The Corporate Governance Review

Second Edition

Editor
Willem J L Calkoen

Law Business Research

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For further information please email
Adam.Sargent@lbresearch.com

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Second Edition

Editor
Willem J L Calkoen

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Gideon Roberton

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Adam Sargent

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EDITOR'S PREFACE

Willem J L Calkoen

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

In this second edition, we can see that corporate governance is becoming a hotter topic with each passing year. What should outside 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 outside directors know the business? How much time should they spend on the function?

Governments, the European Commission and the Securities and Exchange Commission are all pressing for more formal inflexible acts, especially in the area of remuneration, as opposed to codes of best practice.

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

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at GM and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code and many countries produced national codes along the model of the Cadbury 'comply or explain' method. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been many instances where imperial CEOs gradually amassed too much power and companies have fallen into bad results – and sometimes even failure. More have failed in the financial crisis than in other times, hence the increased outside interest in government acts, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists.

This all implies that executive and non-executive directors should work harder and more as a team on strategy and entrepreneurship. It is still a fact that more money is lost due to lax directorship than to mistakes. On the other hand, corporate risk management is an essential part of directors' responsibility, and especially the tone from the top.

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

My aim as General 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 by reading about the laws 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
April 2012

Chapter 16

NETHERLANDS

Geert Raaijmakers and Marlies Stek[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 ('the 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 holdings collectively representing at least 10 per cent of the company's issued share capital or having a nominal value of at least €225,000[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.

1 Geert Raaijmakers is a partner and Marlies Stek is a professional support lawyer at NautaDutilh.

2 Under the Bill Amending the Rules on Inquiry Proceedings (32 887), a higher capital interest would be required for capital companies with issued capital exceeding €22.5 million. The bill is currently before the Lower House of the Dutch Parliament.

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 ('the 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 ('the AFM').

Alongside these statutory rules, there is a system of self-regulation consisting of codes of conduct containing principles and best-practice provisions. The first Dutch Corporate Governance Code (also known as the Tabaksblat Code), containing governance rules for listed companies, entered into effect in 2004. Since 2009, a revised version (also known as the Frijns Code; hereinafter 'the Code') has been in effect, with more attention being paid to risk management, the supervisory duties of the supervisory board and the level and structure of remuneration. January 2010 saw the entry into effect of the Banking Code: this mirrors the Code in many respects, but also contains rules specifically targeted at banks (risk appetite, the treatment and interests of clients). The Banking Code applies to both listed and unlisted banks. In addition, the Insurers Code for the insurance industry took effect on 1 January 2011. The Insurers Code is nearly identical to the Banking Code and relates to both listed and non-listed insurance companies. Thus, listed banks and insurance companies fall under the Code, as well as the Banking and Insurers Codes.

The above-mentioned codes adopt a 'comply-or-explain' system: in its annual report, the relevant company or bank must state how it has applied the principles and best-practice provisions or, if applicable, provide a reasoned explanation of why a principle or best-practice provision has not been applied or not applied in full. For all these codes, there is a 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

From the late 1990s, the attention of the legislature and courts in the Netherlands was focused on strengthening the role of shareholders in the governance of companies – a development that was originally motivated by various accounting scandals, which had undermined confidence in management. In this regard, the tide now appears to be turning. It is felt that the stakeholder model traditionally followed in the Netherlands, the main focus of which is balancing the different interests of the various parties involved in a company, has come under too much pressure from shareholder activism. It became apparent that newly acquired shareholder rights were being exercised not by institutional investors, but by short-term investors, such as certain hedge funds. For these investors, short-term increases in shareholder value are more important than the company's long-term interests. Since the commencement of the financial crisis in 2008, the regulatory focus in the Netherlands has shifted toward improving corporate management and supervision and promoting dialogue between, on the one hand, the management and supervisory boards and, on the other, shareholders.

In this connection, attention is currently being paid in the Netherlands (but also at a European level) to the issue of how the participation of institutional investors can be enhanced. The underlying notion is that the existence of a sustainable relationship between a company's management board and such shareholders with a long-term vision will serve to benefit the company. To this end, efforts are being made to facilitate the exercise of shareholder rights and to also make this process more transparent, so that the behaviour of shareholders is easier to understand and predict. Another subject being discussed is the role of the different stakeholders in determining a company's policy and strategy. An important judgment on this issue was issued by the highest court in the Netherlands, the Supreme Court, in the summer of 2010; this judgment is discussed later (see Section V(iii), *infra*).

Furthermore, and as a result of public pressure, the remuneration of board members of financial institutions has been the subject of new self-regulation initiatives and legislation. More particularly, limits have been placed on the variable component of remuneration, the idea being to bring a stop to the adoption of short-term strategies. The expectation is that banks that are receiving or have received government assistance in connection with the financial crisis will soon be statutorily prohibited from awarding executive bonuses. A bill to this effect is currently being debated in the Upper House of the Dutch Parliament.[3]

Lastly, improving the trustworthiness and expertise of board members, and hence the quality of the management and supervision of companies, is now receiving a great deal of public attention. Legislation regarding the financial sector has recently been enacted in this area, too.[4]

In short, the subject of corporate governance has remained high on the agenda in the Netherlands. An actual change in culture and behaviour is expected of companies in general and 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 statutory provisions); however, the institution of a supervisory board is only mandatory for companies subject to the 'structure regime' (Book 2, Title 4, Part 6 DCC). 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.

3 Bill on Limitation of Liability for the Dutch Central Bank ('DNB') and the AFM and Bonus Ban for State Aided Institutions (33 058).

4 Act of 22 December 2011 in connection with the Introduction of the Suitability Requirement and the Strengthening of Cooperation between Regulators concerning the Suitability Test and the Trustworthiness Test (Bulletin of Acts and Decrees 2012, 7). The Act will come into force on 1 July 2012.

Through the influence of international developments, the one-tier board structure, consisting of a single board comprising both executive and non-executive members, has made its way into Dutch corporate practice. Because current Dutch law is not based on this type of governance model, Parliament passed 'the Management and Supervision Act'[5] to create a statutory basis for and deal with the special characteristics of one-tier board companies. This Act is expected to enter into force on 1 July 2012 or, if its consideration by the Dutch Parliament encounters delays, by 1 January 2013. The Code already contains provisions relating to listed companies with a one-tier board structure.

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 (Article 2:129 DCC). 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.

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 (Article 2:140(2) DCC). 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 (Article 2:164 DCC).

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 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, a remuneration committee and a selection and appointment committee, whose duties are also specified (see Code III.5).

5 Act of 6 June 2011 Amending Book 2 of the DCC in connection with Amendment of the Rules on Management and Supervision in Public Limited Liability Companies and Private Limited Liability Companies (Bulletin of Acts and Decrees 2011, 275).

ii Directors

Appointment and removal; qualifications

As stated above, management board members of structure-regime companies are appointed and removed by the supervisory board. In companies not under this regime, the general meeting of shareholders has this power. Under the Code, management board members may be 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 (*Unidek*, 15 April 2005). Removal does not, however, preclude the management board member from seeking to recover damages on the grounds of an obviously unreasonable dismissal.

Under the Code, the remuneration in the event of dismissal may not exceed one year's salary (fixed remuneration component). According to the Corporate Governance Monitoring Committee's reports, 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. The Monitoring Committee's most recent report shows that compliance in this respect improved in 2010. Under the Management and Supervision Act, management board members of listed companies will explicitly no longer have an employment relationship with the company. The intention is to prevent management board members from bringing an action for damages on the grounds of an obviously unreasonable dismissal if they are removed.

Supervisory board members of structure-regime companies are appointed by the general meeting of shareholders based on a nomination by the supervisory board (Article 2:158 DCC). 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 (Article 2:161 DCC). 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.

The DCC and the Code contain several provisions intended to safeguard the independence of supervisory board members. For example, neither the board member nor his or her relatives may have a business relationship with the company (see Code III.2). Due in part to the financial crisis, during which the supervision exercised by supervisory boards proved in some cases to be inadequate, the functioning of such boards is now in the political spotlight. The Code and Banking Code therefore pay a great deal of attention to the expertise of supervisory board members. For example, under Chapter 2 of 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. Nevertheless, legislation has been enacted subjecting new management and supervisory board members of financial institutions to a stricter 'fit and proper' test starting 1 July 2012, with this test to be applied by the AFM.[6] Such a test would be in line with the common practice in countries with a one-tier board model.

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 (Article 2:130 DCC). 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

If the company's interest in relation to a particular matter conflicts with that of a management board member, the company will as a general rule be represented by the supervisory board. Under current law, the company is in principle not bound towards third parties if a management board member represents the company notwithstanding a conflict of interest; the transaction is invalid. Because of the legal uncertainty this can create, the Management and Supervision Act will shift the protection of companies against conflicts of interest from the domain of external representation to the decision-making phase. In line with the Code, 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. If he or she nevertheless does so, this will no longer invalidate the transaction (Code II.3.3 and III.6.2).

Internal liability

A management board member who has performed his or her duties improperly may be held personally liable to the company (Article 2:9 DCC). In principle, each board

6 *Op. cit.* 4.

member is liable for the entire damage resulting from mismanagement by each other board member (principle of collective responsibility). A board member may, however, avoid liability by proving that the relevant matter did not fall within his or her specific duties, that he or she cannot be blamed for the mismanagement and that he or she has not been negligent in taking measures to prevent the consequences of the mismanagement. Case law has established that a board member will not be held personally liable in the absence of serious fault. The same liability rules also apply to supervisory board members.

The explanatory memorandum to the Management and Supervision Act specifically states, with respect to the one-tier board model, 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.

The Supreme Court has held that only the company may sue a board member for mismanagement under Article 2:9 DCC; shareholders in the Netherlands are not entitled to file a derivative action to recover damages for a reduction in the value of their shares (*Poot-ABP*, 2 December 1994). The rationale for this decision is that an action by the company benefits all creditors, while an action by a shareholder benefits only himself or herself.

External liability

In principle, management board members are not personally liable for the company's debts. If a company is declared bankrupt, however, 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) DCC, the failure of the management board to comply with its accounting obligations and its obligation to file the annual accounts gives rise to an irrebuttable statutory presumption of clear mismanagement and a rebuttable statutory presumption that such mismanagement was an important cause of the bankruptcy. An individual management board member is not liable if he or she proves that the clear mismanagement was not due to any failure on his or her part and that he or she was not negligent in acting to prevent the consequences of the mismanagement. 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. The rules were introduced in 1987 in an effort to combat the abuse of legal entities, and are regularly invoked by bankruptcy trustees.

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 Code also lays down several specific financial disclosure obligations.

The DCC contains rules with regard to the composition of the annual accounts and annual report, the auditor's opinion, 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 such proceedings, the Court can order the company to amend the annual accounts and annual report in accordance with its instructions.

The transparency requirements in the FSA can, in general terms, be divided into two categories: one-off disclosure obligations and periodic disclosure obligations. The main example of the first category is the obligation to immediately publish price-sensitive information (Section 5:25i FSA). Publication may only be postponed if the postponement serves a legitimate interest of the issuer, the postponement is unlikely to deceive the public and the issuer can guarantee the confidentiality of the information.

The periodic disclosure obligations consist mainly of the annual, half-yearly and quarterly financial reporting requirements (Section 5:25c *et seq.* FSA). In addition, shareholders are required to notify the AFM if their holdings of voting rights or capital in listed companies reach, exceed or fall below particular thresholds (Section 5:38-44 FSA). 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 are also required to notify the AFM of their holdings of shares or voting rights in the company and of any transactions in such shares or changes in such voting rights.

Finally, Chapter V of the Code 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.

IV CORPORATE RESPONSIBILITY

As stated above, 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 Paragraph 7 of its preamble, the 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. Paragraph 8 of the preamble indicates that corporate social responsibility issues must also be taken into account by the management and supervisory boards. This social undertone is not surprising, given that the Code was drawn up in response to the accounting scandals in the US 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 policy statement setting out, *inter alia*, the corporate social responsibility issues that are relevant to the enterprise. This policy statement must be submitted to the supervisory board for approval, and its main elements must be published in the annual report. The management and supervisory boards are required to take this policy statement into account in their actions.

As a result of the financial crisis, risk management in listed companies also gained a prominent position in the Code. The management board is responsible for managing the risks associated with the company's activities (Principle II.1 Code). This is elaborated upon in the Code's best practice provisions. In addition, Article 2:391 DCC requires the management board to describe in the annual 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 annual report must also contain an analysis of both financial and non-financial performance indicators, including environmental and employment-related issues. Through the obligation to include non-financial factors in its analysis, the company is indirectly encouraged to bear in mind its corporate social responsibility.

The corporate social responsibility of listed companies must also be reflected in their remuneration policy. This policy must promote the interests of the company in the medium and long term. It must 'not encourage management board members to act in their own interests or take risks that are not in keeping with the adopted strategy, and must not 'reward' failing board members upon termination of their employment' (Principle II.2 Code).

As far as the banking sector is concerned, it should be noted that an independent fact-finding committee established in 2008 to investigate the banking crisis (the Maas Committee) concluded in its final report that banks must once again focus mainly on their clients and less on the interests of shareholders. The Committee stressed the banks' public role and responsibility. According to the Committee, in order to restore confidence in the banking sector and its management, remuneration policy and practices also had to change.

The Banking Code reflects these principles to a certain extent. It specifically provides that 'maintaining a continued focus on its clients' interests is a necessary precondition for the continuity of the bank' (Paragraph 3.2.2). The Banking Code Monitoring Committee reported in its provisional findings for the 2010 financial year that banks are taking this principle seriously but are wrestling with how to put it into practice and bring about the changes in culture it demands. In the final report for the financial year 2010, the Monitoring Committee was more optimistic about the implementation of the principle. It concluded that application of the Banking Code had resulted in fewer, simpler and more transparent products. It noted, however, that phasing out more risky products and activities would have repercussions on returns, which in turn would affect the banks' capacity to lend money.

The Banking Code also contains an extensive section on remuneration policy. This policy must be 'meticulous, restrained and long term, in line with the bank's strategy and risk appetite, objectives and values, taking into account the bank's long-term interest, the relevant international context and wider societal acceptance' (Section 6). In the event of dismissal, remuneration may not exceed one year's salary (the fixed remuneration component). The allocation of variable remuneration must be related to the bank's long-term objectives and must be based in part on the bank's results. The variable remuneration *per annum* may not exceed 100 per cent of the management board member's fixed income. A bill recently submitted to Parliament provides that, if this standard is violated, the rate to be paid under a newly introduced bank tax will go up by 5 per cent.[7]

The current national debate, however, focuses on the granting of bonuses to management board members of banks that received public funds during the financial crisis. The Banking Code contains no specific provisions in this regard. Under political pressure, a bill was introduced in late October 2011, in which banks receiving state aid would be prohibited from granting bonuses. The fixed salaries would be frozen as well, to avoid compensation for the loss of bonuses. The bill is expected to come into force soon. It is hoped that these measures will bring about the desired behavioural and cultural change at banks. Expectations are also high concerning the requirement – introduced by the Banking Code – that management board members sign a moral and ethical conduct declaration. The Dutch government intends to give this declaration a legislative basis.

In the meantime, new rules applicable to remuneration in the financial sector have been enacted as part of legislation implementing the third European Capital Requirements Directive (CRD III) in Dutch law.[8] These rules require financial enterprises to lay down in writing and implement remuneration policies aimed at preventing the remuneration of policymakers, co-policymakers and employees engaged in the provision of financial services from leading to the improper treatment of clients and consumers. In addition, the remuneration policy must not encourage the taking of unacceptable risks. Therefore, variable remuneration may only be granted under strict conditions.

Finally, in order to ensure that employees are not afraid to report abuse, the Code contains whistle-blowing arrangements (II.1.7). It should be pointed out that the need for such arrangements in the Netherlands became urgent after the construction fraud affair in 2001. The whistle-blower who reported a large-scale fraud within the construction sector (work-sharing, prohibited price agreements and double accounting) lost his job and was himself prosecuted for his part in that fraud.

V SHAREHOLDERS

i Shareholder rights and powers

Under the DCC, 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 DCC assigns all residual powers (i.e.,

7 Bank Tax Bill (33 121).

8 Decree on Sound Remuneration Policies 2011 pursuant to the FSA and Regulation on Sound Remuneration Policies 2011 pursuant to the FSA.

those not assigned to the management board or other corporate bodies) to the general meeting of shareholders. The general meeting of shareholders 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 (Article 2:107a DCC). 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. It should be noted that in 2007 the Supreme Court rendered a judgment interpreting Article 2:107a 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 (*ABN AMRO*, 13 July 2007).

At European level as well, the focus at the turn of the century was on promoting greater shareholder participation in corporate governance. This was expressed in the Shareholder Rights Directive (2007/36/EC), which grants shareholders in listed companies various rights aimed at facilitating voting (including cross-border), such as e-voting and proxy voting. Under Dutch law, however, shareholders already had these rights. To improve the transparency of the voting process, the Directive also requires listed companies to publish voting results on their website within a period not exceeding 15 days after the general meeting. This right is new in the Netherlands (Article 5:25ka(3) FSA) and is quite important: given the complex chain of intermediaries between the ultimate investor and the company, it is in practice often unclear whether the investor's vote has in fact been cast in accordance with his or her instructions. The obligation to publish voting results is intended to correct this.

The Directive also provides for the system – now mandatory in listed companies – 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. *Inter alia*, the introduction of a record date eliminates the need for share blocking – a mechanism prohibiting share trading during the period immediately before a general meeting – in order to facilitate voting. Share blocking discourages institutional investors from voting because it requires them to suspend their investment activity in respect of the blocked shares during the relevant period. The introduction of record dates removes this obstacle to voting and therefore enhances participation by institutional investors.

Another important shareholder right is the right to have items placed on the agenda of a general meeting (Article 2:114a DCC). In 2004, this right was granted to shareholders in listed companies whose holdings represent at least 1 per cent of the issued capital or have a value of at least €50 million. With the implementation of the Shareholder Rights Directive in July 2010, this right was strengthened. Until then, under Dutch law the company could refuse such a request based on a compelling interest; the legislation implementing the Directive in the Netherlands eliminated this possibility. 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(iii), *infra*.

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 (Article 2:92 DCC). The articles of association may, however, provide otherwise. The principle of one share, one vote also applies (Article 2:118(2) DCC). There are important exceptions to these principles, a few of which are mentioned below.

The first exception is distribution of a 'loyalty dividend', an extra dividend given as a reward to long-term shareholders. The Supreme Court has held that the distribution of loyalty dividends is permitted (*DSM*, 14 December 2007).

A second exception 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. 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 (*RNA*, 18 April 2003).

A third exception 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. It is noteworthy that with respect to the issuance of financing preference shares, the Code provides that the voting rights attached to such shares must be based on the fair value of the capital contribution (IV.1.2). This represents an attempt to return to the one share, one vote principle.

ii 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. Paragraph 9 of the Code's preamble provides: 'The greater the interest which the shareholder has in a company, the greater is his responsibility to the company, the minority shareholders and other stakeholders.'

Institutional investors in particular are being called upon to accept greater responsibility. Although the Code recognises such investors act primarily in the interest of their ultimate beneficiaries or investors, it also provides that 'they have a responsibility to the ultimate beneficiaries or investors and the companies in which they invest, to decide, in a careful and transparent way, whether they wish to exercise their rights as shareholder in a listed company' (IV.4).

In this connection, the 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 (IV.4.1–IV.4.3). Eumedion, the interest group representing institutional investors, adopted a set of 'Best Practices on Shareholders' Social Responsibility' in June 2011. These best practices call on institutional investors to inform clients of conflicts of interest if, in relation to a particular matter, such investors have divergent roles that could affect their voting behaviour. An example of this is the role of an insurance company and its clients – the voting behaviour of an insurance company on shares held in a portfolio company could be affected if the portfolio company is also a client or potential client of the insurance company.

iii Shareholder activism

In practice, the shareholder rights described in Section V(i), *supra*, such as the right to have an item placed on the agenda of a general meeting, have been exercised mainly by hedge funds and far less by institutional investors. 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 revealed a shadow side to the increased participation. In particular, the focus on short-term profits has had adverse effects in some cases.

An example of this is 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. 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 was able to have this proposal placed on the agenda of the general meeting and it was ultimately adopted. In the end, TCI's conduct led to the acquisition of ABN Amro by three foreign banks.

This transaction caused the government and political parties to reconsider the desirability of shareholder activism and raised the question of whether the enhancement of shareholder rights had gone too far.

In May 2007, the Corporate Governance Committee recommended certain legislative changes intended to counteract the short-term orientation of activist shareholders. In the Committee's view, a sustainable relationship should exist between a company and its shareholders. To achieve this, shareholder conduct must become more transparent and dialogue between the parties must be encouraged. A bill on corporate governance that is currently before the Dutch Parliament is intended to contribute to these aims.[9] The bill reduces the minimum threshold for the obligation to disclose substantial holdings of capital or voting rights in listed companies (from 5 per cent to 3 per cent), and couples this with the obligation to publicly disclose whether or not the shareholder agrees with the company's overall strategy. In addition, the bill raises the threshold for the right of shareholders to have items placed on the agenda for a

9 Bill in response to the Corporate Governance Code Monitoring Committee's Recommendation of 30 May 2007 (32 014).

general meeting (from 1 per cent to 3 per cent). Finally, the bill introduces a mechanism enabling a listed company to identify its 'ultimate investors'.

The bill's aim is to enable the management board, through the introduction of the above 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 new obligations will also prevent a small group of unknown shareholders from surprising the company at a general meeting and forcing it to make certain policy changes. The fate of the bill is still uncertain.

It should be noted that the bill does not contain provisions on either empty voting or securities lending. 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. In the Netherlands the period between the record date and general meeting is relatively long (28 days). Consequently, it is clear for institutional investors that parties who seek to engage in securities lending near the record date presumably do so with a view to influencing decision-making at the general meeting, and not for the purpose of dividend arbitrage.

The Code also goes further than the bill in limiting the right to have items placed on the agenda (II.1.9 and IV.4.4). The Code provides that a shareholder may exercise this right only after having consulted the management board about this. If the item to be placed on the agenda may 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 can use this period to confer with the relevant shareholder. Because the Code is not enforceable, however, it is unlikely that an activist shareholder will be deterred from requesting that an item be placed on the agenda shortly before a general meeting. The statutory period for such requests is 60 days before the meeting.

The trend toward limiting shareholder rights can also be discerned in Dutch case law. For example, the Supreme Court fairly recently 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 (*ASMI*, 9 July 2010). The management board is therefore not obliged to involve the shareholders in advance in decisions on the strategy to be pursued. This judgment limits the possibility for shareholders to demand strategic changes.

Finally, it is noted that at European level, hedge funds will become subject to government supervision within the foreseeable future. The Alternative Investment Fund Managers Directive (Directive 2011/61/EU) establishes a licence system for this purpose. The Directive must be transposed into national regulations by the end of July 2013.

In short, it can be concluded that politicians have been taking measures to stem the excesses of shareholder activism in order to restore the balance of powers within companies. At the same time, efforts are being made to increase the participation of shareholders with a long-term vision.

iv 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 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 IV.3.13 of the 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.

VI OUTLOOK

Several issues are currently at the forefront of corporate governance in the Netherlands. First, there seems to be a growing call to put an end to the bonus culture within the banking world. Those calling for such action feel that the sector has been unable to regulate itself effectively. Up to now, the Dutch government has merely acceded to the demand to prohibit executive bonuses at financial institutions receiving state aid, but preparations are being made in Parliament to introduce a more far-reaching bill in this regard.

The Code's principles and best-practice provisions also appear in practice to be having a knock-on effect in other sectors. The Code only applies to listed companies, but small- and medium-sized businesses, as well as other non-listed companies, are increasingly opting to follow the codes of conduct voluntarily. This trend is occurring within the European Union, too, as can be seen from the European Commission's Green Paper of April 2011; the question posed there was whether the EU ought to promote the development of separate codes for non-listed companies.

The report of the Corporate Governance Monitoring Committee published in December 2011 also sets out a number of specific points of attention for the future:

a Exercise of voting rights – the Committee concluded that proxy advisory firms have a strong influence on how votes are cast at shareholder meetings. This may be at odds with the principle that shareholders should vote as they see fit. According to the Committee, it is also often unclear whether a vote has actually been cast and, if so, whether it has been cast in accordance with the shareholder's instructions. The Committee announced a further investigation of these issues.

b Composition of the supervisory board – the Committee concluded that no progress had been made with respect to diversity (number of women in the supervisory board) and that there was room for improvement on this point.

c The quality of the explanations given when the Code is not applied – the Committee concluded that not every explanation for non-application is acceptable. In the Committee's view, insufficient explanation represents non-compliance; otherwise, the commitment to following the Code would become minimal.

The most fundamental issue that the Monitoring Committee touched on concerns the relationship between law and self-regulation. The Committee concluded that the legislature increasingly selects specific best-practice provisions from the Code (such as provisions on bonuses and clawback) and converts them into law. The reason given for this by the legislature is that it enables existing contracts to be broken open. In addition, the legislature often increases the scope of the rules, which also become enforceable. According to the Committee, however, the switch from self-regulation to regulation jeopardises the broad support for the Code and detracts from the willingness of the target group to cooperate in complying with the Code.

The last word on this subject has certainly not been said. The underlying question is whether a change in culture and conduct can best be brought about through legislation or self-regulation.

To summarise, corporate governance is a hot topic in the Netherlands. The goal is to create a proper balance between the interests of the various stakeholders within an enterprise. The model adopted should also discourage risky conduct and enable public confidence in the management boards of banks and companies to be restored.

Appendix 1

ABOUT THE AUTHORS

GEERT RAAIJMAKERS

NautaDutilh

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. He publishes regularly on developments in corporate and securities law, including articles on shareholder activism, corporate governance, mergers and sovereign wealth funds.

MARLIES STEK

NautaDutilh

Marlies Stek is a professional support lawyer at NautaDutilh and specialises in corporate law. She previously worked for the Advisory Committee on the Assessment of Restitution Applications for Items of Cultural Value and the Second World War, where she advised on issues relating to the restitution of Jewish cultural assets. She also has experience as a legislation specialist in the legal department of the Ministry of Economic Affairs.

NAUTADUTILH

Strawinskylaan 1999
1077 XV Amsterdam
The Netherlands
Tel: +31 20 717 1992
Fax: +31 20 717 1327
geert.raaijmakers@nautadutilh.com

www.nautadutilh.com