & Young LLP stated that approximately 60 per cent of almost 200 companies that received proxy access shareholder proposals for 2016 annual meetings adopted proxy access by-laws before the proposal even went to a vote.⁹ Although shareholder proxy access is becoming more prevalent, it remains to be seen to what extent shareholders will seek to exercise proxy access rights.

Historically, brokers holding stock of a corporation on behalf of clients have voted that stock at their discretion when their clients do not provide specific voting instructions. However, the NYSE listing rules now prohibit broker discretionary voting for listed companies on certain topics including governance-related proposals, and the Dodd-Frank Act eliminated broker discretionary voting in elections related to the election of directors, executive compensation and 'any other significant matter' as determined by the SEC. As a result, directors in uncontested elections have more difficulty achieving majority votes. Lack of broker discretionary voting also increases the influence of activist shareholders and increases the power of proxy advisory firms such as ISS. Further concentrating voting power in the hands of activists is the problem of 'empty voting', in which an activist uses derivatives and similar arrangements to purchase voting power without taking on commensurate

8 Seoungpil Ahn and Keshab Shrestha, 'The Differential Effects of Classified Boards on Firm Value', *Journal of Banking and Finance*, Volume 37, Issue 11 (2013).

9 EY Center for Board Matters, 'Four takeaways from proxy season 2016' (2016).

economic exposure to the corporation's stock – for example, by simultaneously purchasing and short-selling a stock, resulting in no net economic exposure or investment costs aside from transaction fees.

In uncontested elections, directors were historically selected by plurality vote, but in recent years, 'majority voting' policies have been adopted by approximately 90 per cent of companies included in the S&P 500 index. Under a majority voting policy, directors in uncontested elections must receive a majority of the votes cast, rather than the plurality required by Delaware law, and if they do not, must tender their resignation, although Delaware courts will generally defer to a board's business judgement in whether to accept or reject a resignation from a director in such circumstances. Because directors must win a plurality of votes regardless of a corporation's majority voting policies, these policies have relatively less effect in the context of contested elections; their primary effect is to increase the power of 'withhold' recommendations from ISS against incumbent directors running in uncontested elections.

ii Directors

Directors' most basic and important responsibility is to exercise their business judgement in a manner they reasonably believe to be in the best interest of the corporation and its shareholders. In most situations, directors do not and should not manage the day-to-day operations of the corporation, but instead exercise oversight in reasonable reliance on the advice of management, outside consultants hired by the corporation and their own understanding of the corporation's business. The courts will generally defer to the decisions that boards make, granting them the 'presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company' – a presumption referred to as 'the business judgement rule'.¹⁰ The business judgement rule applies to most decisions that a board of directors makes. When a shareholder challenges a board's business judgement, 'the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation's objectives'.¹¹ To obtain the protection of the business judgement rule, directors must satisfy their duty of care, which entails reviewing the available material facts, and their duty of loyalty, which requires disinterest and independence of the directors. In practice, the business judgement rule will protect directors when the corporate records reflect that they reviewed and considered the facts available to them and the advice of their advisers and when the directors did not have a conflict of interest in the decision.

The board of directors should work with management to set an appropriate 'tone at the top' of the corporation to encourage conscientiousness, transparency, ethical behaviour and cooperation throughout the organisation. It should approve the company's annual operating plan and guide its long-term strategy, and should monitor and periodically assess the corporation's performance in terms of these goals. The board should monitor and evaluate its own performance as well, noting any deficiencies in its expertise and composition with an eye towards rectifying them with future director nominations. It should monitor the organisation's risk management practices as well as compliance with applicable law and best practices, set standards for corporate social responsibility, and oversee relations with

10 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

11 *In re Dollar Thrifty S'holder Litigation* (Del. Ch. 8 September 2010).

regulators and the corporation's various constituencies, which increasingly includes engaging directly in director-level dialogue with shareholders. It should evaluate the corporation's CEO and senior management and ensure that a succession plan is in place for the CEO and senior management, an issue that has received heightened focus in light of increased turnover rates and visible succession crises. When the company receives a proposal for a large transaction that creates a conflict – or the appearance of a conflict – between the interests of the corporation's shareholders and its management, the board should take care to place itself at the centre of the transaction, and should consider the merits of a special committee of independent directors to oversee the company's response to the proposal.

Directors enjoy substantial protection against personal liability for failures of board oversight. Under Delaware law, directors can be held personally liable for a failure to monitor only where there is 'sustained or systemic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists', which is a 'demanding test'.¹² Delaware courts have repeatedly emphasised that they will not impose liability under this standard unless directors have intentionally failed to implement any reporting system or controls or, having implemented such a system, intentionally refused to monitor the system or ignored any red flags that it raised. Proxy advisory firms and institutional investors have also been increasingly willing to wield the threat of 'withhold' vote recommendations in response to perceived risk oversight failures or missteps.

III DISCLOSURE

Public corporations are subject to a disclosure regime that generally requires annual and quarterly reports, as well as current reports, to be filed following the occurrence of certain events, such as entry into material agreements, completion of significant acquisitions or dispositions of assets, and changes in officers or directors and amendments to the corporation's charter or by-laws. Public disclosure is also required of certain transactions in the corporation's securities by corporate insiders such as officers and directors, and of material non-public information that a corporate insider has disclosed to certain individuals, such as stock analysts or shareholders. Additionally, the corporation must make significant disclosure whenever it solicits proxies for the votes of shareholders, as it must in connection with the election of directors or significant transactions, such as mergers or the sale of substantially all corporate assets.

Securities regulations require substantial annual disclosure of compensation awarded to the five named executive officers (NEOs) of a corporation, which are the CEO, CFO and the three other most highly compensated executive officers. The disclosure must describe all material elements of the NEOs' compensation, including the overall objectives of the compensation programmes, the process for determining the amount of each element of compensation and the rationale underlying that process. Federal securities laws also require disclosure about the relationship between executive compensation and the company's financial performance, the company's policies governing hedging transactions of the company's stock by employees and directors, and the ratio of the total compensation of the CEO to the median compensation of the company's employees. In furtherance of the Dodd-Frank Act requirements, in 2015 the SEC adopted a rule requiring companies to disclose in registration statements, proxy statements and annual reports the ratio of CEO compensation to the

12 *In re Caremark International Inc Derivative Litigation*, 698 A.2d 959, 971 (Del. Ch. 1996).

median compensation of the company's employees. The methodology for identifying the median employee compensation is not set forth in the rule, but is instead determined by each company.

IV CORPORATE RESPONSIBILITY

The board of directors should ensure that the corporation has a healthy and balanced attitude towards risk – keeping in mind that there is danger in excessive risk-aversion, just as there is danger in excessive risk taking – and it should set standards for corporate risk management. When the corporation's risk management functions raise a red flag, the board of directors should investigate the occurrence and see that the corporation takes measures appropriate to remedy any problems that it uncovers. The board should periodically review the effectiveness of the corporation's risk management reporting functions (including how risks are identified and reported upward, how management responsibility for risk management is allocated and whether risk managers have access to the board of directors and senior management) and repair any deficiencies that it uncovers. In the United States, recent cybersecurity-related intrusions have brought heightened attention and scrutiny to questions of risk oversight and effective risk mitigation practices.

Some corporations have a dedicated board-level risk management committee, which the Dodd-Frank Act requires of certain publicly traded bank holding companies and non-bank financial holding companies, but most boards situate the risk management function at the audit committee, in response to a listing rule of the NYSE that requires the audit committee to discuss risk assessment and risk management policies. Companies are required to disclose in their annual proxy statement the extent of the board's role in risk oversight activities and how the board administers its oversight function. The SEC has also issued specific guidance addressing when and how cybersecurity risks should be publicly disclosed. The reputational damage to boards and companies that fail to properly manage risk is a major threat, and ISS now includes specific reference to risk oversight as part of its criteria for choosing when to recommend withholding votes in uncontested director elections.

V SHAREHOLDERS

i Shareholder rights and powers

Shareholders are permitted to vote at annual and special meetings. State corporation law typically entitles shareholders to vote on matters including elections of directors, amendments to the corporation's charter, transactions in which the corporation is acquired and sales of substantially all of the corporation's assets. The NYSE requires a shareholder vote prior to the issuance of stock that will exceed 20 per cent of the voting power or common stock outstanding after the issuance. In addition, Rule 14a-8 under the federal Securities Exchange Act permits shareholders to propose and vote on additional non-binding resolutions, which typically concern issues of social justice or corporate responsibility. Of the 205 such 'social' shareholder resolutions proposed in 2016, 75 concerned political contributions or lobbying, 67 concerned environmental policy, 30 concerned human rights and global labour standards, nine concerned diversity on the board of directors, six concerned sexual orientation and equal employment opportunity policy and two concerned animal welfare.

Corporations must also conduct a non-binding shareholder vote at least every three years to approve the compensation of the corporation's NEOs – votes that ISS policy also

encourages – and an additional non-binding shareholder vote at least every six years to determine the frequency of these ‘say on pay’ votes.¹³ Non-binding advisory votes are also now required with respect to ‘golden parachute’ compensation arrangements triggered by a merger or acquisition transaction. However, the Jumpstart Our Business Startups Act, or the JOBS Act, signed into law in January 2012, exempts newly public ‘emerging growth companies’ from say on pay votes and certain other requirements for the earlier of five years or until the company meets specified size thresholds.

ii Hostile takeovers and shareholder activism

Hostile takeovers and shareholder activism – the capture of corporate control or influence over corporate policy by discrete groups of shareholders, typically to subjugate the corporation’s long-term strategy in pursuit of short-term profits – are a significant threat to US corporations. In addition to cultivating strong relationships with its long-term institutional shareholder base, dealing with unsolicited offers and pressure from shareholder activists is more art than science.¹⁴ A critically important tool for enabling boards of directors to discharge their fiduciary duties in the face of the threat of hostile takeovers and shareholder activism under current law remains the shareholder rights plan, or ‘poison pill’.

The shareholder rights plan entails a dividend of special ‘rights’ to each of the corporation’s shareholders. In the event that a shareholder amasses equity ownership in excess of a predetermined threshold – often 10 to 15 per cent (with perhaps a higher threshold used for ‘passive’ institutional investors) – without the approval of the board of directors, the rights held by every other shareholder ‘trigger’ and convert into the right to purchase stock of the corporation at a price substantially below the current market value. Alternatively, most rights plans provide that the board of directors may instead choose to exchange one share of common stock for each right held by shareholders other than the hostile bidder or activist shareholder. Either way, the result of this conversion or exchange is that the ownership position of the triggering shareholder is substantially diluted.

The rights plan is the only structural takeover defence that allows a board to resist a hostile takeover attempt, and it has also been deployed in numerous activism situations. While it does not provide complete immunity from a takeover, it allows the board to control the process and provides the corporation with leverage to bargain for a higher acquisition price and the power to reject underpriced or otherwise inappropriate bids. It is also implemented exclusively by the board of directors and does not require shareholder approval, so it can be put in place in very short order.

The principal disadvantage of the rights plan is that ISS will typically recommend a ‘withhold’ vote for all directors after the adoption of a rights plan that the company does not subject to shareholder ratification within a year of adoption. As a result, and because a rights plan can be adopted quickly, most corporations adopt a rights plan only after a takeover threat appears – and prior to that time, the plan is kept ‘on the shelf’.

13 For a discussion of effective shareholder engagement in the context of compensation policies, see Michael J Segal et al., ‘Compensation Season 2015’, The Harvard Law School Forum on Corporate Governance and Financial Regulation (9 January 2015), <http://blogs.law.harvard.edu/corpgov/2015/01/09/compensation-season-2015>.

14 See Martin Lipton and Sabastian V Niles, ‘Dealing with Activist Hedge Funds’, The Harvard Law School Forum on Corporate Governance and Financial Regulation (6 November 2014), <http://blogs.law.harvard.edu/corpgov/2014/11/06/dealing-with-activist-hedge-funds-3>.

Keeping a rights plan on the shelf offers almost all of the protection of an active rights plan without any risk from an adverse ISS recommendation, but it can leave a corporation vulnerable to ‘stealth acquisitions’, in which an activist shareholder purchases just under 5 per cent of the company’s stock, and then buys as much as possible on the open market within the next 10 days. Because Regulation 13D under the Securities Exchange Act gives shareholders 10 days after acquiring over 5 per cent of a company’s stock to publicly disclose their ownership stake, this technique can result in an acquisition of a substantial portion of a company’s equity before it is ever disclosed.¹⁵ Similarly, Regulation 13D patrols a narrow beat with regard to derivatives. While all interests must be disclosed after a shareholder crosses the 5 per cent threshold, only some derivative interests are counted towards that threshold – generally, only those that are settled ‘in kind’ (for stock of the corporation rather than for cash from the derivatives counterparty), and only those that can be exercised within the next 60 days.¹⁶ However, because an activist may accumulate its position in a corporation, without public disclosure, the board of directors may not have any warning of the activist’s behaviour, and there is thus some risk that a company may not be able to adopt a rights plan in time to avoid a significant accumulation of stock in unfriendly and opportunistic hands.

Other defences against activist shareholders include a classified board of directors, limiting shareholders’ ability to call a special meeting, adopting an ‘advance notice’ by-law that requires rigorous disclosure of a shareholder’s holdings and other interests in a corporation to nominate a director candidate or propose other items of business at a special or annual meeting, and limiting shareholders’ ability to act by written consent (71 per cent of S&P 500 companies prohibit shareholder action by written consent).

Overall, the availability of takeover defences has been steadily eroded over the years, predominantly as a result of shareholder activism led by ISS, union and public pension funds and academics. Today, only 3 per cent of S&P 500 companies have a rights plan in effect, down from 45 per cent in 2005 and 60 per cent in 2000. In 2016, shareholders at 19 companies voted on proposals to grant shareholders the right to call special meetings, with an average level of support of 41 per cent, and shareholders at 17 companies voted on proposals to grant shareholders the right to act by written consent, with an average level of support of 41 per cent.

iii Contact with shareholders

Shareholder relations have become increasingly complicated as a result of activist trends and have required greater attention at the board level, prompting a renewed focus on the proper role

15 See Adam O Emmerich, Theodore N Mirvis, Eric S Robinson and William Savitt, ‘Fair Markets and Fair Disclosure: Some Thoughts on the Law and Economics of Blockholder Disclosure, and the Use and Abuse of Shareholder Power’, *Harvard Business Law Review*, Volume 3 (2013), for a discussion of the shortcomings of Regulation 13D.

16 Regulation 13D discourages shareholders from employing contracts or arrangements that divest beneficial ownership of a security as part of a plan or scheme to evade the reporting requirements of Section 13(d) of the Securities Exchange Act by counting the securities towards the 5 per cent threshold (Securities Exchange Act Rule 13d-3(b)). One court applied this provision to impute beneficial ownership to a shareholder of securities in which the shareholder had acquired derivative interests: *CSX Corp v. Children’s Inv Fund Management*, 562 F. Supp. 2d 511 (SDNY 2008). Still, no bright-line rule has emerged to determine when a shareholder’s use of derivative instruments is suspicious enough to constitute such a plan or scheme to evade the reporting requirements, so the case offers only marginal protection from raiders and activist shareholders.

of direct dialogue between boards and shareholders, as well as the benefits and disadvantages of more open, regular lines of communication. Shareholder engagement is increasing, as both companies and institutional investors have sought to engage in more regular dialogue on corporate governance matters. A report by the EY Center for Board Matters at Ernst & Young LLP suggests that approximately 57 per cent of S&P 500 companies included disclosures about their shareholder engagement efforts in their 2016 proxy statements, compared with approximately 6 per cent in 2010.¹⁷ Recent disclosure reform efforts have also sought to require institutional shareholders to report their share positions on a more current basis as of the end of each quarter than is now the case, as well as suggesting more frequent reporting. Management generally serves as the primary caretaker of shareholder relationships, with the board providing oversight as to the presence of an effective shareholder relations programme. However, institutional investors are increasingly voicing their expectation that companies should provide access to independent directors. Some activists have also been seeking direct dialogue generally with companies in which they invest, independent of whether operational or other performance issues exist. In 2013, PGGM Investments and RPMI Railpen Investments called on independent directors to begin meeting with shareholders on a regular basis, rather than only in extraordinary circumstances. Similarly, in 2016, a group of large public companies and investors jointly developed and endorsed a set of principles on corporate governance that, among other things, called for active engagement with shareholders on key issues. Where shareholders request direct communications with the board, it may be desirable for directors, in appropriate circumstances and following consultation with management, to accommodate those requests. The policies and arrangements best suited for any given company will depend on, among other things, the preferences of directors, the nature and extent of existing relationships with major shareholders, the expressed preferences of those shareholders, and the structure and staffing of the company's existing shareholder relations programme.

In 2000, the SEC promulgated Regulation FD to prevent companies from selectively disclosing material and non-public information to large investors and analysts. Under Regulation FD, certain employees of a company – including directors, officers, public relations or investor relations professionals and others with similar responsibilities or who regularly communicate with market professionals or shareholders – may intentionally disclose material non-public information about the company only if the material is simultaneously disclosed to the public. If they disclose the information unintentionally, the same information must promptly be disclosed publicly. Disclosures made to the press and disclosures made in the ordinary course of business (e.g., customary communications with distributors or customers) are exempted. Intentional disclosures include disclosures in which the employee was reckless in not knowing that the information is material and non-public.

Information is considered material if there is a substantial likelihood that a reasonable investor would consider the information important when making investment decisions, and if the information adds significantly to the total mix of information available. Even if information is quantitatively insignificant, it may still be considered qualitatively material, and information is more likely to be deemed material in hindsight in light of subsequent reaction by the market. The SEC has issued guidance that certain categories of information are particularly likely to be considered material – among them, information related to earnings; corporate events such as mergers, bankruptcy, tender offers or changes in control;

17 EY Center for Board Matters, 'Four takeaways from proxy season 2016' (2016).

and products, discoveries and developments with respect to material contracts, customers or suppliers. And while purported clarifications to previously announced information can themselves be considered material and non-public, 'Regulation FD does not require that corporate officials only utter verbatim statements that were previously publicly made'.¹⁸

Regulation FD makes unscripted dialogues between company officials and individual analysts and shareholders risky.¹⁹ While it is unusual for companies to prohibit such meetings altogether, they should be approached carefully and by professional spokespeople only. Boards of directors should adopt corporate governance guidelines that ensure that the company's media strategy is executed only through approved channels, and with the understanding that analysts and shareholders will often engage in such private dialogues with the hope of ferreting out exactly the sort of information that Regulation FD forbids company officials from disclosing in such a forum.

VI OUTLOOK

Corporate governance in the United States has changed dramatically over the past 30 years, and will undoubtedly continue to evolve in significant ways in the coming years. In particular, the SEC has signalled its interest in 'proxy plumbing', including with respect to accuracy, transparency and efficiency of the voting process; shareholder communications and retail participation in the voting process; and misalignment of voting power and economic interests (including through 'empty voting' strategies involving purchasing voting securities and then hedging away the economic exposure with derivatives). The SEC has also indicated that it continues to review the role of proxy advisory firms such as ISS and Glass Lewis in the voting process, which, in light of ISS's substantial influence in the evolution of corporate governance norms over the past several decades, may have long-term and far-reaching implications. The SEC has also received many proposals for the reform of the Regulation 13D reporting regime, including to encompass additional forms of economic interests and to close the 10-day reporting window that raiders have used in recent years to facilitate stealth acquisitions of control blocks without paying a premium. Similarly, in 2016, legislation was introduced in the Senate seeking amendments to Regulation 13D that would require greater transparency from investors accumulating large positions in public securities.

At the state level, the courts of Delaware have been refining the fiduciary duty rules applicable to conflict transactions and review of merger and acquisition proposals in recent years, often to increase the scrutiny the directors will face in connection with such transactions and, more generally, to recalibrate the relative power of shareholders and directors. Spurred on by the accounting scandals of the early 2000s and the financial crisis at the end of the past decade, the political and public appetite for ever more corporate governance remains strong. However, recent years have seen a heightened awareness of short-termist pressures in the markets and their impact on boards of directors charged with guiding the company's strategy to achieve long-term value creation and an increased focus on the extent to which new corporate governance reforms may exacerbate, rather than ameliorate, short-termist pressures. Shareholder engagement practices have significantly evolved as well, with the frequency and depth of engagement increasing alongside a more fundamental rethinking

18 *SEC v. Siebel Systems, Inc.* 384 F. Supp. 2d 694, 704-05 (S.D.N.Y. 2005).

19 See David A Katz, David B Anders and Sabastian V Niles, 'Regulation FD Compliance Requires Continued Vigilance', *Securities Reform Act Litigation Reporter*, Volume 36, Number 1 (2013).

of the nature of relationships with shareholders and the role that these relationships play in supporting – or undermining – board efforts to take long-term perspectives. A central aspect of the continuing debate is whether initiatives styled as governance reforms operate to shift the locus of control over the corporate enterprise from those with direct knowledge, involvement in and fiduciary responsibilities for the enterprise towards entities lacking in those attributes, and whether imposing some forms of duties, regulations or mandated best practices on such entities is needed.

In many respects, the relentless drive to adopt corporate governance mandates seems to have reached a plateau in the United States, with essentially all of the prescribed best practices – including say on pay, the dismantling of takeover defences, majority voting in the election of directors and the declassification of board structures – having been codified in rules and regulations or voluntarily adopted by a majority of S&P 500 companies. Whether this portends a new era of more nuanced corporate governance debates, where the focus has shifted from ‘check the box’ policies to more complex questions such as striking the right balance in recruiting directors with complementary skill sets and diverse perspectives, and tailoring the board’s role in overseeing risk management to the specific needs of the company, remains to be seen.

Continued debate over, and the evolution of, US governance rules thus appears likely.

UNITED STATES: DELAWARE

*Ellisa O Habbart and Michael S Swoyer*¹

I OVERVIEW OF GOVERNANCE REGIME

i Sources of Delaware law

The position of Delaware law is illustrated by the fact that more than half of the US public companies (including 66 per cent of the Fortune 500) are incorporated in the state. Delaware's corporate governance regime draws from two bodies of law. The first is the General Corporation Law of the State of Delaware (DGCL), a statutory framework adopted by the Delaware legislature in 1899, substantially revised in 1967, and regularly amended to date. Updates and revisions are made each year by the Delaware legislature based on the recommendations of the Council of the Corporation Law Section of the Delaware State Bar Association. As a result, the DGCL is constantly under review by the most knowledgeable members of the Delaware Bar.

Judicial decisions comprise the second source of corporate governance law in Delaware. The state's Court of Chancery (the Chancery Court) is largely regarded as the nation's premier business court. The Chancery Court is a court of equity, which consists of five expert judges chosen to adjudicate corporate and commercial disputes. Appeals from the Chancery Court are heard by the Delaware Supreme Court.

ii Enforcement of Delaware's corporate governance regime

Derivative, direct, and class actions each provide a method for shareholders to seek redress against corporations and their directors and officers for alleged wrongdoing. Class actions are essentially an aggregation of direct claims being prosecuted by one or more persons as representatives of a group of shareholders. Direct claims involve an injury to the suing shareholder individually, as opposed to the corporation. Where there is an actual injury to the corporation to which any relief would flow, the cause of action must be brought by the corporation or by the shareholders derivatively if the corporation fails to act. In practice, the classification of a particular claim as derivative or direct may be challenging.

The classification of a claim is significant because a shareholder plaintiff may not proceed against the corporation with a derivative claim without first making a demand on the corporation to pursue the claim itself, unless the making of a demand would be futile. The Chancery Court will excuse the failure to make a demand based on futility if the complaint creates a reasonable doubt that the corporation's directors are disinterested and independent or the challenged action was otherwise the product of valid business judgement.² Under the

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2 *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

first prong of the well-known *Aronson* test, a director is interested if he or she sits on both sides of a transaction or derives a benefit from a transaction that is not shared by the corporation or all shareholders generally. Independence is lacking if the director's decision is based on extraneous influences rather than the merits. When addressing *Aronson*'s second prong, the plaintiff must create a reasonable doubt that either: the action was taken honestly and in good faith; or the board was adequately informed in making the decision. Demand also may be excused under the second prong of *Aronson* if a plaintiff properly pleads a waste claim.³

iii Nature of the corporate governance regime and recent developments

Delaware's corporate governance regime is founded on the fundamental principle set forth in Section 141(a) of the DGCL that, unless otherwise provided in a corporation's certificate of incorporation, the business and affairs of a corporation must be managed by or under the direction of its board of directors. Delaware decisional law reflects a constant tension between directors and shareholders over the shareholders' desire to exert influence over corporate management and potentially usurp the board's decision-making authority. Aside from the corporate electoral process and the reservation of the shareholders' right to vote on various fundamental corporate actions,⁴ the board's power is limited only by certain well-established fiduciary obligations.

Notably, in 2016, the Delaware Supreme Court determined that the statutory basis for finding jurisdiction over Delaware directors and officers was more expansive than it has been interpreted to be by Delaware courts for over 30 years.⁵ Now, non-resident officers and directors of Delaware corporations are deemed to have consented to personal jurisdiction not only in any action against that director or officer for violation of a duty in that capacity, but also in all civil actions brought in Delaware by, on behalf of, or against a Delaware corporation, in which the director or officer is a necessary or proper party.

II CORPORATE LEADERSHIP

i Board structure and practices

The board of directors must consist of at least one member, and all members must be natural persons.

Term of office

Under Section 141(b) of the DGCL, each director holds office until the director's successor is elected and qualified, or until the director's earlier resignation or removal. Typically, the term of each director is one year unless the board has been structured as classified. Pursuant to Section 141(d) of the DGCL, the certificate of incorporation, the initial by-laws of the company or a by-law adopted by the shareholders may divide the board into a maximum of three classes of directors who serve staggered terms. If three classes of directors are created, then only one class of directors stands for election each year.

3 See footnote 6, *infra*.

4 These matters include amendments to the certificate of incorporation, certain mergers, sales of substantially all or all of the corporation's assets and dissolution.

5 *Hazout v. Tsang Mun Ting*, 134 A.3d 274 (Del. 2016).

Qualifications

The DGCL does not specify any qualifications for directors other than that they be natural persons. However, pursuant to Section 141(b) of the DGCL and the common law, the certificate of incorporation and by-laws may prescribe reasonable director qualifications. The Delaware courts are likely to enforce qualifications that are reasonably related to the corporation's business. Valid qualifications might include a minimum ownership requirement or experience in a certain field of business.

Board action

Directors act collectively, and all directors possess equivalent voting rights unless the certificate of incorporation otherwise provides. Any action may be taken by vote of a majority of the directors present at a meeting at which a quorum is present unless the certificate of incorporation or by-laws provide for a supermajority vote. Unless directors are restricted by the certificate of incorporation or by-laws, directors may act without a meeting by unanimous written or electronic consent, including email transmissions.

Committees

Certain managerial duties may be delegated by the board of directors to committees of the board consisting of one or more directors. Generally, a properly constituted board committee may exercise the full powers of the board of directors in the management of the business and affairs of the corporation with two significant exceptions: (1) a board committee cannot approve, adopt or recommend to shareholders any action or matter expressly required by the DGCL to be submitted to shareholders for a vote (other than the election or removal of directors); and (2) a board committee cannot adopt, amend or repeal any by-law. Advisory committees of the corporation may include members who are not directors, but any such committee's function must be purely advisory in nature.

Officers

Corporations must have such officers as established by the by-laws or by resolution of the board of directors. A court will generally uphold a delegation of authority to officers by a corporation's board of directors unless the delegation is of a task specifically assigned by the DGCL to the board. However, if the delegation conflicts with some overriding public policy or provision of a corporation's certificate of incorporation, it will not be upheld. Unauthorised acts of officers may be validated by ratification by the board of directors unless the acts are beyond the authority of the corporation.

Compensation

The board of directors may fix director compensation in the absence of restrictions in the certificate of incorporation or by-laws. The directors' self-interested decision will be entitled to the protection afforded by the business judgement rule if the compensation plan has been approved by the corporation's shareholders and contains well-defined, specific limits on potential self-dealing. Otherwise, if challenged, the board will have to show that the compensation arrangements are fair to the corporation by demonstrating that services of value are actually being rendered, and that the level of compensation for these services is similar to either industry standards or compensation at corporations of similar size and profitability. The board should also approve the compensation of executive officers of the corporation.

As a matter of customary practice, most corporations delegate the responsibility for fixing executive compensation to outside directors. At a minimum, directors do not participate in the discussion of, or vote upon, their own compensation as officers or employees to minimise the appearance of self-dealing. Executive compensation decisions made by disinterested directors are generally upheld in the absence of waste.⁶

Takeover practice

The responsibility for responding to takeovers is generally held to reside with the board of directors pursuant to the managerial authority provided in Section 141(a) of the DGCL. The board of directors has a fiduciary responsibility to advance the best interests of the corporation's shareholders in responding to takeovers.

ii Directors

Fiduciary duties

All directors of a Delaware corporation owe fiduciary duties of care and loyalty to the corporation and its shareholders. The courts have also recognised that directors have fiduciary duties of disclosure and good faith, which are not separate duties, but rather specific applications of the fiduciary duties of care and loyalty. These duties are owed by all directors to the corporation and shareholder body as a whole without regard to whether any director is an inside or outside director or was elected by a particular class of shareholders.

Duty of care

The duty of care requires that directors inform themselves using all material information reasonably available to them before making a business decision. This duty extends to the board's delegation functions. However, directors are not expected to oversee every detail of day-to-day corporate activities and may rely in good faith upon the records of the corporation and upon information, reports, opinions, and statements of corporate officers and employees.

Duty of loyalty

Directors also owe a duty of loyalty to the corporation. The duty of loyalty mandates that a director cannot consider or represent interests other than the best interests of the corporation and its shareholders in making a business decision. Where a director has an interest in a decision that is different from or in addition to the interests of the corporation and shareholders generally, the director is said to be an 'interested director'. Interested directors should disclose the interest to the other members of the board and, if the interest is material, consider abstaining from any board vote on the matter.

The duty of loyalty also encompasses cases where the director fails to act in good faith.⁷ Bad faith may be shown where the director's conduct is motivated by an actual intent to do harm or where the director intentionally acts with a purpose other than that of advancing the

6 See *Calma on Behalf of Citrix Systems, Inc. v. Templeton*, 114 A.3d 563, 590 (Del. Ch. 2015) ('To state a claim for waste, it must be reasonably conceivable that the directors authorize[d] an exchange that [was] so one sided that no business person of ordinary, sound judgement could conclude that the corporation has received adequate consideration.') (internal quotations and citations omitted).

7 *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006).

best interests of the corporation or with the intent to violate applicable law. Bad faith is also demonstrated where the director intentionally fails to act in the face of a known duty to act, thereby demonstrating a conscious disregard for his or her duties.

Liability of directors

Directors may be found to be personally liable for monetary damages if they breach their fiduciary duties of loyalty and care. Directors may be exculpated from paying monetary damages for liability arising from breach of the fiduciary duty of care if the corporation's certificate of incorporation contains an exculpatory provision authorised by Section 102(b) (7) of the DGCL. Whether a director will be found liable for breach of fiduciary duty depends largely on the standard of review applicable to the challenged action or decision of the director. However, the Delaware Supreme Court recently clarified that regardless of what standard of review applies, a plaintiff seeking only monetary damages against a director protected by an exculpatory provision must plead claims for breach of the duty of loyalty to survive a motion to dismiss.⁸

Standards of review

Delaware has three standards of review for evaluating director decision-making: the business judgement rule, entire fairness and intermediate scrutiny.

The business judgement rule

The business judgement rule is the default standard of review. In general, the business judgement rule is a presumption that, in making a business decision on behalf of the corporation, the directors acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.⁹ When a court finds that the business judgement rule applies, the business decisions of disinterested directors will not be disturbed if they can be attributed to any rational business purpose.

Entire fairness

If the business judgement rule's presumption is rebutted, the burden generally shifts to the defendant directors to show the 'entire fairness' of the transaction. The entire fairness standard is the most exacting standard of review applied by Delaware courts when reviewing a challenged transaction and has two elements: fair price and fair dealing.¹⁰ Fair price relates to the economic and financial considerations of a transaction. Fair dealing requires a review of when the transaction was timed, how it was initiated, structured, negotiated, and disclosed to the directors, and how the approvals of the directors and the shareholders were obtained.

8 See *In re Cornerstone Therapeutics Inc. Stockholder Litig.*, 115 A.3d 1173 (Del. 2015).

9 *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013), *aff'd sub nom., Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

10 *In re Riverstone Nat., Inc. Stockholder Litig.*, 2016 WL 4045411, at *15 (Del. Ch. 28 July 2016).

Intermediate scrutiny

Unocal

A Delaware court will apply an intermediate level of scrutiny in reviewing a board's responses to takeovers that are defensive in nature under the *Unocal* enhanced scrutiny test.¹¹ If this test applies, directors must show that they had 'reasonable grounds for believing that a danger to corporate policy and effectiveness existed'¹² and that their action was 'reasonable in relation to the threat posed'.¹³ If the defensive action was neither preclusive nor coercive, the court will determine whether the directors have met their burden of showing that the response was within a range of reasonableness considering the threat posed.

Revlon

Intermediate scrutiny will also be applied to review a board's actions in the context of transactions involving a change in control or a break-up of the corporation under *Revlon*.¹⁴ To meet this standard, the directors must focus on one primary objective – to secure the best value reasonably available for the shareholders. The Delaware courts have recognised that there is no single blueprint to follow in reaching the ultimate goal of maximising shareholder value. Thus, under *Revlon*, directors are generally free to select the path to value maximisation so long as they choose a reasonable route. For example, in *C&J Energy Services, Inc. v. City of Miami General Employees*, the Delaware Supreme Court reversed a Chancery Court decision that held that a board must conduct a pre-signing active solicitation process to satisfy its duties under *Revlon*.¹⁵ The Court found that so long as any bidder interested in paying more for the target company had a reasonable opportunity to do so, the company was not required to actively shop itself.¹⁶

Procedural protections may modify standard of review

In certain situations, the use of specific procedural protections will warrant the application of a more deferential standard of review. For example, transactions involving a conflicted controlling shareholder are generally subject to entire fairness. However, the business judgement standard of review will apply to such a transaction if, and only if, the transaction is conditioned on the approval of both an independent special committee of the board and a minority shareholder vote, and (1) the special committee is empowered to freely select its own advisers and to say no definitively; (2) the special committee meets its duty of care in negotiating a fair price; (3) the vote of the minority is informed; and (4) there is no coercion of the minority.¹⁷

Additionally, the business judgement standard of review will irrebuttably apply to a post-closing challenge of a transaction generally subject to enhanced scrutiny if a majority

11 *Unocal Corp v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

12 *Id.* at 954.

13 *Id.* at 955.

14 *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

15 107 A.3d 1049, 1067-69 (Del. 2014).

16 *Id.* at 1069.

17 *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014); *Larkin v. Shah*, 2016 WL 4485447, at *9 (Del. Ch. 25 August 2016).

of disinterested, uncoerced and fully informed shareholders approved the transaction.¹⁸ Similarly, a transaction that involves a conflicted board of directors that would generally be subject to entire fairness will be subject to the irrebuttable application of the business judgement standard of review if a majority of disinterested, uncoerced and fully informed shareholders approved the transaction.¹⁹ If the challenged transaction involves a conflicted controlling shareholder, however, the shareholder vote will not result in the irrebuttable application of the business judgement standard of review.²⁰ In transactions involving a conflicted controlling shareholder, the shareholder vote will merely shift the burden of persuasion from the controlling shareholder to the minority shareholders.²¹

Indemnification

Under Section 145 of the DGCL, a director may be indemnified for expenses incurred in defending derivative claims and for expenses, judgments, fines, and amounts paid in settlement incurred in connection with defending direct actions. However, if the director has been successful on the merits or otherwise in the defence of the proceeding, the director is entitled to mandatory indemnification for expenses actually and reasonably incurred. To be indemnified in criminal actions or proceedings, the director must also have had no reason to believe that the challenged conduct was unlawful. Advancement of expenses to a director prior to the final disposition is also permitted if the director executes an undertaking to repay the monies advanced if it is ultimately determined that he or she is not entitled to indemnification. These rights cannot be eliminated by a corporation after a director's period of service ends unless the individual knows at the time he or she chooses to serve that his or her rights will terminate or can be eliminated at a later time.²² Notably, indemnification and advancement rights apply only where the director has been sued 'by reason of the fact' that the director is or was a director of the corporation.²³ This standard cannot be modified by contract.²⁴

Election of directors

An annual meeting of shareholders of a Delaware corporation is mandated to elect directors. To permit an orderly period of solicitation of shareholder nominations prior to a meeting, many corporations have adopted provisions in their certificates of incorporation or by-laws to provide for advance notice of the nomination of directors by shareholders. Such provisions typically require that the shareholder making the nomination be a shareholder of record. The nominating shareholder must also submit specific information within a specified window to the corporation about himself or herself; the beneficial owner, if any, on whose behalf the nomination is being made; and about each of his or her director nominees. The information required typically includes all information about the nominee that would be required

18 See *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015); *City of Miami General Employees v. Comstock*, 2016 WL 4464156 (Del. Ch. 24 August 2016); *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016).

19 *Larkin v. Shah*, 2016 WL 4485447, at *13.

20 *Id.* at *9.

21 *Id.*

22 See *Marino v. Patriot Rail Co.*, 131 A.3d 325, 342-43 (Del. Ch. 2016).

23 See, e.g., *Charney v. American Apparel, Inc.*, 2015 WL 5313769, at *14 (Del. Ch. 11 September 2015).

24 *Id.*

to be disclosed under federal securities laws and whether the nominating shareholder or the beneficial owner, if any, intends to solicit proxies from other shareholders. By-law provisions requiring advance notice of nominations have been found inequitable in specific factual circumstances.²⁵

III DISCLOSURE

Under Delaware law, obligations relating to corporate disclosure are derived from common law fiduciary duties, not the DGCL. The ‘duty’ of disclosure is a component of a director’s fiduciary duties of care and loyalty, and its scope and requirements depend on context. Corporate fiduciaries can breach their duty of disclosure by making a materially false statement, by omitting a material fact or by making a partial disclosure that is materially misleading. The duty of disclosure applies in a number of situations, including when directors seek shareholder action such as the ratification of director compensation.²⁶

IV CORPORATE RESPONSIBILITY

In contrast to US federal law, Delaware does not have a statutory regime addressing risk management, compliance policies, whistle-blowing or other issues of corporate responsibility. Rather, Delaware relies on fiduciary duty law to encourage and enforce ethical behaviour by directors and officers of Delaware corporations.

A claim of breach of fiduciary duty that seeks to hold directors of a Delaware corporation liable for either knowingly causing the corporation to violate the law or for failing to establish an effective system for monitoring the corporation’s compliance with the law is rarely successful.²⁷ Plaintiffs are faced with the difficult burden of establishing the necessary linkage between illegal conduct and a conscious board decision. If plaintiffs cannot point to a particular board decision demonstrating the board’s conscious decision to violate the law, the plaintiff must plead that the board deliberately failed to act after learning about incidents or occasions of possible illegality. Alternatively, the plaintiffs could establish that the illegality occurred because the board abrogated its oversight function by failing to ensure that the corporation possessed an adequate compliance system. For example, a plaintiff might be successful if the board did not form an audit or other compliance committee.

Section 204 and Section 205 of the DGCL, which were adopted in 2014 and amended in 2015, act as powerful tools for current boards of Delaware corporations. These provisions grant boards the power to ratify, and the Chancery Court authority to validate, defective corporate acts that failed to comply with the DGCL or the corporation’s organisational documents. The Section 204 ratification procedure involves adopting resolutions, obtaining shareholder approval if such approval is legally required, and filing a certificate of validation in accordance with Section 103 of the DGCL. Under Section 205, the Chancery Court can

25 See, e.g., *JANA Master Fund, Ltd. v. CNET Networks, Inc.*, 954 A.2d 335 (Del. Ch. 2008).

26 The failure to disclose material information in this context will negate any effect a shareholder vote otherwise might have on the validity of the transaction or the applicable standard of review.

27 This type of claim is known colloquially as a *Caremark* claim, after the seminal decision by the Chancery Court in *In re Caremark International Inc.* See *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

determine the validity of any defective corporate act that has not been ratified or has been ratified effectively under Section 204, regardless of whether the defective corporate act would have been capable of ratification pursuant to Section 204.

V SHAREHOLDERS

i Shareholder rights and powers

Equality of voting rights

Unless otherwise provided in the certificate of incorporation, shareholders are entitled to one vote for each share of capital stock held by the shareholders pursuant to Section 212 of the DGCL. A common type of variation from the one vote per share rule is the creation of preferred stock with contingent voting rights. Generally, all holders of the same class or series of stock must have equivalent voting, dividend and other rights under the common law doctrine of equal treatment. However, the Chancery Court has upheld scaled and tenured voting patterns where specifically authorised by the certificate of incorporation, as well as other types of discrimination among holders of the same class or series of stock where the discrimination was not inequitable.²⁸

Shareholders' ability to influence the board

Generally, the shareholders' ability to influence the board is limited to the power to elect and remove directors, with or without cause,²⁹ and to approve or disapprove certain actions as required by the DGCL or as may be provided in the corporation's certificate of incorporation.

Shareholders may also exercise influence by dissolving the corporation without board approval if the written consent of all shareholders is obtained. A shareholder who owns 90 per cent or more of the outstanding shares of each class of capital stock of a Delaware corporation may force a 'short-form' merger of the corporation without board or other shareholder approval under Section 253 of the DGCL. The only other significant power that shareholders may exercise without prior board action is the amendment of the corporation's by-laws pursuant to Section 109 of the DGCL. The board may be given concurrent power to amend the by-laws in the corporation's certificate of incorporation, and the certificate of incorporation or by-laws may impose supermajority voting requirements for shareholder amendments to the by-laws. However, in no case may the ability of the shareholders to amend the by-laws be completely eliminated.

Rights of dissenting shareholders

Aside from the right to an appraisal of the 'fair value' of their shares by the Chancery Court in connection with certain types of mergers, shareholders do not enjoy dissenters' rights under the DGCL. Generally, appraisal rights are triggered in connection with the merger of a listed company incorporated in Delaware if the shareholders of the corporation are required to accept in the merger consideration other than stock in the surviving corporation or publicly traded stock in another corporation. If the Chancery Court finds that the fair value of the shares is higher than the merger consideration and the petitioning shareholders have properly

28 See, e.g., *Lacos Land Co. v. Arden Group, Inc.*, 517 A.2d 271, 275 (Del. Ch. 1986).

29 Unless the corporation's certificate of incorporation otherwise provides, in the case of a corporation whose board is classified, shareholders may effect such a removal only for cause.

asserted their appraisal rights, then the shareholders are entitled to receive the difference between the merger price and the price determined by the Chancery Court to constitute fair value, plus interest.

In the past, Delaware courts have generally adopted the merger consideration as the best evidence of fair value of an entity's shares. However, in the Chancery Court's 2016 *In re Appraisal of Dell Inc* decision,³⁰ appraisal petitioners of Dell Inc were awarded fair value for their shares that was significantly higher than the merger consideration paid to the other public shareholders in the merger. This rare decision can most likely be attributed to the unique set of facts presented to the court, which included (1) the transaction at issue was a management buyout; (2) extensive and compelling evidence of a 'valuation gap between the market's perception and the target company's operative reality'; (3) limited pre-signing competition for the target company; (4) the only active bidders were financial, rather than strategic buyers; and (5) the special committee that negotiated the deal did not consider fair value – instead, it focused on the market price of the company's common stock, and 'negotiated without determining the value of its best alternative to a negotiated acquisition'. Nevertheless, this decision makes clear that Delaware courts have broad discretion to determine share value based on the facts and circumstances of each individual appraisal action before deferring to the merger consideration as the best evidence of fair value.

ii Shareholders' duties and responsibilities

A controlling shareholder owes fiduciary duties to the shareholders of the corporation he or she controls. A controlling shareholder may not exercise control over the management and affairs of the corporation to his or her benefit and to the detriment of the corporation and the minority shareholders.³¹ Indeed, whenever a corporation enters into a transaction with, or at the behest of, its controlling shareholder, the applicable standard of review is normally entire fairness, placing the burden of proof on the defendant to demonstrate the fair value and process of the transaction.³² This burden of proof is shifted to the plaintiffs if the controlling shareholder transaction is approved either by an independent and well-functioning special committee or by a majority of the minority shareholders.³³

iii Shareholder activism and takeover defences

Shareholder activism has increased significantly over the past decade, and Delaware has not been immune to its expanding influence.³⁴ A Delaware corporation will often regulate shareholder activism by including defensive provisions in its certificate of incorporation and by-laws. These include: advance notice by-laws, staggered board provisions, supermajority

30 *In re Appraisal of Dell Inc.*, 2016 WL 3186538 (Del. Ch. 2016).

31 Delaware does not impose fiduciary duties or other obligations upon shareholders who are not controlling shareholders. A controlling shareholder may possess less than a majority of the corporation's outstanding voting power and still be considered a controlling shareholder if the shareholder exercises actual domination and control of the corporation.

32 *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110, 1117 (Del. 1994).

33 *Id.*

34 See *Third Point LLC v. Ruprecht*, 2014 WL 1922029 (Del. Ch. 2 May 2014).

requirements for by-law amendments and prohibitions on the shareholders' ability to act by written consent and to fill vacancies on the board. These defences, often used in combination, allow corporations to effectively prevent or defeat hostile tender offers.³⁵

iv Contact with shareholders

Communications between the board and the shareholders mainly occur in connection with the solicitation of the shareholders' vote on matters in which the shareholders are required to act.

Under Delaware law, when directors communicate with shareholders outside the context of seeking shareholder action, the directors' fiduciary duty of disclosure still applies but on a more limited basis. In such circumstances, the directors must communicate with honesty. For example, if a director speaks 'through public statements made to the market, statements informing shareholders about the affairs of the corporation, or public filings required by the federal securities laws, he or she must not knowingly disseminate false information that results in injury to a shareholder'.³⁶

VI OUTLOOK

The ongoing and active involvement of the members of the Delaware Bar in maintaining and recommending amendments to the DGCL, as well as the quality of Delaware's courts and Office of the Secretary of State are likely to ensure that Delaware remains the jurisdiction of choice for incorporation and adjudication of business disputes in the United States.

35 In some cases, a board will employ a 'white-knight' defence, which entails management of the target company recruiting a rival bidder that will save them from an initial, unfriendly offer or by offering a more attractive deal.

36 *In re Wayport, Inc. Litig.*, 76 A.3d 296, 315 (Del. Ch. 2013) (quotations and citations omitted).

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Héctor Hernández has been an associate at Carey since 2014. He is active in all fields of corporate and commercial law, including mergers and acquisitions, private equity, corporate restructurings, capital markets, corporate governance and general commercial advice.

Mr Hernández represents Chilean and international companies in connection with various cross-border transactions, including stock and asset acquisitions, tender offers, private equity and venture capital investments, joint ventures and bank financings.

Héctor received his law degree in 2013 from the Pontifical Catholic University of Chile, where he also obtained a degree in negotiation and coaching. He was admitted to the Chilean Bar in 2014. During his undergraduate studies, he spent two years working in the Negotiation Centre of the Pontifical Catholic University of Chile, and has also worked as a teaching assistant in matters related to international public law, criminal law, administrative law and corporate law.

KLAUS ILMONEN

Hannes Snellman Attorneys Ltd

Klaus Ilmonen is a partner at Hannes Snellman working with transactions involving public corporations. He has considerable experience in public takeovers, as well as with equity capital markets transactions. Klaus also works with governance and regulatory matters related to public corporations.

Klaus serves as member of an expert working group for ESMA in relation to EU corporate finance regulation and has participated in drafting Finnish takeover regulation. Klaus holds a Doctor of Laws degree from the University of Helsinki and an LLM degree (Stone Scholar) from Columbia University. Klaus has also been a visiting researcher at Harvard Law School.

JORGE INCHAUSTE

Guevara & Gutiérrez

Jorge Luis Inchauste has been a partner at Guevara & Gutiérrez SC for more than 14 years, and focuses his practice on project finance and corporate law. Mr Inchauste obtained an LLM degree from Georgetown University Law Center and is admitted to practise law in Bolivia and in the State of New York, United States.

ELKE JANSSENS

NautaDutilh

Elke Janssens focuses on corporate law and corporate governance. She advises listed companies and has assisted in several public offerings. Elke also regularly acts in negotiations for M&A transactions and restructurings.

Elke received her law degree from the Vrije Universiteit Brussel (VUB) in 1996. She obtained a master's degree in business law from the Université libre de Bruxelles (ULB) in 1998 and a master's in management from VUB in 2001. She completed coursework in the executive MBA programme at the Solvay Business School from 2006 to 2007. Elke was admitted to the Brussels Bar in 1997 and is a partner at NautaDutilh.

Elke is the author of numerous publications in the fields of corporate and financial law, she serves on the editorial board of various law journals and regularly lectures at seminars.

ANNIINA JÄRVINEN

Hannes Snellman Attorneys Ltd

Anniina Järvinen is a senior associate in Hannes Snellman's M&A group. She specialises in corporate and securities market law. She has experience in several capital market transactions, equity and bond issues, as well as mergers and acquisitions. Prior to joining Hannes Snellman, Anniina worked for the Finnish Financial Supervisory Authority in the conduct of business supervision department. She joined Hannes Snellman in 2012 and was admitted to the Finnish Bar in 2016.

SOFIA KIZANTIDI

Tsibanoulis & Partners

Sofia Kizantidi has been a senior associate at Tsibanoulis & Partners since 2009. She has assisted clients on a broad range of corporate, banking and capital markets issues, and has also advised banks, investment firms and large corporations. She has participated in major privatisation projects, acting on behalf of both the seller and the bidder. Ms Kizantidi also deals with corporate litigation procedures, mainly involving representation of minority shareholder matters. She has represented private corporations and banks in actions concerning their bad debts.

GUDMUND KNUDSEN

Advokatfirmaet BA-HR DA

Gudmund Knudsen is a Norwegian-qualified lawyer (and former partner, 1990–2017) at Advokatfirmaet BA-HR DA. He is a specialist in company law, including corporate governance. He has been a member of several governmental expert committees on company law and is an author and co-author of articles and books on company law.

BJÖRN KRISTIANSSON

Hannes Snellman Attorneys Ltd

Björn is a partner in Hannes Snellman's public M&A group. He specialises in public M&A and corporate governance. He has extensive transaction experience and has been active on the Swedish Corporate Governance Board since its foundation in 2004 and since 2011 as an executive member.

ANTTI KUHA

Hannes Snellman Attorneys Ltd

Antti Kuha is a senior associate in Hannes Snellman's M&A group. He specialises in corporate and securities market law. Antti's experience includes work in relation to several public tender offers as well as equity and bond issues and M&A transactions. Antti graduated from the University of Helsinki in 2009 with a Master of Laws degree. In 2013, Antti received an LLM degree in corporate governance and practice from Stanford Law School, where he studied as a Fulbright scholar.

ERIK LANGSETH

Advokatfirmaet BA-HR DA

Erik Langseth is a partner at Advokatfirmaet BA-HR DA. He has extensive experience in transactions for both listed and unlisted companies, including real estate transactions, issuance of bonds and convertible bonds. He is also among Norway's foremost experts on company law and has worked extensively on intra-group restructurings and shareholder agreements.

BENJAMIN Y LI

Lee and Li Attorneys-at-Law

Benjamin Y Li is a partner at the firm's corporate department, specialising in mergers and acquisitions, capital markets and cross-border investments. He focuses on the representation of listed issuers and leading investment banks and private equity firms, and also has assisted a number of multinational companies in complex commercial disputes and anti-corruption investigations, as well as with corporate governance issues.

Benjamin was educated at Lincoln College, University of Oxford (MBA), New York University School of Law (LLM) and the National Taipei University (Bachelor of Laws). He is licensed to practise law in Taiwan and New York, and is fluent in English and Mandarin Chinese, with conversational Taiwanese and Cantonese. His speaking engagements include the Asia Business Conference at Harvard Business School (March 2010), G2E Asia (June 2010) and the Foreign Issuers IPO Seminar hosted by Taipei Exchange in Bangkok (May 2012) and Kuala Lumpur (October 2012).

ANDREW MACDOUGALL

Osler, Hoskin & Harcourt LLP

Andrew MacDougall is a partner in the corporate law group at Osler, Hoskin & Harcourt LLP, specialising in corporate governance, executive compensation and shareholder activism. He leads the Osler corporate governance practice and co-chairs Osler's executive compensation practice group. He regularly advises boards and in-house counsel on a broad spectrum of corporate governance issues, including director responsibilities, executive compensation, shareholder engagement and shareholders' meeting matters. He has a long-standing interest in corporate governance matters and has written and spoken extensively on corporate governance matters. He has also advised Canadian securities regulators and various professional bodies in Canada that are active in the governance area. Mr MacDougall is an inaugural fellow of the American College of Governance Counsel and a graduate of the Directors Education Program of Canada's Institute of Corporate Directors.

PRIYA MAKHIJANI

Bharucha & Partners

Priya has been a member of the transaction advisory practice at Bharucha & Partners for over two years. Her special focus is on financing and stressed assets.

DIDIER MARTIN

Bredin Prat

Didier Martin is one of the leading specialists on French public tender offers, securities law and privatisations. He devotes a significant part of his time to litigation in various areas such as securities law and takeovers, white-collar crime and bankruptcy.

He has published numerous books and articles on a wide variety of corporate law subjects, with a particular emphasis on French tender offers, including the reference works *Les Offres Publiques d'Acquisition*, *Les Sociétés Holdings* and *Mergers & Acquisitions in France*. He is also responsible for the drafting and publication of the commentaries on the French Monetary and Financial Code (updated each year).

He is a member of various committees and associations, including the Financial Transactions Committee of the MEDEF and ANSA (major French business associations), as well as the Haut Comité de Place, chaired by the French Minister for the Economy and the Haut Comité Juridique de la Place Financière, created by the AMF and the Bank of France.

Mr Martin is also co-president of the Europe Commission (within the Club des Juristes – a leading French legal think tank), which makes proposals for improving company law and stock exchange regulations.

He is also a founding member of the Observatoire de la Communication Financière, an organisation that seeks to promote best practices in financial communication through the publication of guidelines and the organisation of conferences and workshops.

ALFONSO MONROY

Santamarina y Steta, SC

Alfonso Monroy has worked at Santamarina y Steta, SC, since January 2005. He also worked at Paul Hastings' New York office from September 2012 to September 2013.

He has represented Mexican and US underwriters and Mexican issuers in various equity and debt offerings in the United States, Europe and Mexico, including the drafting of all necessary Mexican and US law-governed documentation. He has also represented US and Mexican issuers in the initial and follow-on offerings of several of the first real estate investment trusts, and has reviewed, negotiated and drafted financing and infrastructure documents, including legal and title opinions, public and private bids, and acquisitions in regulatory sectors. Alfonso has drafted, reviewed and negotiated documents related to acquisitions, mergers, joint ventures, asset and stock purchases, the restructuring of private and public companies, banking and securities, credit agreements, the irrevocable transfer of domain trusts, guaranty trusts, leveraged lease structures and syndicated lending. He has also participated in aircraft regulatory and financing transactions with Mexican aviation authorities, such as the General Bureau of Civil Aeronautics and the Mexican Aviation Registry.

Alfonso was educated at the La Salle University, AC and received his Master of Laws degree from Northwestern University Pritzker School of Law, as well as a Certificate in Business Administration from the Kellogg School of Management at Northwestern University.

DENIS MOROZOV

Herbert Smith Freehills CIS LLP

Denis is a Russian and US-qualified lawyer of our Moscow office specialising in corporate and capital markets.

Denis graduated from Saratov State University with a degree in law. He also holds an LLM in international law from the George Washington University, United States, and has been qualified to practise in the state of New York (United States) since June 2011. Denis joined the firm in 2010.

TATSUYA NAKAYAMA

Nishimura & Asahi

Tatsuya Nakayama has been a partner in the M&A/corporate group at Nishimura & Asahi since 2017 and was previously seconded to the US international law firm Weil, Gotshal & Manges LLP, in New York for one year. Mr Nakayama's practice covers a broad range of legal issues mainly related to corporate, securities and exchange, insurance, antitrust, intellectual property and tax law, and he has handled various domestic and cross-border M&A transactions including mergers, tender offers and incorporation of joint ventures, equity finance and strategic alliances, while also providing advice and legal support in commercial litigation.

Mr Nakayama obtained his LLB from the University of Tokyo in 2004, and his LLM degree and the Certificate of Merit Award in Mergers and Acquisitions from the University of Michigan Law School in 2012. Mr Nakayama was admitted to the Japanese Bar in 2005 and the New York Bar in 2013.

SABASTIAN V NILES

Wachtell, Lipton, Rosen & Katz

Sabastian V Niles focuses on rapid-response shareholder activism, takeover defence and corporate governance; US and cross-border mergers, acquisitions, buyouts, investments, divestitures, and strategic partnerships; and other corporate and securities law matters and special situations. Mr Niles writes and speaks frequently on corporate and governance matters and received his Juris Doctor degree from Harvard Law School, where he co-founded the Harvard Association for Law and Business and participated in the Program on Negotiation.

RAFAEL NÚÑEZ-LAGOS

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Rafael Núñez-Lagos is a partner at Uría Menéndez. He is based in the Madrid office.

His practice focuses on corporate law and corporate governance, and extends to other areas of business practice and private law, including banking, finance, capital markets, and mergers and acquisitions.

Mr Núñez-Lagos is a lecturer on business and corporate law in law degrees and master's degree programmes in Spain and has published several articles on different topics within his practice areas.

OLUWATUNMISE OMOTOYINBO

Olaniwun Ajayi LP

Oluwatumise Omotoyinbo is an associate with the firm's enterprise practice and government business practice groups. She has vast experience advising both local and international clients on corporate governance, and regulatory and compliance matters.

S ILIANA ONGUN

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S Iliana Ongun focuses on mergers and acquisitions and other strategic transactions, as well as corporate governance and securities law matters. Ms Ongun received her Juris Doctor degree from Harvard Law School.

EFI C PALAIOLOGOU

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Efi Palaiologou is an associate at Tsibanoulis & Partners. She joined the firm in 2017 and focuses primarily on corporate and transactional matters, corporate governance and commercial law. In addition, Efi possesses experience in the fields of competition and European law. Efi holds an LL.M degree from the University of California, Berkeley, School of Law, and is a European-qualified and New York-licensed attorney.

CARLOS PAREDES

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Carlos Paredes is a partner at Uría Menéndez. He is currently based in the Madrid office.

His practice focuses on commercial and company law, mergers and acquisitions, corporate governance, banking and securities law, corporate restructuring transactions and issues of equity and debt. He regularly advises private and listed companies, financial entities and venture capital firms.

He is acknowledged as one of the best lawyers in his areas of practice by the main national and international ratings guides (Best Lawyers in Spain, *Chambers Europe* and *Chambers Global*).

Mr Paredes is a lecturer on business and corporate law in several universities and master's degree programmes at various prestigious Spanish institutions, and he has published several articles on different topics within his practice areas.

KATJA ROTH PELLANDA

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Katja Nicole Roth Pellanda, is the head of corporate law at Novartis AG. A graduate of the University of Basel, she received a doctorate in law from the University of Zurich, was a visiting researcher at Stanford Law School and holds a Master of Laws degree in banking and financial regulation from the London School of Economics and Political Science. She regularly publishes on governance and company law matters.

OLAYIMIKA PHILLIPS

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Olayimika Phillips is the partner in charge of the enterprise practice group. She specialises in corporate and regulatory matters across numerous sectors, including energy, real estate, manufacturing, health, media, advertising, hospitality and labour. Olayimika has gained experience advising both local and international clients on group reorganisations, M&A, demergers, corporate finance and general corporate governance matters.

MARCOS SALDANHA PROENÇA

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Marcos Saldanha Proença graduated with an LLB degree from the Pontifical Catholic University of Rio de Janeiro (PUC/RJ) faculty of law in 2000. Mr Proença is a senior associate in the corporate division of Pinheiro Neto in Rio de Janeiro, where he has worked for 19 years. Mr Proença has also worked as a foreign associate at Latham & Watkins LLP in Los Angeles (2005–2006). He specialises in corporate and contractual law, with a focus on capital markets and mergers and acquisitions.

GEERT RAAIJMAKERS

NautaDutilh NV

Geert Raaijmakers is a partner at NautaDutilh and specialises in corporate law, corporate governance and financial regulatory law. Geert is also a professor of corporate and securities law at the VU University in Amsterdam and a member of the Dutch Banking Code Monitoring Committee, the government advisory committee on company law and the joint practitioners' committee on company law. He publishes regularly on developments in corporate and securities law, including articles on corporate governance, mergers and acquisitions and shareholder activism.

SUZANNE RUTTEN

NautaDutilh NV

Suzanne Rutten is a professional support lawyer specialising in corporate law. She regularly publishes and teaches on developments in this area. Suzanne earned her master's degree in private law from Utrecht University in the Netherlands. Before joining NautaDutilh in October 2014, Suzanne was a teacher for six years at the Amsterdam University of Applied Science at the faculty of applied social sciences and law. She is also the editor of a study book on corporate law.

ANDY RYDE

Slaughter and May

Andy Ryde is a partner at Slaughter and May. He is active in all fields of company and commercial law, including private acquisitions and disposals, public company takeovers and joint ventures, private equity investments and international equity offerings.

ALBERTO SAAVEDRA

Santamarina y Steta, SC

Alberto Saavedra joined Santamarina y Steta, SC in 1983 and became a partner in 1992.

His professional practice is focused on the general corporate area, including securities and capital markets, as well as foreign investment, mergers and acquisitions, and project finance. He has also vast experience in the corporate governance of public and private companies and has counselled groups and families on their corporate organisation, as well as in relation to family estate planning.

He chairs the ethics and standards committee of the Mexican Stock Exchange, is chair of the board of directors of the Mexican Derivatives Exchange and participates in the governing bodies of non-profit organisations in Mexico. He is an official entrusted lawyer of the Swiss embassy in Mexico and member of the Mexican Bar Association.

Alberto was educated at the Ibero-American University, with a specialisation in commercial law from the Panamerican University.

PER SAMUELSSON

Hannes Snellman Attorneys Ltd

Per Samuelsson is an associate in Hannes Snellman's Public M&A group. He works mainly with corporate and securities market law. Per's experience includes work in relation to several public tender offers and public M&A transactions, as well as various corporate issues.

WILLIAM SAVITT

Wachtell, Lipton, Rosen & Katz

William Savitt focuses on representing corporations and directors in litigation involving mergers and acquisitions, proxy contests, corporate governance disputes, class actions involving allegations of breach of fiduciary duty, and regulatory enforcement actions relating to corporate transactions. Mr Savitt writes and speaks extensively on corporate and securities law topics and has developed and teaches a course at Columbia Law School on transactional litigation.

CLEMENS PH SCHINDLER

Schindler Rechtsanwälte GmbH

Clemens Philipp Schindler is a founding partner of Schindler Attorneys. Before establishing the firm, he spent six years as partner at Wolf Theiss, where he led some of the firm's most prestigious transactions and headed its Brazil operations. Prior to that, he practised with Haarmann Hemmelrath in Munich and Vienna, as well as with Wachtell Lipton Rosen & Katz in New York. Mr Schindler's practice focuses on corporate and tax advice in relation to public and private M&A, private equity and corporate reorganisations (such as mergers, spin-offs and migrations), most of which have a cross-border element. Mr Schindler is ranked by international legal directories such as *Chambers Global*, *Chambers Europe*, *IFLR1000* and *Who's Who Legal*. The German legal directory *JUVE* lists him as one of Austria's top 20 corporate and M&A lawyers, and the Austrian business magazine *Format* named him among Austria's top 10 capital markets lawyers.

SVEN H SCHNEIDER

Hengeler Mueller Partnerschaft von Rechtsanwälten mbB

Sven H Schneider is a partner of Hengeler Mueller in Frankfurt. He studied at the universities of Freiburg/Breisgau and Heidelberg. He holds a doctorate degree (Dr jur) from the University of Mainz and an LLM from Boalt Hall School of Law at the University of California at Berkeley. After serving his legal clerkship at the Higher Regional Court of Hamburg, he was admitted to the German Bar in 2003 and joined Hengeler Mueller in 2005. Dr Schneider specialises in banking regulatory and corporate law. He has published several articles in these areas.

BOGDANA SHTOMA

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Bogdana is a Russian-qualified corporate lawyer specialising in M&A, corporate reorganisation and restructuring, joint ventures and general corporate advisory matters. Bogdana also advises on anti-monopoly law issues.

Bogdana graduated from the Moscow State University of International Relations (MGIMO). Before joining the firm in 2012, she worked with two other international law firms.

NICHOLAS WILLIAM BOE STENDERUP

Plesner Law Firm

Nicholas William Boe Stenderup primarily focuses on issues relating to company law and securities law, corporate governance and compliance.

Mr Stenderup graduated with a Bachelor of Business Administration and Commercial Law from Copenhagen Business School in 2005 and subsequently with a master's degree in law from the University of Copenhagen in 2010. The same year he started working as an assistant attorney with Plesner Law Firm and in 2013 he was admitted to the Bar.

Mr Stenderup is the author of a number of articles about company law, including an article about the Danish corporate governance recommendations that was printed in *The Board of Directors Handbook* (2013 and 2014), published by *Børsen* (a leading Danish journal for trade and industry), and an article about shareholder agreements in the light of Section 82 of the Danish Companies Act, printed in *Justitia* in 2010.

STELLA STRATI

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Stella Strati is a limited partner with the corporate finance department at Patrikios Pavlou & Associates LLC, specialising in corporate law, commercial law and corporate finance. She received her law degree from the University of Athens in Greece in 2003 and then she returned to Cyprus, where she was admitted to the Cyprus Bar Association. Stella also obtained an LLM in EU commercial law from the University of Leicester in 2006. She is a member of the International Bar Association, currently appointed as the national reporter of the Taxes Committee thereof and a member of the Society of Trust and Estate Practitioners (STEP). Stella has gained extensive teaching experience while teaching A-level law to young students at a local private institute and as an adjunct professor with the George Washington

University in 2011. Stella has also participated as a speaker and a panellist in various seminars and conferences, both in Cyprus and abroad. She has authored several publications, is fluent in Greek and English and has a good knowledge of German.

MICHAEL S SWOYER

The Delaware Counsel Group LLP

Michael S Swoyer represents domestic and international clients in complex corporate, commercial and structured finance transactions with a Delaware connection. Mr Swoyer's practice involves drafting and negotiating business entity agreements and organisational documents, as well as advising clients on the structure and use of Delaware corporations and alternative entities for various purposes. Mr Swoyer also provides third-party legal opinions concerning Delaware's General Corporation Law, Delaware's alternative entity statutes, and Articles 8 and 9 of the Delaware Uniform Commercial Code.

Prior to joining The Delaware Counsel Group LLP, Mr Swoyer served as judicial law clerk to Justice Henry duPont Ridgely and Justice James T Vaughn Jr of the Delaware Supreme Court. He graduated *magna cum laude* from Widener University Delaware Law School, where he served as articles editor on the board of the *Delaware Journal of Corporate Law* and co-founded the Transactional Law Honor Society. Additionally, he served as a Josiah Oliver Wolcott Fellow.

Mr Swoyer is the author of several publications, including: 'Don't Let the Name Fool You: Delaware Statutory Trusts are Controlled by Contract', *Bus. L. Today* (December 2016); "'Mandatory" But Not Guaranteed: Delaware Court of Chancery Narrows the Broad Scope of Corporations' Mandatory Advancement Provisions', *Bus. L. Today* (October 2015); and 'Home and Abroad: The First Sale Doctrine's Application to Foreign Made Goods Sold in the United States', Pennsylvania Bar Association Spring Newsletter (2014).

JOANA TORRES EREIO

Uría Menéndez – Proença de Carvalho

Joana Torres Ereio joined Uría Menéndez as a trainee lawyer in September 2007 and became a senior associate in September 2012.

She spent the period from October 2011 to February 2012 on secondment to the Uría Menéndez offices in Madrid.

Joana focuses her practice on corporate and commercial law, mergers and acquisitions, private equity and restructurings.

Joana has a postgraduate qualification in commercial law and a course on finance and accounting from the Catholic University of Portugal and also completed an intensive course on corporate finance at the University of Lisbon.

JORGE UGARTE

Carey

Jorge Ugarte is a partner at Carey and co-head of the firm's corporate, mergers and acquisitions and capital markets group. His practice focuses mainly on mergers, acquisition and transfer of companies, public takeovers, joint ventures, shareholder agreements and capital markets and bank transactions in general. He is the author of several publications on civil and corporate law, and of the book *Share Transfer Agreements*, published in 2016.

Mr Ugarte represents Chilean and international companies in connection with various cross-border transactions, including stock and asset acquisitions, tender offers, private equity and venture capital investments, joint ventures and bank financings. He has also advised various boards of directors on corporate governance matters.

Jorge obtained his LLB from the Pontifical Catholic University of Chile and his LLM from Columbia University in 2009. He currently works as a professor of corporate law at the Pontifical Catholic University of Chile.

JOHN VALLEY

Osler, Hoskin & Harcourt LLP

John Valley is a partner in Osler's Toronto office and practises corporate and securities law, with a particular focus on corporate governance and mergers and acquisitions. Mr Valley's corporate governance practice includes advising companies and boards of directors on matters regarding director duties, indemnification, stakeholder engagement, disclosure and other governance matters. He is also a member of a cross-disciplinary risk management and crisis response practice, which is focused on advising companies and boards of directors on taking proactive steps to avoid and prepare for and, where necessary, on responding to extraordinary crisis situations. Mr Valley's graduate research at the University of Cambridge, England focused on corporate governance in enterprises with significant government shareholders.

HUGO MEYER VAN DEN BERG

Koep & Partners

Meyer van den Berg is an attorney and notary practising as a partner with Koep & Partners in Windhoek. He specialises in mineral law, energy law, environmental law, competition law and general corporate and commercial law. Meyer holds a bachelor's degree in law and a bachelor's degree with honours *cum laude* in classical literature (Latin) from the University of Stellenbosch, as well as a master's degree *cum laude* and a PhD from the University of Cape Town. His postgraduate studies focused on mineral and petroleum law.

Meyer is a project leader for the Mineral Law in Africa (MLiA) Project, hosted by the University of Cape Town. He is a member of the Law Society of Namibia and the International Bar Association. He is also member of the Namibian Law Society's Commercial Law Committee, Legal Education and Professional Development Committee and the Law Reform Committee.

CARSTEN VAN DE SANDE

Hengeler Mueller Partnerschaft von Rechtsanwälten mbB

Carsten van de Sande studied law at the University of Bayreuth and Duke University School of Law. He received his doctorate in law in 2000 with a thesis on the supervision of groups of companies in the banking and insurance sector, and his LLM in US law in 2001. Mr van de Sande joined the Düsseldorf office of Hengeler Mueller in 2001 and, following a secondment to London, transferred to the Frankfurt office in 2004. He became a partner in 2007 and is a member of the corporate and dispute resolution groups of Hengeler Mueller. He advises domestic and foreign clients on German corporate law, including corporate

governance and corporate compliance, and deals with both national and international litigation and arbitration cases. Carsten is admitted to the Bar in Germany and in the state of New York.

STEVEN VAN WAAS

NautaDutilh Avocats Luxembourg S.à r.l.

Steven van Waas is an associate in the corporate practice of NautaDutilh Avocats Luxembourg. He assists clients on various corporate matters including M&A, private equity, corporate finance and general corporate and commercial advice.

Mr van Waas graduated from Utrecht University in 2010 with an LL.M degree in Dutch civil law and an LL.M degree in corporate, social and economic law. In 2011, he obtained an LL.M degree in European law from Panthéon-Assas University (Paris II).

DANIEL VELÁZQUEZ

Santamarina y Steta, SC

Daniel joined Santamarina y Steta, SC, in January 2013. He previously worked as a paralegal at the Mexican Stock Market and at a publicly held company. In 2017, he will be doing an internship practice at CMS Hasche Sigle in Frankfurt.

He has drafted, reviewed and negotiated documents related to acquisitions, mergers, joint ventures, asset and stock purchases, the restructuring of private and public companies, banking and securities, credit agreements, project finance, the irrevocable transfer of domain trusts, guaranty trusts, mortgages and credit restructurings. He has represented Mexican issuers in drafting various documentation for CNBV and US Securities and Exchange Commission filings, including disclosure requirements.

Daniel graduated with honours from the National Autonomous University of Mexico, and holds a Master of Laws degree from the University of Pennsylvania Law School, as well as the Wharton Business and Law Certificate from the Wharton School of the University of Pennsylvania. During his LL.M academic year, he was part of the University of Pennsylvania Law School Global Research Seminar on corporate governance.

MARCELO VIVEIROS DE MOURA

Pinheiro Neto Advogados

Marcelo Viveiros De Moura obtained his LL.B degree from the Rio de Janeiro State University (UERJ) faculty of law in 1988 and his LL.M degree from the University of Cambridge in 1993. He is a partner in the corporate division of Pinheiro Neto in Rio de Janeiro, where he has worked for 31 years. Mr Moura has also worked as a visiting associate at Slaughter and May in London. He specialises in mergers and acquisitions (corporate restructuring), regulatory law in relation to oil and gas, capital markets, insurance, project finance, administrative law, government procurements and contracts.

ROLF WATTER

Bär & Karrer AG

Rolf Urs Watter is a partner with Bär & Karrer AG and served on the board and the management committee of the firm for nine years. He graduated from the University

of Zurich with a doctorate in law and holds a Master of Laws degree from Georgetown University in Washington, DC. He has been lecturing as a professor at the University of Zurich since 1990.

Rolf Watter is currently chairman of PostFinance, vice-chairman of the listed AP Alternative Portfolio Ltd and a board member of Aryzta. He previously served, *inter alia*, as chairman of Nobel Biocare and a board member of Zurich Insurance and Syngenta. Furthermore, he is a member of the regulatory board of the SIX. He regularly publishes on governance matters and transaction issues and is an editor of the law journal *GesKR* and the *Basler Kommentar*.

PAUL WHITE

A&L Goodbody

Paul White is a partner in the corporate department specialising in the areas of corporate and commercial law, mergers and acquisitions, corporate restructurings, corporate governance and corporate finance.

Paul was awarded ‘Ireland Corporate Lawyer of the Year 2016’ by Client Choice. He is recommended by a number of leading publications and directories, including: Best Lawyers, *Who’s Who*, *Chambers Global*, *The Legal 500*, *IFLR1000* and *Chambers Europe*.

‘Commended by several [. . .] he has very strong communication skills, is very commercial, very professional and good to work with’ (*IFLR1000* 2017); ‘Ability to deliver advice at a high level and to summarise complex strands of advice [. . .] expert knowledge of complex ECM matters [. . .] he is responsive, commercial, in tune with our needs’ (*Chambers Global* 2016); ‘a corporate law specialist with broad industry knowledge and expertise in equity capital markets and M&A’ (*Chambers Global* 2014).

He has been a partner with the firm since 1996; managed A&L Goodbody’s London office from 1999 to 2004; served as head of the firm’s corporate department between 2005 and 2010, and as chairman of the firm between 2010 and 2016; and continues actively to serve clients on a range of corporate and commercial law matters. Paul also carries management responsibility for a number of the firm’s key relationships.

ANDRZEJ WIERCIŃSKI

WKB Wierciński, Kwieciński, Baehr

Andrzej Wierciński is a co-founder and senior partner at WKB Wierciński, Kwieciński, Baehr. He heads the M&A, and restructuring and insolvency teams and advises clients on state aid matters. His extensive experience derives from many years’ work on the most high-profile and innovative projects, such as the very first cases of privatisation of state enterprises and state-owned banks, and the creation of the first joint ventures in post-transformation Poland. He also assisted on a number of international restructuring and distressed M&A transactions, including the first successful attempt to restructure high-yield debt in Poland. He holds a higher doctorate in law, and is a former visiting lecturer at Trinity College Oxford. Andrzej is engaged as a professor at the faculty of law of SWPS University of Social Sciences and Humanities, Warsaw, and he is the author of numerous publications, including the recently published *Commentary on the Competition and Consumer Protection Act*.

MARGARETHA WILKENHUYSEN

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Margaretha (Greet) Wilkenhuysen is a partner in the corporate practice of NautaDutilh Avocats Luxembourg. She specialises in cross-border corporate transactions, with a particular focus on mergers and acquisitions, joint ventures and international corporate restructurings and corporate finance. Her clients include major international corporations and she has represented both domestic and international clients in a variety of high-end transactions. Her extensive experience and knowledge resulted in her being nominated from 2011 through 2017 as a ‘Leading Lawyer’ in the *IFLR1000*.

Ms Wilkenhuysen received her law degree from the Katholieke Universiteit Leuven in 1991, a master’s degree in business and tax law from the Free University of Brussels in 1993, and an LLM from Duke University School of Law in 1996. She joined NautaDutilh in 1997 and became a partner in 2007.

Ms Wilkenhuysen is a frequent writer and speaker and has published various books and articles (e.g., *Due Diligence* (2011 – new edition), *Cross Border Mergers* (2011) and *Capital Directive* (2014)). She also published an article on cross-border mergers in ‘Un siècle d’application de la loi du 10 août 1915 concernant les sociétés commerciales’ (2015). She is also a member of the International Bar Association, the European Private Equity and Venture Capital Association and the Duke Alumni Association.

JOHN WILLIAMSON-NOBLE

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John Williamson-Noble is a partner in Australian law firm Gilbert + Tobin’s corporate advisory group and has been with the firm since 1995.

He has advised on many of Australia’s high-profile transactions. He has been recognised as a leading lawyer in corporate governance, capital markets, mergers and acquisitions, and private equity in a range of industry guides. He has advised on transactions that were, at the time: Australia’s largest successful merger – the merger of Westpac and St George Bank; Australia’s largest private equity deal – KKR’s acquisition of Brambles Australia; and Australia’s largest float – the IPO of Qantas.

He regularly advises on mergers and acquisition transactions, private equity deals and capital markets issues. He also regularly advises on corporate governance issues.

Mr Williamson-Noble is a member of the LPD Council of the International Bar Association (the world’s leading organisation of international lawyers) (IBA) and past chair of the IBA’s Corporate and M&A Committee. John is ranked by *Chambers Asia Pacific* (2014) for equity capital markets and private equity and by *IFLR1000* (2014) as a leading lawyer in the area of mergers and acquisitions. John has also been recognised by Best Lawyers International since 2008 as a leading lawyer in equity capital markets, financial institutions, leveraged buyouts, mergers and acquisitions, private equity and venture capital, and was awarded Best Lawyers’ ‘Sydney Lawyer of the Year 2014–2015’ for leveraged buyouts. He was also included in the *Lawyer Monthly* magazine’s Leading Lawyer Global 250 for 2014.

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Anna Wojciechowska is a counsel at WKB Wierciński, Kwieciński, Baehr and co-head of the company law and corporate governance team. She also co-heads the German desk. Anna advises on company law and M&A, including to German-speaking clients. She has extensive experience in advising on share purchases and corporate structuring. She works for many clients from the publishing and media industries. Anna graduated in Polish–German studies at the faculty of law at the Viadrina European University in Frankfurt (Oder), Germany, and from the faculty of law and administration of Adam Mickiewicz University in Poznań, Poland. She also holds a master's degree in German and Polish law (LLM) and has completed a post-graduate programme on intellectual property law at the University of Warsaw's faculty of law and administration, as well as a course on public international law at Utrecht University's faculty of law.

STEPHEN C WU

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Stephen joined Lee and Li in 2000 and became a partner in 2008.

Having completed a Fair Trade Act programme conducted by the Taiwan Fair Trade Commission in 2001, Stephen specialises in competition law and has been recognised as being among the world's leading competition lawyers since 2012 by *Who's Who Legal: Competition Lawyers & Economists*. He is currently the partner leading the competition law practice group of Lee and Li and also the founding chairman and active member of the Competition Law Committee of the Taipei Bar Association. With the support of a team with extensive knowledge and experience, he has successfully handled numerous antitrust filings, cartel investigations and unfair competition cases on behalf of domestic and international clients. He keeps abreast of the latest developments in global antitrust and competition laws and regularly contributes briefings and articles to the *Global Competition Review*, *AntitrustAsia.com* and many competition law publications.

Stephen also has extensive experience in handling M&A transactions including, but not limited to, the acquisition of KG Telecom by Far EasTone, several of Carlyle's deals related to cable TV business, HSBC's disposal of shares in Tong Lung Metal Industry Co, Ltd, and several of Philips' deals in Taiwan. In addition, he is active in public policy reforms in various areas, such as M&A, knowledge-based economy, corporate governance, telecom and media convergence, venture capital, limited partnerships, industrial holding companies and investor protection.

ANNA WYRZYKOWSKA

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Anna Wyrzykowska is a counsel at WKB Wierciński, Kwieciński, Baehr and co-head of the company law and corporate governance team. She also co-heads the French desk. She specialises in company law, mergers, divisions and corporate transformation processes, and preparing internal regulations with respect to corporate governance. She also manages M&A transactions, including the sale and acquisition of companies and enterprises and represents clients before common and administrative courts in matters related to company law and real estate. A graduate of the faculty of law and administration at the University of Warsaw and

the School of American Law at the Centre for American Law Studies, Anna holds a master's degree in French and European business law from the University of Poitiers in France and has completed a postgraduate programme at Warsaw School of Economics entitled 'The Legal Basis of the Construction Process'. She is a co-author of the book *Limited Liability Companies: A Practical Guide* and recently published book *Liability of Members of Capital Company Governing Bodies*.

ROBERT YALDEN

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Robert Yalden is a partner in Osler's Montreal office. He is co-chair of the firm's national mergers and acquisitions group and head of the Montreal office's corporate group. His career with Osler spans over 25 years, during which he has been involved with some of Canada's most innovative and ground-breaking transactions. Mr Yalden has advised boards of directors and senior management in connection with a wide range of corporate governance and M&A mandates. He was part of the Osler team that implemented the first poison pill in Canada. He led the Osler legal teams involved in Canada's largest-ever completed leveraged buyout, as well as the largest private equity deals in Quebec in 2014 and 2015. He has recently been involved with a significant proxy fight that has seen the problems of 'empty voting' on the part of hedge funds receive considerable public scrutiny in Canada. He is the co-author of *Business Organizations, Policies and Practices* (2008) and teaches a course in comparative corporate governance at McGill University's faculty of law.

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Derrick joined Lee and Li in 2011 and focuses on corporate investment, M&A transactions, tax consultancy, estate planning and dispute resolution. He is admitted to practise law in Taiwan and New York.

Derrick obtained a bachelor's degree and a master's degree in law in Taiwan. In 2005, Derrick passed the ROC Bar Examination and the Civil Service Level III Senior Examination. After completing his law firm apprenticeship, Derrick joined the Taipei National Tax Administration, where he handled personal income tax and withholding tax cases. In 2009, Derrick continued his legal studies in the LLM programme in the Northwestern University School of Law. After graduating from the Northwestern University, he entered the Permanent Mission of the Republic of the Marshall Islands to the United Nations in New York as an adviser for a one-year term.

Appendix 2

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