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Corporate Governance 2023

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Contributing Editor
James Palmer
Herbert Smith Freehills

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Global Practice Guides

Corporate Governance

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2023

Chambers Global Practice Guides

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Published by
Chambers and Partners
165 Fleet Street
London
EC4A 2AE
Tel +44 20 7606 8844
Fax +44 20 7831 5662
Web www.chambers.com

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CONTENTS

INTRODUCTION
Contributed by James Palmer, Gareth Sykes and Isobel Hoyle, Herbert Smith Freehills p.5

BAHRAIN
Law and Practice p.10
Contributed by Hassan Radhi & Associates

BRAZIL
Law and Practice p.29
Contributed by Mello Torres
Trends and Developments p.51
Contributed by Mello Torres

CANADA
Trends and Developments p.58
Contributed by Dentons

CHINA
Law and Practice p.71
Contributed by Global Law Office

COTE D'IVOIRE
Law and Practice p.90
Contributed by Houda Law Firm
Trends and Developments p.112
Contributed by Houda Law Firm

FRANCE
Law and Practice p.119
Contributed by PR & Associés AARPI
Trends and Developments p.139
Contributed by Lacourte Raquin Tatar

GERMANY
Law and Practice p.147
Contributed by POELLATH
Trends and Developments p.169
Contributed by POELLATH

GHANA
Law and Practice p.177
Contributed by Addison Bright Sloane
Trends and Developments p.197
Contributed by Addison Bright Sloane

GIBRALTAR
Law and Practice p.206
Contributed by ISOLAS LLP

GREECE
Law and Practice p.227
Contributed by Karatzas & Partners

INDIA
Law and Practice p.248
Contributed by Wakhariya & Wakhariya
Trends and Developments p.268
Contributed by Wakhariya & Wakhariya

IRAQ
Law and Practice p.275
Contributed by AMERELLER
Trends and Developments p.288
Contributed by AMERELLER

ITALY
Law and Practice p.294
Contributed by NUNZIANTE MAGRONE

JAMAICA
Law and Practice p.311
Contributed by Henlin Gibson Henlin

JAPAN
Law and Practice p.327
Contributed by Nagashima Ohno & Tsunematsu
Trends and Developments p.349
Contributed by Anderson Mori & Tomotsune

KUWAIT
Law and Practice p.358
Contributed by Meysan Partners
Trends and Developments p.378
Contributed by Meysan Partners

MEXICO
Trends and Developments p.386
Contributed by Mijares, Angoitia, Cortés y Fuentes, S.C.

CONTENTS

MONTENEGRO
Law and Practice p.392
Contributed by Radonjic Associates
Trends and Developments p.409
Contributed by Radonjic Associates

NETHERLANDS
Law and Practice p.415
Contributed by Stibbe

NEW ZEALAND
Law and Practice p.443
Contributed by Webb Henderson

NIGERIA
Law and Practice p.465
Contributed by Olajide Oyewole LLP
Trends and Developments p.484
Contributed by Olajide Oyewole LLP (Lagos - HQ)

NORTH MACEDONIA
Law and Practice p.492
Contributed by Polenak Law Firm

PANAMA
Law and Practice p.510
Contributed by Arias, Fábrega & Fábrega

PUERTO RICO
Law and Practice p.526
Contributed by Ferraiuoli LLC

SENEGAL
Law and Practice p.541
Contributed by Houda Law Firm
Trends and Developments p.563
Contributed by Houda Law Firm

SOUTH AFRICA
Law and Practice p.569
Contributed by ENSafrica

SWITZERLAND
Law and Practice p.595
Contributed by Schellenberg Wittmer Ltd

UAE
Law and Practice p.617
Contributed by Matouk Bassiouny
Trends and Developments p.633
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UK
Law and Practice p.638
Contributed by Herbert Smith Freehills

USA
Law and Practice p.659
Contributed by Sullivan & Cromwell LLP
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INTRODUCTION

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Herbert Smith Freehills operates from 25 offices across Asia Pacific, Europe, the Middle East, Africa and North America. The firm is at the heart of the new global business landscape, providing premium-quality, full-service legal advice. Herbert Smith Freehills provides many of the world's most important organisations with access to market-leading dispute resolution, projects and transactional legal advice, combined with expertise in a number of global industry sectors, including banks, consumer products, energy, financial buyers, infrastructure and transport, mining, pharmaceuticals and healthcare, real estate, TMT, and manufacturing and industrials. The dedicated corporate governance advisory team comprises governance specialists with technical expertise who provide practical advice to clients on the full spectrum of governance issues. The team advises listed and privately held companies on the regulatory, reporting and governance standards applicable to them. The firm draws on its wide-ranging experience to advise on legal and regulatory requirements, emerging trends and market best practice.

Contributing Editors

James Palmer is a senior corporate and governance lawyer who was the chair and senior partner of Herbert Smith Freehills. He is one of the UK's leading M&A, capital markets and corporate lawyers, with deep experience of corporate governance and regulation, including financial regulation. He is frequently involved in helping clients in situations where they face significant and unusual challenges. These include hostile takeovers, board and governance disputes, regulatory and other investigations, business crises, interactions with governments or government bodies, significant liability or solvency exposures, as well as significant transactions. He is also recognised as a leading expert in relation to both Brexit and foreign direct investment regulation.

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INTRODUCTION

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HERBERT SMITH FREEHILLS

INTRODUCTION

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Governance: Balancing Good Regulation Against Excessive Regulatory Interference

In order for any market to function efficiently and to operate properly for those who use it, there must be well designed, proportionate, clearly drafted and consistently applied regulation. Too little regulation fails to protect market users and risks undermining the reputation of the market as a stable investment environment. Too much regulation and an excessive governance burden stifle growth and may damage the market's appeal, driving both existing and new companies to list on alternative markets or to seek alternative sources of investment.

Achieving a balanced regulatory regime is a key issue for governments and their appointed regulators, and how they try to strike the right balance can be seen in the regulatory approaches adopted in different jurisdictions. Whatever approach individual regulators decide to take, the occurrence of seismic events, such as the COVID-19 pandemic and the Russian invasion of Ukraine, and existential threats, such as climate change, can fundamentally disrupt this balancing act.

Climate Change: Assessing Companies' Preparedness

So long the elephant in the room, few can now credibly deny the threat presented by climate change. Corporates are expected to play a significant role in the drive to lessen the impact of climate change and regulators across the globe continue to work on initiatives to increase engagement by companies in the move to a greener future.

The recommendations and recommended disclosures of the Taskforce on Climate-related Financial Disclosures (TCFD) have been endorsed by regulators in a number of jurisdictions. The work of the TCFD forms part of the basis for the new standards being developed by the IFRS' International Sustainability Standards Board (ISSB), which have the potential to drive this harmonisation programme to the next level. This is providing a uniform platform against which companies' contributions to climate change, their commitments to address this contribution, and progress against these commitments, can be assessed across jurisdictions.

Measures, such as the UK government's intention to introduce the mandatory disclosure of transition plans by companies and the EU's adoption of the Corporate Sustainability Reporting Directive, highlight the importance of understanding the risks faced by, and the opportunities presented to, companies as they prepare for a more sustainable economy. Better quality disclosures help companies, investors and the broader community evaluate the contribution of companies to the climate crisis and the potential scope of their role in addressing this crisis.

Embracing transparency in relation to green credentials however must not inadvertently encourage greenwashing by companies – the misleading marketing of their environmental impact. In this regard, the work to create comprehensive "green" taxonomies to support sustainability disclosure requirements is of key importance.

Diversity and Inclusion: Breaking Away From Groupthink

For a number of years, conventional wisdom has been that diversity improves economic performance. See for example, the study by Boston Consulting Group published in 2018 which concluded that companies with above-average diversity amongst their management teams reported 19% higher innovation revenue as compared with companies with below-average

diversity in their teams. Recognising the value of diversity in theory however is different from effecting diversity in practice. Regulators have been exploring in recent years how best to drive diversity and inclusion. Some jurisdictions have adopted formal quotas - a recent example of this approach being the EU's Gender Balance Directive (2022/2381), which was adopted in November 2022. The Directive requires member states to put in place implementing measures under which large EU companies listed on EU regulated markets will be required to have met prescribed targets by 30 June 2026 for the percentage of director and non-executive director positions occupied by the "underrepresented sex".

The UK has adopted an alternative approach, seeking to achieve balanced boards through voluntary targets for gender and ethnic diversity. Previously, the attainment of these targets was monitored and reported on by two review boards but, with effect from financial years starting on or after 1 April 2022, listed companies themselves need to report against prescribed targets on a comply or explain basis in their annual reports and also include prescribed data relating to diversity.

Russian Sanction Regime: Measures to Drive Compliance

A number of jurisdictions (including the UK, USA and EU) have over the last year reinforced the sanction regimes adopted in respect of Russian entities and individuals in response to the ongoing Russian invasion of Ukraine. Ensuring compliance with these regimes is crucial to their effectiveness. Understanding who owns the economic benefit of trading counterparties is a vital tool for companies seeking to comply with the regimes and for governments seeking to enforce such compliance. To enable this understanding, in jurisdictions such as the EU and the UK, companies have been required to disclose the identity of those who exercise significant control over them. The UK has taken these transparency obligations a step further and now requires the beneficial ownership of overseas entities which own land or property in the UK to be disclosed on a register at the companies registry, Companies House.

It is possible that, in contrast to sanction regimes which have been in place for some time with respect to other jurisdictions, the sustained spotlight on Ukraine (both in the media and in society as a whole) has helped keep companies focussed on the need for vigilance and continued monitoring of whom they are interacting with. The risk of penalties for breach being imposed on a strict liability basis, as is the case in the UK and the USA, also helps to reinforce the need for this vigilance and adds weight to arguments against attempts to circumvent the restrictions.

Cost of Living Crisis: Are We All in This Together?

Another issue which has dominated news coverage over the last year and which is, at least in part, linked to the war in Ukraine, is the global cost of living crisis. One of the many aspects which companies need to consider as part of their response to the crisis is directors' pay. Whilst investors in an increasing number of jurisdictions are regularly involved in the process of setting executive remuneration (including for example through consultation on, and approval of, remuneration plans and share schemes), there is heightened attention on awards being made to directors. Against the backdrop of levels of inflation not seen in some countries since the 1980s, and associated calls for, or enforcement of, general pay restraint by governments and/

or central banks, companies need to be mindful of how any increases in executive remuneration compare to pay rises being offered to the wider workforce. Companies have been called on by investor bodies to show restraint when setting executive pay and should anticipate dissent where they fail to do so. This in turn can create challenges in filling leadership roles where real global competition for talent applies.

Enhancing the Attractiveness of Public Markets

As noted at the outset, the public markets in any particular jurisdiction are competing to attract investment against not only overseas public markets but also private capital markets. Various factors including the impact of the COVID-19 pandemic, the economic turmoil of the last 12 months and, in the context of the UK, Brexit, have led regulators to investigate how to enhance the attractiveness of public capital markets. Issues explored have included how to improve the speed, ease and costs involved in accessing public markets, without exposing investors to unnecessary risks or introducing obscurity in place of transparency. The UK government in particular has been engaged in a lengthy review process, with numerous workstreams being taken forward. This is often looked at through the prism of international competition between public markets. The bigger competition may in fact be between public and private market access to capital.

The activities in this area are reflective of the broader tension for governments to ensure that regulation in their jurisdiction operates effectively and does not create too great a regulatory burden. The goal should always be to embrace quality of regulation over quantity. It should be recognised that it is not the role of regulation to eliminate all investment risk but rather to create a fair and transparent market in which investors can participate. Good corporate governance is central to this aim and has the capacity to contribute significantly to flourishing markets, accessible to all.

BAHRAIN

Law and Practice

Contributed by:
Noor Radhi, Fatima Alali and Saifuddin Mahmood
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Contents

1. Introductory p.14
1.1 Forms of Corporate/Business Organisations p.14
1.2 Sources of Corporate Governance Requirements p.15
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.16

2. Corporate Governance Context p.18
2.1 Hot Topics in Corporate Governance p.18
2.2 Environmental, Social and Governance (ESG) Considerations p.18

3. Management of the Company p.18
3.1 Bodies or Functions Involved in Governance and Management p.18
3.2 Decisions Made by Particular Bodies p.19
3.3 Decision-Making Processes p.20

4. Directors and Officers p.20
4.1 Board Structure p.20
4.2 Roles of Board Members p.21
4.3 Board Composition Requirements/Recommendations p.21
4.4 Appointment and Removal of Directors/Officers p.21
4.5 Rules/Requirements Concerning Independence of Directors p.22
4.6 Legal Duties of Directors/Officers p.22
4.7 Responsibility/Accountability of Directors p.23
4.8 Consequences and Enforcement of Breach of Directors' Duties p.23
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.23
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.23
4.11 Disclosure of Payments to Directors/Officers p.23

5. Shareholders p.23
5.1 Relationship Between Companies and Shareholders p.23
5.2 Role of Shareholders in Company Management p.24
5.3 Shareholder Meetings p.24
5.4 Shareholder Claims p.26
5.5 Disclosure by Shareholders in Publicly Traded Companies p.26

6. Corporate Reporting and Other Disclosures p.27
6.1 Financial Reporting p.27
6.2 Disclosure of Corporate Governance Arrangements p.27
6.3 Companies Registry Filings p.28

7. Audit, Risk and Internal Controls p.28
7.1 Appointment of External Auditors p.28
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.28

Hassan Radhi & Associates is one of the largest and most reputable leading law firms in Bahrain and in the Gulf region. The office was founded in 1974 by Hassan Ali Radhi, the senior partner of the firm, and has 48 years of legal experience and professionalism in the legal sector, especially in banking, finance and corporate law. The firm has a team of 16 lawyers, supported by a dedicated and professional administrative team that provides exceptional legal services, locally and internationally, in Arabic and English. As part of the Lex Mundi global network, HRA is the only member firm in Bahrain and can provide its clients with access to more than 21,000 lawyers around the world with in-depth experience in 100-plus countries worldwide, all from a single point of contact.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Persons choosing to conduct business in Bahrain may choose from a variety of business structures set out in the Commercial Companies Law (CCL) promulgated by Decree Law No (21) of 2001, which is amended periodically.

The most common types of business entities in Bahrain are limited liability companies, public joint stock companies and closed joint stock companies. All are entities in which the shareholders' liability towards creditors is limited to their shareholding in the capital (ie, limited liability).

Limited Liability Companies

Limited liability companies are companies with a minimum of one and a maximum of 50 partners who are responsible only to the extent of their shareholding in the capital. Partners may not resort to public subscription for raising shares or loan capital. This type of company is barred from undertaking insurance activities, banking or the investment of funds for the account of third parties (shareholders of this kind are referred to as "partners").

The company is not required to have a board of directors unless the number of partners exceeds ten.

Joint Stock Companies

Other types of company include:

- a closed joint stock company is established with a minimum of two shareholders and a minimum share capital of BHD250,000 (around USD661,205); the shares of the company may not be publicly offered; and
- a public joint stock company is established by a number of persons who subscribe to it via negotiable shares.

This last form is subject to a minimum share capital of BHD1 million (around USD2.6 million). The minimum number of shareholders is two, with the exception of companies formed by the government or in which the government is associated in the formation thereof.

General Partnerships/Simple Commandite Partnerships

Less regulated types of business entities are general partnerships companies and simple commandite partnerships:

- a general partnership company is owned by two or more persons whose liability is unlimited and who are jointly and severally liable to cover the company's debts and commitments. The company's name consists of the name of one or more of the partners with the addition of "and Co" to indicate the partnership; and
- a simple commandite partnership is one which is established by two types of partners, joint partners and sleeping partners.

Regarding a commandite partnership, joint partners are those who are involved in the management of the company and have unlimited liability towards creditors. Sleeping partners are not involved in the management of the company and are only liable for the obligations of the company to the extent of their shareholding in the capital.

Branches of Foreign Companies

Another form of business entity is a branch of a foreign company which must be guaranteed by the head office of the company. The activities of a business entity licensed as a "branch" shall

match the activities of the head office. Branches licensed as a representative office are limited to gathering financial, economic and commercial information, carrying out general promotional activities and providing general assistance of a non-specific nature to customers of its parent company.

Holding Companies

Holding companies are very common in Bahrain. They may be in the form of a public or private joint stock company, or a limited liability company. The role of holding companies is limited to the investment of funds, ownership of shares in its subsidiaries, management of its subsidiaries and the provision of financing or guarantees for its affiliates.

Commercial Companies

Commercial companies are mainly governed by the CCL and may be subject to other laws and regulations depending on the nature of their activity. Most importantly, companies licensed to provide regulated financial services by the Central Bank of Bahrain (CBB) are subject to the laws and regulations concerning the regulated services.

1.2 Sources of Corporate Governance Requirements

The main legislations related to corporate governance that must be observed by companies incorporated in Bahrain are as follows.

The CCL

The CCL is the law governing commercial companies, their types, formation and management. The CCL has been in force since 2001 and has subsequently been amended, with the latest amendment issued on 9 September 2021. It includes rules related to the segregation of powers and scope of powers of the board of directors and the shareholders, as well as accountability and cases of personal liability.

Rules relating to disclosure of interests by board members and avoidance of conflict of interest are included in the CCL.

The Corporate Governance Code

The Corporate Governance Code was issued by Decision No (19) of 2018 by the Minister of Industry and Commerce pursuant to Article 358 bis of the CCL. This code provides the minimum required standards for corporate governance and applies to all joint stock companies incorporated in Bahrain, with the exception of companies carrying out regulated financial services and licensed by the Central Bank of Bahrain, which are subject to a designated corporate governance code.

This code includes 11 main corporate governance principles as follows:

- the board shall be effective, qualified and have the required expertise;
- the directors and executive management shall have full loyalty to the company;
- there must be rigorous controls for financial audit and reporting, internal control and compliance with the law;
- the requirement for effective procedures for appointment, training and evaluation of the directors;
- fair and responsible remuneration for directors and senior officers;
- the requirement of a clear and efficient management structure with defined job titles, powers, roles and responsibilities;
- shareholder involvement by encouraging communication, participation;
- disclosure of companies' corporate governance;

- for companies with offer Islamic services, adherence to the principles of Shari'a;
- integrity of the financial statements and the importance of external auditors as a responsibility of the board; and
- social responsibility.

Boards of joint stock companies, closed and public, are required to form a corporate governance committee to appoint a corporate governance officer to ensure compliance with the corporate governance rules and submit a corporate governance report annually to the Ministry of Industry and Commerce, setting out each principle and the measures taken to comply therewith, with a special section for related-party transactions.

The principles of the Corporate Governance Code are advised to be observed by all types of companies, including limited liability companies. The reporting requirements, however, are enforced on closed and public joint stock companies.

The Rulebook of the CBB

The Corporate Governance Code is embedded in the High-Level Control Module of the Rulebook of the CBB applicable to each category of CBB licensee. This is issued by the CBB and the compliance therewith is supervised by the CBB.

This code includes the first nine principles of the Corporate Governance Code listed above.

Constitutional Documents

The memorandum and articles of association of a company (the "Constitutional Documents"), produced by the company's shareholders, which provide company-specific rules that include the authority of the board, the extent of its powers, its duties, and remuneration.

Rules, Regulations and Circulars

The rules, regulations and circulars by the CBB and the Bahrain Bourse (the company taking over the powers of the Bahrain Stock Exchange) applicable to listed companies (all public companies and some listed closed companies) as detailed in **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Within the CCL, the provisions for each type of company are included in a separate chapter. The chapter relating to the management of public joint stock companies includes the most and more stringent rules. For example, the rules relating to the board of directors require a minimum of five directors that must include independent and non-executive directors, director appointment and election rules, the requirement to have an audit committee within the board, and the limitation on director remuneration in the years when no dividends are to be paid to the shareholders.

The rules under the CCL are mandatory.

The Corporate Governance Code applies to all types of companies, with an emphasis on the importance of compliance especially by joint stock companies due to the role they play in the national economy. Compliance with the principles of the Corporate Governance Code is on a comply-or-explain basis and the standard applied by the Ministry of Industry and Commerce for listed and public joint stock companies is higher than that applied to the other forms of companies.

In addition to the CCL and Corporate Governance Code, additional rules by the CBB and the Bahrain Bourse are put in place for listed companies, of which the following include provisions related to corporate governance.

The Bahrain Bourse Listing Rules

These Listing Rules have been approved in Board of Directors Meeting (4/2019) of Bahrain Bourse dated 8 October 2019.

The purpose of these Listing Rules is to set out the requirements that must be complied with by all applicants, issuers, their directors, officers, advisers or other persons to whom these Listing Rules are directed. The Listing Rules comprise of both requirements which have to be met before securities may be listed and also continuing obligations that an issuer must comply with after listing.

The principles on which these Listing Rules are based include the following:

- issuers shall have acceptable standards of quality, operations, management experience and expertise;
- investors and their professional advisers shall be kept fully informed by the issuer of all facts and information that might affect their existing or potential interests in the Issuer; in particular, full, accurate and timely disclosure shall be made of any information which may reasonably be expected to have a material effect on the price, value or market activity in the securities of issuers;
- all holders of any Class of Securities will be treated fairly and equitably;
- directors, officers and advisers of issuers will maintain the highest standards of integrity, accountability, corporate governance and responsibility; and
- directors of an issuer shall act in the interests of shareholders as a whole.

The Disclosure Standards by the Bahrain Bourse

Disclosure Standards were issued by Bahrain Monetary Agency (now known as the Central Bank of Bahrain) pursuant to its circular dated 3 December 2003. Except for the First Chapter, which is superseded by the Offering of Securities Module under Rulebook 6, the Disclosure Standards still apply to listings, public offerings and sales of securities in Bahrain. The Disclosure Standards contain, inter alia, guidelines for trading by directors and senior management and policy on immediate public disclosure of material information regarding an issuer's affairs, or about events or conditions in the market that will affect the issuer's securities, relating to the business that would significantly affect the market price or value of any of the issuer's securities, or that would reasonably be expected to have a major influence on any investor's decisions.

The Offering of Securities Module Issued by the CBB

This Module contains the CBB's Directive (as amended from time to time) relating to the issuing and offering of securities. The directive in this Module is applicable to all market participants and relevant persons, including but not limited to issuers of securities or any person acting on their behalf, listed companies, any person acting for or on behalf of listed companies, shareholders of listed companies.

This Module describes, among other things, the eligibility criteria for issuing securities and the application procedures for obtaining the regulator's approval. Most importantly it explains the requirement for companies to prepare a prospectus or offering circular when they offer their

securities to the public or on private placement basis. The directors of the company must accept responsibility for the accuracy of the content of such prospectus or offering circular.

The Takeovers, Mergers and Acquisitions Module by the CBB

This Module applies to persons involved in, engaging in or intending to engage in an offer for, takeover or merger or acquisition of a controlling interest (30% or more) in a company whose primary listing of its ordinary equity securities is on a licensed exchange in Bahrain. Each director of an offeror and of the offeree company, as well as those acting in concert and their professional advisers, has a responsibility to ensure, so far as they are reasonably able, that the requirements of this Module are complied with in the conduct of transactions which are the subject of this Module.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The market is closely monitored by the Ministry of Industry and Commerce, the Bahrain Bourse, and the CBB through the various directorates under its umbrella. As a result of close monitoring, regulations, circulars and directives are issued on a regular basis with focus on transparency, efficiency, clear communication, fairness, accountability and anti-money laundering.

2.2 Environmental, Social and Governance (ESG) Considerations

Companies with activities that are environment-related are subject to the rules and regulations governing this sector and are required to adhere to the laws on Environment and Public Health as well as the regulations and standards of the Supreme Council for Environment. Ensuring compliance with the law is good governance and is the responsibility of the company and its board of directors.

Social responsibility is one of the principles of corporate governance detailed in **1.2 Sources of Corporate Governance Requirements**. Companies are considered to have social responsibility and the board of directors is expected to have a code in place which sets out the requirements of social responsibility of the company. A report on activities undertaken in this respect shall be included in the company's annual report.

Generally, companies make voluntary contributions to the environment as part of their social responsibility.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The management of the company is the role of:

- the board of directors in joint stock companies, including the committees formed within the board;
- the board of managers in limited liability companies;
- the general meeting of the shareholders (ordinary and extraordinary as detailed in **5.3 Shareholder Meetings**).

The powers of the board of managers in limited liability companies pursuant to the CCL are determined by the company's Constitutional Documents.

The board of directors of joint stock companies has the power to run the management of the company subject to certain restrictions that

specifically require the approval of the general meeting of the shareholders as detailed in **3.2 Decisions Made by Particular Bodies**.

Boards of joint stock companies are required to form an audit committee from amongst the members of the board. The audit committee shall have the mandate of reviewing the audit, accounting and financial practices of the company, and the extent of compliance with the provisions of the law and the Constitutional Documents. To fulfil its mandate, the audit committee shall be able to access all company's records, documents and information, and shall submit a report of its work in the annual report to the shareholders.

The Corporate Governance

The Corporate Governance Code requires the companies subject to its provisions to set up audit, remuneration, nomination and corporate governance committees from amongst the board members as required by the Code, and allows the board to decide on setting up additional specialised committees as required by the activities of the company:

- the audit committee is in charge of reviewing the company's audit, financial and accounting procedures, and ensuring compliance with the law and the company's Constitutional Documents;
- the remuneration committee is in charge of reviewing and setting the basis for remunerating directors and senior managers;
- the nomination committee is in charge of making nominations and recommendations for directorship and senior management positions in the company. It is also in charge of reviewing the independence criteria and status of directors on an ongoing basis – this committee may be merged with the remuneration committee and usually is; and
- the corporate governance committee is in charge of reviewing the company's corporate governance policy and making recommendations to ensure compliance – this committee may be merged with the nomination and remuneration committee.

3.2 Decisions Made by Particular Bodies

The board of directors of a joint stock company has the authority, by law, to do all actions necessary for the management of the company in accordance with its objectives, except as restricted by law, the Constitutional Documents or general meeting resolutions.

The CBB Rulebook provides more detailed guidance on the role of the board, but this guidance can apply to all companies. This role includes setting the overall business strategy of the company, ensuring that financial statements are prepared in a manner that accurately reflects the company's financial position, monitoring management performance, convening and preparing the agenda for shareholder meetings, monitoring conflicts of interest and preventing abusive related party transactions and assuring equitable treatment of all shareholders, including minority shareholders.

Unless allowed by a company's Constitutional Documents, the board shall not have the power to issue securities, conclude loans for more than three years, sell the company's assets or business, mortgage such assets, provide guarantees for third parties, discharge the company's debtors from their liabilities, reach a settlement in respect thereof or donate the company's assets without approval of the general meeting of the shareholders unless such actions fall within the essence of the company's objectives.

The shareholders participate in the management of the company through general meetings. There are two types of general meetings, each with a defined scope of powers, as detailed in **5.3 Shareholder Meetings**.

3.3 Decision-Making Processes

The Shareholders

The shareholders are required to hold one ordinary general meeting within three months from the end of the fiscal year, and an extraordinary general meeting whenever required. The details of the process of each type of meeting are found in **5.3 Shareholder Meetings**.

The Board

In Joint Stock Companies:

- a board is required to meet at least four times a year, by invitation from the chairman of the board (the "chairman") or at least two directors; the board issues resolutions for the management of the company;
- the quorum for the meeting is half the number of directors, subject to a minimum of three, unless a higher amount is required in the Constitutional Documents;
- there shall be no attendance by proxy unless allowed by the Constitutional Documents. Decisions are issued by a majority vote of the directors in attendance. In case of a tie, the chairman shall have the casting vote;
- any director who objects to a decision must minute their objection. If a case is lodged against the board on the basis of a decision with negative outcome, the minutes will serve to absolve the objecting director of liability;
- meetings of the board may be attended by video or teleconference if the Constitutional Documents allow; and
- decisions may be issued by circulation if the Constitutional Documents of the company allow for the same.

Regarding the third bullet point, only a director or representative of a corporate shareholder may hold the proxy for a board meeting. A maximum of two directors may attend by proxy, and at least half the directors must attend in person, including the chairman, for the meeting to be valid, subject to a minimum of two in closed companies and three in public companies.

4. Directors and Officers

4.1 Board Structure

With Limited Liability

May be managed by the partners or a manager or board of managers appointed by the partners.

A board of managers is not required unless the number of partners exceeds ten. The formation of the board of managers and its powers shall be set out in the Constitutional Documents.

Closed Joint Stock

Managed by a board of directors of a minimum of three directors and a maximum of 15 directors, with a maximum term of three years, renewable by the general assembly.

The boards of closed joint stock companies that are listed in the Bahrain Bourse must include independent and non-executive directors. The Minister of Industry and Commerce and CBB may issue decisions to include more categories of closed joint stock companies to which this requirement is to apply.

Public Joint Stock

Managed by a board of a minimum of five directors and a maximum of 15 directors, with a maximum term of three years, renewable by the general assembly. The board must include independent and non-executive members.

The board of directors of joint stock companies must choose a chairman and vice-chairman from its members by way of secret ballot. The Ministry must be informed of the decision.

For CBB licensees, the chairman is required to be an independent member and must be approved by the CBB for that position.

The board of directors of public companies and some closed companies must form committees from amongst its members as set out in **3.1 Bodies or Functions Involved in Governance and Management** and **6.2 Disclosure of Corporate Governance Arrangements**.

Companies licensed by the CBB are subject to the independence requirements set out in the applicable Rulebook volume for their type of licence.

4.2 Roles of Board Members

The Chairman

The chairman is considered the head of the company. The chairman represents the company before third parties and their signature solely shall bind the company in its relationship with third parties, unless the Constitutional Documents require the chairman to have joint signature authority with one director or more. The chairman must ensure that the decisions of the board are executed.

The Vice Chairman

The vice-chairman shall take the role of the chairman in their absence.

The Directors

Jointly, the directors must fulfil the role of the board in the management of the company. Severally, each director must ensure that they work in the best interest of the company and make the decisions and actions required to serve that interest.

In addition to the committees within the board, the roles are set out in **3.1 Bodies or Functions Involved in Governance and Management**.

4.3 Board Composition Requirements/Recommendations

The composition of the board of directors is as set out in **4.1 Board Structure**.

The board of joint stock companies must include independent and non-executive directors, and may also include non-independent and executive directors as detailed in **4.5 Rules/Requirements Concerning Independence of Directors**.

In the case of CBB licensees, half of the board of directors, including the chairman, are required to be independent.

4.4 Appointment and Removal of Directors/Officers

Directors are nominated by appointment or election by the general meeting of the shareholders. The general meeting of the shareholders is the authority with director removal powers.

Pursuant to the CCL, any shareholder owning at least 10% of the capital of the company has the right to appoint a director, subject to the size of the board and the requirements of director-

ship and approval requirements in case of CBB licensees.

Shareholders not eligible to appoint or those who do not choose to appoint a director may use their percentage to elect directors by cumulative voting.

4.5 Rules/Requirements Concerning Independence of Directors

Independent directors are those that are deemed by the board to be independent of any specific shareholder and who do not have any significant business interest with the company.

Non-independent directors are those who represent a shareholder or those who have a business interest with the company.

A director is considered non-independent if they:

- hold 10% or more of the shares of the company, the parent company, or any of its subsidiaries or associates;
- represent a legal person who holds 10% or more of the shares of the company, parent, or any of its subsidiaries or associates;
- served in an executive position in the company, its parent, or any of its subsidiaries or associates, in the two years preceding their nomination;
- are a first-degree relative of an existing director or any person in a key executive management position in the company, its parent or any of its subsidiaries or associates;
- are a director of the company's parent or any of its subsidiaries or associates;
- were employed by any of the company's contracting parties such as external auditors, major suppliers, etc, in the two years preceding their nomination;
- were employed by the parent company of any of its subsidiaries or associates in the two years preceding their nomination;
- have made or received payment from the company in the value of over BHD50,000 (around USD132,212), apart from directors' remuneration if they are an existing director in the past year;
- are a relative of a partner in the company's external auditor or an employee thereof, or has been in the past two years; or
- are an employee or partner at a company that provides consulting services to the company, its parent, or any of its subsidiaries and associates (this does not apply if the parent company is owned at least 75% by the government or is a government entity).

Executive directors are those who hold senior management positions within the company. Executive directors are not considered independent.

Non-executive directors are those who are not involved in the day-to-day management of the company or a controller of a company, subsidiary or affiliate thereof.

4.6 Legal Duties of Directors/Officers

The legal duties of directors of a company may be summarised as follows:

- to participate in the management of the company in a diligent, skilful, and efficient manner in accordance with the law and the Constitutional Documents;
- to serve the company as a representative of the interests of all the shareholders, and not one or a specific group of shareholders; and
- to disclose any personal interest they may have in any of the issues discussed in board

or general meetings and to refrain from voting in respect of any of these issues.

4.7 Responsibility/Accountability of Directors

Once a director is on the board, they owe a duty towards all the shareholders, and the interests of all the shareholders must be considered.

However, any stakeholder affected by any decision of the board or a director has the right to lodge a claim at court in accordance with Article 185 and 18 bis of the CCL (detailed in **5.4 Shareholder Claims**).

4.8 Consequences and Enforcement of Breach of Directors' Duties

The consequence of a breach of directors' duties includes dismissal from office, and possibly a claim at court in accordance with Article 18 bis of the CCL as detailed in **5.4 Shareholder Claims**.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Directors, officers and even shareholders may be held personally liable without limitation if any of the breaches listed under Article 185 and Article 18 bis of the CCL (see **5.4 Shareholder Claims**) are proven.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The Constitutional Documents of a company may set out the procedure and requirements for determining the remuneration of the directors, subject to a maximum remuneration of 10% of the net profit after deducting legal reserves and distributing dividends not less than 5% of the company's paid-up capital.

In the years where no dividends are paid to the shareholders, the company is prohibited to pay remuneration to the directors, unless the specific approval of the Minister of Industry and Commerce for such payment is obtained. In case of CBB licensees, the CBB must approve the payment and value of remuneration to the directors.

A detailed report on all payments made to the directors and executive management in a fiscal year must be prepared by the board and submitted to the shareholders. This must detail any and all payments, including salaries, sitting fees, representation fees, allowances, etc. Failure to submit the report subjects the directors to liability that may include personal liability for failure to comply with the law.

4.11 Disclosure of Payments to Directors/Officers

Information on the remuneration, fees or benefits payable to each of the directors and officers is required to be submitted to the general meeting of the company's shareholders.

Public disclosure of such information is only required in case of offering of securities pursuant to the CBB's Offering of Securities Module.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The constitutional documents of a company (Memorandum and Articles of Association) bridge the relationship between the shareholders and the company. The constitutional documents of the company (which is drafted within the frameworks of the Commercial Companies Law) describes the rights and obligations of the shareholders towards the company.

The inherent rights and obligations of the shareholders include the following:

Rights

- receiving profit or dividends decided for the shareholders;
- receiving a share of the company's total property upon liquidation;
- participating in the company's management, whether through the general assemblies and as a member of the board of directors, according to the company's constitutional documents;
- obtaining a printed booklet comprising the company's balance sheet for the past fiscal year, the profit and loss account and the reports of the board of directors and the auditor; and
- filing lawsuits to nullify any decision issued by the general meeting or by the board of directors in violation of the law, the public order or the constitutional documents of the company.

Obligations

- Payment of accrued instalments and delay interests following the expiration of the date thereof without the need for serving a notice upon them;
- payment of expenses incurred by the company in collecting unpaid instalments and sale of shares;
- refraining from any action intended to cause harm to the company; and
- execution of any decision legally passed by the general meeting.

5.2 Role of Shareholders in Company Management

The general meeting of the shareholders is the ultimate decision-making authority in the company.

The company's Constitutional Documents specify the extent of the board of directors' powers in the company. Some decisions require the approval of the general assembly, such as the decisions set out in **3.2 Decisions Made by Particular Bodies**.

The involvement of shareholders in the company's management and participation in controlling the activities of the directors is through their participation in the general meetings and the decisions made therein.

5.3 Shareholder Meetings

There are two types of general meetings of the shareholders of a company, an Ordinary General Meeting, and an Extraordinary General Meeting, each with different scope of powers. To ensure that all shareholders are allowed the same opportunity to participate in the general meetings, there are specific provisions regarding the invitation to the meetings.

Ordinary General Meeting

The Ordinary General Meeting of shareholders convenes at the invitation of the chairman of the board of directors at the time and venue specified in the company's constitutional documents. The meeting must convene at least once per year during the three-month period following the end of the company's fiscal or financial year. The invitation to convene the Ordinary General Meeting of shareholders is required to be published in at least two daily Arabic newspapers and one of them at least to be local.

The minimum notice period is 21 days and the notice of the meeting must include the agenda of the meeting. Copies of the invitation documents must also be forwarded to the Ministry of Industry and Commerce at least ten days before the Ordinary General Meeting. The Ordinary General

Meeting is presided over by the chairman of the board of directors or their deputy or whoever is delegated by the board of directors or by the Ordinary General Meeting.

Validity

The Ordinary General Meeting shall not be valid unless it is attended by a number of shareholders who have the right to vote and representing more than half the capital of the company. If this quorum is not attained, an invitation is required to be sent for a second meeting to be held for the same agenda within seven to 15 days from the date fixed for the first meeting.

Second and third meetings

The second meeting shall not be valid unless it is attended by a number of shareholders who have the right to vote and representing more than at least 30% of the capital of the company.

The third meeting shall be valid regardless of the number of shareholders present. Each shareholder, regardless of the number of their shares in the company, shall have the right to attend the Ordinary General Meeting, and shall have a number of votes equal to the number of their shares. Any provision or decision to the contrary shall be deemed null and void.

Delegates and representatives

Any shareholder may delegate a person, from among the shareholders or third parties to attend the Ordinary General Meeting on their behalf, provided that this person is not the chairman of the board or a board member or an employee of the company. However, this shall not prejudice the right to delegate a first-degree relative by virtue of a written special power of attorney, to be prepared by the company for this purpose.

Members lacking capacity or incapacitated (for instance minor or person with unsound mind) shall be represented in the meeting by their legal representatives.

Extraordinary General Meeting

The Extraordinary General Meeting convenes at the invitation of the board of directors or by virtue of a written request addressed to the board of directors by a number of shareholders representing at least 10% of the company's capital.

Validity

The Extraordinary General Meeting shall not be valid unless attended by shareholders representing at least two thirds of the company's capital. If this quorum is not present, a second meeting shall be invited within 15 days following the first meeting. The second meeting shall be valid if attended by shareholders representing more than one-third of the capital.

If such quorum is not available at the second meeting, a third meeting shall be convened within 15 days from the date of the second meeting. The third meeting shall be valid if attended by a quarter of the shareholders. A new invitation is not required to be sent for the last two meetings if their dates have been specified in the invitation to the first meeting, provided that publication is made in at least two daily Arabic newspapers – one of them must be local – to the effect that none of these meetings has occurred.

Decisions

The decision of the Extraordinary General Meeting shall be passed by a two-thirds majority of the shares represented at the meeting, unless the decision relates to the increase or decrease of the company's capital, the extension of the company's term, dissolution, conversion or merging thereof with another company, in

which case it shall not be valid unless passed by a three-fourths majority of the shares present at the meeting and with whose attendance the meeting is considered valid. The Extraordinary General Meeting's decisions shall become effective upon the approval of the Ministry of Industry and Commerce.

Other

In addition to the above, the founders shall invite the constituent assembly to convene within a period no later than 21 days from the date of the closing of the subscription (in case of public joint stock company) and seven days from the date of the incorporation approval by the Ministry of Industry and Commerce (in case of closed joint stock company).

The invitation to convene the constituent assembly of shareholders shall be published in at least two daily Arabic newspapers – one of them at least to be local. The minimum notice period is 21 days and the notice shall include the agenda of the meeting. Copies of the invitation documents shall be forwarded to the Ministry at least ten days before the meeting.

5.4 Shareholder Claims

The bases of claim that exist for shareholders against the company are as follows:

- a shareholder may lodge a claim seeking to nullify a decision by the general meeting if such decision is not issued in accordance with the law and the Constitutional Documents of the company;
- pursuant to Article 168 bis of the Commercial Companies Law a shareholder may lodge a claim against the company if its business is being conducted in a manner that unfairly causes damage to the shareholders or a group of shareholders, or if the company intends to take an action that causes damage to the shareholders or a group of shareholders; and
- pursuant to Article 18 bis of the Commercial Companies Law, a shareholder may lodge a claim against any officer, director or even another shareholder, on the basis of the following:
  - (a) providing incorrect information about the company's capital in any document likely to affect the company's financial standing;
  - (b) using the company for fraudulent or illegal purposes;
  - (c) using the company's assets as if they are their own;
  - (d) conflict of interest;
  - (e) making decisions or taking actions that encumber the company with obligations knowing that the company cannot fulfil, or if the company is unable to fulfil its obligations as a result of an officer, director, or shareholder's gross negligence or error;
  - (f) if their decisions and actions cause the company to be unable to pay taxes or official fees;
  - (g) violation of the provisions of the law or company's constitutional documents;
  - (h) the limitation of powers is not observed or duties are performed in a fraudulent or gross negligent manner; and
  - (i) failure to act as a prudent, reasonable person in a given circumstance.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Any person whose ownership, in a publicly traded company, alone, or their ownership together with that of their minor children, or any other accounts under their disposal, or the ownership of any of their associate or affiliate companies, amounts to 5% or more of any listed security of a joint stock company, must notify the licensed

exchange (Bahrain Bourse) forthwith, which shall in turn notify the CBB of this fact and the CBB may declare the name of the person who owns such stake.

All persons must obtain a CBB prior written approval to execute any order that will bring their ownership alone or their ownership together with their minor children, or the accounts standing under their disposal to 10% or more in any listed security. Any further increase of 1% or more shall also be subject to CBB prior written approval.

Companies are further required to disclose ultimate beneficial owner information to the Ministry of Industry and Commerce.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Limited liability companies, branches of foreign companies and joint stock companies are required to submit the audited financial statements of the company to the Ministry of Industry and Commerce.

Joint stock companies shall annually prepare a detailed list, approved by the chairman and the managing director, if any, of the names and capacity of the chairman and members of this board, and the managers of the company. The company shall keep a copy of this list and the original shall be sent to the Ministry of Industry and Commerce accompanied by the annual report prepared by the board of directors, the company's balance sheet and the profits and losses account.

Companies licensed by the CBB must submit the reports to the CBB in accordance with the Rulebook volume applicable to its type of licence.

6.2 Disclosure of Corporate Governance Arrangements

Joint stock companies are required to disclose its corporate governance, which may be achieved by fulfilling the following requirements:

- The board shall adopt written corporate governance guidelines covering the matters stated in the Corporate Governance Code and other corporate governance matters deemed appropriate by the board; such guidelines shall include or refer to the principles and instruction of the Corporate Governance Code.
- The company shall publish the guidelines and instruction mentioned in the preceding paragraph on its website, if any.
- At each annual shareholders' meeting, the board shall report on the company's governance according to the form prepared by the Ministry of Industry and Commerce and available on its website, which includes the topics listed in Appendix 5 to the Corporate Governance Code, explaining the extent of its compliance with the guidelines and instruction of the Corporate Governance Code, and explaining the reasons for non-compliance, if any.
- The board shall establish a corporate governance committee of at least three independent directors.
- The company shall appoint an employee as the company's corporate governance officer. They shall undertake the tasks of verifying the company's compliance with the corporate governance rules, laws, regulations and decisions issued to implement them. They shall co-ordinate with the corporate governance committee in relation to all corporate govern-

ance matters, follow up and co-ordinate with the concerned department on the corporate governance matters.

6.3 Companies Registry Filings

Joint stock companies are required annually to prepare a detailed list approved by the chairman and the managing director, if any, of the names and capacity of the chairman and members of this board, and the managers of the company. The company shall keep a copy of this list and the original shall be sent to the Ministry of Industry and Commerce accompanied by the annual report prepared by the board of directors, the company's balance sheet and the profits and losses account.

The board of directors of public shareholding company is required to publish the balance sheet, the profit and loss account and an executive summary of the annual report and the full text of the auditor's report in a local daily newspaper published in Arabic, at least 15 days before the general meeting. Failure to publish the same gives rise to liability that may extend to personal liability, and will render the invitation invalid, and the general meeting voidable.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The board of joint stock company is required to ensure the integrity of the financial statements submitted to shareholders through appointment of external auditors.

The general assembly meeting of joint stock companies shall appoint one or more auditors for the company and determine their fees upon the proposal of the board of directors. The auditor shall, among others, monitor the company's business, give opinion on the validity of the company's financial statements and request to adjust them if there is any impact on their validity, verify the company's ownership of assets and legality of obligations. Most importantly, the auditor attends the general assembly meetings, reads their report to the shareholders and answers their questions and queries regarding the financial statements for the year end.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The board of joint stock company shall have rigorous controls for financial audit and reporting, internal control, and compliance with law. This is achieved through establishment of an audit committee and development of a whistle-blowing programme.

The board of directors shall form an audit committee consisting of at least three directors, the majority of whom shall be independent, and the chairman of the committee shall be an independent director.

The board of directors shall establish a whistleblowing programme that will allow the company's employees to report internally their concerns about any improper or suspicious practices in financial reports, internal control systems or any other matters, and make appropriate arrangements for an independent and fair investigation of such practices, while ensuring the confidentiality of such reporting in order to protect them against any adverse reaction or damage that may result from the reporting of such practices.

BRAZIL

Law and Practice

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Contents

1. Introductory p.33
1.1 Forms of Corporate/Business Organisations p.33
1.2 Sources of Corporate Governance Requirements p.34
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.34

2. Corporate Governance Context p.35
2.1 Hot Topics in Corporate Governance p.35
2.2 Environmental, Social and Governance (ESG) Considerations p.35

3. Management of the Company p.36
3.1 Bodies or Functions Involved in Governance and Management p.36
3.2 Decisions Made by Particular Bodies p.38
3.3 Decision-Making Processes p.39

4. Directors and Officers p.39
4.1 Board Structure p.39
4.2 Roles of Board Members p.39
4.3 Board Composition Requirements/Recommendations p.40
4.4 Appointment and Removal of Directors/Officers p.40
4.5 Rules/Requirements Concerning Independence of Directors p.41
4.6 Legal Duties of Directors/Officers p.42
4.7 Responsibility/Accountability of Directors p.43
4.8 Consequences and Enforcement of Breach of Directors' Duties p.43
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.43
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.44
4.11 Disclosure of Payments to Directors/Officers p.44

5. Shareholders p.44
5.1 Relationship Between Companies and Shareholders p.44
5.2 Role of Shareholders in Company Management p.45
5.3 Shareholder Meetings p.45
5.4 Shareholder Claims p.47
5.5 Disclosure by Shareholders in Publicly Traded Companies p.48

6. Corporate Reporting and Other Disclosures p.48
6.1 Financial Reporting p.48
6.2 Disclosure of Corporate Governance Arrangements p.49
6.3 Companies Registry Filings p.49

7. Audit, Risk and Internal Controls p.49
7.1 Appointment of External Auditors p.49
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.50

Mello Torres is a full-service firm, with offices in São Paulo and Rio de Janeiro, that brings together the expertise of renowned professionals with in-depth experience in the corporate and financial markets and the enthusiasm of young lawyers with solid academic backgrounds. Within its corporate governance team and other related practice areas, such as M&A, it employs highly qualified experts, most of whom hold international experience acquired from postgraduate courses in well-known foreign universities or working as international associates at large law firms of major financial centres around the world. The firm applies optimum strategies to assist clients on corporate governance matters, to structure and negotiate mergers, acquisitions, joint ventures, private equity investments and other sophisticated transactions, both in Brazil and abroad. In these often-complex procedures, the firm focuses on what is important to its clients.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Business organisations may take various forms in Brazil, including sole proprietorships *micro-empreendedor individualsociedade empresária limitada unipessoal*, co-operatives, limited liability companies *sociedades limitadas*, and joint stock companies *sociedades por ações*. As the subject of this book is corporate governance, this chapter will focus on limited liability companies and joint stock companies, which are the most common forms of business organisations.

The central characteristics of both limited liability companies and joint stock companies are as follows.

- Limitation of liability - the shareholders/quotaholders are not personally liable for corporate obligations, unless the requirements for lifting the corporate veil are met.
- Continuity of existence - such business organisations have perpetual existence, unless a shorter term is specified in their organisational documents.

A limited liability company is a legal entity regulated by the Brazilian Civil Code and is formed by the filing of its articles of association *contrato social* with the appropriate commercial or civil registry. Its capital structure consists of equity participations called “quotas”, and equity holders are called “quotaholders”. A limited liability company may have one or more quotaholders, which may be either individuals or entities, resident or non-resident (non-resident quotaholders must be represented by an individual resident in Brazil). The corporate governance of limited liability companies generally involves only two bodies: the quotaholders and the officers, provided that most limited liability companies do not have a board of directors. Due to super majority rules set forth by statutory law, control of a limited liability company requires 75% of the voting power. Small, medium and large companies may use the limited liability company corporate form with a few variations in its corporate governance.

A joint stock company is a legal entity regulated by Law No 6,404 of 15 December 1976, as amended (the “Brazilian Corporations Law”). The capital structure of a joint stock company is divided into shares, which may be of different classes or types (common or preferred shares). A joint stock company is generally incorporated by two or more shareholders subscribing its capital stock and approving its bylaws, but may also be incorporated by a single shareholder, as a wholly owned subsidiary, as long as the shareholder is a Brazilian legal entity. In 2021, the Brazilian Corporations Law was amended and introduced super-voting shares with up to ten votes per common share, whereas, as a rule, a common share has one vote at shareholders’ meetings.

A joint stock company may be a closely held or a publicly traded company, depending on whether its securities have the authorisation of the Brazilian Securities and Exchange Commission *Comissão de Valores Mobiliários* or CVM) to be traded on the stock exchange or on the over-the-counter market.

There are two important differences between limited liability companies and joint stock companies, as set out below.

- Transferability of ownership/equity interests - as a rule, ownership interest in limited liability companies cannot be transferred without the

consent of all the partners. However, equity interests in joint stock companies are freely transferrable, unless otherwise agreed.
- Withdrawal rights - quotaholders have the right to withdrawal from a limited liability company by serving a notice on the other partners, regardless of any cause. Shareholders of a joint stock company do not have such right.

1.2 Sources of Corporate Governance Requirements

The principal sources of corporate governance requirements in Brazil are:

- the Brazilian Civil Code, which contains a specific section for limited liability companies;
- the Brazilian Corporations Law, which applies to publicly traded joint stock companies, closely held joint stock companies and limited liability companies that expressly elect to be governed by such law;
- the company's organisational documents – the bylaws (for joint stock companies) or articles of association (for limited liability companies) and shareholders agreement (if any);
- rules, regulations and guidance set out by the CVM in relation to publicly traded joint stock companies;
- the Brazilian Corporate Governance Code coordinated by the Brazilian Institute for Corporate Governance (IBGC); and
- rules, regulations and guidance enacted by the São Paulo stock exchange (B3 S.A. – Brasil, Bolsa, Balcão, or B3), with varying degrees of applicability depending on the chosen listing segment.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Public companies are required to comply with several mandatory reporting and other requirements, which may vary pursuant to the B3 listing segment its securities are listed under. Apart from the specific requirements under each listing segment, public companies are obliged to:

- submit and disclose audited financial statements on a quarterly and annual basis to the CVM, prepared in accordance with the applicable regulation, consistent with Brazilian GAAP and IFRS accounting principles;
- have a board of directors, provided that they have independent directors and CEO (the positions of chairperson of the board and CEO of publicly traded companies cannot be held by the same person);
- provide for a statutory tag-along right, in which, in the event of a change in control of a publicly traded company, the new controlling shareholder must carry out a tender offer to the minority shareholders, extending 80% or 100% (pursuant to the listing segment joined by the company) of the price paid for the shares belonging to the controlling block;
- prepare, update and submit to the CMV the *formulário de referência*("reference form") annually, within five months of the end of the fiscal year, and keep its most relevant information updated – the reference form discloses to the market detailed information on issuer's activities, risk factors, capital structure, financial data and management (among other things);
- submit to the CVM, on an annual basis, an *Informe sobre o Código Brasileiro de Governança Corporativa* ("Corporate Governance Code Report") detailing which recommendations set out in the Code were adopted and, if

any of the recommended practices were not adopted, the companies must explain why (the "comply or explain approach");
- disclose certain information on an ordinary basis and prior to each shareholders' meeting;
- timely disclose material information and restrictions on trading based on private information; and
- have at least 20% independent members on the board of directors.

As mentioned above, the B3 provides for differentiated listing segments with rules setting out corporate governance practices and transparency requirements in addition to those already established under Brazilian Corporate Law. The main difference between such segments are the required governance practices.

The *Novo Mercado* ("New Market") has the highest level of corporate governance requirements, in particular:

- the company's corporate capital must be represented only by common shares;
- the company must maintain a minimum "free float", which may vary between 15% and 20% of the company's total capital, depending on the average trading volume of the company's shares or public offerings;
- a company's board of directors (board) must comprise at least five members, with a unified term of office of two years, and at least 20% of the total board members or two (whichever number is higher) must be independent;
- a company must prepare an annual agenda of its corporate events (such as ordinary corporate meetings, disclosure of the results or public meetings with market analysts and investors);
- in the event of a company's delisting or cancellation of registration as a publicly traded company, the company, or its controlling shareholder(s), as the case may be, must carry out a tender offer for the acquisition of the company's shares using the economic value criteria;
- any dispute involving the company must be settled by arbitration by a specific arbitration chamber;
- a company must prepare a trading policy regarding its securities, which must be applicable, at least, to the company itself, the controlling shareholder(s), company's officers, members of the board, members of the fiscal council (if established) and members of any statutory bodies with technical or advisory functions;
- mandatory establishment of a statutory or non-statutory audit committee; and
- mandatory implementation of a statutory public offering in the case of an acquisition of relevant stake in the company.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The ESG movement is key to Brazilian companies, especially because clients and customers increasingly want to be linked to companies that generate sustainable awareness with concrete actions.

2.2 Environmental, Social and Governance (ESG) Considerations

Publicly traded companies should prepare, update and submit a reference form annually, within five months of the end of the fiscal year, and keep its most relevant information updated. All publicly traded companies registered under category "A" (issuers authorised to list shares,

share depositary receipts or securities which entitle the holder to acquire shares or depositary receipts under the securities market) are required to disclose the following information related to ESG practices in their reference forms.

- Activities of the issuer: the company should state whether it discloses information in an annual or corresponding report, the methodologies used in preparing the report, whether it is audited by an independent entity, whether it considers any materiality matrix and ESG performance indicators, as well as how the UN Sustainable Development Goals (SDGs) are accounted for, whether the company observes the recommendations of recognised entities and related to climate issues, and finally provide information on whether the company carries out inventories of greenhouse gas emissions.
- Management comments: the company should disclose information on which initiatives are included on the company's business plan in relation to ESG policies.
- Risk factors: the company should provide information regarding any ESG issue that could impact investors decisions to buy or sell its securities issued.
- General meeting and management: the company should provide information about the composition of its management and audit committee, including the total number of members grouped by the self-declared identity of (i) gender; (ii) colour or race; or (iii) diversity attributes that it deems relevant. In addition, the company should specify its objectives in relation to diversity. In addition, the company should state the role of management in assessing, managing and supervising climate-related risks and opportunities.
- Management compensation: the company should provide detailed information related to management compensation, including the board of directors, statutory and non-statutory officers and certain committees.
- Human resources: the company should set out the number of employees by groups, based on the activity, geographic location and diversity indicators, which, within each hierarchical level of the company, cover self-declared gender identity, the self-declared identity of colour or race and age group.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The governance of Brazilian limited liability companies and joint stock companies may be comprised by three major bodies: the quotaholders/shareholders, the board of directors, and the officers.

Provided that most Brazilian companies have concentrated ownership and do not have a board of directors, the quotaholders/shareholders have extensive legal power to appoint and elect the management and to approve key matters involving the company, such as:

- amendment of the bylaws;
- election of the joint stock company managers;
- preparation and approval of the business plan; and
- approval of mergers, acquisitions, spin-offs, liquidation, extinction, etc.

It also takes the managers' actions into account every year and analyses the financial statements. In general, it has the powers to decide upon any material matter of the joint stock company and it is highly recommended, for governance pur-

poses, that it convenes its shareholders to give their respective inputs on any material decision that the company must take.

The Brazilian Corporations Law considers a controlling shareholder the entity/person that can:

- make, permanently, most of the decisions in the general meeting;
- elect most of the joint stock company managers; and
- exercise its powers to conduct the joint stock company activities.

The controlling shareholder can be one or more shareholders and must abide to certain duties provided by law. The controlling shareholders have the duty to use their controlling power to make the company accomplish its corporate purpose and perform its social role, and have duties and responsibilities towards the other shareholders of the company, being responsible for any loss caused by abuse of power. If the company has a board of directors, the powers of the quotaholders/shareholders are generally significantly reduced, being the board of directors responsible to elect the officers and to define the corporate policies.

Brazilian law states that (i) every limited liability company should have at least one officer, and (ii) every joint stock company must have a board of officers with at least two members, whose main duty is to carry out the day-to-day management.

The bylaws of every joint stock company should provide for a fiscal council (*conselho fiscal*), whose main function is to analyse all acts taken by the managers of the company (it works as a fiscal for the minority shareholders). The fiscal council may be permanent or function only if there is demand by the joint stock company shareholders (at least 10% of owners of common stock or 5% of owners of preferred stock).

In addition to the foregoing, a Brazilian joint stock company may (or, in the case of certain regulated companies, must) create additional committees or corporate bodies, the objectives and powers of which should be set forth in the bylaws. A specific committee to assist the board of directors in respect of certain activities of the joint stock company would be an example. However, the power and authority ascribed by law to the general shareholders' meeting, the board of directors, the board of officers and the fiscal council may not be delegated to any other committee or body that the joint stock company mandatorily has or may, at its discretion, choose to constitute.

A limited liability company customarily has no body similar or equivalent to the board of directors of a joint stock company, and the managers generally carry out their functions with less formality than the directors of a joint stock company (but a board of directors can be stated). A limited liability company may have a fiscal council should the articles of organisation choose to provide one, in which case such a body may be permanently active or only activated with reference to a given fiscal year when so requested by shareholders. Like a joint stock company, a limited liability company may choose to create additional bodies or committees, specifying the powers and authority of those bodies or committees in the articles of organisation. That said, the limited liability company may not delegate any of the powers or authority granted by law regarding the management and the fiscal council of the company to a different body or committee.

3.2 Decisions Made by Particular Bodies

In those joint stock companies where a board of directors exists, the board of directors is responsible, among other things, for establishing the general policies of the joint stock company and the overall orientation of the company's businesses. Other than the authority specifically set forth in the bylaws (eg, the authorisation for the execution of certain agreements by the company), the Brazilian Corporations Law sets out the competence of the board of directors on specific matters (if the joint stock company, in fact, has a board of directors), including:

- the election and removal of the officers;
- the oversight of the management of the company;
- calling the general shareholders' meeting;
- opining on management's annual report and management's accounts; and
- the election and removal of independent auditors, if applicable.

The managers (in a limited liability company) and the officers (in a joint stock company) are responsible for the day-to-day management, carrying out the objectives laid down by the board of directors. The managers or officers (as the case may be) have the power to bind and represent the company, including the authority to grant powers of attorney. Furthermore, the bylaws of a joint stock company may provide that certain decisions be made by the board of officers as a collegiate committee.

The fiscal council, in and of itself, has no authority to make decisions. Rather, the fiscal council oversees the other management bodies of the company and their acts, thus assisting the shareholders' meeting. The Brazilian Corporations Law provides for competence of the fiscal council on specific matters, including:

- the oversight of the acts carried out by directors and officers;
- the drafting of an annual opinion with respect to the businesses and operations of the company, based on its financial statements for the fiscal year in which the fiscal committee is operating;
- rendering an opinion on proposals made by directors and/or officers to the general shareholders' meeting relating to the modification of the capital stock, the issuance of debentures or warrants, investment plans or capital expenditure budgets, dividends distribution, and the transformation, merger or spin-off of the company;
- denouncing errors, frauds or crimes which are identified by the fiscal council;
- convening the annual general shareholders' meeting in the event the directors and officers fail to do so for a period greater than 30 days, and calling special general shareholders' meetings in the event of severe or urgent matters;
- analysing on a quarterly basis the periodic financial statements of the company;
- analysing and opining with respect to the annual financial statements of the joint stock company; and
- carrying out the same functions during the liquidation of the company.

In a limited liability company, the fiscal council is responsible for the following, without prejudice to other responsibilities set forth in the law and in the articles of organisation:

- the analysis, on a quarterly basis, of the constitutive and financial documents of the company;
- the registration in the relevant book of the opinions of the fiscal council (concerning

oversight of the acts carried out by directors and officers);
- the drafting of an annual opinion with respect to the businesses and operations of the company, based on the financial statements of the company for the fiscal year in which the fiscal council is operating;
- denouncing errors, frauds or crimes which are identified by the fiscal council;
- convening the annual shareholders' meeting, in the event the managers fail to do so for a period greater than 30 days; and
- carrying out the same functions during the liquidation of the company.

3.3 Decision-Making Processes

The board of directors and the fiscal council are collegiate bodies, making decisions as a group. Normally, both collegiate bodies have internal statutes that regulate the decision-making process. The managers (in a limited liability company) act individually and so, as a rule, do the officers (in a joint stock company). In the case of officers of a joint stock company, however, the bylaws may provide that certain decisions be made by the board of officers acting as a collegial body. Unless a higher quorum is required, decisions are made by most votes among those members present and voting at a given meeting.

4. Directors and Officers

4.1 Board Structure

The bylaws of the company must state the number (or an interval number) of members of the board of directors, all of whom are elected by the general shareholders' meeting. The number of members of the board of directors should be at least three and there is no maximum number. If the bylaws set forth a range of members of the board of directors, the shareholders' meeting shall decide on the exact number of members within the applicable range. The bylaws of a joint stock company must determine whether the chairperson of the board of directors is to be appointed by the general shareholders' meeting or by the board of directors itself. The bylaws may also provide that the board of directors have a deputy chairperson.

The bylaws should provide for the frequency of the ordinary meetings of the board of directors, without prejudice to extraordinary meetings according to the actual needs of the relevant joint stock company or its business. It is important that joint stock companies have an internal statute of the board of directors to regulate its functioning.

As mentioned in **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**, the B3 also has special requirements for the board of directors of publicly traded companies. The requirements vary depending on the listing segment that they trade within.

4.2 Roles of Board Members

As a collegial body, all members of the board of directors have the same role, ie, to take part in the meeting of the board of directors and to vote on the matters under consideration. The chairperson of the board of directors has additional administrative functions within the board, such as being responsible for calling the meetings of the board, presiding over these meetings, and generally representing the board before the other bodies of the joint stock company (but not before third parties). Additionally, depending on what the bylaws provide, the chairperson may or may not have the casting vote to decide on matters under deadlock. If provided by the bylaws, the deputy chairperson may replace the chairperson in the general event of absence. Other

than that, the deputy chairperson acts as an ordinary board member.

4.3 Board Composition Requirements/ Recommendations

The Brazilian Corporations Law states that the board should have a minimum of three members, but no maximum number is set by law. That said, the regulations in special listing segments of the B3 have different composition requirements.

The Brazilian Corporations Law sets out the legal requirements for a person to be appointed, elected and installed as a director. In summary, convictions for certain crimes (such as bankruptcy offences, bribery or corruption) and/or declaration of incapacity by the CVM would disqualify a person from holding a position in the board of directors. In addition, holding a management position in a competing entity and other conflicts of interest are also grounds for prohibiting a person from being elected a director, except in cases where a specific waiver is granted by the general shareholders' meeting.

Only natural persons may be members of a board of directors or officers. This rule emphasises the personal nature of the role of directors and officers, as well as their corresponding individual duties and responsibilities. Foreigners may be members of the board of directors and/or officers of Brazilian companies, provided they have a representative in Brazil with broad powers to be sued in the name of the respective board member or officer.

A maximum of a third of the members of the board of directors may be officers of the respective joint stock company. The bylaws of a joint stock company may provide for representatives of employees, chosen by the employees, to participate in meetings of the board of directors. Furthermore, the Brazilian Corporations Law prohibits, in publicly held companies, the accumulation of the position of chairperson of the board of directors and the position of chief executive officer or chief executive of the company.

The CVM regulations require that at least 20% of the total board members of publicly held companies are independent. Regulations of the B3 in respect of certain listing segments require publicly traded joint stock companies to have at least 20% independent members(but in no event fewer than two individuals) among the total number of members of the board.

Whenever the election of directors is carried out by the cumulative voting procedure and the holders of common shares or preferred shares exercise the right to appoint a member of the board, the shareholder, or shareholders bound by voting trust, holding more than 50% of voting shares have the right to appoint the same number of members appointed by all remaining shareholders, plus one member, regardless of the number of board members specified in the bylaws.

4.4 Appointment and Removal of Directors/Officers

The election of directors, if the joint stock company has a board of directors, and officers, if the joint stock company does not have a board of directors, is typically a matter for the annual general shareholders' meeting. However, as a rule, the election of a member of management may take place in any general shareholders' meeting. The CVM regulations require a series of preparatory acts in the case of publicly traded joint stock companies for a person to be elected as a director in any given general shareholders' meeting.

The removal of members of the management (that is, of a director, if the joint stock company has a board of directors, or an officer, if the joint stock company does not) may be carried out at any general shareholders' meeting. As a result, Brazilian companies cannot have a staggered board. If the directors have been elected by a cumulative voting procedure, the removal of any director results in the removal of all the other directors, after which a new election must be held.

There are two basic voting procedures for electing directors: (i) straight ballot voting, and (ii) cumulative voting. In the straight ballot voting procedure, each share carries one vote, and each shareholder votes for one (and only one) whole ballot. Each ballot is a complete slate of members proposed to the board of directors. By voting for a ballot, each shareholder, in effect, votes to fill all seats of the board at once. The persons proposed for the board of directors on the ballot obtaining the majority of votes become the members of the board. The cumulative voting procedure provides that each shareholder has as many votes as the number of shares held multiplied by the number of positions of the board to be filled. Shareholders may accumulate all their votes and give them to one candidate for a board position; or, alternatively, shareholders may distribute their votes among various candidates. In either case, the candidates accumulating the greatest number of votes are elected. The straight ballot vote is the standard voting procedure and generally applies unless there is a request for cumulative voting.

As a rule, shareholders holding shares representing at least 10% of the voting stock are entitled to request the adoption of the cumulative voting system in any given election. However, with respect to publicly traded joint stock companies, the minimum shareholding required for the exercise of the right to request the cumulative voting procedure decreases according to the capitalisation of the company, in some cases reaching as low as 5%.

In addition, shareholders holding shares representing at least 5% of the voting stock and shareholders holding preferred non-voting shares, or with voting restrictions representing at least 10% of the total capital stock, have, in each case, the right to elect one member of the board of directors in a separate election, with no participation of the controlling shareholder. If the foregoing thresholds have not been met, shareholders holding voting stock, non-voting stock and stock with restricted voting may join forces to elect separately one director and the respective alternate director. The same share may not be used in the separate election and in the cumulative voting procedure. For publicly traded joint stock companies with a single class of common shares, the minimum shareholding required for the exercise of the right of a separate election is 10% of the capital stock of the company.

When so provided for in the bylaws, the employees of a joint stock company may choose a representative to sit on the board of directors. This representative is elected by means of a separate election.

4.5 Rules/Requirements Concerning Independence of Directors

As a rule, for closely held joint stock companies there are no specific rules requiring the appointment of independent managers. As a result, the directors and officers do not have full independence from the general shareholders' meeting (and the controlling shareholder, as applicable) or its resolutions, considering the hierarchical

position of the general shareholders' meeting in the political structure of a joint stock company and its legitimate political power to direct the functioning of the administrative bodies of the joint stock company. Nevertheless, from an operational and legal standpoint, the directors preserve their discretion to act according to their convictions and always in compliance with law and in the joint stock companies' interests.

The CVM regulations require that at least 20% of the total board members of publicly held companies are independent. The stock exchange regulations applicable to joint stock companies listed in the New Market segment require that at least 20% (but in no event fewer than two individuals) of the listed joint stock companies' board members must be independent directors. A director is deemed "independent" for the purpose of the regulations if they are formally independent, meaning that the director is not a party related to the indicating shareholder. These regulations provide that a director will be considered "independent" if they:

- have no ties to the joint stock company, other than a possible equity interest;
- are not a controlling shareholder, spouse or close family member (to the second degree) of a controlling shareholder, and have no ties to any company or entity related to a controlling shareholder;
- have not been an employee or officer of the joint stock company, or of the controlling shareholder, or of a subsidiary of the company, at any time in the past three years;
- are not a direct or indirect supplier to the joint stock company or buyer from the joint stock company of goods or services, to an extent that would imply loss of independence;
- are not an employee or senior manager of any company that is a service or product provider or consumer of the joint stock company to an extent that would imply loss of independence;
- are not a spouse or close family member (to the second degree) of any senior manager of the joint stock company; and
- are not entitled to any payment by the joint stock company other than the consideration earned as a director.

With respect to conflicts of interest, directors and officers are subject to certain specific fiduciary duties including a duty of loyalty under which managers may not, among other things:

- use any corporate or commercial opportunity which may come to their knowledge, by virtue of their position, for their own benefit or for the benefit of a third party, whether damage is caused to the company; or
- fail to exercise or protect the company's rights or seek to obtain advantages for themselves or for a third party.

Moreover, directors and officers are prohibited from taking part in any decisions related to corporate transactions in which that manager has a conflicting interest with the company. Managers are required to inform the board of directors or the officers of the joint stock company of the existence of the conflicting interest and to register the nature and extent of the interest in the minutes of the meeting of the board of directors or officers.

4.6 Legal Duties of Directors/Officers

Pursuant to the Brazilian Corporations Law, the duties of directors and officers are generally:

- to exercise reasonable care, meaning that the managers must exercise such care and diligence as is usually employed by all industrious and honest persons in their own affairs

(the duty of exercising reasonable care being considered the broadest duty, carrying the basic structure for all other duties, directing the discretion of the managers, and having the purpose of achieving the efficient management of the company's business);
- to avoid the misuse of powers and authority, either conferred by law or the bylaws, by using them solely to achieve the purpose and in the interests of the company, taking into consideration the common good and the social role of the company;
- loyalty (standard of loyalty), which includes the duty of secrecy and the duty to protect sensitive information of the company between the company and the managers, and prevents the use of privileged information;
- to abstain from acting whenever there is a conflict of interest; and
- to inform shareholders, in general, and the market, as applicable.

4.7 Responsibility/Accountability of Directors

A manager must fulfil their duties to the company and must carry out their functions in the interest of the company, always in compliance with their duties, regardless of any particular interest of the shareholders or group or class of shareholders that appointed the manager.

4.8 Consequences and Enforcement of Breach of Directors' Duties

The general shareholders' meeting (and the controlling shareholder, as applicable), as the supreme body of the joint stock company, can re-examine all acts of the other bodies of the joint stock company, including the managers. This power of re-examination of the general shareholders' meeting works as a corporate enforcement, including by remediating the breach of the managers' duties and possibly mitigating its effects. Further, there is always the possibility of a judicial remedy, with a lawsuit filed either by the company or a third party that has suffered a direct damage.

As a rule, a lawsuit against the managers for breach of duties must be filed by the company itself. There are, however, exceptions, the first one being the possibility of the corporate claim being filed by shareholder(s) if the company remains inert in filing such a suit. The second conceptual exception occurs if a third party (which can be a shareholder) suffers a direct damage, such claim being an individual claim (as opposed to corporate claim). In this case, the relevant third party may seek any remedies available, including indemnification. The CVM may also file an administrative procedure against directors and officers of publicly traded companies due to the breach of their statutory fiduciary duties or the commission of acts that are not compliant with the company's bylaws. Companies listed in the Level 2 and New Market segments of the B3 are required to provide that arbitration will be the mechanism for dispute resolution, which provision is binding on the shareholders.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Directors may be held liable for damages caused as a result of a breach of their fiduciary duties, as well as damages resulting from acts performed with negligence, wilful misconduct or abuse of power. Violations of applicable laws and regulations (including regulations covering mandatory disclosure, tender offers, conflicts of interest, etc) and of the company's bylaws may bring about claims against the directors and result in their liability. Members of management may not be held personally liable for obligations undertaken on behalf of the company in the ordinary

course of business so long as they have acted as required for the careful management of the company (business judgement rule).

Each officer performs their duties on an individual basis and according to their respective assignments, positions, powers and authority. No director or officer will be personally liable for acts or omissions of other officers unless they were involved in those acts, negligent in discovering the acts or failed to prevent the acts once they became aware of them. Neither will any director or officer be personally liable for an act of the relevant board so long as that director or officer, as the case may be, expressly makes their dissent manifest in writing. Indemnity agreements, hold harmless arrangements and bylaws indemnity provisions may be put in place, as may insurance policies (D&O and E&O). Mandatory disclosure requirements apply as discussed at **4.11 Disclosure of Payments to Directors/Officers**.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Shareholders determine the aggregate or individual total compensation payable to the management (including stock-based compensation and additional benefits offered), taking into consideration in each case the manager's position, professional standing, responsibility undertaken, skills, time devoted to the company and compensation available in the market for a person holding a similar position. If shareholders approve compensation on an aggregate basis, the board of directors may receive the authority to approve its allocation between the directors and officers. A share of the company's profit may be payable to the management if certain statutory requirements are met. It is important to highlight that the super-voting (plural) shares instituted under Complementary Law No 182/2021 are not available for resolutions on the management's compensation.

4.11 Disclosure of Payments to Directors/Officers

Information regarding compensation must also be disclosed in the reference form, which will include information on policies or practices adopted by the company regarding:

- management compensation;
- quantitative data on total compensation paid;
- variable compensation offered and paid;
- stock-based compensation;
- outstanding options;
- vested and exercised options (and number of shares delivered);
- pension plans;
- individual compensation (highest, average and lowest, on a no-name basis);
- insurance and similar arrangements;
- other compensation payable (for other activities, positions or services); and
- any other information the management deems material.

Mandatory disclosure also applies to indemnity agreements benefiting management, as well as to any other transaction entered by members of the management of the company that is a related-party transaction required to be entered into at arm's length.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The relationship between the company and its shareholders is basically governed by statutory laws and internal regulations (articles of associa-

tion for a limited liability company, bylaws for a joint stock company, and shareholders agreements, if any). The shareholders, together and as a whole, take part in the general shareholders' meeting, and as such the shareholders participate as a body of the company.

Individually, the shareholders have rights and obligations before the company. Several rights of the shareholders are exemplarily referred to in the Brazilian Corporations Law on a non-exhaustive basis, such as the right to:

- participate in profits;
- participate in the distribution of assets, in the event of liquidation;
- monitor how the company's business and affairs are being carried out;
- exercise pre-emptive rights to subscribe to new shares upon an increase in capital, in proportion to the number of shares held; and
- dissent from the company in certain cases provided for in the Brazilian Corporations Law.

Shareholders basically have two obligations: (i) to pay in the subscribed shares, and (ii) to exercise their voting rights in the interest of the company, should the shareholder have voting rights and when effectively exercising such rights.

5.2 Role of Shareholders in Company Management

A limited liability company is governed by its articles of association which, in turn, provide for the management of the company through certain managers indicated therein or otherwise designated by an act of the quotaholders of the company. It is common, though not mandatory, that the managers of a limited liability company are quotaholders. The management of a limited liability company can even be delegated to all quotaholders in the articles of association. In a limited liability company, certain company decisions require the approval of quotaholders as a matter of law, and the articles of association may also provide for additional matters that require approval of the quotaholders, including matters concerning the day-to-day operations of the business.

In a joint stock company, as a rule, shareholders (as such) have no power to, individually, get involved in the management. Nevertheless, the general shareholders' meeting has the authority to decide on any and all matters relating to the joint stock company and is considered the supreme body of a joint stock company. As such, the general shareholders' meeting may take any measures on behalf of the joint stock company as it may deem appropriate for the purpose of protecting and developing the joint stock company, including reviewing the decisions of any other body of the joint stock company.

Although the controlling shareholder is not itself a body of the joint stock company, Brazilian law acknowledges the power of the controlling shareholder (an individual or a group of shareholders acting exercising control together) in the corporate governance, regulating its duties and responsibilities.

5.3 Shareholder Meetings

In a limited liability company, quotaholders' decisions may be adopted at quotaholders' meetings; or, as in most cases, any such decisions may also be adopted by means of a quotaholders' resolution, duly signed by all quotaholders, regardless of whether the resolution was adopted at a meeting at which the quotaholders were present or was adopted by circulating the resolution for signature. A copy of any the minutes or decisions, as applicable, duly authenticated by

the managers, must be presented to the Commercial Registry for filing.

A quotaholders' meeting must be held at least once a year within the first four months after the closing of the prior fiscal year in order to:

- vote to accept (or not) the financial statements prepared by management;
- designate managers, if necessary; and
- decide on any other matter brought before the quotaholders' meeting.

The Civil Code provides for two different types of quotaholders' meetings for limited liability companies: (i) the general quotaholders' meeting (assembleia geral), and (ii) the quotaholders' meeting (*reunião de sócios*). Certain procedures for calling a general quotaholders' meeting may be waived if all shareholders attend the general quotaholders' meeting or otherwise declare, in writing, that they are aware of the place, date, time and agenda of the relevant general quotaholders' meeting. A quotaholders' meeting must be called by means of public announcements published at least three times and no later than eight days prior to the date of the general quotaholders' meeting. The general quotaholders' meeting will take place on its original scheduled date if shareholders representing at least three quarters of the capital stock are present at the meeting. If no such quorum is achieved, the general quotaholders' meeting must be adjourned to a later date, to be determined by the company through publication of a second announcement, at least five days prior to the rescheduled date. The general quotaholders' meeting may take place on the rescheduled date with any number of shareholders present.

Limited liability companies owned by ten or fewer quotaholders may opt to resolve the matters subject to the decision of the quotaholders by means of a quotaholders' meeting instead of a general quotaholders' meeting, should the articles of organisation of the company so provide. The articles of association may contain specific provisions regarding how the calling, voting of proposals and other procedures in connection with the quotaholders' meeting are to be carried out, and should require less formality and procedures than those of a general quotaholders' meeting. If the articles of association are silent, the legal provisions in the Civil Code regarding the general quotaholders' meeting will apply to the quotaholders' meeting.

In a joint stock company, the shareholders' decisions are reached at the general shareholders' meetings. There are two kinds of general shareholders' meetings: the annual (ordinary) general meeting, and the extraordinary general meeting. Each year, the shareholders must meet at an annual (ordinary) general shareholders' meeting within the first four months after the close of the prior fiscal year to:

- vote to approve (or not) the financial statements prepared by management;
- decide on the allocation of the joint stock company's profits; and
- elect the members of the board of directors (if the joint stock company has a board of directors) or officers (if the joint stock company does not have a board of directors), if necessary.

An extraordinary shareholders' meeting may be called at any time for the purpose of deciding upon matters relating to the corporate purposes of the joint stock company or those considered to be convenient to the protection or development of the joint stock company, including any

corporate action that may result in an amendment to the bylaws.

The Brazilian Corporations Law does not authorise resolutions to be passed by simple written consent with no meeting held. A copy of any minutes of the general shareholders' meeting must be presented to the Commercial Registry for filing.

Call notices for shareholders' meetings in a publicly traded joint stock company must be published at least three times, and the first call must be published, as a rule, at least 21 days in advance (in a closely held joint stock company the first call must be published at least eight days in advance). Certain procedures for calling a general shareholders' meeting may be waived if all shareholders attend the general shareholders' meeting or otherwise declare, in writing, that they are aware of the place, date, time and agenda of the relevant general shareholders' meeting.

Shareholders may be represented at a general shareholders' meeting by a proxy appointed as such less than one year before the date of the meeting, who must also be either a lawyer, another shareholder, an officer, a director of the joint stock company or a financial institution (in case of a publicly traded company); no maximum term is required in case of powers granted under a shareholders' agreement.

In a joint stock company, the general shareholders' meeting will take place on its original scheduled date if shareholders representing at least one quarter of the voting capital stock are present at the meeting. However, if the general shareholders' meeting has been called to decide on the amendment of the bylaws, the presence of at least two thirds of the voting capital stock is required. In a second call, the meeting may be called to order with any number of shareholders present at the meeting.

5.4 Shareholder Claims

The basic rights of a shareholder that could serve as basis for a claim against a company are either political rights or economic rights to:

- share in profits;
- participate in the distribution of assets, in the event of liquidation;
- monitor how the joint stock company's business and affairs are being carried out;
- exercise pre-emptive rights to subscribe to new shares upon an increase in capital, in proportion to the number of shares held; and
- withdraw from the company in certain cases provided for in the Brazilian Corporations Law.

In the majority of cases in which shareholders are seeking recovery for damages, the common practice of corporate litigation reveals that shareholders customarily seek protection from acts of abuse or violations committed either by another shareholder (frequently the controlling shareholder) or by management, in the event of a violation of legal and statutory duties. A company may appear as a defendant. However, since it is not currently common in Brazil for shareholders to seek remedies against a company, it is often the case that a company may participate in the litigation as an intervening party.

As managers of a joint stock company, directors and officers are all subject to the same legal duties, namely:

- to act with the same level and care and diligence that a reasonable person would apply in carrying out their own business matters;

- to put the interests of the joint stock company ahead of the interests of whoever elected them; and
- to serve the joint stock company with loyalty and avoid taking advantage of business opportunities or participating in any business decisions where they may have a conflict of interest.

Shareholders are entitled to hold directors and officers liable for breach of such legal duties. The most common actions filed by shareholders usually allege:

- breach of duty of care (the broadest duty);
- misuse of powers and authority;
- breach of duty of loyalty (standard of loyalty), which includes the duty of secrecy and the duty to protect sensitive information of the company, and prevents the use of privileged information;
- acting with conflict of interest; or
- breach of duty to inform shareholders, in general, and the market, as applicable.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Publicly traded companies must disclose to the market any material acts or facts relevant to their business, as further detailed by the CVM, which regulates the mandatory disclosure obligations pursuant to the spirit of full disclosure set forth in the Brazilian Corporations Law.

Any individual or entity (acting alone, in concert with a third party or representing the same interest) who carries out a material trade involving shares of a company must notify the company immediately after making the trade (with information regarding the person's intention, if any, to interfere in the controlling block or the management of the company, as well as any intention of entering into any shareholders' or voting agreement). A trade is deemed material whenever (and each and every time) it results (individually or in aggregate with other trades) in one crossing a 5% threshold stake in the total outstanding shares of a type or class of shares (either by increasing or decreasing its holding).

Shareholders are also required to comply with disclosure rules in the context of tender offers launched for shares of a publicly traded company. Controlling shareholders are also required to notify the company of any decisions that may impact the price of the company's securities (or impact any decision to buy, sell or hold such securities) and the exercise of other shareholders' rights, such as a transfer of control to a third party.

Publicly traded companies are required to disclose information in relation to the ultimate beneficial owner, up to controlling shareholder level if applicable.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Publicly traded companies must disclose their annual financial statements, together with the management report, the independent auditor's report (and the opinion of the fiscal council, if active), at least one month prior to the date the annual ordinary shareholders' meeting will take place (required by the Brazilian Corporations Law to take place within four months from the end of the fiscal year).

Listed companies must also disclose their:

- DFP (a standard form of financial statements created within the CVM's system with information gathered from the audited annual financial statements) within three months from the end of their fiscal year; and
- ITR, quarterly financial information (including in electronic format, complete with information extracted from the company's quarterly financial information), together with a special review report issued by the independent auditors.

Information included in the annual financial statements must also be included in the reference form, which publicly traded companies are required to file and keep duly updated with the CVM.

Companies listed in special segments of trading of the B3 are required to disclose their financial information both in Portuguese and in English. If listed in the New Market segment, they are also required to hold a public presentation (either in person, by teleconference or videoconference) of the information disclosed in their quarterly earnings results or financial statements (within five business days of their respective release). If listed in the Level 2 or Level 1 listing segments, they are required to hold at least one annual public meeting with analysts and other third parties to discuss their financial and economic situations, projections and expectations.

Depending on a company's business activities, whether its fiscal committee is active and whether there are any pro forma financial statements, etc, other specific financial reporting requirements may apply.

Closely held companies are also required to disclose their financial statements by publishing them in printed and digital newspapers as specified by law. The Complementary Law No 182/2021 allows that closely held companies with an annual gross revenues of up to BRL78 million may replace the mandatory publications in newspapers provided by law with electronic publications.

6.2 Disclosure of Corporate Governance Arrangements

As a rule, the fact that a shareholders' agreement in respect of a publicly traded company has been executed must be disclosed upon release of a material fact and filed with the CVM (depending on the type of securities listed by the company). A description of such arrangements must also be included in the reference form. No disclosure requirement applies to closely held companies.

6.3 Companies Registry Filings

As a condition for enforceability against third parties, companies are required to file their financial statements (and file evidence of their publication), minutes of shareholders' meetings, minutes of meetings of the board of directors or officers, meetings of the fiscal council, and any other corporate act. Publicly traded companies must also disclose such documents on their respective websites and file them with the CVM. The material so filed is publicly available.

Failing to make these filings may subject the publicly traded companies and its managers to fines and the sanctioning of administrative proceedings under the CVM regulations.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Publicly traded companies must appoint external auditors registered with the CVM and these

external auditors must be independent. Accordingly, the external auditors are prohibited from rendering certain services to the company they audit – such as issuing valuation and appraisal reports, and reviewing and issuing reports on provisions and technical reserves – and trading, directly or indirectly, in securities issued by the company.

As a rule, publicly traded companies are also required to change their independent external auditors at least every five years. If, however, the company has a permanently activated audit council, the company may continue to use the same external auditors for a period of up to ten years before it is required to make the change. Once a change in auditors has taken place, the company cannot reappoint the previous auditors for a period of at least three years. Lastly, a publicly traded company must disclose information regarding its relationship with the external auditors, such as the amount of fees charged and paid, and policies adopted to prevent conflicts of interest.

Unless the company falls within the definition of a large enterprise (based on its gross revenue threshold or on the total amount of its assets) or has a private equity investment fund (FIP) as a shareholder, a closely held company is not required to appoint independent external auditors.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Requirements for the appointment of directors and a listing of their statutory duties are set down in the Brazilian Corporations Law. In general terms, the activation of a fiscal council is not mandatory.

A publicly traded company may adopt a management risk and internal controls policy, in which case the policy must be publicly disclosed by means of a detailed description included in the reference form. This description will specify the responsibility of each committee, management body or similar structure (and each of their members). If no such policy is adopted, the company must disclose that fact and justify its decision in this regard. Managers must comply with such a policy and make certain that the external auditors review and report their assessment and recommendation concerning the company's internal controls. Managers are required to comment on any recommendation in this regard presented by the external auditors and any action taken to implement any such recommendation; if the recommendation is not implemented, the managers must specify the reason for non-implementation.

Trends and Developments

Contributed by:
Carlos José Rolim de Mello, Roberto Panucci and Rafael Biondi Sanchez
Mello Torres

Mello Torres is a full-service firm, with offices in São Paulo and Rio de Janeiro, that brings together the expertise of renowned professionals with in-depth experience in the corporate and financial markets and the enthusiasm of young lawyers with solid academic backgrounds. Within its corporate governance team and other related practice areas, such as M&A, it employs highly qualified experts, most of whom hold international experience acquired from postgraduate courses in well-known foreign universities or working as international associates at large law firms of major financial centres around the world. The firm applies optimum strategies to assist clients on corporate governance matters, to structure and negotiate mergers, acquisitions, joint ventures, private equity investments and other sophisticated transactions, both in Brazil and abroad. In these often-complex procedures, the firm focuses on what is important to its clients.

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Tax: Increase in Tax Inspections, Casting Vote in Adminstrative Court of Tax Appeals (CARF) and Retroactive Tax Collection

The newly elected government plans to increase tax collection to support government expenses and end the federal government deficit. In addition to revoking tax benefits and increasing taxes, the federal government is seeking alternatives to expand its revenue sources. The government aims to eliminate the deficit by 2024 and achieve a surplus by 2025.

The first aspect is the increase in tax inspections and audits. This has been made clear in recent discussions involving the taxation of cross-border online purchases by consumers. Currently, a tax exemption applies to transactions made between two individuals where the value of the products is lower than USD50. Otherwise, the consumer must pay at least 60% tax on products bought from foreign websites.

The government considered revoking this exemption but decided to maintain it and increase inspections to ensure that the exempted online purchases are made between individuals and not companies. In addition to increasing tax collection (estimated at around BRL8 billion), the government argues that this measure will also benefit local businesses by inhibiting unfair competition.

Another announcement made by the government relates to the supervision of tax waivers. The federal government currently waives the collection of BRL600 billion, and the government's goal is to reduce it to BRL150 billion. According to the Minister of Finance, many tax waivers lack transparency and legal grounds, which will be subject to thorough investigation and potential revocation.

An additional relevant tax matter is the return of the casting vote in the Administrative Court of Tax Appeals (CARF). The CARF is responsible for judging appeals filed by taxpayers challenging tax infraction notices issued by the Brazilian Internal Revenue Service (IRS). Half of the members of the CARF's judgment panels are composed by judges appointed by the tax authorities, and the other half are appointed by associations of taxpayers. The chairperson of the judgment panels is always a member appointed by the tax administration.

From 1934–2020, the chairperson had a casting vote, rendering the final ruling when there was a tie in the judgment panel. In 2020, a new law was approved that determined that all draws would benefit the taxpayer's claim. In January 2023, the new government reinstated the former rule, and the casting vote of the chairperson is now decisive in tied cases.

In February 2023, the Brazilian Supreme Court (STF) issued a decision that allows the overturning of final court decisions that authorised the non-payment of taxes that were not confirmed by a binding decision of the STF. As a result of this judgment, the Brazilian IRS will be able to collect amounts that have not been paid by the taxpayer in the past due to an individual favourable decision.

Until the 2023 decision rendered by Brazilian Supreme Court, the overturning did not occur automatically. The tax authorities could only request the reversal of decisions and the collection of unpaid taxes through a specific instrument called the "action for relief from judgment", which may or may not be accepted by the justice system.

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Privatisation

In recent years, there has been a significant increase in privatisations, and if the former government were re-elected, there are plans to continue this agenda. The former government's privatisation plan included Correios (national postal service) and Petrobras (oil and gas).

The newly elected government overturned this trend towards privatisation on the basis that certain strategic sectors must be controlled by the government. The new government ordered the withdrawal of eight public companies from the federal government's privatisation and concession programme, including Correios, which was at an advanced stage of the privatisation process.

Additionally, the new government has also been considering ways to reverse the privatisation of certain companies. However, the privatisation plan includes provisions aimed at preventing such a move. The current government and other parties have tried to discuss the privatisations undertaken by the former government, such as Eletrobras, one of the largest electricity companies in Latin America, but with limited success. An alternative that has not been dismissed by the current government is to revert the privatisation by buying back the shares.

High Interest Rates: Bankruptcy

One of the main concerns in the Brazilian market is the high interest rates the country has been facing. Brazil's benchmark interest rate is currently at a six-year high of 13.75%. The Minister of Finance and the President attest that this is the main obstacle to economic growth and may be the cause of bankruptcy for many companies.

The Brazilian Central Bank, the institution responsible for issuing the benchmark interest rate, argues that it is necessary to keep the interest rate at 13.75% to prevent inflation from rising. However, the federal government argues that the inflation targets are too low and detrimental to economic growth.

Last year, many companies expected a better scenario for this year and believed the Central Bank would be quicker to decrease the benchmark interest rate. With the expectation of lower interest rates in the medium term, many companies began to opt for post-fixed interest rate loans.

However, with the benchmark interest rate remaining high for longer than expected, interest on these debts will also be higher than originally foreseen. This, in turn, could even lead to increased corporate delays and defaults as many companies will simply not be able to pay their debts.

In this scenario, there has been a significant increase in the number of judicial recoveries ("Chapter 11") and bankruptcy procedures. Comparing January 2022 to January 2023, there was an increase of 37% in the judicial recovery filings and 56% in bankruptcy requests. The interest rate being held so high for so long will not change this scenario. Many specialists forecast that in 2023, there will be an increase in the application of judicial recovery procedures of more than 50% compared to 2022.

CVM: ESG

The Brazilian Securities and Exchange Commission (CVM) published Resolution No 59, which, among other matters, provides new rules on the regime for disclosing information by publicly held companies in their reference forms. In general, regarding ESG reporting, companies must provide information on:

- whether they disclose ESG data in the annual report or in some other specific document;
- if the report or document considers the disclosure of the materiality matrix and ESG key performance indicators, and what the material indicators are for the company;
- greenhouse gas emission inventories;
- opportunities included in the company's business plan related to ESG aspects; and
- social, environmental and climate risk factors specific to the company, their relevance to the risk matrix and the sustainability report.

There are numerous benefits for a company resulting from such a strategy, such as: the effective implementation and maintenance of diversity and inclusion policies, given the volume of employees who declare themselves to belong to a group benefited by them; and meeting the demands required by regulatory bodies while maintaining governance levels in line with the new CVM rules.

The steps to be taken in this regard involve:

- the development or adequacy of a corporate governance programme that includes ESG criteria, especially diversity and inclusion;
- the analysis, adequacy or implementation of privacy policies that comply with the provisions of the Brazilian Data Protection Law (LGPD) and related rules and do not conflict with the rules of the CVM; and
- legal assistance in complying with other applicable rules to fulfil ESG provisions that need to be demonstrated by the company, according to the "practice or explain" model.

CVM: Tokens

CVM issued Circular Letter No 4/2023/CVM/SSE on 4 April 2023, in which it classifies most of the fixed income tokens and receivables issued in Brazil as securities. The letter aims to notify companies that work with tokenisation about the new system.

The Circular Letter mentions that tokens with underlying assets from the following areas, among others, may be considered securities:

- corporate debt, known as payment streams;
- quotas of consortiums; and
- energy commercialisation.

Additionally, other tokens may also be considered as securities. From now on, companies that issue these tokens may face a "stop order", meaning the paralysis of their operations if they do not follow the procedures established by CVM for the public offer of securities.

According to the Circular Letter, tokens that may be considered securities have the following characteristics.

- They are offered publicly through "exchanges", "tokenisers", or other means.
- They grant fixed, variable or mixed remuneration to the investor.
- They may be representative, linked or backed by credit rights or debt securities. Interest payments and amortisation to the investor result from the cash flow of one or more receivables or debt securities.
- The credit rights or debt securities represented by the tokens are assigned or issued in favour of final investors or third parties who "custody" the underlying assets on behalf of the investors.
- The remuneration is defined by a third party, which can be the token issuer, the assignor, the structurer or any agent involved in the operation.

CVM: Investment Advisory

The CVM issued Resolution Nos 178 and 179, which represent the new regulatory framework for investment advisory activities. The new rules will come into effect in June 2023.

Below are some determinations promoted by the CVM.

- End of exclusivity: individual or legal entity investment advisors may act as representatives of one or more intermediaries, although exclusivity bonds can be created through contractual provisions.
- Flexibility in the adoption of corporate types: the requirement that corporate investment advisers necessarily adopt the form of a simple company has been eliminated, allowing greater flexibility in choosing the corporate type.
- Appointment of responsible officer: the position of the responsible officer of the corporate investment adviser has been created. This position shall be held by an individual investment adviser who will be responsible for providing all the information required by applicable laws and regulations, among other obligations.
- Transition rule: legal entity investment advisers that were already constituted upon the entry into force of the rule are entitled to adapt their denomination to investment adviser or AI only on the occasion of the next amendment they may make in their articles of incorporation or equivalent document.
- End of the requirement of an exclusive corporate purpose: a significant advance compared to what was contained in the public hearing notice. Now, legal entity investment advisers are allowed to carry out complementary activities related to the financial, insurance and capitalisation markets, provided that they do not conflict with investment advisory activities.

M&A: Trends

The M&A market in 2023 began with a trading volume 35% below last year, and the scenario is expected to remain challenging over the coming months. The main reasons for this are the global rise in inflation and the consequent increase in interest rates.

Political instability and low growth in the economies of the Latin American region have resulted in a 10-15% drop in the number of transactions and a 40% drop in the value of deals.

There are five trends for the M&A market in 2023 that can signal where business opportunities will be, as set out below.

Return of the "lipstick effect"

The so-called "lipstick effect" indicates the concentration of buyers in smaller and more accessible businesses instead of the search for large transactions. This movement has already been observed since last year. No mega deals, valued at more than USD10 million, closed during the third quarter of 2022, and large deals valued at more than USD1 million decreased significantly compared to the same period in 2021.

Cheap M&A opportunities

Macroeconomic difficulties should also increase the number of companies disposing of non-core assets in the pursuit of long-term value creation.

Technology

Companies should continue investing in technological transformation, with a focus on artificial intelligence and machine learning in 2023. The speed required in transformation makes compa-

nies seek expertise outside their homes through M&A.

Geopolitical impact

Supply chain disruptions caused by the pandemic are expected to continue impacting business decisions. The expectation is that companies will seek M&A operations to reinforce their operational resilience.

ESG

ESG factors should remain in the spotlight in 2023. The expectation is that the growing scrutiny of investors, combined with the pressure for transparency, can boost businesses focused on this area.

CANADA

Trends and Developments

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Introduction

Corporate governance in Canada continues to evolve. Diversity continues to be a focus of regulatory and proxy advisory policy change, and for boards, is a key component of ESG concerns. The adoption of majority voting in the Canada Business Corporations Act (CBCA) strengthens shareholders' hands at shareholder meetings. The introduction of legislation governing disclosure of beneficial ownership of company shares, as well as certain other matters not previously subject to mandatory disclosure, are showing a trend towards increased transparency. Climate change is another core aspect of ESG concerns at the board level. Proposed climate-related disclosure rules will entail very significant changes to corporate governance that will require boards of directors to undertake a comprehensive review of the corporation's governance structures and practices. Changes continue to be made to corporate statutes to remove perceived technical burdens.

Diversity – Boards and Senior Management

Diversity on boards and in senior management is being reviewed by corporate regulators and stakeholders, and the legal and "soft law" requirements have and are continuing to evolve. Since 2014, TSX-listed corporations have been required to make diversity-related disclosure in their annual disclosure documents on a "comply or explain" basis, including:

- on their policies and targets regarding the representation of women on the board of directors and in executive positions;
- how the representation of women is considered in selecting board and executive officer candidates;
- gender representation on the board and in executive officer positions; and
- term limits.

See National Instrument 58-101 of the Canadian Securities Administrators (CSA) Disclosure of Corporate Governance Practices (NI 58-101).

Public corporations existing under the CBCA have been required to make diversity-related disclosure regarding women, indigenous peoples, persons with disabilities and members of visible minorities (designated groups) since 2020 on a "comply or explain" basis. These requirements include:

- disclosure of term limits or other board renewal mechanisms, a description of written diversity policies for the selection of individuals from designated groups as board nominees and a description of progress made in achieving the policy objectives;

- whether the level of representation of designated groups on the board or in senior management is considered in appointing new candidates;
- whether targets have been established for representation of designated groups on the board and in senior management, as well as progress towards those targets; and
- the number of members of each of the designated groups on the board and in senior management.

Enhanced guidelines for making this disclosure were published by Corporations Canada in February 2022.

Increasingly, governance ratings organisations and industry groups developing "best practices" are focusing on gender and other diversity measures as critical elements of measuring/rating corporate governance. See, for example, the Canadian Coalition for Good Governance (CCGG) and The Globe and Mail Board Games.

Proxy advisory firms are following suit, with both Glass, Lewis & Co ("Glass Lewis") and Institutional Shareholder Services (ISS) adopting gender diversity policies in respect of Canadian public corporations (regardless of jurisdiction of incorporation).

Glass Lewis has updated its voting policies with respect to board gender diversity effective for shareholder meetings on or after 1 January 2023, as set out below.

- Glass Lewis has transitioned from a fixed numerical approach to board gender diversity to a percentage-based approach and will generally recommend voting against the nominating committee chair of any TSX-listed company board that is not at least 30% gender diverse, as well as all members of the nominating committee of a board with no gender diverse directors. Glass Lewis defines "gender diverse directors" as women and directors that identify with a gender other than male or female.
- For companies listed on junior exchanges, and for all boards with six or less total directors, Glass Lewis' minimum threshold remains at one gender diverse director.
- Glass Lewis may refrain from recommending that shareholders vote against the election of directors of companies when boards have provided a sufficient rationale or plan to address the lack of diversity on the board.

Beginning with shareholder meetings held after 1 February 2023, the ISS voting guidelines have changed as follows.

- ISS will recommend against the election of the chair of the nominating committee, or its equivalent, of a company listed on the S&P/TSX Composite Index with less than 30% representation of women on its board of directors.
- ISS will make an exception for a company that (i) recently joined the S&P/TSX Composite Index and was not previously subject to a 30% representation of women on the board requirement; or (ii) due to extraordinary circumstances, fell below the 30% threshold after having previously achieved such level of representation at the preceding annual meeting. To qualify for such an exemption, a company must have provided a publicly disclosed written commitment to achieve at least 30% women on its board of directors at or prior to the company's next annual meeting.
- For TSX-listed companies which are not also included in the S&P/TSX Composite Index, ISS will generally vote against the election

of the chair of the nominating committee, or its equivalent, if there are zero women on the board of directors.

ISS has also broadened its policy on diversity beyond gender to include requirements for racially and/or ethnically diverse board members (defined as Aboriginal peoples, meaning persons who are indigenous, Inuit or Métis, and members of visible minorities, meaning persons other than Aboriginal peoples, who are non-Caucasian in race or non-white in colour). For meetings on or after 1 February 2024, ISS will generally recommend against the election of the chair of the nominating committee, or its equivalent, of S&P/TSX Composite Index companies that have no apparent racially or ethnically diverse members of the board. ISS will make an exception if there was racial and/or ethnic diversity on the board at the preceding annual meeting and the company makes a firm public commitment to appoint at least one racially and/or ethnically diverse member at or prior to their next annual meeting.

Federally incorporated issuers may soon be required to report on diversity amongst the "members of senior management" (as defined in the regulations). Under the proposed Section 172.1(1) of the CBCA, which is not yet in force, CBCA-incorporated issuers will be required to provide certain "prescribed information", which includes, but is not limited to, reporting on whether the board of directors or its nominating committee have considered the level of representation in management roles of "designated groups". The designated groups are defined as: women, indigenous peoples (First Nations, Inuit and Métis), persons with disabilities and members of visible minorities.

Securities regulators in Canada continue to focus on diversity disclosure requirements. In January 2021, the Capital Markets Modernization Taskforce (the "Taskforce"), established by the Ontario government, issued its final report suggesting, among other things, that:

- Ontario securities legislation be amended to require that Canadian public companies set goals and implement timelines for diversity amongst directors and executive management, and report annually on the levels of representation at the board and executive management of those identifying as women, BIPOC, a person with a disability or LGBTQ+; and
- appropriate target levels for representation be at 50% for women and 30% for BIPOC, persons with disabilities and LGBTQ+.

Additionally, on 27 October 2022, staff of the CSA published Multilateral Staff Notice 58-314 – Review of Disclosure Regarding Women on Boards and in Executive Officer Positions, the eighth annual review by the CSA on disclosure regarding women on corporate boards and in executive officer positions. The CSA reported a small increase, as compared to its prior year's report, in the overall percentage of women on boards and in executive officer positions.

The CSA has requested stakeholders' comments on new approaches towards diversity disclosure. On 13 April 2023, the CSA proposed amendments to Form 58-101F1 – Corporate Governance Disclosure and National Policy 58-201 – Corporate Governance Guidelines pertaining to diversity, board renewal and board nominations. The CSA has proposed two versions of Form 58-101F1 for comment, "Form A" and "Form B", which are applicable to non-venture issuers.

Form A

Form A requires disclosure on an issuer's approach to diversity in respect of the board and executive officers but would not mandate disclosure in respect of any specific groups, other than women.

For example, an issuer would disclose its chosen diversity objectives, how progress is measured, and the mechanisms in place to achieve these objectives.

This can be achieved by collecting data with respect to specific groups the issuer identifies as being relevant for its approach to diversity and for comparative purposes.

There is no required format on how to present this information; the approach taken in this form is intended to provide each issuer with flexibility to design practices and policies respecting how it will address diversity in its specific circumstances, and not requiring it to report data on any specific group.

Form B

Form B requires disclosure on the representation of five designated groups, being:

- women;
- indigenous peoples;
- racialised persons;
- persons with disabilities; and
- LGBTQ2SI+ persons;
- persons on boards and in executive officer positions.

An issuer may also choose to voluntarily provide disclosure in respect of other groups beyond the foregoing designated groups.

All such data would be reported in a standardised tabular format to promote consistent and comparable disclosure. This information would be based on voluntary self-disclosure by directors and executive officers.

In addition, this form would require disclosure regarding any written strategy, written policies and measurable objectives relating to diversity on an issuer's board of directors.

The key difference between the two forms is that Form B mandates disclosure on historically underrepresented groups, which is a similar approach as the board diversity disclosure requirements under the CBCA. In contrast, Form A mandates disclosure only on women's representation and is based on a view that securities regulators should not select categories of diversity. Form A defers to an issuer to determine what additional categories or aspects of diversity they wish to implement based on the company's business and strategy. Under the same notice, the CSA has also proposed enhanced guidelines for issuers relating to board nominations and renewals. The comment period for the proposed CSA amendments is open until 12 July 2023.

Transparency – Beneficial Ownership

Recent beneficial ownership disclosure requirements are showing a trend towards increased transparency, with the goal of assisting law enforcement agencies in targeting potential money laundering and tax evasion.

Effective 1 January 2023, the Business Corporations Act (Ontario) (OBCA) was amended to require certain private corporations existing under the OBCA to prepare and maintain a register of individuals with "significant control" over

the corporation. Under the OBCA, an individual with significant control is someone who:

- is the registered or beneficial owner of, or has direct or indirect control or direction over, any number of shares that carry 25% or more of the voting rights attached to all of the corporation's outstanding voting shares;
- is the registered or beneficial owner of, or has direct or indirect control or direction over, any number of shares that is equal to 25% or more of all of the corporation's outstanding shares measured by fair market value;
- has any direct or indirect influence that, if exercised, would result in control in fact of the corporation; or
- is an individual to whom circumstances prescribed by regulation apply.

Certain groups, such as individuals with jointly held rights or interests in shares, who are parties to a voting or similar arrangement, and/or having certain familial relationships, are considered on a collective basis towards meeting the threshold test for significant control; where a group has met the test, all members are required to be disclosed.

For each individual with significant control, the register must include the following information per the OBCA:

- name, date of birth, and last known address;
- jurisdiction of residence for tax purposes;
- the date on which the individual became (or ceased to be) an individual with significant control;
- description of how the individual meets the definition of significant control;
- any other information that may be provided for in regulations enacted in the future; and
- a description of the steps taken to identify all individuals with significant control and to ensure that the information in the register is accurate, complete and up to date.

The amendments to the OBCA are similar to other corporate transparency initiatives introduced by the CBCA and in the provinces of British Columbia, Saskatchewan, Manitoba, Nova Scotia, PEI, Newfoundland and Labrador and, most recently, Quebec. Effective 31 March 2023, the Act respecting the legal publicity of enterprises (LPE) requires certain companies to submit information about their "beneficial owners" to the *Registraire des entreprises du Québec* (REQ). The amended LPE requires the disclosure of "ultimate beneficiaries", which is generally defined as a natural person who holds a right that allows them to benefit from a portion of the income or assets of an enterprise, or a right that allows them to direct or influence the activities of the enterprise. Registrants must provide the REQ with the following information on the ultimate beneficiaries:

- first and last name (or name if the ultimate beneficiary is a legal person) and other names used in Quebec;
- date of birth;
- residential address;
- the type of control exercised, including the holding percentage where applicable; and
- the date on which the person became an ultimate beneficiary and, if applicable, the date on which the person ceased to be one.

On 22 March 2023, under Bill C-42, the government of Canada proposed new legislation amending the CBCA with respect to disclosure of beneficial ownership. Bill C-42 proposes to amend the CBCA to, among other things:

- require the director (as defined under the CBCA) to make available to the public certain information on individuals with significant control over a corporation;
- protect the information and identity of certain individuals;
- add, or broaden the application of, offences and provide the director with additional enforcement and compliance powers; and
- add regulatory authority to prescribe further requirements in certain provisions. It also makes consequential and related amendments to other Acts.

Transparency – Say-on-Pay Vote

Upcoming amendments to the CBCA would require the directors of prescribed corporations to annually disclose their approach to renumeration and to provide shareholders with a non-binding "say-on-pay" vote. The CBCA amendments (under proposed Section 172.4) are not yet in force. The Taskforce has also suggested a number of changes including mandating an annual advisory "say-on-pay" similar to the CBCA requirements. Many public companies already voluntarily provide their shareholders with a "say-on-pay" vote.

Glass Lewis has clarified its voting policies with respect to shareholder opposition to "say-on-pay" proposals and a board's level of engagement and responsiveness to shareholder concerns. Glass Lewis generally expects a board's minimum appropriate level of responsiveness to correspond to the level of shareholder opposition (in a single year and over time) and may recommend holding compensation committee members accountable for failing to adequately respond to shareholder opposition, having regard for the level of opposition and history of the company's compensation practices.

Transparency – Incentive Awards and Clawback Policies

A clawback policy allows an employer to reclaim compensation previously paid to employees. Clawback policies typically relate to compensation paid under incentive-based plans to certain executives and are typically administered by a company's compensation committee or board of directors for the purpose of responding to changing financial metrics. Clawback policies may also extend to incentive-based compensation based on non-financial results of the company (ie, safety, retention and production). Many public companies have already established clawback policies.

Effective 27 January 2023, the United States Securities and Exchange Commission (SEC) has adopted new amendments and rules governing clawback policies. The CBCA, under proposed Section 172.3, could also require a company to disclose prescribed information about the recovery of incentive benefits paid to directors and employees who are members of senior management.

Innovation, Science and Economic Development Canada (ISED) provided further guidance on the prescribed information outlined in the proposed CBCA amendments. ISED explains that the prescribed information should follow a "disclose or explain" regime where companies indicate whether they have a clawback policy, and if not, the reasons why they have not adopted one. If the company does have a policy, it will be required to disclose the policy's objectives and key provisions.

Beginning in 2023, Glass Lewis will raise concerns about executive pay programmes where less than half of an executive's long-term incentive awards are subject to performance-based

vesting conditions. As with the past year, Glass Lewis may refrain from a negative recommendation in the absence of other significant issues with the programme's design or operation, but a negative trajectory in the allocation amount may lead to an unfavourable recommendation. The CCGG also encourages the use of such policies to monitor performance-based compensation.

Transparency – Voting "For" or "Against" Directors of Public Corporations

Canadian corporate statutes have historically required that shareholders either vote for or withhold their vote on the election of directors at annual meetings. This has meant that if a director receives just one vote for their election at an uncontested shareholder meeting, then that director will be elected, even if a vast majority of shares are withheld from voting for that director.

Starting in 2014, all corporations listed on the Toronto Stock Exchange (TSX) were required to adopt a majority voting policy pursuant to which each director must be elected by a majority of votes cast with respect to their election, except at a contested meeting. Majority voting policies must also require:

- a director to immediately tender their resignation if they are not elected by at least a majority (50% +1 vote) of the votes cast with respect to their election;
- the board to determine whether to accept the resignation within 90 days of the shareholder meeting, and the resignation should be accepted in the absence of exceptional circumstances;
- the resignation to become effective when accepted by the board;
- a director who tenders a resignation not to participate in board or committee meetings at which the resignation is considered; and
- the issuer to promptly issue a news release with the board's decision including, in the case of a board not accepting the resignation, the reasoning behind such a decision.

On 31 August, 2022, amendments to the CBCA came into force that changed the majority voting requirements for board nominees, as set out below.

- CBCA-incorporated public corporations must allow shareholders to vote "for" or "against" individual director nominees in an uncontested election, rather than "for" or "withhold".
- Where only one nominee is up for election for each board seat and less than 50% of the votes cast by shareholders are "for" a particular director nominee, such a nominee will not be elected as a director (subject to provisions in the issuer's articles). However, if an incumbent director is not elected by a majority of "for" votes at the meeting, they will still be permitted to remain as a director until the earlier of: (i) the 90th day after the day of the election; or (ii) the day on which their successor is appointed or elected.
- The elected directors may reappoint the incumbent director even if they do not receive majority support in the most recent election in certain limited circumstances:
  - (a) where it is required to satisfy the CBCA's Canadian residency requirement; or
  - (b) where it is required to satisfy the CBCA's requirement that at least two directors of a distributing corporation are not also officers or employees of the corporation or its affiliates.

Contributed by: Bill Gilliland and Jessica Myers, **Dentons**

Preparing for Mandatory Climate-Related Disclosure – Governance Changes for Public Corporations

On 18 October 2021, the CSA published a proposed National Instrument 51-107 – Disclosure of Climate-related Matters and its proposed Companion Policy 51-107CP (together, the "Climate Disclosure Proposals") for comment. The Climate Disclosure Proposals would take effect for annual filings made in early 2024 (for TSX-listed issuers with 31 December year ends) and early 2026 (for TSXV-listed issuers with 31 December year ends). These effective dates may change as the Climate Disclosure Proposals evolve.

The Climate Disclosure Proposals would require disclosure based on recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). The Climate Disclosure Proposals would require issuers to make disclosure in the following areas.

- Governance – describing the board's oversight of climate-related risks and opportunities, and management's role in assessing and managing climate-related risks and opportunities.
- Strategy – describing any climate-related risks and opportunities identified over the short, medium and long term and describing the impact of these risks and opportunities on its business, strategy and financial planning.
- Risk management – describing its processes for identifying, assessing and managing climate-related risks and how these processes are integrated into overall risk management.
- Metrics and targets – describing its metrics used to assess climate-related risks and opportunities and targets used to manage these risks and opportunities.

The TCFD contemplates that issuers should disclose greenhouse gas emissions (Scope 1, 2 and 3). The Climate Disclosure Proposals would require issuers to make this disclosure or explain why they do not. The Climate Disclosure Proposals would not require issuers to disclose the resilience of their strategy with reference to various climate scenarios, a key element of the TCFD recommendations.

In preparing to comply with the new requirements, corporations and boards should be taking the following steps.

- Boards of directors should expressly establish oversight of climate-related risks and opportunities of the issuer. This will require reviewing, and where necessary amending, board charters and mandates and board skills and competencies matrices, and then reviewing whether any changes need to be made in board composition to ensure the board has the necessary climate competencies to effectively provide this oversight.
- Boards of directors should expressly task management with responsibility for assessing and managing climate-related risks and opportunities. This will involve the review and revision of role descriptions and mandates. As climate-related disclosure is added to an issuer's management information circular, annual information form (AIF) or management's discussion and analysis (MD&A), the annual and interim CEO/CFO certifications (National Instrument 52-109 Certification of Disclosure in an Issuer's Annual and Interim Filings) will apply to that climate-related disclosure. Management will need to have designed disclosure controls and procedures to provide reasonable assurance that climate-related material information will be made known to the CEO and CFO, and that

required disclosure on climate-related matters is made. Boards of directors will need to be comfortable that these controls and procedures are in place and have oversight over their effectiveness.

- Boards of directors should consider board committee roles in the review and assessment of climate-related risks. Boards of directors should consider the mandates of any board committees that have delegated responsibilities around risk review and assessments, and carefully consider where the assessment of climate risks should fit within those board committees, if at all.
- Boards of directors should specifically consider the role of the audit committee in the review and assessment of climate-related risks and opportunities. The assessment of climate-related risks and opportunities is likely to be done within existing enterprise risk management systems, often overseen by the audit committee. At a minimum, the audit committee will need to ensure that once climate-related risks and opportunities are assessed, their implications are properly reflected in the issuer's financial reporting including in assumptions, uncertainties and estimates made in the preparation of financial statements.
- Boards of directors should be aware that the Climate Disclosure Proposals require climate-related disclosure to be contained in documents that by law must specifically be reviewed and approved by the board (namely, the corporation's AIF, management proxy circular and, in some cases, the MD&A). Climate-related disclosure is often made in standalone sustainability or other reports.
- Boards of directors will need to assess the materiality of climate-related risks and opportunities. The Climate Disclosure Proposals require an issuer to disclose:
  (a) climate-related risks and opportunities (short, medium and long-term) and their impact on the issuer's businesses, strategy and financial planning ("Strategy");
  (b) the issuer's processes for identifying, assessing and managing climate-related risks ("Risk Management"); and
  (c) metrics and targets used by an issuer to assess and manage climate-related risks and opportunities ("Metrics and Targets") only where the information is "material" – ie, where a reasonable investor's decision to buy, sell or hold securities is likely to be influenced if the information is omitted or misstated.
- Boards of directors should develop a familiarity with the TCFD recommendations. The Climate Disclosure Proposals do not specifically incorporate the TCFD recommendations. However, the disclosure under the Climate Disclosure Proposals is intended to be consistent with the TCFD recommendations on the stated areas of disclosure, and issuers are encouraged to refer to those recommendations in preparing the required disclosure under the Climate Disclosure Proposals.
- Boards of directors should consider the need for scenario analysis as contemplated within the TCFD recommendations. Boards of directors should consider whether in order to properly identify climate-related risks and opportunities, and their impact on an issuer's business, management needs to undertake some scenario analysis as contemplated within the TCFD recommendations notwithstanding that the Climate Disclosure Proposals do not require disclosure in respect of those scenarios. In turn, boards would need to review that analysis. The use of scenario analysis as a tool to assess risks and opportunities is generally understood to offer benefits in situations where the precise

timing and magnitude of risks are uncertain, the analysis needs to be forward-looking, and risks (and opportunities) can be high impact where historical experience is not necessarily a guide to the likelihood of their future occurrence.

- Boards of directors will need to consider the annual timing of preparation of an issuer's climate-related disclosure. Currently, many issuers are reporting this type of information in standalone sustainability reports and/or other documents released throughout the year on different schedules from the typical annual disclosure cycle.
- Boards of directors should consider any de facto requirement to disclose GHG emissions. Boards of directors should consider whether there will develop (or maybe already has developed in some cases) a de facto requirement to disclose GHG emissions in their disclosure documents, notwithstanding that the Climate Disclosure Proposals adopt a "comply or explain" model allowing issuers to omit that disclosure if they explain why. Access to the various sustainable finance tools or funding from some institutional investors may already require that an issuer discloses its GHG emissions. As issuers are entering into sustainability-linked financings based on GHG emissions, they will be reporting their GHG emissions to banks and bond holders. Canada's largest banks (and other Canadian and international financial institutions) are now members of the Net-Zero Banking Alliance. Members of the Net-Zero Banking Alliance have committed to transition the GHG emissions attributable to their lending and investment portfolios to align with pathways to net zero by 2050, and to set interim targets for at least 2030 and every five years onwards to 2050. To satisfy these requirements, it seems likely issuers will face more general requirements to provide this GHG emissions disclosure to their banks. Many issuers are already providing GHG emissions information in investor presentations or in separate sustainability reports. Where investors and other stakeholders are asking for this data, it becomes harder to argue the information is not "material".
- Boards of directors should consider whether the issuer should start early in addressing the disclosure contemplated by the Climate Disclosure Proposals.
- Boards of directors will need to monitor the development of climate disclosure ratings and rankings established by third parties. As has occurred in respect of general governance disclosure (see, for example, the CCGG and The Globe and Mail Board Games), benchmarking of issuers' climate-related disclosure has started. See, for example, the Climate Action 100+ corporate benchmarking which looks at corporate disclosures around climate-related governance, reduction of GHG emissions and public disclosure following the TCFD recommendation. These rankings (and their score cards) are likely to become a consideration in the preparation of issuers' public disclosure documents.

Since the CSA's Proposed Climate Disclosure Proposals, the International Sustainability Standards Board (ISSB) has proposed a climate-related disclosure standard as well as a proposed general standard for sustainability-related financial information ("Proposed ISSB Rules"). The ISSB is currently finalising the Proposed ISSB Rules, which are tentatively expected to be effective for annual reporting periods beginning on or after 1 January 2024, and to be published in final form before the end of June 2023. The SEC also has proposed amendments to require registrants to provide certain climate-related

information in their registration statements and annual reports.

On 12 October 2022, the CSA announced that it was reviewing the ISSB and SEC proposals and how they may impact or further inform the Canadian climate-related disclosure proposals. The CSA noted that the Canadian rule would need to reflect Canadian capital markets and investor needs, but also have considered international consensus with a view to providing climate-related disclosure standards "that as a priority elicit consistent and comparable disclosure for investors and that support a comprehensive global baseline of sustainability disclosures". It is anticipated that the Proposed ISSB Rules, and to some extent the SEC proposals, will impact CSA's final version of the Climate Disclosure Proposals.

ISS and Glass Lewis have also introduced new climate accountability voting policies addressing climate-related disclosure and board oversight of climate-related issues. Effective for shareholder meetings held after 1 February 2023, and under its "Climate Accountability Policy", the ISS will make negative voting recommendations for the incumbent chair of the appropriate committee (or other directors) of companies that are significant GHG emitters (ie, companies identified by the Climate Action 100+) and do not: (i) make adequate climate risk disclosure in line with the four-pillar framework established by the TCFD; or (ii) adopt appropriate GHG emissions targets.

Similar to ISS, and effective for shareholder meetings held after 1 January 2023, Glass Lewis has adopted a "Board Accountability for Climate-related Issues" policy under which it will make negative voting recommendations for the chair of the relevant committee (or board) of high-emitting companies (ie, whose GHG emissions represent a financially material risk, including companies identified by the Climate Action 100+) that do not: (i) provide thorough TCFD-aligned disclosure; or (ii) clearly define board oversight responsibilities for climate-related issues. The Glass Lewis policy may be extended to the chair of the governance committee where no committee (or board) has been assigned oversight of climate-related issues and could also apply to other directors. The group of companies to which the Glass Lewis policy applies appears to be broader than for the ISS policy. Glass Lewis believes that boards of high-emitting companies should have explicit and clearly defined oversight responsibilities for climate-related issues, which builds on broader Glass Lewis and ISS policies requiring board-level oversight of environmental issues and disclosure of such oversight.

Shareholder Meetings and Materials

Recent legislative amendments have introduced flexibility for companies with respect to shareholder meetings, such as the following.

On 31 May 2022, amendments to the Business Corporations Act (Alberta) (ABCA) came into force adjusting the notice period of shareholder meetings for Alberta private corporations to a minimum of seven days and a maximum of 60 days (formerly, minimum of 21 days and maximum of 50 days). The amendments under the ABCA also permit corporations to send documents required to be sent to directors and shareholders by electronic means.

On 3 April 2023, under Bill 91, the government of Ontario proposed changes to the OBCA relating to shareholder meetings. Bill 91 proposes to expressly allow virtual shareholder meetings (under proposed Section 94(2)) and also allows companies to determine the manner by which

shareholder meetings are held (under proposed Section 94(3)(a)).

Written Resolutions of Shareholders

Corporate statutes in Canada have long contemplated that shareholders can sign written resolutions in lieu of holding a shareholder meeting. Typically, these resolutions need to be signed by all shareholders to be valid, and so have been a helpful tool for closely held corporations. On 28 March 2023, amendments to the ABCA came into force allowing for written resolutions signed by holders of at least two thirds of the shares entitled to vote at the shareholder meeting to be valid as if passed at a meeting. The reduced threshold is eligible only for private Alberta Corporations, and brings the ABCA into alignment with other corporate statutes in Canada (such as in Ontario and British Columbia) that permit non-unanimous written resolutions.

Canadian Director Residency Requirements

Canadian corporate statutes have required that a certain percentage (typically 25%) of the directors of a corporation be Canadian residents. “Canadian resident” has been defined to include Canadian citizens and permanent residents, in each case, who are ordinarily resident in Canada.

In March 2023, the Business Corporations Act, 2021 (Saskatchewan) was amended to remove the Canadian resident director requirement. In its place, corporations without a director or officer who is a Saskatchewan resident must designate an attorney in Saskatchewan. The Saskatchewan amendment is in line with the majority of Canadian provinces and territories including British Columbia, Alberta, Ontario, Quebec, Nova Scotia and New Brunswick.

CHINA

Law and Practice

Contributed by:
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Contents

1. Introductory p.75
1.1 Forms of Corporate/Business Organisations p.75
1.2 Sources of Corporate Governance Requirements p.75
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.75

2. Corporate Governance Context p.76
2.1 Hot Topics in Corporate Governance p.76
2.2 Environmental, Social and Governance (ESG) Considerations p.77

3. Management of the Company p.78
3.1 Bodies or Functions Involved in Governance and Management p.78
3.2 Decisions Made by Particular Bodies p.78
3.3 Decision-Making Processes p.79

4. Directors and Officers p.79
4.1 Board Structure p.79
4.2 Roles of Board Members p.79
4.3 Board Composition Requirements/Recommendations p.80
4.4 Appointment and Removal of Directors/Officers p.81
4.5 Rules/Requirements Concerning Independence of Directors p.81
4.6 Legal Duties of Directors/Officers p.82
4.7 Responsibility/Accountability of Directors p.82
4.8 Consequences and Enforcement of Breach of Directors' Duties p.83
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.83
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.83
4.11 Disclosure of Payments to Directors/Officers p.84

5. Shareholders p.84
5.1 Relationship Between Companies and Shareholders p.84
5.2 Role of Shareholders in Company Management p.85
5.3 Shareholder Meetings p.85
5.4 Shareholder Claims p.85
5.5 Disclosure by Shareholders in Publicly Traded Companies p.86

6. Corporate Reporting and Other Disclosures p.87
6.1 Financial Reporting p.87
6.2 Disclosure of Corporate Governance Arrangements p.87
6.3 Companies Registry Filings p.88

7. Audit, Risk and Internal Controls p.89
7.1 Appointment of External Auditors p.89
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.89

Global Law Office (GLO) was one of the first leading law firms in the PRC to take an international perspective on its business, fully embracing the outside world. With more than 600 lawyers practising in the Beijing, Shanghai, Shenzhen and Chengdu offices, the firm continues to set the pace as one of the most innovative and progressive legal practices in China. Over the last 40 years, GLO has helped set the agenda for change through precedents, including working on the first foreign general offer targeting Chinese companies on the Hong Kong Stock Exchange, the first state-owned red chip company listed in Hong Kong acquiring the controlling interest in an A-share company listed in China by means of a reverse takeover, and the first reverse merger case in which a red chip Hong Kong-listed public company span off part of its China business to list on a share market.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

There are three principal forms of corporate/business organisation in China:

- companies;
- partnership enterprises; and
- individual proprietorship enterprises.

Only companies have the status of legal persons, and shareholders shall bear liabilities for a company to the extent of their respective subscribed capital contribution/shares. However, a shareholder who abuses the independent legal person status of the company or the shareholder's limited liabilities to evade debts, thereby prejudicing the interests of the creditors of the company, shall be jointly and severally liable for the debts of the company.

Companies are classified as limited liability companies and joint stock limited companies. Joint stock limited companies whose shares are listed and traded on a stock exchange are publicly traded companies. Currently, there are three stock exchanges in Mainland China:

- the Shanghai Stock Exchange (SSE);
- the Shenzhen Stock Exchange (SZSE); and
- the Beijing Stock Exchange (BSE).

1.2 Sources of Corporate Governance Requirements

The principal sources of corporate governance requirements for companies are the Company Law of the People's Republic of China (the "Company Law") and five judicial interpretations of the Company Law. In addition to the laws, judicial interpretations and regulations, the activities of a company and all participants (including shareholders, directors, supervisors and officers) are governed by the articles of association of the company.

Publicly Traded Companies

Provisions on the supervision and administration of publicly traded companies are numerous and complex. As publicly traded companies are a type of joint stock limited company, the provisions of Chapter 4 of the Company Law, regarding joint stock limited companies, also apply to them. The organisation and activities of publicly traded companies are also regulated by the Securities Law of the People's Republic of China, the regulatory supervision rules of the China Securities Regulatory Commission (CSRC) and the relevant stock exchanges. The regulations relate to the issuing and trading of securities, corporate governance, disclosure, restructuring, delisting and other aspects. In short, publicly traded companies are subject to comprehensive and strict supervision because of their involvement of public interests.

On 17 February 2023, the CSRC issued a whole new set of rules for the comprehensive implementation of the stock issuance registration system, which took effect from the date of the announcement. With information disclosure at the core, the new rules replace the securities offering approval system and aim to simplify, standardise and clear the entire lifecycle of securities issuance and listing.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Corporate governance requirements for companies with publicly traded shares mainly include the following:

- the company shall establish and improve the systems of shareholder meetings, boards of directors, boards of supervisors, independent directors, board secretaries and special committees in accordance with the law;
- the company shall be encouraged to appoint officers in an open and transparent manner;
- the company shall establish fair and transparent standards and procedures for evaluating the performance of directors, supervisors and officers;
- the company shall establish a mechanism linking remuneration with the company's performance and individual performance;
- the company shall be strictly independent from its controlling shareholder and actual controller in terms of personnel, assets, financial affairs, institutions, business, accounting and the assumption of responsibilities and risks;
- decision-making procedures and information disclosure obligations shall be strictly performed in connection with affiliated transactions in accordance with the relevant provisions;
- the company shall establish and implement a management system of information disclosure – it shall make public disclosures on documents such as periodic reports, interim reports, prospectuses, offering prospectuses, listing announcements, acquisition reports, etc; and
- internal control and risk management systems shall be established.

Corporate governance requirements for companies with publicly traded shares are mainly stipulated in the Code of Corporate Governance of Publicly Traded Companies. Some requirements are mandatory, while some are voluntary. However, certain provisions seem to be voluntary but in fact have become quasi-mandatory, because companies may be confronted with unnecessary complications if they have not strictly complied with them in the IPO procedure.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Environmental, social and governance (ESG) is by far the hottest topic in corporate governance. In one of its recent working plans, the State-Owned Assets Supervision and Administration Commission of the State Counsel expected all publicly traded companies controlled by central state-owned enterprises to issue an ESG special report by 2023. Other publicly traded companies and other state-owned enterprises voluntarily followed this trend. For more details on ESG considerations, please see **2.2 Environmental, Social and Governance (ESG) Considerations**.

A second round of draft revisions to the Company Law was published for public opinion in early 2023, with the following highlights in corporate governance issues:

- introducing authorised capital for joint stock limited companies and allowing the authorisation of boards of directors to decide the issuance of a certain number of new shares within the authorised capital;
- increasing the liabilities related to capital contribution by shareholders, including loss of shareholder rights for failure to pay capital contribution, acceleration of capital subscription period if the company fails to pay off its due debts, and supplementary liabilities of the transferor if the transferee fails to pay a capital contribution for the transferred shares;
- strengthening the functions and powers of the board of directors;

- introducing an audit committee under the board of directors, which can exercise functions in place of the board of supervisors or supervisors;
- increasing the liabilities of directors, supervisors and officers under certain scenarios and introducing directors' liability insurance; and
- introducing awareness of corporate social responsibilities and encouraging the publication of social responsibility reports.

2.2 Environmental, Social and Governance (ESG) Considerations

The current supervision regulations have not imposed compulsory requirements on publicly traded companies to disclose ESG reports but do encourage them to make voluntary disclosure. However, the disclosure of certain special ESG issues is mandatory.

Environmental Issues Reporting

With respect to reporting on environmental issues, a publicly traded company shall disclose, in its annual report, any administrative penalties on it due to environmental issues during the reporting period. A company or its major subsidiary that is a key pollutant discharging entity, as established by the environmental protection department, shall also disclose major environmental information, including:

- pollutant discharge information;
- the construction and operation of pollution prevention and control facilities;
- environmental impact assessments of construction projects and other environmental protection administrative licensing;
- contingency plans for emergent environmental accidents; and
- self-monitoring plans for environmental protection.

Companies are encouraged to voluntarily disclose the measures that have been taken to reduce carbon emissions and the effect of such measures during the reporting period. Other commonly seen topics include energy saving, water saving, the use of recycled resources, pollutant supervision, the adoption of environmental management systems, etc.

SSE and SZSE each have more detailed disclosure requirements on environmental issues in addition to the above general requirements. The Ministry of Ecology and Environment also imposes more stringent disclosure requirements on publicly traded companies that have violated ecology and environment laws and regulations in the previous calendar year.

Social Issues Reporting

With respect to reporting on social issues, certain index companies listed on the SSE or the SZSE, companies listed both onshore and offshore, and listed financial companies shall disclose a corporate social responsibility report ("CSR Report") at the same time as disclosing annual reports. Other publicly traded companies are encouraged to disclose a CSR Report.

The contents of a CSR Report shall include the construction and implementation of social responsibility systems concerning the protection of workers, environmental pollution, the quality of commodities, and relationships with relevant communities. In addition, publicly traded companies are encouraged to disclose the active fulfilment of their social responsibilities in consideration of their particular industrial characteristics, particularly the consolidation and expansion of achievements in poverty alleviation and rural revitalisation. Other commonly seen topics include employees' welfare and equality, information and privacy protection, anti-bribery, sup-

ply chain management, participation in public welfare, etc.

Governance Issues Reporting

With respect to reporting on governance issues, please see **6.2 Disclosure of Corporate Governance Arrangements** for specific disclosure requirements.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

In China, the principal bodies involved in the governance and management of a company include the shareholder meeting, the board of directors, the board of supervisors and the manager. The shareholder meeting is the key organ of authority, responsible for making decisions on fundamental issues and electing the main members of the board of directors and the board of supervisors. The board of directors is the executive organ, and the manager is the auxiliary executive organ. The manager is appointed by the board of directors. The board of directors is responsible for making decisions on day-to-day operation and management, and the manager assists the board of directors in the execution of the company business. The board of supervisors is the supervisory organ, responsible for supervising the execution of business and the company's financial status.

3.2 Decisions Made by Particular Bodies

Decisions of the Board of Directors

The board of directors is responsible for making decisions on day-to-day operation and management, and shall decide on the following matters:

- determining the company's business plans and investment programmes;
- formulating plans in respect of the company's annual budget and final accounts;
- determining the establishment of the company's internal management departments;
- formulating the company's basic management system; and
- deciding on the hiring or dismissal of the manager and their remuneration.

In addition to its decision-making power over operation, management and personnel matters, the board of directors shall also have the right to formulate plans in respect of the company's dividends distribution, loss recovery, increase/decrease of registered capital, issuance of bonds, merger, division, dissolution, or change of the company form, provided that all such plans are subject to the review and approval of the shareholder meeting.

Decisions of the Shareholder Meeting

The shareholder meeting is responsible for making decisions on fundamental issues, including but not limited to:

- electing and replacing directors and supervisors, and determining their remuneration;
- amending the articles of association of the company;
- making resolutions on any increase or decrease of the company's registered capital; and
- making resolutions on merger, division, dissolution or liquidation of the company, or change of the company form.

The shareholder meeting shall also have the right to review and approve the plans formulated by the board of directors, such as plans for the company's annual budget and final accounts, dividends distribution, loss recovery, etc. If a publicly traded company purchases or sells

significant assets, or guarantees an amount exceeding 30% of the company's total assets within one year, such actions must be authorised by resolutions of the shareholder meeting.

In addition, a publicly traded company shall state principles of authorisation by the shareholder meeting to the board of directors in its articles of association, and the contents of the authorisation shall be clear and detailed. The shareholder meeting shall not authorise the statutory functions or powers to the board of directors.

3.3 Decision-Making Processes

The shareholder meeting or the board of directors shall make decisions by convening meetings to review and vote on the relevant matters and form a resolution. However, a decision may be made without convening a shareholder meeting if shareholders unanimously agree in writing (all shareholders sign and seal on the resolution documents).

Normally, meetings of the board of directors shall be convened and presided over by the chair of the board. When the board of directors votes on a resolution, each director shall have one vote. For a limited liability company, the methods of deliberation and voting procedures of the board of directors shall be specified in the company's articles of association, unless otherwise provided in the Company Law. The following applies for a joint stock limited company:

- the board of directors shall convene at least two meetings a year, which must be notified to all directors and supervisors ten days in advance;
- shareholders representing more than a tenth of voting rights, or more than a third of the board of directors or the board of supervisors, may propose to convene an interim meeting of the board of directors;
- no meeting of the board of directors can be held unless more than half of the directors are present; and
- when the board of directors makes a resolution, it shall be adopted by more than half of all the directors.

With respect to the shareholder meeting, please see **5.3 Shareholder Meetings** regarding decision-making processes.

4. Directors and Officers

4.1 Board Structure

The board of directors in a limited liability company shall consist of three to 13 members, while a smaller limited liability company or a limited liability company with fewer shareholders may have an executive director, but without the board of directors. The board of directors in a joint stock limited company shall consist of five to 19 members. A publicly traded company shall have independent directors and board secretaries, and its board of directors shall establish an audit committee; it may also establish special committees on strategy, nomination, remuneration and assessment. The second round of draft revisions to the Company Law proposes to eliminate the maximum limit for the number of board members in both limited liability companies and joint stock limited companies, and to lower the minimum limit of members for joint stock limited companies.

4.2 Roles of Board Members

The board of directors shall be presided over by a chair, and may have one or more vice-chairs. The chair shall be responsible for presiding over shareholder meetings, convening and presid-

ing over meetings of the board of directors, and inspecting the implementation of resolutions of the board. A vice-chair assists the chair in its work. If the chair cannot or does not carry out its duties, such duties shall be carried out by the vice-chair; if the vice-chair cannot or does not carry out its duties, the duties shall be carried out by a director jointly elected by more than half of the directors.

Members of the board of directors in wholly state-owned companies shall include representatives of the employees, and the Company Law allows employees to take positions of members of the board of directors in other limited liability companies and joint stock limited companies, although this is not very common in practice.

A publicly traded company shall have independent directors and board secretaries. Independent directors shall be responsible for supervising the directors and officers, and shall report their work to the shareholder meeting annually. The board secretary shall be responsible for the preparation of shareholder meetings and meetings of the board of directors, custody of documents, management of shareholders' materials, disclosure of information, investor relations and other matters. The second round of draft revisions to the Company Law proposes that a limited liability company and a joint stock company can set up an audit committee in the board of directors in accordance with the company's articles of association, to exercise the functions and powers of the board of supervisors, in lieu of having a board of supervisors or supervisors.

4.3 Board Composition Requirements/Recommendations

Terms of office for directors on the board shall be specified by the articles of association of the company, provided that each term of office shall not exceed three years. Upon the expiration of their term of office, a director can serve another term if re-elected.

A person may not serve as a director of a company in any of the following circumstances:

- they are without civil capacity or have limited civil capacity;
- they have been sentenced to criminal penalties for corruption, bribery, embezzlement or misappropriation of property or for sabotaging the socialist market economy order, and less than five years has elapsed since the expiration of the period of execution;
- they have been deprived of their political rights for committing a crime, and less than five years has elapsed since the expiration of the period of execution;
- they have served as a director or manager of an enterprise that has been declared bankrupt and bear personal responsibility, and less than three years has elapsed since the date of completion of the bankruptcy liquidation;
- they have served as the legal representative of an enterprise whose business licence has been revoked or has been ordered to close its business operations due to a violation of law and bear personal responsibility, and less than three years has elapsed since the date of the revocation of business licence; and
- they have a large amount of debt, which is due but has not been repaid.

In addition to those listed in **4.1 Board Structure** and **4.2 Roles of Board Members**, members of the board of directors shall have the knowledge, skills and qualities that are necessary for the performance of their duties. Furthermore, diversity among members of the board of directors is encouraged.

4.4 Appointment and Removal of Directors/Officers

The directors who are not representatives of the employees shall be appointed and removed by the shareholder meeting. The representatives of the employees shall be democratically elected by the employees through the employees' congress, through the employees' meeting or in other ways. The method of appointing the chair and vice-chair of the board of directors in a limited liability company shall be stipulated in the articles of association of the company. In practice, the chair and vice-chair can be elected or recommended by the shareholder meeting or the board of directors. The chair and vice-chair of the board of directors in a joint stock limited company are elected by more than half of all the directors on the board of directors.

The manager shall be appointed and removed by the board of directors. The appointment and removal of the deputy manager and chief financial officer shall be recommended by the manager and decided by the board of directors. The appointment and removal of other officers shall be decided by the manager unless otherwise stipulated in the articles of association of the company.

4.5 Rules/Requirements Concerning Independence of Directors

The rules and requirements concerning the independence of directors are mainly applicable to publicly traded companies. According to the regulatory supervision rules, publicly traded companies shall establish rules for independent directors. At least a third of members of the board of directors in a publicly traded company shall be independent directors. Independent directors shall constitute a majority of the members of the audit committee, the nomination committee and the remuneration and assessment committee, and shall act as the convener therein.

Independent directors must have independence, which means they shall perform their duties and responsibilities independently, without interference from the major shareholders, the actual controller, or other entities or individuals that are interested parties of the publicly traded company. The General Office of the State Council issued its opinions on the reform of the independent director system of publicly traded companies in April 2023, to further strengthen the requirement for the independence of independent directors, pursuant to which the CSRC has issued detailed management measures to solicit public opinions.

Independent Director Requirements

Independent directors of publicly traded companies are required to meet the general requirements for directors as stipulated in the Company Law, as well as the specific qualifications for independent directors under regulatory supervision rules applicable for publicly traded companies. In principle, an individual may concurrently hold the position of independent director in no more than five publicly traded companies. The following persons may not hold the position of independent director:

- those who hold a position in the publicly traded company or one of its subsidiaries, or where their immediate family members or persons with whom they have major social relations do so;
- natural person shareholders who directly or indirectly hold more than 1% of the issued shares of the publicly traded company or who rank in the top ten shareholders of the publicly traded company, and their immediate family members;

- those who hold a position in entities that directly or indirectly hold more than 5% of the issued shares of the publicly traded company or that rank in the top five shareholders of the publicly traded company, and their immediate family members;
- those to whom any of the circumstances in the three bullet points above have applied in the last year; and
- those who provide financial, legal, consulting or other services to the publicly traded company or its subsidiaries.

A person holding the position of independent director shall:

- be qualified to hold the position of a director of a publicly traded company;
- possess a basic knowledge of operation of publicly traded companies;
- be familiar with relevant laws, administrative regulations, rules and regulations of publicly traded companies; and
- have more than five years of working experience in law, economics or another field, giving them the experience necessary to perform the duties of an independent director.

4.6 Legal Duties of Directors/Officers

The principal legal duties of directors and officers of a company are duties of loyalty and diligence to the company. The duty of loyalty requires directors and officers not to take advantage of their position to pursue illegitimate interests, with the following important restrictions:

- directors and officers shall not enter into contracts or engage in transactions with the company they are serving in violation of the articles of association or without the consent of shareholder meetings;
- without the consent of shareholder meetings, directors and officers shall not seek business opportunities that would have belonged to the company for themselves or others by taking advantage of their position; and
- without the consent of shareholder meetings, directors and officers shall not engage in business that is similar to the company's, for themselves or others.

The duty of diligence requires that directors and officers shall perform their duties with reasonable care in the best interests of the company, including:

- timely understanding the operation and management of the company's business;
- diligently exercising the powers granted by the company to ensure that the commercial activities of the company comply with the requirements of laws, administrative regulations and various economic policies; and
- ensuring the commercial activities do not go beyond the scope of business stipulated in the business licence.

4.7 Responsibility/Accountability of Directors

The board of directors is responsible for the shareholder meeting, and the directors owe duties of loyalty and diligence to the company. Directors are required to take into account the overall interests of the company and the interests of all shareholders when discharging their duties. In publicly traded companies, the directors are required to pay special attention to the interests of the minority shareholders, as well as other interested parties, such as creditors, employees, clients, suppliers and communities.

4.8 Consequences and Enforcement of Breach of Directors' Duties

If directors or officers breach their duties and thereby cause losses to the company, any income arising from the breach shall belong to the company, and the directors or officers shall be liable to compensate the company. In such a situation, the company may file a lawsuit with the people's court. Shareholders holding equities of a limited liability company, or shareholders individually or collectively holding more than 1% of shares of a joint stock limited company for more than 180 consecutive days, may request the board of supervisors in writing to file a lawsuit with the people's court. If the board of supervisors does not file a lawsuit, a shareholder satisfying the aforesaid conditions has the right to file a lawsuit with the people's court in their own name directly, in the interests of the company. In an emergency, instead of requesting the board of supervisors to file suit, the shareholder may do so directly. If directors or officers breach their duties and thereby cause losses to shareholders, the directors or officers shall be responsible to compensate the shareholders, who may file a lawsuit with the people's court.

Directors and officers of publicly traded companies may also be subject to administrative punishment from the CSRC due to false statements, breach of promises, insider trading and manipulation of the market, and shall be responsible to compensate the investors who have suffered losses as a result of such conduct.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

There are other bases for claims or enforcement against directors or officers for breaches of corporate governance requirements; for example, directors shall be responsible for resolutions of the board of directors. If a resolution of the board of directors violates laws, administrative regulations, the articles of association of the company or resolutions of shareholder meetings, the shareholders may petition the people's court to invalidate or revoke the resolutions. If the company suffers serious losses as a result thereof, the directors who participated in the adoption of such resolutions are responsible for compensation. However, the liability of a director or officer can be limited. If a director can prove that they expressed an objection to such resolutions in the vote, and their objection was recorded in the minutes of the meeting on that resolution, then such director can be exempted from liability.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

According to the Company Law, remuneration, fees or benefits payable to directors are decided by the shareholder meeting. Payments to the manager are decided by the board of directors, and payments to the deputy manager and chief financial officer are decided by the board of directors upon proposals by the manager.

In a publicly traded company, when the board of directors or the remuneration and assessment committee is evaluating the performance of a director or is discussing their compensation, the director shall not participate in such evaluation or discussion. The remuneration distribution plan for officers shall be approved by the board of directors, explained at shareholder meetings and fully disclosed.

Publicly traded companies shall provide appropriate allowances to independent directors. The proposed standard of such allowances shall be formulated by the board of directors, then reviewed and approved by the shareholder meeting, and disclosed in the annual report of

the company. In addition to the above-mentioned allowances, independent directors shall not accept additional, undisclosed benefits from the publicly traded company, its major shareholders or entities/individuals that are interested parties of the company.

4.11 Disclosure of Payments to Directors/Officers

According to the Company Law, a joint stock limited company shall regularly disclose to its shareholders the remuneration, fees or benefits payable to directors and officers. A publicly traded company shall disclose the appointments, changes of shareholding and annual remuneration of its directors and officers in its annual report, including but not limited to:

- decision-making procedures, the basis of determination and the actual payment of the remuneration;
- the total amount of pre-tax remuneration received from the company and the aggregates of all the directors and officers; and
- whether or not the directors and officers receive remuneration from affiliated parties of the company.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Shareholders mainly have the following rights with regard to the company.

- The right to income:
  (a) dividend claims;
  (b) residual claims;
  (c) pre-emptive rights for new shares;
  (d) dissenting shareholders' right to request repurchase of shares; and
  (e) pre-emptive rights for shares sold by other shareholders in limited liability companies.
- Voting rights and related rights:
  (a) voting rights;
  (b) rights to attend shareholder meetings;
  (c) rights to propose to convene interim shareholder meetings and meetings of the board of directors; and
  (d) rights of proposal.
- The right to know and other rights.

The shareholders' principal obligation to the company is to invest capital in accordance with their committed payment schedule provided in the articles of association of the company. The second round of draft revisions to the Company Law further proposes that a shareholder who fails to complete its capital contribution obligation within its committed payment period, and fails to cure such delay within the grace period specified by the company, may lose rights to the unpaid portion of its equity interests/shares.

In addition, the shareholders shall exercisetheir rights in accordance with laws, administrative regulations and the articles of association of the company, and shall not abuse their rights to damage the interests of the company or other shareholders. Moreover, the shareholders shall not abuse the independent legal person status of the company and limited liabilities of shareholders to damage the interests of the company's creditors. The second round of draft revisions to the Company Law proposes a mechanism for the acceleration of contributions, according to which, in the event that the company is unable to pay off its due debts, upon the request of the company or creditors of the due debts, the shareholders' obligations to capital contributions will be accelerated even if its corresponding committed payment period has not expired.

5.2 Role of Shareholders in Company Management

Ownership of companies is somewhat separated from management rights. The managers are responsible for the operation and management of the company while, as owners of the company, shareholders do not normally participate directly in the daily operation and management of the company. Their management in a company is indirect, which means they exercise their rights in a collective manner by participating in shareholder meetings and voting on proposals in accordance with the procedures provided by laws and the articles of association of the company. The shareholders may make decisions on fundamental issues and elect the main members of the board of directors by exercising their voting rights and thereby control the company.

5.3 Shareholder Meetings

The shareholder meetings of a limited liability company are divided into regular meetings and interim meetings. Regular meetings shall be convened in accordance with the articles of association of the company, while interim meetings shall be convened upon proposal by the shareholders representing more than a tenth of voting rights or more than a third of directors or (the board of) supervisors. Generally, shareholder meetings are convened by the board of directors and presided over by the chair of the board. If there is no special provision in the articles of association of the company, all the shareholders shall be notified 15 days before a shareholder meeting is held, and the shareholders shall exercise their voting rights at the meeting in proportion to their capital contribution. According to the Company Law, resolutions on the amendment of the articles of association, increases/decreases of registered capital, mergers, divisions, dissolutions or changes of the company form shall be approved by shareholders representing more than two thirds of voting rights.

Shareholder meetings of a joint stock limited company shall be held once a year. An interim shareholder meeting shall be held within two months under any of the following circumstances:

- the number of directors is less than two thirds of the number required by the Company Law or the articles of association of the company;
- the company's uncovered losses amounted to a third of its paid-in capital;
- shareholders individually or collectively holding more than 10% of the company's shares make a request;
- the board of directors deems it necessary; or
- the board of supervisors proposes to hold it.

A meeting hall shall be set up for the shareholder meeting, and the meeting shall be held by way of combining an on-site meeting and network voting. All the shareholders shall be notified of the time, place and agenda of the shareholder meeting 20 days in advance of a regular meeting or 15 days in advance of an interim meeting. For a publicly traded company where a single shareholder and any persons acting in concert with them hold more than 30% of the shares, the cumulative voting system shall be adopted in the election of directors and supervisors at the shareholder meeting – ie, each share shall have the same number of voting rights as the number of directors or supervisors to be elected, and the voting rights held by shareholders may be exercised cumulatively.

5.4 Shareholder Claims

Normal claims of shareholders against the company are asserted in situations where shareholders' rights have been infringed. The common claims include:

- requesting the company to distribute dividends;
- requesting confirmation of the non-existence, invalidity or revocation of the resolution of the shareholder meeting or the board of directors; and
- requesting the inspection or copying of certain documents or materials of the company.

In addition, investors of a publicly traded company who have suffered losses in securities trading due to the company's false statement have the right to sue the company for compensation.

The base of a claim for shareholders against the directors is the directors' breach of their duties of loyalty and diligence, which has led to damage to the interests of the shareholders or the company. The shareholder may claim damages against the directors in their own name for the company's interests. Investors in a publicly traded company who have suffered losses in securities trading due to the company's false statement, the directors' breach of promises, insider trading or manipulation of the market have the right to sue the directors for compensation. Furthermore, the Supreme People's Court issued regulations in 2022 stipulating that administrative penalties or criminal judgments will no longer be preconditions for the courts to accept such civil compensation cases filed by the investors.

5.5 Disclosure by Shareholders in Publicly Traded Companies

According to the regulatory supervision rules, a shareholder or actual controller of a publicly traded company shall inform the board of directors and co-operate with the company in performing information disclosure obligations under any of the following circumstances:

- a relatively significant change in the control of the company, or the shareholding of shareholders who hold more than 5% of the company's shares, or the actual controller;
- a relatively significant change in the situation of engagement in business identical or similar to the company that is taken by the company's actual controller and other enterprises controlled by the actual controller;
- the controlling shareholder was prohibited from transferring their shares by a court ruling or judgment;
- more than 5% of the company's shares held by any shareholder are pledged, frozen, judicially auctioned, kept in custody or established in trust, or their voting rights are restricted, or there is a risk of being forced to transfer ownership; and
- a plan to significantly restructure assets or business of the publicly traded company.

Where the controlling shareholder or actual controller of a publicly traded company plays an important role in the occurrence or progress of a significant event that may have a great influence on the trading prices of the company's securities and derivatives, the controlling shareholder or actual controller shall inform the company of the relevant situation in writing in a timely manner, and co-operate with the company in performing information disclosure obligations, including the cause, current status and possible impact of the disclosed event. In addition, any promise made by a publicly traded company's controlling shareholder or actual controller shall be disclosed.

The CSRC also requires that, where any shareholder of the company applying for an IPO has a shareholding structure consisting of two or more layers and is a company or a limited partnership with no actual business activities, the ultimate

beneficial owner of such shareholder should be disclosed, in the case that the buy-in price of such shareholder is apparently abnormal.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Publicly traded companies are subject to annual and interim financial reporting requirements. According to the regulatory supervision rules, an annual report shall record the key accounting data and financial indicators, and the full text of the financial statement and the audit report. An interim report shall record the key accounting data and financial indicators, and the financial statement. An annual report shall be prepared and disclosed within four months from the end of each fiscal year, and an interim report shall be prepared and disclosed within two months from the end of the first half of each fiscal year.

6.2 Disclosure of Corporate Governance Arrangements

There are some requirements for publicly traded companies to disclose their corporate governance arrangements in the interim report and annual report.

In the interim report, a publicly traded company shall disclose its corporate governance arrangements, including:

- the annual shareholder meeting and interim shareholder meetings held during the reporting period;
- the removal of directors, supervisors and officers, as well as the reasons for doing so, during the reporting period;
- whether the dividends distribution plan and the plan for conversion of capital reserve fund to share capital comply with the articles of association and provisions for review procedure, and have adequately protected the legitimate interests of the minority investors, and whether the independent directors have issued opinions; and
- the implementation of an equity incentive plan, employees' stock holding plan or other incentive measures for employees during the reporting period.

In addition to the arrangements mentioned above, a publicly traded company shall also disclose the following in its annual report:

- the measures that the controlling shareholder and actual controller take to guarantee the independence of the company;
- the situation of engagement in business that is identical or similar to the company that is taken by the controlling shareholder, actual controller and other enterprises controlled by them;
- the implementation of and changes to the arrangements on difference in voting rights during the reporting period;
- basic information on and annual remuneration of directors, supervisors and officers;
- meetings of the board of directors held during the reporting period and the performance of each director;
- the membership of the special committees under the board of directors, and meetings of special committees held during the reporting period;
- opinions of the board of supervisors on supervision matters during the reporting period;
- employees of the company's parent company and its main subsidiaries;

- the construction and implementation of the internal control system during the reporting period; and
- management of its subsidiaries during the reporting period.

6.3 Companies Registry Filings

A company is required to register the following items with the companies registry:

- company name;
- company type;
- business scope;
- domicile;
- registered capital;
- name of the legal representative; and
- names of shareholders of a limited liability company or promoters of a joint stock limited company.

An application for change of the above registered items shall be made within 30 days from the date of passing the relevant resolution or decision on such change or the date of occurrence of the statutory change. If a company fails to make such application for a change of registered items, the companies registry will order the company to rectify or impose a fine of no less than RMB10,000 but no more than RMB100,000 if the company refuses to rectify, or revoke the business licence if the circumstances are serious.

A company is required to file the following items with the companies registry:

- articles of association;
- operation period;
- capital contributions subscribed for by the shareholders of a limited liability company or promoters of a joint stock limited company;
- directors;
- supervisors;
- senior officers;
- the contact person; and
- the recipient for serving legal documents of a foreign-invested company.

An application for a change of the above filing items shall be made within 30 days from the date of passing the relevant resolution or decision on such change or the date of occurrence of the statutory change. If a company fails to make such application for a change of filing items, the companies registry will order the company to rectify or will impose a fine of no more than RMB50,000 if the company refuses to rectify.

If a joint stock limited company established by public offering issues shares to the public, it shall also submit the approval documents of the CSRC to the companies registry.

The following stakeholders may apply to the companies registry to inquire about the registered matters of the company by submitting corresponding documents:

- where a public security authority, state security authority, procuratorial authority, judicial authority, discipline inspection and supervision authority or audit authority makes an inquiry, an official letter of the authority and a valid identification certificate of the inquirer shall be presented;
- where a company makes an inquiry about its own registration administration files, it shall present a power of attorney and a valid identification certificate of the inquirer; and
- where a lawyer makes an inquiry related to legal matters undertaken by such lawyer, such lawyer shall present the lawyer’s licence, the certificate of the law firm and the relevant letter of commitment.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

A company shall prepare a financial statement upon the end of each fiscal year, which shall be audited by an accounting firm in accordance with laws. According to the articles of association of the company, the decision to hire or dismiss the accounting firm that undertakes the company's auditing business shall be taken by the shareholder meeting or the board of directors. When the shareholder meeting or the board of directors votes on the dismissal of the accounting firm, said accounting firm shall be allowed to state its opinions. The board of directors of a publicly traded company shall establish an audit committee to supervise and evaluate the external auditing work, and to propose hiring or replacing the external auditing institution.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Large and Medium-Sized Companies

The key requirements for directors in connection with the management of risk and internal controls in large and medium-sized companies are set out below.

- The board of directors shall be responsible for the establishment and implementation of internal controls. The board of supervisors shall supervise the establishment and implementation of internal controls by the board of directors. Managers shall be responsible for organising and leading the day-to-day operation of the company's internal controls. A company shall establish a special department or designate an internal department to be specifically responsible for organising and co-ordinating the establishment and implementation of internal controls and daily work.
- A company shall establish an audit committee under the board of directors. The audit committee shall be responsible for examining the company's internal controls, supervising effective implementation and self-evaluation of internal controls, and co-ordinating the audit of internal controls and other related matters.
- The internal audit institution shall supervise and inspect the effectiveness of the internal controls, and shall have the right to report any major defect of internal controls discovered during the supervision and inspection directly to the board of directors and its audit committee and the board of supervisors.

Publicly Traded Companies

Specific requirements for directors in connection with the management of risk and internal controls in publicly traded companies include the following.

- A publicly traded company shall establish internal control and risk management systems, and establish a special department or designate an internal department to be responsible for inspecting and supervising the important operations of the company, the management of subordinate companies, the disclosure of financial information and compliance with laws and regulations.
- A publicly traded company shall regularly disclose the construction and implementation of its internal control system, as well as the audit opinions of accounting firms on the effectiveness of the internal controls.

COTE D'IVOIRE

Law and Practice

Contributed by:
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Contents

1. Introductory p.93
1.1 Forms of Corporate/Business Organisations p.93
1.2 Sources of Corporate Governance Requirements p.95
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.95

2. Corporate Governance Context p.96
2.1 Hot Topics in Corporate Governance p.96
2.2 Environmental, Social and Governance (ESG) Considerations p.96

3. Management of the Company p.97
3.1 Bodies or Functions Involved in Governance and Management p.97
3.2 Decisions Made by Particular Bodies p.98
3.3 Decision-Making Processes p.99

4. Directors and Officers p.100
4.1 Board Structure p.100
4.2 Roles of Board Members p.100
4.3 Board Composition Requirements/Recommendations p.100
4.4 Appointment and Removal of Directors/Officers p.101
4.5 Rules/Requirements Concerning Independence of Directors p.101
4.6 Legal Duties of Directors/Officers p.102
4.7 Responsibility/Accountability of Directors p.102
4.8 Consequences and Enforcement of Breach of Directors' Duties p.103
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.104
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.105
4.11 Disclosure of Payments to Directors/Officers p.106

5. Shareholders p.106
5.1 Relationship Between Companies and Shareholders p.106
5.2 Role of Shareholders in Company Management p.107
5.3 Shareholder Meetings p.107
5.4 Shareholder Claims p.108
5.5 Disclosure by Shareholders in Publicly Traded Companies p.109

6. Corporate Reporting and Other Disclosures p.109
6.1 Financial Reporting p.109
6.2 Disclosure of Corporate Governance Arrangements p.109
6.3 Companies Registry Filings p.109

7. Audit, Risk and Internal Controls p.110
7.1 Appointment of External Auditors p.110
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.111

Houda Law Firm is a multi-sectoral and multi-disciplinary law firm based in Senegal and Côte d'Ivoire. The firm has a total staff of 53 people, composed of a team of lawyers, jurists and paralegals. The staff work in French and English, to ensure the satisfaction of local and international clients. Houda Law Firm provides legal advice and assistance to a diverse clientele in a variety of practice areas, including business law, insurance law, banking and finance, public and private international law, contract law, mining, oil and gas, renewable energy, and tax. The firm has proven expertise in the energy and extractive sector, in PPPs, banking and finance, corporate and commercial law.

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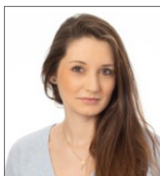

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Commercial companies are governed in Côte d'Ivoire by the Uniform Act on the Law of Commercial Companies and Economic Interest Grouping, published on 30 January 2014 (AUS-CGIE).

The most commonly used commercial forms are, in order, the *société à responsabilité limitée* (SARL), the *société anonyme* (SA) and *the société par actions simplifiée* (SAS). In Côte d'Ivoire, the creation of a SA or SAS requires the recourse to a notary public.

The SARL

This company is the simplest of commercial companies, in which the liability of the shareholders is limited to contributions.

The SARL may be established by one natural or legal person, or between two or more natural or legal persons.

It does not require any minimum share capital for its creation and its capital is divided into shares. It is often characterised by a fairly strong *intuitu personae*, which is why transfers of shares are often governed by specific authorisation rules given by the non-transferring shareholder.

The SARL is managed by one or more natural persons, associated or not.

In addition, the SARL is not required to appoint an auditor unless it meets two of the following conditions at the end of the financial year:

- a balance sheet total exceeding XOF125 million;
- an annual turnover exceeding XOF250 million; and/or
- a permanent staff of more than 50 persons.

The shareholders of the SARL meet in a general assembly, either ordinary (each year for the approval of the accounts of the closed financial year) or extraordinary (for any modification of the articles of association).

The SARL is a corporate form adapted to greenfield projects, commercial activities and services. It is also suitable for young entrepreneurs with few resources, due to its low formation cost.

The SA

The SA under the AUSCGIE may be held by a single shareholder.

The founder(s) must choose unequivocally in the articles of association for the management and administration between:

- an SA with a board of directors (from one shareholder); or
- an SA with a managing director (up to three shareholders).

The minimum share capital of an SA is XOF10 million. It must be fully subscribed by the shareholders and may be paid up by at least one quarter upon incorporation.

The founders of an SA must appoint a statutory auditor, and an alternate auditor, chosen from among experts who are members of the Order of Chartered Accountants of Côte d'Ivoire (article 695 of AUSCGIE).

The SA with a board of directors

The board of directors is composed of a minimum of three persons and a maximum of 12 members, shareholders or not.

The articles of association may require each director to own a number of shares of the company over which they preside.

It is possible to appoint corporate directors, who appoint a permanent representative to the board.

The board appoints the chairman of the board of directors from among the natural persons who are members of the board, as well as the chief executive officer of the company, who may be one third of the board.

It may also be decided to appoint a chairman and chief executive officer who will combine both functions.

The board of directors determines the orientations of the company's activity and ensures their implementation. It controls and verifies the proper functioning of the company and settles matters regarding the company through its deliberations.

The chairman of the board of directors presides over board meetings and general meetings. He or she must ensure that the board assumes control of the management of the company entrusted to the chief executive officer.

The chief executive officer is responsible for the general management of the company. He or she represents it in its relations with third parties.

On the proposal of the chief executive officer or the chairman and chief executive officer, the board of directors may appoint one or more individuals to assist the chief executive officer, or the chairman and chief executive officer, as deputy chief executive officer.

The SA with a managing director (administrateur général)

The managing director assumes, under his or her responsibility, the administration and general management of the company. He or she represents it in its relations with third parties, and convenes and chairs the general meetings of shareholders. He or she is vested with the broadest powers to act in all circumstances on behalf of the company and exercises them within the limits of the corporate purpose, and subject to those expressly attributed to shareholders' meetings by the AUSCGIE and, where applicable, the articles of association.

On the proposal of the managing director, the general assembly may mandate one or more deputy managing director(s) to assist the director, as well as to decide other powers delegated to the deputy managing director.

The SA is a suitable form of company for the establishment of joint ventures, for companies with significant investments to make and for companies engaged in regulated banking or financial activities.

The SAS

Recently introduced in the AUSCGIE in 2014, the SAS is defined as a company set up by one or more shareholders whose articles of association freely provide for the organisation and operation of the company, subject to certain mandatory rules (competence of the shareholders' general meeting to approve the accounts or amend the articles of association, for example).

The liability of the shareholders is limited to the contributions and there is no minimum share capital to create an SAS. When created by a single shareholder, it is called a single-person simplified joint-stock company (SASU).

The company is represented by a chairman, appointed under the conditions provided for in the articles of association. The chairman is vested with the broadest powers to act on behalf of the company within the limits of the corporate purpose.

The articles of association freely determine the decisions that must be taken collectively by the shareholders in the forms and conditions they stipulate. Decisions taken in violation of the statutory clauses are null and void.

The appointment of one or more auditors is optional unless the SAS meets two of the following conditions at the end of the financial year:

- a balance sheet total exceeding XOF125 million;
- an annual turnover exceeding XOF250 million; and/or
- a permanent workforce of more than 50 people.

An SAS that controls or is controlled by one or more companies is also required to appoint at least one auditor.

This form of commercial company is appropriate for companies whose shareholders have different profiles: investors and project leaders, equity companies and companies operating in the field of services and new technologies.

1.2 Sources of Corporate Governance Requirements

In Côte d'Ivoire, company law is subject to the Organization for the Harmonization of Business Law in Africa (OHADA) law and more specifically to the Uniform Act on Commercial Companies and Economic Interest Groups (ACSCGIE). The articles of association and the shareholders' agreement are also sources of corporate governance.

Ivoirian law can also be a source of corporate governance requirements for companies that can complement the laws of OHADA as long as it does not contradict them.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Companies making a public offering of their shares in one or more contracting states or

whose shares are listed on the stock exchange of one or more contracting states are required to have a board of directors.

The boards of directors of the companies must be composed of at least three members and at most 15 members when a company's shares are admitted to the stock exchange.

However, in the event of a merger involving one or more companies whose shares are admitted to the stock exchange of one or more "States Parties", the number of 15 may be exceeded up to the total number of directors in office for more than six months in the merged companies, but may not exceed 20.

No new directors may be appointed, nor may directors who have died or ceased to hold office be replaced, until the number of directors has been reduced to 15 when the shares of the company are admitted to the stock exchange of one or more of the party states.

If a company admitted to the stock exchange of one or more States Parties is delisted from that stock exchange, the number of directors shall be reduced to 12 as soon as possible.

Within the various limits set out above, the number of directors is freely determined in the articles of association.

The board of directors of the companies is obliged to have an audit committee (*comité d'audit*).

The audit committee is composed exclusively of directors who are not employees of the company or who do not hold a position as chairman and chief executive officer, chief executive officer or deputy chief executive officer within the company. The board of directors ensures the competence of the directors it appoints to the audit committee.

The main tasks of the audit committee are to:

- review the accounts and ensure the relevance and consistency of the accounting methods used to prepare the company's consolidated and parent-company financial statements;
- monitor the process of preparing financial information;
- monitor the effectiveness of internal control and risk management systems;
- issue an opinion on the auditors proposed for appointment by the General Meeting; and
- report regularly to the board of directors on the performance of its duties and inform it without delay of any difficulties encountered.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

No specific hot topics in Côte d'Ivoire in the area of corporate governance have been identified.

2.2 Environmental, Social and Governance (ESG) Considerations

There are no regulations on Environment, Social and Governance (ESG) in OHADA law. These provisions will, for example, be provided for by the board of directors or by the internal regulations on a case-by-case basis for companies that can draw on international regulations in this area.

Ivoirian law can also be a source of ESG requirements for companies if it was enacted but it cannot be in conflict with OHADA laws.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

In general, in commercial companies:

- toward third parties, the management body, officers and board shall have, within the time-limits set forth in the Uniform Act for each type of company, full powers to bind the company without having to produce a special power of attorney, and any limitation of their legal powers by the articles of association shall be unenforceable against bona fide third parties; and
- the company shall be bound by acts of its management body, officers and board that are not within the company purpose, unless it can prove that the third party was aware that the act was unrelated to that purpose or could not ignore it given the circumstances, and the mere publication of the articles of association is not enough to prove it.

In an SARL

The company is managed by one or more managers (*gérants*) who must be natural persons. Managers may or may not be shareholders of the company.

The managers are appointed by the shareholders in the articles of association or by a decision of the general assembly.

In the absence of specific provisions in the articles of associations, the manager(s) is (are) appointed for four years and are re-eligible.

There is no requirement of nationality or residence for managers.

In an SA

The articles of association must specify under which of the following three management structures the company will be managed:

- a board of directors and a single chairman and general manager (*président-directeur général*), who must be a director of the company and a natural person; or
- a board of directors with a chairman of the board and a general manager (*directeur général*) who must be a natural person, who may or may not be a director of the company and who may be assisted by one or more assistant general managers.

In both of these points, directors may or may not be shareholders of the company, unless provided for in the articles of association. The board must have at least three and no more than 12 directors.

Companies having fewer than three shareholders may choose not to constitute a board of directors and to appoint a general manager (*administrateur general,* who may or may not be a shareholder of the company) who will be responsible for the administration and direction of the company.

In an SAS

Towards third parties, the SAS is represented by a president, who may be a natural or legal person and who may or may not be a shareholder of the company. The articles of association may provide for the conditions under which one or more individuals other than the president, with the title of general manager or deputy general manager, may exercise the powers entrusted to him or her by these articles. The provisions of the articles of association, and the decisions of legal representatives restricting the powers

of the president, the general manager or deputy general manager shall not be enforceable against third parties.

It is also possible to set up a board of directors.

3.2 Decisions Made by Particular Bodies

In an SARL

In relations between the shareholders and in the absence of determination of his or her powers by the articles of association, the manager may carry out all acts of management in the interest of the company.

Where there is more than one manager, they shall hold separately the powers provided for in the articles, except for the right of each of them to object to any transaction before it is concluded.

Opposition by one manager to the acts of another manager is without effect with regard to third parties, unless it is established that they have knowledge of it.

In an SA

SA with a board of directors

The board of directors determines the orientations of the company's activity and ensures their implementation. Subject to the powers expressly attributed to the shareholders' meetings and within the limits of the company's purpose, it deals with any issue concerning the proper operation of the company and through its deliberations settles matters that concern it.

The board of directors carries out any such controls and verifications as it deems appropriate.

The board of directors may entrust one or more of its members with special mandates for one or more specific purposes.

The chairman of the board of directors chairs the meetings of the board of directors and the general assemblies. He or she must ensure that the board of directors assumes the control of the management of the company entrusted to the general manager.

At any time, the chairman of the board of directors may carry out the verifications he or she deems appropriate and may obtain from the general manager, who is obliged to comply, all the documents he or she deems useful for the accomplishment of his or her purpose.

The general manager is responsible for the general management of the company. He or she represents the company in its relations with third parties.

SA with a general director

The managing director is responsible for the administration and general management of the company. He or she represents the company in its relations with third parties. He or she convenes and chairs the shareholders' meetings. He or she shall be vested with the broadest powers to act in all circumstances in the name of the company and shall exercise them within the limits of the corporate purpose and subject to those powers expressly conferred on shareholders' meetings by the Uniform Act and, where applicable, by the articles of association.

Meetings in the SA

Extraordinary general assembly

The extraordinary general assembly is the only body empowered to modify the statutes in all their provisions.

The extraordinary general meeting is also competent to:

- authorise mergers, demergers, transformations and partial contributions of assets;
- transfer the registered office to any other city of the contracting state where it is located or to the territory of another state; and
- dissolve the company early or extend its term (see **5.3 Shareholder Meetings**).

Special meeting

The special meeting brings together the holders of shares of a given category.

The special meeting approves or disapproves the decisions of the general meetings when these decisions modify the rights of its members.

Ordinary general assembly

The ordinary general meeting takes all decisions other than those expressly reserved for extraordinary general meetings and those reserved for special meetings (see **5.2 Role of Shareholders in Company Management**).

In an SAS

The SAS is a company set up by one or more shareholders and whose articles of association freely provide for the organisation and operation of the company.

The company is represented with respect to third parties by a president appointed under the conditions provided for by the articles of association.

The president is vested with the broadest powers to act in all circumstances on behalf of the company, within the limits of the corporate purpose.

The articles of association may provide for the conditions under which one or more persons other than the president, bearing the title of chief executive officer or deputy chief executive officer, may exercise the powers conferred on the latter by these articles.

The articles of association shall determine the decisions which must be taken collectively by the shareholders in the forms and under the conditions which they stipulate.

However, the powers vested in the extraordinary and ordinary general meetings of joint-stock companies, in matters of increase, amortisation or reduction of capital, merger, demerger, partial contribution of assets, dissolution, transformation into a company of another form, appointment of auditors, annual accounts and profits, are, under the conditions stipulated by the articles of association, exercised collectively by the shareholders.

3.3 Decision-Making Processes

Decisions are taken by general meetings, which may be ordinary or extraordinary, and which decide according to the majority and quorum rules set out in the AUSCGIE or in the articles of association for the SAS.

These rules differ according to the corporate form (see **5.3 Shareholder Meetings** for the majority and the type of decision).

These general meetings are convened by the corporate representatives according to a formalism prescribed by the AUSCGIE.

The shareholders are convened at least 15 days before the meeting of the assembly by hand-delivered letter against a receipt or by registered letter with a request for acknowledgement of a receipt, fax or email.

The notice of meeting indicates the date, place and agenda of the meeting.

The assembly cannot deliberate on a question which is not registered on its agenda.

These decisions of the shareholders must be recorded in the minutes, which indicate the date and the place of the meeting, the names and first names of the shareholders present, the agenda, the documents and reports submitted for discussion, a summary of the debates, the text of the resolutions put to the vote and the result of the votes.

4. Directors and Officers

4.1 Board Structure

An SA may be managed by a board of directors consisting of at least three and not more than 12 members, who may or may not be shareholders. The articles of association may require that each director own a number of shares in the company for which they make determinations.

This provision shall not apply in the case of employees appointed as directors.

Every director must, on the day of his or her appointment, hold the number of shares required by the articles of association or during his or her term of office.

In the case of an infringement, he or she shall resign from his or her office within three months of his or her appointment or, if the infringement occurs during his or her term of office, within three months of the date of the transfer of shares giving rise to the infringement. At the end of this period, he or she shall be deemed to have resigned from his or her mandate and must return the remuneration received, in whatever form, without the validity of the deliberations in which he or she took part being called into question.

The auditors shall exercise a supervisory role and shall disclose any violations in their report to the annual general meeting. The first directors shall be appointed by the articles of association or, where appropriate, by the constituent general meeting.

During the life of the company, the directors shall be appointed by the ordinary general meeting.

However, in the event of a merger, the extraordinary general meeting may appoint new directors.

Any appointment made in violation of the provisions of these articles shall be null and void. The term of office of the directors shall be freely determined by the articles of association, but may not exceed six years in the case of appointment during the life of the company and two years in the case of appointment by the articles of association or by the constituent general meeting.

4.2 Roles of Board Members

The board of directors determines the orientations of the company's activities and ensures their implementation. The board of directors has a chairman.

The board of directors may entrust one or more of its members with special mandates for one or more specific purposes.

4.3 Board Composition Requirements/Recommendations

The choice of directors is freely determined by the shareholders. There is no longer a quota

rule to be respected between the number of shareholder and non-shareholder directors, as was the case with the old pre-2014 AUSCGIE. However, the articles of association may require that each director own a number of shares of the company for which they make determinations. In practice, the composition of the board of directors often mirrors the composition of the company's shareholding.

4.4 Appointment and Removal of Directors/Officers

The directors or officers are appointed by the articles of association at the time of the company's incorporation, or during the company's life, by the general meeting.

The terms of appointment, re-election, replacement and dismissal are freely determined by the articles of association.

The directors may be re-elected unless the articles of association state otherwise.

In an SA, the duration of office of the president and managing director is aligned with that of the directors.

The termination of the functions of the directors must be published in the commercial register.

4.5 Rules/Requirements Concerning Independence of Directors

Two mechanisms are provided for by the AUSCGIE to prevent conflicts of interest between the company and its directors.

The Rules of Non-cumulation of the Functions of Legal Representatives (in an SA)

For directors (in an SA with a board of directors)

Subject to certain reservations, a natural person, director in his or her own name or permanent representative of a legal entity director may not simultaneously belong to more than five boards of directors of SA companies which have their registered office in the territory of the same State Party.

Any natural person who, upon taking up a new term of office, finds himself or herself in breach of this rule must, within three months of his or her appointment, resign from one of his or her terms of office.

For the president and managing director

No person may simultaneously hold more than three offices as president and managing director of an SA which has its registered office in the territory of the same party state.

Likewise, the function of president and managing director may not be held concurrently with more than two functions of general director or general manager of an SA which has its registered office in the territory of the same contracting state. Any natural person who, upon taking up a new term of office, finds himself or herself in breach of this rule, within three months of his or her appointment, shall resign from one of his or her offices.

For the general director

No person may simultaneously hold more than three offices as a general director of corporations which have their headquarters in the territory of the same State Party. Similarly, the office of general director may not be held concurrently with more than two offices of president and general

manager or general manager of an SA which has its registered office in the territory of the same contracting state. A director who, upon taking up a new term of office, is in violation of this rule must, within three months of his or her appointment, resign from one of his or her offices.

The Procedure for Regulated Agreements (in an SARL, an SA and an SAS)

According to Article 438 of the AUSCGIE, the following agreements must be subject to prior authorisation by the board of directors of an SA:

- any agreement between the SA and one of its directors, general managers or assistant general managers;
- any agreement between a company and a shareholder who holds 10% or more of the company's capital;
- any agreement in which a director, general manager, deputy general manager or shareholder with a holding of 10% or more of the company's capital is indirectly interested or in which he or she deals with the company through an intermediary; and
- any agreement between a company and a business or legal entity, if one of the directors, the general manager, the assistant general manager or a shareholder holding a stake equal to or greater than 10% of the company's capital is an owner of the business or an indefinitely liable shareholder, manager, director, general manager, assistant general manager, general manager, assistant general manager or other corporate officer of the contracting legal entity.

Similar provisions are provided for the SARL and the SA; regulated agreements must be approved by the ordinary general meeting (Articles 350 and 853-14 of the AUSCGIE).

4.6 Legal Duties of Directors/Officers

There are no specific provisions in the law.

However, Article 480 Section 2 of the AUSCGIE provides that the chairman must ensure that the board of directors assumes control of the management of the company entrusted to the general manager.

Thus, the chairman and the board of directors each have a role.

4.7 Responsibility/Accountability of Directors

In an SARL

The managers shall be liable, individually or jointly and severally, as the case may be, to the company or to third parties, either for infringements of the legal or regulatory provisions applicable to private limited companies, or for breaches of the articles of association, or for faults committed in their management.

If several managers have co-operated in the same acts, the competent court determines the contributory share of each of them in the remedy of the damage (Article 330 of the AUSCGIE).

In an SA

The directors shall be individually or jointly and severally liable to the company or to third parties, either for infringements of the legal or regulatory provisions applicable to an SA, or for violations of the provisions of the articles of association, or for faults committed under their management.

Where several directors have co-operated in the same acts, the competent court shall determine the contributory share of each of them in the remedy of the damage (Article 740 of the AUSCGIE).

In an SAS

The rules governing the liability of the members of the board of directors of *sociétés anonymes* are applicable to the chairman and the officers of the *société par actions simplifiée* (Article 853-10 of the AUSCGIE).

4.8 Consequences and Enforcement of Breach of Directors' Duties

Liability Actions

Two types of actions are provided for by the AUSCGIE.

The individual action

Pursuant to Articles 161 et seq of the AUSCGIE, third parties or shareholders may take individual action to hold a corporate officer liable for misconduct in the performance of his or her duties, without prejudice to the company's potential liability. If several corporate officers have participated in the same acts, they are jointly and severally liable to third parties.

This individual action is an action for damages suffered by a third party or by a shareholder, where the latter suffers a loss distinct from the loss suffered by the company, as a result of a fault committed individually or collectively by the corporate officers or directors in the exercise of their duties.

This action is brought by the person who suffers the damage.

The corporate action (action sociale) – Article 165 et seq of the AUSCGIE

A corporate action is the action for compensation for the damage suffered by the company as a result of a fault committed by corporate officer(s) in the performance of their duties.

The corporate action filed against one or several corporate officers can be initiated either by the company itself (through the other officers who are not involved), or by one or several shareholders in the case of failure of the competent bodies.

The corporate action is reserved only to the shareholders holding shares on the day it is implemented and who retain the status of shareholder during the whole duration of the procedure.

In the case of an SARL, Article 331 of the AUSCGIE provides that several shareholders may only claim compensation for the damage suffered by the company if they represent one quarter of the shareholders and one quarter of the company shares. These two conditions are cumulative. However, in the case of an SA, the shareholders can only exercise the corporate action if they represent at least one twentieth of the share capital (Article 741 of the AUSCGIE).

The individual and corporate action can be triggered and acted upon concurrently/simultaneously.

Grounds for Liability

A breach of directors' duties would give rise to their liability.

Similar provisions govern the rules pertaining to the liability of corporate officers and directors in the different types of companies that have been described: SARL, SA and SAS.

A distinction must be made between civil and criminal liability.

Civil liability of the manager of an SARL and the directors of an SA

The liabilities are similar for the manager of an SARL and the directors of an SA. They are liable, individually or jointly and severally, as the case may be, to the company or to third parties, either for breaches of the laws or regulations applicable to companies, or for breaches of the articles of association, or for misconduct in their management. If several managers or directors have co-operated in the same acts, the competent court shall determine the contribution of each of them to the compensation for the damage.

In addition to the action for compensation for the damage suffered personally, the shareholders representing one quarter of the shareholders and one quarter of the shares may, either individually or by grouping together, proceed with the social action for liability against the manager or director(s). No clause in the articles of association may make the exercise of the corporate action subject to the prior notice or authorisation of the meeting or entail a waiver in advance of the exercise of this action.

No decision of the meeting may have the effect of extinguishing an action for liability against the managers for misconduct committed in the performance of their duties. Any decision to the contrary is null and void.

Civil liability of the chief executive officer of an SA

The same rules of individual and social responsibility apply to the chief executive officer.

Civil liability of the directors of an SA

Directors are individually or jointly and severally liable to the company or to third parties, either for breaches of the laws or regulations applicable to an SA, or for breaches of the provisions of the articles of association, or for misconduct in their management.

Civil liability of the president/chairman of an SAS

The same rules of individual and social responsibility as those mentioned for the manager and the chief executive officer apply to the president.

Criminal liability

The AUSCGIE contains criminal provisions in the event of offences committed by corporate officers:

- the incorporation of companies;
- the management, administration and direction of the company;
- general meetings;
- changes in the capital of an SA, capital reductions;
- company control;
- dissolution of companies;
- liquidation of companies; and
- in the event of a public offering for savings.

Law n° 2017-727 of 9 November 2017 of Côte d'Ivoire describes the penalties incurred for the offences referred to in the Uniform Act. It provides for sanctions against those in control of the company, who may abuse their power or commit crimes by consciously going against the company's interest or by not following procedures and depriving the relevant parties of their rights to participate in the company's management.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Other bases for claims or enforcement against directors or officers for breaches of corporate governance requirements that exist in Côte d'Ivoire are as follows.

The Management Expertise

Pursuant to Article 159 of the AUSCGIE, one or more shareholders representing at least one tenth of the share capital may, either individually or by grouping together in any form whatsoever, request the competent court of the registered office, ruling within a short period of time, to appoint one or more experts to present a report on one or more management operations.

The Provisional Administration

When the normal functioning of the company is made impossible, either because of the management, executive or administrative bodies, or because of the shareholders, the competent court, ruling within a short period of time, may decide to appoint a provisional administrator for the purpose of temporarily managing the company's affairs (Article 160-1 of the AUSCGIE).

Since, according to the general law of civil liability, the potential liability of directors is likely to be implemented as soon as it can be established that they have committed errors in the performance of their duties and that these have had harmful consequences for the company, the shareholders or third parties, the liability of a director or officer can only be limited by proving that the damage results either from a force majeure or from a fault of the victim or a third party.

Any clause to the contrary in the articles of association is deemed to be unwritten.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Article 325 of the AUSCGIE

In an SARL, the duties of a manager may be performed free of charge or with remuneration, under the conditions laid down in the articles of association or in a collective decision of shareholders.

The determination of the remuneration is not subject to the regime of related-party agreements.

In an SA, the ordinary general meeting may allocate to the directors, as remuneration for their activities, a fixed annual sum that it determines at its own discretion (commonly called "*jetons de présence*" in French).

Unless otherwise provided for in the articles of association, the board of directors is free to allocate the compensation among its members.

The board of directors may also allocate to its members exceptional remuneration for the missions and mandates entrusted to them, or authorise the reimbursement of travel expenses and expenses incurred in the interest of the company, subject to the provisions concerning regulated agreements.

A director may enter into an employment contract with the company if that contract corresponds to actual employment.

Apart from sums received under an employment contract, the directors may not receive, in respect of their duties, any other remuneration, permanent or otherwise, than that provided for by the board of directors (Articles 430, 431 and 432 of the AUSCGIE).

The chief executive officer may be bound to the company by a contract of employment. The terms and amount of the remuneration of the chairman and managing director are fixed by the board of directors. Where necessary, the benefits in kind granted to him or her shall be fixed

in the same manner as his or her remuneration. The chief executive officer may not receive any other remuneration from the company (Article 466 of the AUSCGIE).

In the SAS, the remuneration and benefits of the chairman and of the potential other directors are determined by the articles of association and the shareholders.

4.11 Disclosure of Payments to Directors/Officers

No public disclosure obligation in relation to the remuneration, fees or benefits payable to directors and officers for companies has been identified, except for publicly traded companies. Indeed, Article 831-2 of the AUSCGIE requires the disclosure of the report prepared by the chairman of the board of directors containing, in addition to the composition of the board of directors and its operating conditions, the compensation allocated to the corporate officers.

Regarding other disclosures, pursuant to Article 432 of the AUSCGIE the exceptional remuneration of directors for missions and mandates entrusted to them, or the reimbursement of travel expenses and expenses incurred in the interest of the company, must be the subject of a special report by the auditor to the general meeting.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

A shareholder is a natural or legal person who makes a contribution (in kind, cash or industry) to the company. In return, the company delivers shares (Articles 7 and 51 of the AUSCGIE).

The status of shareholder is regulated by Articles 7 to 9 of the AUSCGIE.

Those persons who cannot be a shareholder are:

- any natural or legal person who is subject to a prohibition, incapacity or incompatibility provided for by a legal or regulatory provision; and
- minors and incapable adults in companies where they would be liable for the company's debts beyond their contributions.

Company shares are called "actions" (in French) in joint-stock companies and "*parts sociales*" in other companies (Articles 7 and 51 of the AUSCGIE).

The contribution made by the shareholders determines their rights and obligations within the company:

- a right on the profits made by the company;
- a right on the net assets of the company at the time of their distribution, dissolution or at the time of a reduction of the company's capital of information and intervention in the social affairs of the company;
- an obligation to contribute to the losses in certain forms of company; and
- the right to participate in the vote of shareholders' collective decisions.

The rights and obligations of the shareholders are proportional to their contribution.

In addition, according to Article 54 of the AUSCGIE, are clauses that attribute to a shareholder all of the profit made by the company or exempt him or her from all of the losses, as well as those that exclude a shareholder entirely from the prof-

it or make him or her responsible for all of the losses.

Disagreement between shareholders constitutes a cause for dissolution of commercial companies within the meaning of Article 200 of the AUSCGIE.

In limited liability companies, the shareholders are only liable for the company's debts up to the amount of their contributions.

The limited liability companies are:

- the SARL;
- the SAS; and
- the SA.

In the case of debts in such a company, the liability of the shareholder is limited to the loss of the total amount of his or her contributions in share capital and his or her contributions in the shareholders' current account.

Shareholders who hold management positions within the company may also be liable, individually or jointly, to the company or third parties, either for breaches of the law or the articles of association (civil or criminal liability), or for faults committed in their management.

5.2 Role of Shareholders in Company Management

The shareholders have a certain right of control over the management of the company, which differs according to the type of company.

In an SARL

Any non-managing shareholder can, twice a year, ask the manager, in writing, questions about any fact that could jeopardise the continuity of the business.

The manager must then provide answers within 15 days, in writing, to the questions asked by the shareholders. Within the same time limit, he or she must send a copy of the questions and his or her answers to the auditor, if there is one (Article 157 of the AUSCGIE).

In an SA and an SAS

Any shareholder who does not have managerial status may, twice a year, ask questions, in writing, of the chairman of the board of directors, the chief executive officer or the managing director, as the case may be, on any fact likely to jeopardise the continuity of the business. The chairman of the board of directors or the chief executive officer must then reply, in writing, within 15 days, to the questions asked by the shareholder. Within the same period, he or she must send a copy of the questions and his or her answers to the auditor (Article 158 of the AUSCGIE).

The shareholder is also able to direct the actions of the corporate officers, thanks to:

- the holding of ordinary general assemblies, during which the corporate documents are controlled and approved (summary financial statements, management reports, the auditor's report, the auditor's special report on regulated agreements if any, inventories, draft resolutions);
- individual action (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**); and
- corporate action (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**).

5.3 Shareholder Meetings

All shareholders have the right to participate in the voting of collective decisions (Article 125 of the AUSCGIE).

There are two kinds of collective decisions: ordinary decisions and extraordinary decisions (Article 132 of the AUSCGIE).

These decisions can be taken within the framework of general assemblies or by written consultation (Article 133 of the AUSCGIE). All the deliberations of the shareholders are noted by a minute (Article 134 of the AUSCGIE).

The manager is in charge of convening the general assembly. In the case of their failure to do so, the auditor may substitute for him or her. Failing this, the shareholders may request the convening of the meeting in court.

The methods of convening the meeting are set out in the articles of association.

The ordinary general meeting congregates at least once a year (within six months of the end of the financial year). An extension of the deadline may be requested from the president of the competent court ruling on a petition.

The purpose of the ordinary general meeting is:

- to approve the summary financial statements, the management report and the inventory (Article 140 of the AUSCGIE for the SA, SARL and SAS) – to this end, the aforementioned documents are communicated at least 15 days before the meeting by the company directors;
- to decide on the allocation of the result (Article 142 of the AUSCGIE); and
- to determine the allocations to optional reserves, the share of profits to be distributed, the amount of any retained earnings (Article 144 of the AUSCGIE).

In an SARL and an SA, the decisions are made by a majority of the votes present and represented.

The extraordinary general meeting takes extraordinary collective decisions, ie, decisions to amend the articles of association. It decides by a majority of three quarters of the capital in an SARL and two thirds in an SA.

However, unanimity is required in the case of:

- an increase of the shareholders' commitments;
- transformation into an SAS; and
- transfer of the registered office to a state other than a State Party of the AUSCGIE.

In the event of a loss of half of the share capital, an extraordinary general meeting must be convened within four months of the general meeting which recorded this loss, on pain of penal sanctions or request by any interested party for dissolution of the company.

In an SAS, the rules of majority and quorum are set by the articles of association.

5.4 Shareholder Claims

The bases of claim that exist for shareholders against the company or directors are as follows:

- against the company – the shareholders do not have a liability claim against the company; and
- against the directors – see **5.2 Role of Shareholders in Company Management** (social action, individual action, alert procedure).

5.5 Disclosure by Shareholders in Publicly Traded Companies

As far as is known, there are no disclosure or other obligations on shareholders in publicly traded companies.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Pursuant to Article 137 of the AUSCGIE, at the close of each fiscal year the manager or the board of directors or the managing director, as the case may be, shall prepare and close the financial statements in accordance with the provisions of the Uniform Act on the Organisation and Harmonisation of Companies' Accounting.

As required by the revised Article 140 of the AUSCGIE, for an SA, an SAS and, where applicable, an SARL, the annual summary financial statements and the management report shall be sent to the auditors at least 45 days before the date of the ordinary general meeting.

These documents are presented to the general meeting of the company approving the financial statements, which must be held within six months of the end of the financial year.

6.2 Disclosure of Corporate Governance Arrangements

Pursuant to Article 138 of the AUSCGIE, the manager, the board of directors or the managing director, as the case may be, draws up a management report in which he or she describes the situation of the company during the past financial year, its foreseeable evolution, the important events which occurred between the closing date of the financial year and the date on which it is drawn up and, in particular, the prospects for the continuation of the activity, the evolution of the cash-flow situation and the financing plan.

This report is therefore financial, but the Uniform Companies Act allows for the creation of committees, composed of directors, within the board and under the direction of a director, to deal with particular aspects of the life of the company (Article 437 of the AUSCGIE).

Thus, according to Article 437 Section 2: "It [the board of directors] may decide to create committees composed of directors to study the questions that it or its chairman submits to them for advice. It shall determine the composition and powers of the committees, which shall carry out their activities under its responsibility."

The AUSCGIE also provides for the mandatory presence of audit committees in companies issuing stock to the public, in order to ensure better corporate governance. The audit committee shall report regularly to the board of directors on the performance of its duties and shall inform it without delay of any difficulties encountered (Article 829-1 of the AUSCGIE).

In addition, agreements entered directly or through an intermediary between the company and one of its managers, directors, or shareholders are the subject of a special report by the auditor at the general meeting.

6.3 Companies Registry Filings

Commercial companies are required to make filings with the companies' registry of the registered office when there is:

- the appointment or termination of the functions of company executives (Article 124 of the AUSCGIE);

- a draft merger or demerger (filed in the Trade and Personal Property Credit Register of the registered office of the companies concerned at least one month before the date of the first general meeting called to decide on the operation) (Article 194 of the AUSCGIE);
- the dissolution of the company, by filing in the Trade and Personal Property Credit Register the deeds or minutes deciding upon or recording the dissolution and by amending the entry in the Trade and Personal Property Credit Register (Article 202 of the AUSCGIE);
- liquidation of the company by the deposit of the final accounts drawn up by the liquidator, with either the decision of the meeting of shareholders ruling on these liquidation accounts, the discharge of the liquidator's management and the discharge of his or her mandate, or, failing this, the court decision referred to in the preceding article in order to obtain the striking-off of the company from the Trade and Personal Property Credit Register (Articles 219 and 220 of the AUSCGIE);
- approval of the company's accounts by filing the summary financial statements, ie, the balance sheet, the profit-and-loss account, the financial table of resources and uses and the annexed statement of the past financial year within one month of their approval by the competent body (Article 269 of the AUSCGIE);
- transferable securities (for their enforceability against third parties); and
- transfer of shares (for the enforcement of their rights against third parties) (Articles 319 and 763-1 of the AUSCGIE).

The filings relating to the incorporation or the modification of the company (merger, liquidation of a company) as well as the pledges or the collective procedure are publicly available upon request to the company's registry.

However, specific documents such as financial statements are not available.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

In the SA, the appointment of an auditor is mandatory. It takes place during the constitutive general assembly (for the first appointment).

An SA making a public appeal for savings is required to appoint at least two auditors and two deputies.

An SA that does not make a public offering is required to appoint one auditor and one substitute.

As regards the other corporate forms, this appointment is optional, except where the company exceeds certain thresholds (see **1.1 Forms of Corporate/Business Organisations**).

The auditor's duties include:

- evaluating the contributions in kind realised at the time of the constitution of an SARL and an SA;
- drafting the summary financial statements;
- presenting the agreements between the company and its shareholders or its directors to the general assembly or the board of directors; and
- making requests to the company's directors on all facts likely to compromise the continuity of the operation that he or she has noted during the examination of the documents which are communicated to him or her, or of which he or she has knowledge in the exercise of his or her duties.

The auditor is responsible, with respect to the company and third parties, for the harmful consequences of the faults and negligence he or she may commit in the performance of his or her duties (insufficient investigation or certification of an inaccurate balance sheet, for example).

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The Management Report (Article 138 of the AUSCGIE)

The manager, the board of directors or the managing director, as the case may be, is required to prepare a management report in which he or she describes the situation of the company during the past financial year, as well as its future situation. This management report is submitted to the approval of the shareholders at the annual general meeting.

Agreements between the Company's Directors and the Company

In an SA with a board of directors (Article 438 of the AUSCGIE), and an SA with a managing director (Article 502 of the AUSCGIE), the regulated agreements are subject to the authorisation of the members of the board of directors and to the approval of the general assembly ruling on the summary financial statements. For an SARL (Article 350 of the AUSCGIE) and an SAS (Article 853-14 of the AUSCGIE), these agreements are subject to approval by the general assembly.

Prohibited Agreements

The managers of an SARL (Article 356 of the AUSCGIE) and the directors of an SA (Article 450 of the AUSCGIE) are prohibited from contracting loans from the company in any form whatsoever, from being granted an overdraft on a current account or otherwise, as well as from being guaranteed or endorsed by the company in respect of their commitments to third parties. These acts are null and void.

Trends and Developments

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Houda Law Firm is a multi-sectoral and multi-disciplinary law firm based in Senegal and Côte d'Ivoire. The firm has a total staff of 53 people, composed of a team of lawyers, jurists and paralegals. The staff work in French and English, to ensure the satisfaction of local and international clients. Houda Law Firm provides legal advice and assistance to a diverse clientele in a variety of practice areas, including business law, insurance law, banking and finance, public and private international law, contract law, mining, oil and gas, renewable energy, and tax. The firm has proven expertise in the energy and extractive sector, in PPPs, banking and finance, corporate and commercial law.

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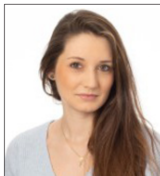

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Good Governance and Transparency in the Revised Uniform Act on Commercial Companies and Economic Interest Groups

The World Bank reports that Cote d'Ivoire has been experiencing one of the fastest and most sustained economic growth rates in sub-Saharan Africa for more than ten years. Indeed, it offers investment opportunities accompanied by a certain legal security thanks to the institution that is the OHADA (Organization for the Harmonization of Business Law in Africa).

The Uniform Act on Commercial Companies and Economic Interest Groups ("Uniform Act on Companies") adopted on 30 January 2014 ensures good governance within companies in that it prescribes the laws relating to the constitution of commercial companies as to the articles of association and their contents, the public offering of securities, the registration of companies, and also their operation and the roles of each actor in the various types of companies.

In March 2022 the Code of Governance of Companies listed on the Regional Securities Exchange (BRVM) was launched by the BRVM and supported by the International Finance Corporation (IFC). The Governance Code presents 11 founding principles complementary to the provisions of the Uniform Act on Companies, with respect to corporate governance.

The Concept of Good Governance in Côte d'Ivoire under OHADA

Definition

Corporate governance does not have a precise and constant definition, but it is often conceived as a legal framework that governs the relations of the internal actors of the company such as the managers and the investors. It is conceived as "the set of organisational mechanisms that have the effect of delimiting the powers and influencing the decisions of managers, in other words, that govern their conduct and define their discretionary space" (Gérard CHARREAUX, (dir), *Le gouvernement des entreprises, Paris, Economica*, 1997, p. 1). This management will therefore have an impact on shareholders and their contributions to the company, but also on subcontractors and consumers. The corporate governance also establishes the structure that allows to define the objectives of the company, the board of directors and its shareholders (" *Principes de gouvernement de l'entreprise de l'OCDE* 2004", p. 11, www.ocde.org).

In this article, corporate governance will be conceived as all the mechanisms that allow

the managers to be held accountable for their management decisions as well as for the performance obtained from the company. The means imposed to guide the management decisions allow to reassure the shareholders as well as the creditors of the company by imposing a certain transparency on the decision-making process.

The Uniform Act on Commercial Companies was revised in 2014 to establish and encourage better corporate governance in OHADA jurisdictions. Improving transparency in corporate management would reassure investors. This revision has made it possible to clearly establish the roles of the actors mentioned above, the control of these actors and the functioning of their decision-making, which has also been reinforced.

The Uniform Companies Act provides for an article on corporate governance codes whereby representative organisation of the companies can elaborate governance code themselves (Article 831-2). This suggests that the institution that is OHADA wants to give force to the provisions concerning good corporate governance.

Good governance in simplified joint stock companies and public limited companies

The Uniform Companies Act contains general provisions for all commercial companies as well as specific provisions for certain types of companies. These provisions govern limited liability companies (SARL), limited partnerships, general partnerships as well as public limited companies (SA) and simplified joint stock companies (SAS).

Among these general provisions applicable to all forms of companies, those on collective decision-making give all partners the right to participate in votes unless otherwise provided for (Article 125 of the Uniform Companies Act). This right allows participation in decisions to balance the roles in the life of the company.

As in all companies, at the close of each financial year, the directors must draw up and close the summary financial statements in accordance with the provisions of the Uniform Act on the Organization and Harmonization of Business Accounting (Article 137 of the Uniform Act on companies). These financial statements, in addition to the management report, make it possible to present a true picture of the company's financial situation and, above all, the management of its directors. This management report presents the situation of the company during its life and the important events that occurred during the closing, but also its foreseeable evolution and the future perspectives of the company's activity (Article 138 of the same Act).

Although the concept of good governance is originally an Anglo-Saxon concept, it has been adapted in many French-speaking jurisdictions to ensure transparency in the management of companies. It is particularly considered in OHADA law, and it is interesting to analyse it through the example of simplified joint stock companies, with the different corporate bodies.

SAs and SASs are very present in Côte d'Ivoire and are very frequently the form chosen whether by large groups or by family businesses. The management of SAs is ensured by a chairman and managing director ("CEO"), a managing director, the directors, or the chairman of the board of directors, the managing director according to the mode chosen at the time of incorporation of the company.

The elements of the mandate, the attributions and the remuneration of the CEO are governed by Articles 462 to 469 of the Uniform Act on

Companies. Among his or her obligations of transparency and good management, he or she must communicate all the documents and information necessary for the accomplishment of his or her mission (Article 465, paragraph 3 of the same Act). Although he or she has the most extensive powers to carry out his or her duties, he or she remains limited, in particular insofar as he or she must discharge his or her obligations to the board of directors.

The board of directors determines the terms and amount of his remuneration (Article 467 of the same Act). The benefits in kind granted to him are fixed, in the same way as his remuneration. He does not take part in the vote concerning his remuneration and may not receive any other remuneration than that provided for by law. This Article of the Uniform Act ensures the transparency and efficiency of the decisions taken by the CEO. This remuneration and its terms are then made available to the shareholders, in order to avoid any excess (Article 831-3 of the same Act). Indeed, the total amount certified by the auditors of the remuneration paid to the company's directors may be requested by the shareholders during an annual ordinary general meeting (Article 525.5 of the same Act). This right is exercised within 15 days prior to the meeting and allows shareholders not only to ascertain the reasonable compensation of corporate officers by the board of directors but also to ascertain the compensation of the highest paid employees.

For the time being, these obligations are limited to companies making public offerings. This naturally allows investors to ascertain the financial situation of the company.

The means of good governance

The revised Uniform Act relating to the law of commercial companies and economic interest groups has also added actors and means to ensure good corporate governance. Audit committees and statutory auditors ensure objectivity in the evaluation of the management of the company by the various corporate bodies. These means also include transparency vis-à-vis the public in public offerings, and criminal sanctions in Côte d'Ivoire. This allows for surveillance during the life of the company but also constitutes a means of dissuasion with respect to mismanagement or infractions.

Audit committees

The Uniform Act on Companies imposes the mandatory presence of audit committees in listed companies. It provides that companies making a public offering of their securities in one or more States parties or whose securities are listed on the stock exchange of one or more States parties must have a board of directors (Article 828).

The boards of such companies must have an audit committee (Article 829-1). For obvious reasons of independence, this audit committee must be composed exclusively of non-employee directors of the company. These directors may not hold a position as CEO, MD, or COO of the company, and they are appointed by the board of directors. The essential missions of this committee are:

- to review the accounts and ensure the relevance and consistency of the accounting methods adopted for the preparation of the company's consolidated and parent company accounts;
- to monitor the process of preparing financial information;
- to monitor the effectiveness of internal control and risk management systems; and

- to issue an opinion on the statutory auditors proposed for appointment by the general meeting.

Through its role, the audit committee adds another evaluation step in listed companies.

Statutory Auditor

The statutory auditor under OHADA law is responsible for verifying and issuing an opinion on the company's financial statements. His opinions must indicate that "the summary financial statements are regular and sincere and give a true and fair view of the results of operations for the past financial year as well as of the financial situation and assets of the company at the end of this financial year" (Article 710 of the same Act).

The auditor is appointed by the articles of association or by the constituent general meeting. This method of appointment gives a certain independence to the auditor from the company's corporate officers. His role is not to interfere in the management of the company but to report objective facts about the results of the company's operations. He must report any irregularities and inaccuracies that he may have noticed during his mission.

They may be one or more in a public limited company, and these roles must be exercised by natural persons or by companies constituted by such natural persons (Article 694 of the Uniform Act on Companies). The Uniform Act also provides that if there is an association of chartered accountants in the State Party of the registered office of the company subject to the audit, only chartered accountants registered in the roll of the association may perform the functions of auditors. The Order of Chartered Accountants of Cote d'Ivoire allows to obtain a list of chartered accountants or chartered accountancy firms for public limited companies. If a public limited company makes a public offering, it will be required to appoint at least two auditors and two deputies. Otherwise, it may be satisfied with one of each.

The Uniform Companies Act provides for the independence of the auditor whose role is essential for the control of the company's management. Indeed, the functions of the auditor are incompatible "with any activity or any act that may undermine his independence and with any salaried employment, and any commercial activity, whether carried out directly or through an intermediary" (Article 697). For obvious reasons of separation of roles and independence, the Uniform Act provides that none of the members of the corporate bodies of the company may be an auditor (Article 698), nor may the auditors become members of these corporate bodies (Article 699).

The information document

The Uniform Act contains specific provisions on public offerings for reasons of transparency towards third parties. The information document must be published in the State where the issuer's registered office is located or in the other States parties whose public is solicited (Article 86). This document is intended for the public.

The document must inform the public about the securities offered or admitted to trading on a stock exchange in a state party. It is necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the issuer and any guarantors, as well as the rights attached thereto (Article 86 of the Uniform Act on Companies).

This information document contains a summary with the key information in a simple and concise manner and in the same language as the information document. In Côte d'Ivoire, the official language being French, this is the recommended language for the information document. In the interest of the public and investors, a warning must be added to the document indicating:

- that it should be read as an introduction to the information document;
- that any decision to invest in the relevant securities should be based on a thorough review of the disclosure document by the investor; and
- that the persons who have presented the summary are civilly liable if the content is misleading or inaccurate in relation to the other parts of the document or if the information document does not provide the essential information in combination with the other documents (Article 86-1 of the Uniform Act on Companies).

It is within this legal framework that OHADA requires companies and their directors to be transparent about their financial affairs. It is important to note that Côte d'Ivoire does not yet have legislation imposing more transparency about environmental and social responsibility (SER).

The management report

Another means by which minority shareholders can verify or evaluate one or more decisions of the company's directors is to request a management report.

They can ask the competent court of the registered office to appoint one or more experts to present a report on one or more management operations (Article 159). One or more partners representing at least one tenth of the registered capital may request the competent court, either individually or in a group, to appoint such an expert. The management operations must be determined and specified at the time of the request. It will therefore not be a request made for an analysis of the general management of the company.

If the competent court grants the request, then it will determine the scope of the mission and the powers of the experts (Article 160 of the same Act). The fees of the experts will be paid by the company and their report will be sent to the applicant as well as to the management, executive or administrative bodies. The auditor will also receive the report, which may enable him to trigger a warning procedure if he considers it necessary.

Criminal sanctions

Law No. 2017-727 of 9 November 2017, on the repression of offences provided for in the Uniform Acts of the Treaty on the Harmonization of Business Law in Africa ("Law 727"), provides for a certain number of penalties, which may deter certain behaviours and thus promote transparency and good governance.

OHADA leaves it up to member states to adopt complementary laws if they do not contradict OHADA law. In 2017, Côte d'Ivoire adopted Law 727 covering different types of offences. Chapter 4 governs the repression of offences provided for in the Uniform Act on Companies, particularly offences relating to the management, administration, and direction of companies. For the good governance of companies in Côte d'Ivoire, these sanctions mainly concern the failure for management, administration, and direction of companies to meet their obligations in the presentation of financial statements, the

trading of non-paid-up shares and the distribution of fictitious dividends.

Indeed, company directors risk a prison sentence of one to five years and a fine of 1,000,000 to 5,000,000 CFA francs if they knowingly publish or present to the shareholders or associates, with a view to concealing the true situation of the company, summary financial statements that do not give, for each financial year, a true and fair view of the operations of the year, the financial situation and that of the assets of the company at the end of that period. Company directors also risk a prison sentence of three months to three years and/or a fine of 100,000 to 1,000,000 CFA francs if they do not file the summary financial statements within one month of their approval.

To our knowledge, these sanctions have not yet been applied in Côte d'Ivoire, and the means of application are still uncertain. However, their existence could still promote compliance with the principle of good governance by corporate officers.

Conclusion

The revised Uniform Act of 2014 imposes more transparency on corporate officers than in its previous version, by providing for criminal sanctions but also by ensuring good internal management through other actors such as audit committees and statutory auditors.

FRANCE

Law and Practice

Contributed by:
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Contents

1. Introductory p.122
1.1 Forms of Corporate/Business Organisations p.122
1.2 Sources of Corporate Governance Requirements p.123
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.123

2. Corporate Governance Context p.124
2.1 Hot Topics in Corporate Governance p.124
2.2 Environmental, Social and Governance (ESG) Considerations p.125

3. Management of the Company p.126
3.1 Bodies or Functions Involved in Governance and Management p.126
3.2 Decisions Made by Particular Bodies p.127
3.3 Decision-Making Processes p.128

4. Directors and Officers p.129
4.1 Board Structure p.129
4.2 Roles of Board Members p.130
4.3 Board Composition Requirements/Recommendations p.130
4.4 Appointment and Removal of Directors/Officers p.131
4.5 Rules/Requirements Concerning Independence of Directors p.131
4.6 Legal Duties of Directors/Officers p.131
4.7 Responsibility/Accountability of Directors p.132
4.8 Consequences and Enforcement of Breach of Directors' Duties p.132
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.132
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.133
4.11 Disclosure of Payments to Directors/Officers p.134

5. Shareholders p.134
5.1 Relationship Between Companies and Shareholders p.134
5.2 Role of Shareholders in Company Management p.134
5.3 Shareholder Meetings p.135
5.4 Shareholder Claims p.135
5.5 Disclosure by Shareholders in Publicly Traded Companies p.136

6. Corporate Reporting and Other Disclosures p.136
6.1 Financial Reporting p.136
6.2 Disclosure of Corporate Governance Arrangements p.137
6.3 Companies Registry Filings p.137

7. Audit, Risk and Internal Controls p.137
7.1 Appointment of External Auditors p.137
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.138

PR & Associés AARPI is a specialist corporate and dispute resolution firm, combining expert legal advice with the focus and flexibility of a boutique practice. The firm was launched in 2020 by renowned M&A and litigation adviser Christophe Perchet (ex Davis Polk) and Nicolas Rontchevsky, one of the most respected corporate and securities law scholars. Jean-Christophe Devouge joined the firm in late 2020 as the third partner. Building up its extensive experience, the team routinely assists companies, boards of directors, investors and senior executives in high-stakes corporate transactions (M&A, tender offers, squeeze-out, spin-offs, joint ventures) and corporate governance matters (CEO succession, executive compensation, related-party transactions, shareholder communications, investigations, etc). Monitoring carefully evolving trends and best practices, the firm's lawyers are at the forefront of regulatory developments both at EU and French levels and actively engage in public policy debates on matters related to listed companies.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

In France, most business organisations are incorporated in the form of companies with distinct legal personality.

French law distinguishes between civil companies, governed by civil laws exclusively, and commercial companies, governed by civil and commercial laws. Civil companies may operate only a limited list of activities, which are deemed civil by nature (eg, agriculture, liberal activities, real estate), while commercial companies may operate any type of activities, including civil activities.

There are three main differences between civil companies and commercial companies:

- civil companies may not conduct commercial or industrial activities; their purpose is therefore limited;
- shareholders' liability is never limited in civil companies, whereas it is limited in most commercial companies; and
- most civil companies are tax transparent – ie, profits of the company are taxed at the shareholders' level and subject to income tax, whereas most commercial companies are subject to corporate tax.

These differences explain that civil companies are far less common than commercial companies, and limited to specific uses. For this reason, they will be excluded from this study.

The corporate forms applicable to commercial companies are numerous and can be classified into two categories: limited liability companies and unlimited liability companies. Unlimited liability companies are rare and used for extremely specific transactions, so they will be also excluded from this study.

Among limited liability companies, the most common corporate forms are:

- public limited companies (*sociétés anonymes* or "SA"), used for large companies, most listed companies being incorporated in the form of SA;
- simplified joint stock companies (*sociétés par actions simplifiées* or "SAS"), a rather new corporate form but largely used thanks to its high flexibility; and

- limited liability partnership (*société à responsabilité limitée* or "SARL"), primarily used for small businesses, as shares of SARL are not freely tradable.

1.2 Sources of Corporate Governance Requirements

Corporate governance requirements are derived from laws and regulations, recommendations and internal rules set forth by companies themselves.

Laws and Regulations

The French Commercial Code (*Code de commerce)* and, to a lesser extent, the French Monetary and Financial Code (*Code monétaire et financier)* contain the majority of corporate governance rules and requirements.

European Union directives and regulations, such as the Shareholder Rights Directive II of 17 May 2017, or the Directive on improving the gender balance among directors of listed companies dated 23 November 2022, also comprise a set of corporate governance requirements applicable to French companies. Requirements issued from EU directives shall be incorporated into French law in order to be enforceable, whereas requirements issued from EU regulations are directly applicable to French companies.

Recommendations

Listed companies are subject to additional recommendations issued by corporate governance codes, to which they must refer (or explain why they decided not to), such as the AFEP-MEDEF Code, intended for large, listed companies, and the MiddleNext Code intended for small and medium-sized listed companies.

They must also take into consideration recommendations issued by the *Haut Comité au Gouvernement d'Entreprise* (HCGE) – a special committee appointed to follow the implementation of the AFEP-MEDEF Code and interpret its recommendations – and by the French Financial Markets Authority (AMF).

To a lesser extent, listed companies may also take into account the voting policies issued by proxy advisors (Proxinvest, ISS), as they are followed by a majority of investors and give guidance on satisfactory governance policies for investors.

Internal Rules

Finally, companies may adopt internal rules, such as by-laws, board internal regulations, codes of ethics or of conduct which set forth specific corporate governance rules and requirements.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Listed companies are subject to additional mandatory corporate governance requirements and recommendations.

First of all, only three corporate forms are authorised to trade their shares on a regulated market: SA, (*Societas Europaea* (SE) and partnerships limited by shares *société en commandite par actions* or "SCA").

Listed companies are subject to other mandatory corporate governance requirements:

- composition of the board – the composition of listed companies' boards of directors (or supervisory boards) is highly regulated. Listed companies are subject to gender balance requirements (the proportion of directors of each gender must be at least 40%)

and requirements related to the appointment of directors representing employees and employee shareholders (please refer to **4.3 Board Composition Requirements/Recommendations**);
- audit committee – listed companies are required to set up an audit committee whose purpose is to provide technical and critical support to management in monitoring the company's accounting and financial policy (please refer to **4.1 Board Structure**);
- compensation of corporate officers ("say on pay") – listed companies must comply with the say-on-pay requirements for the determination and payment of corporate officers' and directors' compensation. The say-on-pay proceedings require a double shareholders' approval on compensations; the shareholders shall vote on the compensation policy determined by the board of directors (ex-ante vote) and on the amounts payable to corporate officers and directors upon implementation of the approved compensation policy (ex-post vote); and
- enhanced governance information – listed companies must include, in their management reports, additional corporate governance and ESG information as well as all relevant information on factors that are likely to have an impact in the event of a tender offer. Listed companies must also publish relevant information regarding related-party agreements.

Listed companies are also subject to various recommendations, including:

- appointment of independent directors – (please refer to **4.5 Rules/Requirements Concerning Independence of Directors**);
- set up of specialised committees – (please refer to **4.1 Board Structure**); and
- limitation of allowances – listed companies shall be prudent with allowances granted to directors and/or officers and subject these allowances to performance criteria and limit their overall amount.

Recommendations applicable to listed companies mostly derive from corporate governance codes. Although these codes are deemed to be non-binding (soft law), listed companies choosing not to follow their recommendations must publicly explain why and justify their choice to the market (comply or explain principle). In addition, companies choosing not to follow recommendations issued by the AMF may be named in the AMF corporate governance report for not complying with its recommendation.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Green Shareholder Activism and "Say on Climate"

Shareholder activism is increasingly focusing on ESG and climate-related issues. As a matter of fact, since 2020, activist investors have started to request issuers operating in high-impact sectors (energy, building industry) to consult their shareholders on their climate strategy, on the say-on-pay model. If most motions proposals submitted in 2020 and 2021 were rejected by the board of directors or disapproved at the general meeting, issuers have taken into account this new issue and included related consultative resolutions at the 2023 general meetings. In this context, the AMF published, in March 2023, a press release encouraging listed companies to submit "say on climate" resolutions for shareholders' approval every year.

Expansion of Multiple Voting Rights Shares

French corporate law has long abandoned the rule "1 share = 1 vote". Multiple voting right shares may be issued by all commercial companies although the use of these shares is still restricted for listed companies. Listed companies may only issue double voting right shares to long-term shareholders; other multiple voting rights are prohibited.

However, the French legislature is anticipating a change is this restriction to encourage more companies to go public. In line with the EU new Listing Act proposal, and based on a report from Legal High Committee for Financial Markets of Paris (HCJP), France is contemplating to authorise non-listed companies to keep their already-issued multiple voting rights shares when going public.

Extra-Financial Reporting and CSRD Directive

Please refer to **2.2 Environmental, Social and Governance (ESG) Considerations**.

2.2 Environmental, Social and Governance (ESG) Considerations

ESG and Strategy

The board of directors is entrusted with the definition of the strategy of the company. In doing so, the board is legally bound to take into account social and environmental issues.

Corporate governance codes increase, year after year, their recommendations towards a better consideration of climate and environment protection-related issues, with the recommendations to create an ESG committee, in charge of investigating ESG matters, the enhanced training of directors or the increase of ESG performance criteria as part of executives' compensation schemes.

Pressure to increase climate strategy reporting to shareholders is in constant evolution (please refer to **2.1 Hot Topics in Corporate Governance**).

Corporate Duty of Care

Since 2017, large French companies have been subject to due diligence obligations to identify any risks and prevent any violations of human rights and fundamental freedoms, or severe abuses of human health and safety and of the environment, resulting from their activities as well as those of their subsidiaries, suppliers and subcontractors. These companies must establish a vigilance plan and a report on their effective implementation, to be included in the annual report.

The European Union has recently adopted similar obligations applicable to EU limited liability companies of substantial size and economic power or with business in defined high-impact sectors.

Raison D'être and Mission-Driven Companies

In 2019, the Pacte Act introduced two optional tools into French corporate law designed for companies intending to redirect their focus on their role in society, beyond their economic performance: the concept of *raison d'être* (core purpose) as well as the status of mission-driven company.

The *raison d'être* determines the orientation of a company's business and defines its identity and vocation, beyond its commercial purpose. Therefore, a company adopting a *raison d'être* makes the choice to define the ethical standards according to which its activities will be conducted. Companies adopting a *raison d'être* are free to define it more or less precisely. One can observe that there is a great deal of variation in

the level of precision and relevance of the chosen *raison d'être* which has an impact on the effectiveness of this tool in terms of creating new ethical standards: the more generic the *raison d'être* the less likely it is to clarify the standards binding the company.

The Pacte Act also allows French companies complying with stricter requirements to be labelled as mission-driven companies. This status may be granted to companies choosing to adopt – in addition to a *raison d'être* – strong commitments towards environmental, ethical and/or social concerns. These commitments are submitted to the general meeting of shareholders and included in the bylaws. Compliance with these commitments is assessed regularly by a mission committee, comprising at least one employee and usually representatives of other stakeholders. Failure to comply with the mission or the commitments not only entails the withdrawal of the status, but could also lead to liability claims against the directors and the company.

Extra-Financial Reporting and CSRD Directive

French listed companies and other large companies are subject to extra-financial reporting obligations in the form of a non-financial performance declaration (DPEF). These requirements will be drastically extended starting in 2025 with the entry into force of the Corporate Sustainability Reporting Directive (CSRD) of 14 December 2022. This directive provides for the substitution of a new extended reporting on sustainability to the previous DPEF, in order to include information on environmental, social and governance issues. The reporting requirements will by based on a double materiality principle: sustainability matters that affect the company as well as the impacts of the company on sustainability matters.

In addition, the scope of companies covered by the CSRD will also be significantly increased to include small and medium-sized companies by 2027.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

There are three main functions involved in the governance and management of French companies:

- deliberative functions;
- supervisory functions; and
- management functions.

Deliberative Functions

Deliberative functions are always delegated to the shareholders of the company. Depending on the corporate form, the shareholders are mandatorily convened in general meetings (SA, SARL) or may be consulted in other ways (SAS).

Supervisory Functions

In elaborate forms of companies, specific bodies are responsible for supervising management, whereas in other forms of companies, management control is left to the shareholders.

In SA with a one-tier board system, the board of directors (*conseil d'administration*) is a hybrid corporate body as it is in charge of supervisory functions over corporate officers, as well as certain management functions (please see below). In SA with a two-tier board system, most supervisory functions are exercised by the supervisory board.

In other corporate forms (SAS, SARL), supervisory functions are performed, in a more lim-

ited way, directly by the shareholders and no dedicated corporate body is provided by law. However, the shareholders may decide, in SAS, to create specific corporate bodies and entrust them with supervisory powers.

Management Functions

The management functions include the definition and implementation of the company's strategy and the representation of the company towards third parties. Depending on the corporate form of the company, management functions are exercised by individuals or collegiate bodies.

SA may be structed pursuant to a one-tier board or a two-tier board system, at the shareholders' discretion. This choice must be registered in the by-laws.

In SA with a one-tier board system, the management functions are split between the board of directors (*conseil d'administration*), which members are appointed by the shareholders, the chairman of the board of directors, appointed by the board among the directors, and the CEO (*directeur général*), also appointed by the board of directors. The board of directors may also decide to name a single person to act as chairman and CEO (*président-directeur général*). The board of directors, upon request of the CEO, may appoint one or more deputy CEOs to assist the CEO and delegate management powers to them.

In SA with a two-tier board system, the management functions are entrusted to the executive board (*directoire*), appointed by the supervisory board. Members of the executive board are not allowed to be part of the supervisory board.

In SAS, the law entrusts the chairman (*président*) with all management functions. The chairman may be a natural or a legal person. The shareholders are free to provide for additional corporate bodies in the bylaws, entrusted with limited management functions.

SARL are managed by one or more managing directors (*gérants*), as the case may be convened in a management board (*conseil de gérance*). The managing directors are natural persons.

3.2 Decisions Made by Particular Bodies

The powers and types of decisions made by the corporate bodies differ depending on the corporate form of the company.

Please refer to **5.2 Role of Shareholders in Company Management** for a description of the shareholders' decision-making powers.

SA

In one-tier board systems, the board of directors is competent to determine the strategic orientations of the company's business and ensure their implementation within the limits of the company's interest and taking into consideration social and environmental issues. In particular, the board of directors:

- appoints the chairman and the CEO and defines their compensation schemes;
- examines and approves the annual financial statements;
- drafts management reports for the shareholders;
- convenes the general meeting of shareholders and sets forth its agenda; and
- approves related-party agreements.

The powers of the board of directors shall be exercised within the limits of the power granted by laws to the general meeting of shareholders.

The CEO and the deputy CEOs, if any, are in charge of the day-to-day management of the company, within the limits of the corporate object of the company and the board of directors' and the general meeting's powers. Via-à-vis third parties, the CEO has the broadest powers to represent the company and act on its behalf.

In two-tier board systems, the supervisory board is responsible for the supervision of the management and the preservation of the company's long-term interest. Therefore, the supervisory board:

- appoints the members of the management board and defines their compensation schemes;
- controls the annual financial statements;
- reviews the management reports; and
- approves related-party agreements.

Unlike the board of directors, the supervisory board is not entitled to make management decisions.

The executive board is in charge of the strategy of the company and its day-to-day management, within the limits of the general meeting's powers. The chairman of the executive board has broadest powers to represent the company towards third parties.

SAS

The chairman of the SAS is the only mandatory management body of the company, and is therefore entrusted with the broadest powers to manage the company and represent it towards third parties, within the limits of the shareholders' powers.

The shareholders may set other corporate bodies to assist or supervise the chairman. Internally, the chairman's powers shall be limited by specific powers granted to these corporate bodies. Those limits may however be enforced towards third parties only if it is proved that they had knowledge of such limitations.

SARL

In the SARL, each of the managing directors has the broadest powers to manage the company and represent it towards third parties, within the limits of the corporate purpose and shareholders' powers. The shareholders may decide to limit the managing directors' powers in the by-laws and require prior authorisation from the shareholders for material management decisions.

The role and powers of the shareholders are described in **5.2 Role of Shareholders in Company Management**.

3.3 Decision-Making Processes

The applicable decision-making process depends on the nature of the corporate body. Please refer to **5.3 Shareholder Meetings** for the shareholders' decision-making processes.

Collegiate management and/or supervisory bodies meet periodically on pre-defined agenda. Meetings are called by the chairman and the convening process is freely determined in the by-laws or other internal rules, if any. For the adoption of defined decisions, such as the approval of annual or interim accounts, the statutory auditors (if any) must be given notice of the meeting. In companies with at least 50 employees, members of the social and economic committee (*comité social et économique*) may also attend the meetings in an advisory capacity.

In SA, the board of directors may also implement specialised committees whose role is to issue

opinions on matters submitted by the board and falling into their competence area. In this case, the board of directors will be convened after the relevant committee and will make decisions based on the committee's opinion.

Decisions are made by voting and the majority and quorum rules are defined by law or in the internal documentation of the company. By exception, and if so provided for in the bylaws, collegiate bodies may adopt decisions by written consultation, without any meeting. Decisions are registered in minutes – drafted by an external secretary or by a member of the corporate body, executed by the chairman of the meeting and usually at least one other member of the body.

French law does not dictate any decision-making process for non-collegiate corporate bodies, although it is recommended that material management decisions are registered in writing. In addition, the by-laws or other internal rules may enforce voluntary decision-making processes.

4. Directors and Officers

4.1 Board Structure

SA

As mentioned in **3.1 Bodies or Functions Involved in Governance and Management**, SA may be structured pursuant to a one-tier board or a two-tier board system.

Given the relative scarcity of the two-tier board system, **4.1 Board Structure** to **4.11 Disclosure of Payments to Directors/Officers** will only deal with one-tier board SA.

SA boards of directors are composed of three to 18 directors, including the chairman of the board. The shareholders appoint the directors, which may be natural or legal persons. In the latter case, they must appoint a permanent representative to the board.

Regulations and recommendations apply to the selection of directors:

- diversity rules require boards of directors of companies having more than 250 employees to have a proportion of directors representing each gender at the board of at least 40%;
- larger companies must appoint directors representing the employees or shareholders' employees; and
- corporate governance codes recommend that a sizable proportion of directors are independent.

The board of directors may set up specialised committees (audit committee, compensation committee, ESG committee) whose role is to issue opinions on matters submitted by the board in order to improve the effectiveness of the board. Specialised committees have consultative powers only and do not substitute for the board. Audit committees are mandatory for companies whose shares are admitted to trading on a regulated market.

The shareholders may also appoint censors to the board of directors, with an advisory role only.

SAS

In SAS, the structure of the board – if the shareholders decided to voluntarily set up such collegiate body – is freely set in the by-laws or any internal rules adopted by the shareholders, if any.

SARL

There is no board of directors in SARL, as the management is exclusively performed by its manager(s).

4.2 Roles of Board Members

The board of directors is a collegiate body. As a principle, the directors collectively exercise the functions assigned to the board and they do not have any individual powers, except for the chairman of the board.

However, the board of directors may grant specific assignments to individual directors, in order to improve the corporate governance of the company and facilitate the board's mission.

Directors may be assigned, given their skills and experience, to one or more specialised committees to help assessing specific matters (please refer to **4.1 Board Structure**).

Also, the board of directors may appoint a lead director chosen from among the independent directors to play a mediating role between the board of directors and the shareholders and improve shareholder dialogue. Lead directors are strongly recommended by the AFEP-MEDEF Code in controlled listed companies.

The chairman of the board has a distinct role: they are in charge of organising and directing the work of the board of directors and reporting to the general meeting. The chairman ensures the proper functioning of the company's bodies and that the directors are able to fulfil their duties.

4.3 Board Composition Requirements/ Recommendations

Various regulations and recommendations apply to the selection of directors and the composition of the board.

- Number of directors – the board of directors shall be composed of at least three and at most 18 directors, including the chairman. Within these limits, the number of directors is determined by the by-laws.
- Individual or legal person – directors may be individuals or legal persons, except for the chairman who must be an individual.
- Share ownership – it is not mandatory for directors to hold shares of the company, but the by-laws may provide otherwise.
- Diversity – boards of directors of companies having more than 250 employees shall comprise a proportion of directors representing each gender at the board of at least 40% or, if the board is composed of eight or less directors, the difference between the representatives of each gender shall not exceed two.
- Age limit – in accordance with the French Commercial Code, not more than a third of the directors may be aged over 70, but the by-laws may provide for a stricter age limit.
- Multiple directorships – directors may not hold more than five directorships in public limited companies, it being understood that directorships in affiliated companies are excluded for the calculation of the directorships.
- Representation of employees – in large companies, employees are entitled to appoint directors representing the employees to the board of directors.
- Representation of employee shareholders – in large companies where more than 3% of the share capital is held by employees, the shareholders shall appoint directors representing the employee shareholders.
- Independence – corporate governance codes recommend that, in listed companies, a sizable proportion of directors be independent (please refer to **4.5 Rules/Requirements Concerning Independence of Directors**).

4.4 Appointment and Removal of Directors/Officers

SA

Directors are appointed and may be dismissed without cause by the general meeting of shareholders. Given that the agenda of the general meeting it set by the board of directors, shareholders are allowed to vote on the appointment and dismissal of one or more directors even if these decisions were not registered in the agenda. When a seat at the board of directors becomes vacant, the board of directors is entitled to provisionally appoint a new director to fill the vacancy, subject to ratification by the next general meeting.

The chairman of the board, whether they assume the CEO's position or not, is appointed from the directors of the board and must be an individual. The chairman is dismissed without cause by the board of directors. If the chairman is dismissed from their role as director by the shareholders, the chairman is automatically dismissed from their chairmanship and, as the case may be, CEO position.

If the chairman does not assume the CEO's position, the CEO is appointed by the board of directors. Deputy CEOs may also be appointed by the board of directors upon proposal from the CEO. The CEO and deputy CEOs may be dismissed at any time by the board of directors. However, in the absence of a cause (*juste motif*), the CEO and deputy CEOs may claim damages.

SAS

The chairman is appointed and dismissed in accordance with the by-laws or internal rules of the company.

SARL

The managing directors of the SARL are appointed and dismissed by the general meeting.

4.5 Rules/Requirements Concerning Independence of Directors

There are no requirements concerning the independence of directors in non-listed companies.

With respect to companies, the securities of which are admitted to trading on a regulated market, the French Commercial Code indirectly requires the appointment of independent directors, since the audit committee must include at least one director deemed independent according to criteria specified and made public by the board of directors.

Also, the corporate governance codes recommend that a sizable proportion of directors be independent. Hence, the AFEP-MEDEF Code recommends that 50% of directors be independent in not-controlled companies, and 33% in controlled companies.

The corporate governance codes set up a list of criteria for the assessment of the independence of directors. The board of directors shall use those criteria to determine which directors are independents, it being understood that even if all criteria are not met, the board remains free to deem a director independent if it is otherwise justified.

4.6 Legal Duties of Directors/Officers

Corporate officers and directors must act in accordance with the best corporate interest of the company, with the additional requirement provided by the Pacte Act of 2019 to "take into consideration" social and environmental issues when making their decisions.

Pursuant to an amendment to the French Commercial Code introduced in March 2022, cultural and sporting concerns are also elements to be considered by directors in deciding the company's orientation. Unexpectedly adopted by the French Parliament, the maintenance of such provision is not ensured.

The scope of directors' duties is also to be further expanded under the draft directive on Corporate Sustainability Due Diligence, even though some proposals have been already integrated into French law.

4.7 Responsibility/Accountability of Directors

Directors must act in accordance with the best corporate interest of the company, which generally overlaps with that of the shareholders, but it is not systematic. In this respect, directors and the board are becoming increasingly pivotal in the implementation of new ethics standards in corporate strategy, with new or renewed interests to be taken into consideration (employees, other stakeholders, etc) when assessing the situation vis-à-vis the corporate interest of the company they manage.

4.8 Consequences and Enforcement of Breach of Directors' Duties

According to the circumstances, a breach of director's duties may be enforced by the following parties:

- the company, by an ut universi action brought through its legal representative. The action can be also brought by a shareholder when the company is held liable for breaches committed by its legal representative. In such case, it would be an ut singuli action;
- the shareholders, in case where they suffered a harm distinct harm from the company; and
- third parties can also hold the director personally liable in case of a fault separate from their functions, which fault is defined by case law as (i) particularly serious, (ii) intentionally committed and (iii) incompatible with the normal exercise of a corporate function.

It is important to point out that unless one of the directors is solely responsible, directors' liability is collective, given the collegial nature of the board. Lastly, the recognition of directors' liability under French law is not that common.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

In France, directors and officers can be held liable for criminal and civil charges.

Regarding criminal liability, they would be liable for any criminal infringement such as misappropriation of corporate assets, distribution of fictitious dividends or publication of inaccurate annual accounts.

Directors and officers can also be civilly liable if they commit breach of laws and regulations applicable to the company (breach of the articles of association or internal regulations). In addition, mismanagement by directors and officers can be a liability cause if they act contrary to the corporate interest of the company. Mismanagement ranges from negligence to fraud.

In addition, directors and officers can also face administrative and tax liability; for example, in case they infringe the AMF securities law-related regulations, the authority is able to pronounce financial sanctions. In the same way, fraudulent acts or breaches of tax obligations can lead to financial sanctions.

Their liability cannot be restricted or limited on a contractual basis. However, it can be excluded in case the directors and officers demonstrate they acted with a legitimate lack of awareness of a wrongful act or if they show they were in opposition to the decision at stake.

Usually, the company offers insurance to the directors and officers that covers specific defence and investigation costs or damages.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

SA

In the case of SA, the directors' and officers' compensation approval process differs, depending on whether or not the company is listed.

In non-listed SA, the general meeting of shareholders must approve the aggregate amount of the compensation to be paid to the board of directors, as a whole. Then, the allocation of this amount between the directors is decided by the board of directors itself. The board of directors also has exclusive authority to set forth the CEO's compensation scheme and authorise any payment made to it, without any prior approval required from the shareholders.

CEO's compensation schemes generally include a fixed and a variable portion, the latter being paid upon achievement of targets set by the board.

Listed SA must comply with the say-on-pay procedure (please refer to **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**). Under this regulation, the directors' and officers' compensation schemes are subject to a double approval process from the shareholders:

- the shareholders' general meeting shall approve the compensation policy for the upcoming fiscal year setting forth the principle and structure of the relevant compensation schemes (ex-ante vote). Any amount paid – or payable – to the directors and/or officers in violation of the approved compensation policy must be void; and
- each year, the shareholders' general meeting shall approve all payments made to directors and officers or amounts owed to them pursuant to the pre-approved compensation policy (ex-post vote). Payment of variable and extraordinary compensation elements shall be subject to the approval of the ex-post vote.

A rejection of the ex-ante vote or of the ex-post vote by the shareholders entails severe consequences:

- if the compensation policy is rejected, the previously approved principles and criteria shall continue to apply or, in the absence of any previously approved policy, the compensation scheme shall be determined in accordance with the compensation attributed for the previous financial year or, if none, in accordance with existing practice within the company; and
- if the compensation paid – or payable – to the directors and/or officers is rejected, the relevant officer shall be deprived of any variable and exceptional compensation due for the relevant fiscal year.

Compensation schemes of listed companies' officers are also subject to various rules and recommendations, including from corporate governance codes (with for instance increasing recommendation to consider ESG criteria for variable compensation).

SAS
In SAS, the conditions for the compensation of the chairman and members of the board (if any) are set in the by-laws.

SARL
The compensation of the managing directors of the SARL is approved by the shareholders.

4.11 Disclosure of Payments to Directors/Officers
Listed companies must disclose any such compensation in a complete and transparent manner in their Universal Registration Document. This disclosure must provide the total compensation, fixed, variable and exceptional, and benefits of any kind attributed or paid to all corporate officers in the last year.

5. Shareholders

5.1 Relationship Between Companies and Shareholders
The company and its shareholders are legally bound by the by-laws, which constitute the company's internal regulations. As far as shareholders are concerned, this set of rules, mainly driven by applicable laws of the French Commercial Code, states their specific rights within the company. For instance, their right to vote, their right to perceive dividends or their right to information about business and management matters.

In SAS, the importance of the by-laws is even more significant since the relationship between the company and its shareholders mainly relies on them; the SAS corporate form being little regulated by law provisions.

5.2 Role of Shareholders in Company Management

Shareholders' Involvement
As a general principle, shareholders are not meant to be in charge of the day-to-day management of the company, which is delegated to the corporate officers.

That being said, shareholders are entitled to have an important role in the making of certain decisions – ie, all matters attributed to the general meeting by laws and the articles of association. For example, the approval of the annual accounts, the appointment and removal of corporate officers and statutory auditors, the amendment of the articles of association or the dissolution of the company.

Besides this "typical" involvement, shareholders now play a more important role as they are increasingly solicited on the management of the company's activity and administration. For example, shareholders are now consulted on the remuneration of executives (say on pay) and can also be consulted on the company's action and influence on climate issues (say on climate).

No Interference in the Exercise of Executive Functions
Nonetheless, shareholders are not meant to have a direct role in the everyday management of the company, this being reserved to the executive officers who have broad powers to represent the company towards third parties. Therefore, shareholders must refrain from interfering in the executive officer's area of responsibility, otherwise courts may consider such a behaviour as a de facto exercise of executive functions, which is unlawful.

5.3 Shareholder Meetings

Ordinary General Meetings

At least once a year, within six months of the end of the financial year, an annual ordinary general meeting of the shareholders must be convened in order to vote on the annual accounts and consolidated accounts, the distribution of dividends and, in listed companies, the compensation of the board members and the executive officers (please refer to **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**).

Under the annual ordinary general meeting, shareholders usually also vote on the appointment or removal of board members, the appointment of the statutory auditors, the related-party transactions and any decision other than those reserved to the extraordinary general meeting of shareholders.

Extraordinary General Meetings

The extraordinary general meeting is competent to approve amendments to the company's articles of association, any changes to the share capital, mergers and spin-offs and the early dissolution of the company.

Shareholders' general meetings are convened by the board or any person designated in the articles of association to do so. Notice for holding meetings must be given at least 15 days in advance in SA and SARL. However, listed companies or companies whose shares are not all held in registered form are required, at least 35 days before the meeting, to publish a notice of the meeting in the Bulletin of Mandatory Legal Announcements (*Bulletin des annonces légales obligatoires*). The notice of the meeting must contain certain mandatory information.

The quorums and majorities required for the validity of meetings vary depending on the ordinary or extraordinary nature of the decision submitted to the shareholders, the corporate form of the company and the provisions of the articles of association.

In SA for instance, adopting an ordinary decision requires a quorum of at least one-fifth of the voting shares on first convocation, no quorum is required on second convocation, and a simple majority of the voting shares of the shareholders present or represented.

The adoption of extraordinary decisions requires a quorum of at least a quarter of the voting shares on first convocation, one-fifth on second convocation, and a two-thirds majority of the voting shares of the shareholders present or represented.

However, it should be noted that increasing the shareholders' commitments towards the company requires a unanimous decision of all the shareholders.

In general, shareholder meetings are held physically at the registered office or any location specified in the notice of the meeting but can also be held remotely or by written consultation if the articles of association provide for it.

5.4 Shareholder Claims

Executive officers and/or directors who violate applicable laws and regulations, the articles of association or are otherwise at fault in their management, are individually or jointly liable towards the company. In this case, one or more shareholders may bring a legal action against the executive officers and directors for damages suffered by the company (action ut singuli). The resulting damages will be paid to the company.

In addition, if the shareholders have suffered personal losses separate from those suffered by the company, executive officers and directors will also be liable to those shareholders (please refer to **4.9 Other Bases for Claims/Enforcement against Directors/Officers**).

5.5 Disclosure by Shareholders in Publicly Traded Companies

Following the Transparency Directive providing for the harmonisation of transparency requirements across the European Union, French securities laws impose certain strict filing and disclosure requirements to which prospective shareholders in publicly traded companies should pay particular attention.

Such reporting obligations fall primarily within the mandatory disclosure of major shareholdings. The French Commercial Code thus requires the disclosure within four trading days to the issuer and to the AMF of any holding of shares or voting rights when the percentage of such shares or voting rights reaches, exceeds or falls below the following thresholds (whether through open market purchases, negotiated transactions or otherwise): 5%, 10%, 15%, 20%, 25%, 30%, one-third, 50%, two-thirds, 90% or 95%. The AMF then publishes this information. Issuers' by-laws may also impose additional disclosure requirements – even below the 5% statutory threshold – for thresholds of not less than 0.5%.

In addition, upon crossing the thresholds of 10%, 15%, 20% and 25% of the capital or voting rights, the relevant shareholder must also inform the company and the AMF, within five trading days, of its objectives for the following six-month period in a statement of intent (*déclaration d'intention*). In the event of a change in intent within the six-month period following the statement of intent that was originally filed, a new statement must be issued promptly to the company and the AMF and made public under the same conditions. The six-month period is reset with this new statement.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Legal Reporting

Companies are required to file various documents relating to their accounts for the previous financial year with the registrar of the commercial court. This filing must be made within one month of the approval of the annual accounts by the annual ordinary general meeting, or two months if the filing is made by electronic means.

The filing covers the following documents:

- the annual accounts;
- the management report, in the case of a listed company. For all other companies, the management report does not have to be filed but a copy must be delivered, at the company's registered office, to any person upon request;
- the auditors' report on the annual accounts;
- the proposal for the allocation of profits submitted to the annual general meeting and the relevant resolution on the allocation adopted by the annual general meeting; and
- the consolidated accounts, the group management report and the auditors' report on the consolidated accounts, in the case of a company required to prepare such accounts.

Specific Complementary Filings for Listed Companies

Listed companies are also required to publish and file with the AMF:

- an annual financial report within four months of the end of the financial year; and
- a half-year financial report within three months of the end of the first half of the financial year.

In addition, listed companies have the option of publishing quarterly or interim financial information at their discretion. If they choose to publish such financial information, the AMF recommends that the publication be presented with a commentary designed to clarify the relevant financial information and thus enable investors to better understand the company's situation.

6.2 Disclosure of Corporate Governance Arrangements

Corporate Governance Report

SA and SCA are required to draw up a report on their corporate governance, which is attached to the management report. For listed companies, this report is usually incorporated in the Universal Registration Document.

Corporate Governance Codes

The corporate governance report of listed companies is required to specify, among other things, the corporate governance code applied by the company. In France, the most widely used corporate governance code is the Afep-Medef Code. If the company chooses not to comply with a specific provision of the corporate governance code, it must explain how it departs from it and why, in accordance with the comply-or-explain principle (please refer to **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**). Companies can also choose to refer to the corporate governance code drawn up by Middlenext, which is intended for medium-sized companies listed in Paris.

6.3 Companies Registry Filings

Any updates to the constitutive documents during the life of the company must be filed with the companies registry. These updates and their related corporate documents are publicly available and include amendments to the articles of association, changes to executive officers and board composition, transfers of the registered office, changes to the share capital and statutory auditors.

The financial reports mentioned in **6.1 Financial Reporting** are also required to be filed with the companies registry.

In case of failure to comply with the filing obligations, companies or their officers, in the event the failure constitutes a fault separate of their functions, may be exposed to civil and criminal fines.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The appointment of an external auditor by the shareholders' ordinary general meeting becomes mandatory if, at the end of the financial year, the company exceeds at least two of the following thresholds:

- a balance sheet total of EUR4 million;
- net turnover of EUR8 million; and/or
- 50 employees.

Auditors are subject to certain requirements regarding their independence, which prohibits them from having any personal, financial or professional relationships that are incompatible with the functions of an auditor.

In addition, any commercial activity or paid employment of the auditor for the benefit of the company whose accounts they audit is prohibited in order to preserve the auditor's independence.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Besides the duty of diligence a director must respect, listed companies are required to describe their internal control and risk management procedures in their annual report. They are also legally required to set up an audit committee composed of board members, which must at least include one independent member with specific expertise in financial or accounting matters.

The audit committee is responsible for monitoring the effectiveness of the internal control and risk management systems and of the internal audit on procedures relating to the preparation and processing of financial and non-financial accounting information.

In addition, the audit committee regularly meets with the heads of internal audit and risk control and gives an opinion on the organisation of their departments.

Trends and Developments

Contributed by:
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Lacourte Raquin Tatar is a fast-paced, growing, independent French law firm, which is highly regarded for its work on domestic and international strategic transactions, and has developed strong relationships with leading, independent law firms throughout Europe. With 23 partners and more than 75 lawyers, Lacourte Raquin Tatar's core practice focuses on M&A, tax and real estate transactions. The firm also has strong expertise in banking, financing, regulatory and asset management activities, as well as in public law and litigation. The M&A team represents French and foreign corporate clients and financial institutions and investors in connection with: (i) acquisitions, disposals and divestments; (ii) joint ventures, partnerships and alliances; (iii) corporate reorganisations (mergers, demergers, contributions, spin-offs); (iv) private equity and venture capital transactions; and (v) securities laws. The firm is a leading expert and highly regarded for its work in the transportation, infrastructure, telecommunication, energy, finance and real estate sectors.

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Introduction

The French corporate governance environment has been recently subject to profound changes, and will continue to significantly evolve as a result of:

- the growing importance of Environmental, Social and Governance (ESG) matters, with more detailed and stringent obligations for French companies and the implementation of a new European ESG reporting framework;
- the continuing pressure of shareholder activism, with recent campaigns having led to significant changes in certain French listed companies, important legal debates, as well as the development of "say-on-climate" resolutions; and
- the significant, steady increase of the compensations of the senior executive officers of listed companies, which is closely scrutinised by investors and proxy advisors and continues to raise debates among the economic and legal community.

Implementation of a New European ESG Reporting Framework

The European Green Deal has resulted, and will continue to result, in the adoption of new ESG-related regulations. The ambition of this strategic plan requires a more detailed, standardised and structured framework for ESG reporting and disclosure to ensure clear, reliable and comparable information among companies and industries. The objective is to place ESG information on the same level as financial information. EU Directive No 2022/2464 on corporate sustainability reporting (CSRD), EU Regulation No 2020/852 on the establishment of a framework to facilitate sustainable investment (the "Taxonomy Regulation") and EU Regulation No 2019/2088 on sustainable finance disclosure (SFDR) as well as the upcoming corporate sustainability due diligence directive (CSDD) (for which the European Commission adopted a proposal in February 2022) are key pillars of this plan. Ensuring that the ESG-related information published by the in-scope companies is actually comparable will be one of the key challenges of this new regulatory framework.

The CSRD significantly strengthens the existing rules introduced by EU Directive No 2014/95 relating to the disclosure of non-financial and diversity information by large companies. It requires in-scope companies to disclose information pursuant to a double materiality principle; ie, sustainability matters that affect the company as well as the impacts of the company on sustainability matters. These companies will have to apply the European Sustainability Reporting

Standards (ESRS) which are intended to improve the quality and comparability of the information disclosed.

The CSRD will progressively apply and extend the EU's sustainability reporting requirements to all large EU companies and most EU companies listed on a regulated market as well as to certain non-EU companies listed on an EU-regulated market and/or meeting certain criteria, as follows: as from 2025 (with respect to reporting related to the financial year 2024) for companies already subject to EU Directive No 2014/95; as from 2026 (with respect to the financial year 2025) for large companies not already subject to EU Directive No 2014/95; and as from 2027 (with respect to the financial year 2026) for small and medium-sized companies. According to the European Commission, this will lead to an expansion of the in-scope companies from approximately 11,000 entities under EU Directive No 2014/95 to approximately 49,000 entities under the CSRD.

These entities will also have to comply with the Taxonomy Regulation which is now effective and is intended to provide for an EU common classification system to identify economic activities considered as sustainable. Pursuant to Article 8 of this regulation, for the first time in 2022 (with respect to reporting related to the financial year 2021), in-scope listed companies, credit institutions and insurance companies were required to publish indicators measuring the scope of their activities/investments eligible for the Taxonomy (without considering whether these activities/investments are effectively aligned with the Taxonomy criteria). In 2023, non-financial companies have to publish full reporting on the alignment of their activities with the Taxonomy, while financial companies will have to do so only in 2024.

The regulatory framework of the Taxonomy will continue to evolve since the European Commission has for now prioritised the classification of activities covering primarily two climate-related objectives (adaptation and mitigation) and will progressively extend the Taxonomy to a larger scope of economic activities and define sustainability criteria for the other four environmental objectives (marine resources, circular economy, pollution and biodiversity).

The information to be published under the Taxonomy Regulation has been identified by the ESMA as one of its priorities in relation to the preparation of annual reports. In November 2022, the AMF issued an important report on the first year of application of the Taxonomy reporting obligations by French issuers, which contains important guidelines as the issuers face unprecedented challenges to obtain, articulate and present some of the required information; the AMF will continue to closely monitor the completeness and the comparability of the information disclosed by the issuers. Interestingly, in the aforementioned report, the AMF noted that most French issuers already made significant efforts to comply with the Taxonomy Regulation, with a significant number of them having even anticipated certain reporting obligations not yet applicable.

Increasing Consideration of ESG Matters in the Board of Directors' Organisation

The strengthening of ESG-related obligations has consequences in the organisation of French boards of directors. In 2023, almost 75% of the SBF 120 (ie, the index of the 120 largest companies listed on Euronext Paris) French-listed companies have set up a committee dedicated to ESG matters (compared to 50% in 2019).

Alongside the customary specialised committees (eg, audit, compensation, nomination, and/or investment committees), this committee's role is to participate in the development of the company's ESG strategy and to evaluate its implementation. This role is even more important now that the AFEP-MEDEF code (issued by the *Association Française des Entreprises Privées* (AFEP) and the *Mouvement des Entreprises de France* (MEDEF)) was revised in December 2022 to expressly recommend that the board of directors of any French listed company referring thereto determines a long-term ESG strategy, including with respect to climate for which precise objectives shall be set for different, relevant time horizons.

In 2022, the AMF annual corporate governance report also pointed out the increasing attention to the competence of board members in ESG matters, with the definition of specific competence criteria and the introduction of regular training. The AMF also mentioned as a good practice the appointment of a lead board member specialised in ESG matters.

Continuing Pressure of Shareholder Activism

Shareholder activism was not unusually high in France in 2022. However, after a certain slowdown following the pandemic period, shareholder activism is expected to be more frequent in France, which is often in the top three EU targeted countries.

Over the last three years, large, listed companies have been targeted (eg, Danone, Lagardère, Saint-Gobain, Atos and Ipsos), and certain activist campaigns have led to important changes; eg, CEO and other executive officers (Danone) or corporate form (Lagardère was converted from an SCA into an SA).

Recent activism campaigns (eg, Casino, Lagardère, Pernod Ricard, SCOR, TotalEnergies, Unibail-Rodamco-Westfield, Danone, Vivendi, Saint-Gobain, Atos and Ipsos) have raised public and legal debates, in particular with respect to the accuracy of the disseminated public information and the right for the company to respond publicly, the need for a regular dialogue between boards and shareholders, the potential risks of massive short-selling strategies and the potential infringement of certain resolutions submitted by shareholders on the powers and authority of the board (in particular its authority to determine the company's ESG strategy).

Over the last three years, the Finance Commission of the French Parliament, as well as several highly regarded organisations (including Paris Europlace, the MEDEF and the AFEP) and think tanks (including a dedicated working group of the *Club des Juristes* chaired by the former president of the AMF) have issued reports and recommendations in connection with shareholder activism. Key debates include whether increased mandatory regulations or additional soft law recommendations and best practices are needed and whether the existing regulations provide for a level playing field for the activists and the targeted issuers.

In April 2020, the AMF issued its report on shareholder activism. In line with the approach generally prevailing in France, the AMF considers that "the active involvement of shareholders in the life of listed companies is a necessary condition for their proper functioning and sound governance. […] the challenge therefore is not how to prevent activism, but how to set limits and make sure that it is able to control excesses". Considering that (i) the legal framework applicable to shareholder activism derives mainly from EU regulations, and (ii) no major changes to the current

French legal framework are required, the AMF proposed, inter alia, to:

- enhance transparency on stake-building by lowering down to 3% (as in most EU member states) the first threshold (currently set at 5%) of shareholding threshold crossing and by making public the crossing of thresholds reported to listed companies pursuant to their articles of association (it being noted that this would require a modification of French law by the French legislature); and
- foster an open dialogue between listed companies and their shareholders. In April 2021, the AMF supplemented its information guidelines accordingly to provide, inter alia, that: (i) subject to compliance with market abuse regulations, issuers may provide the market with any necessary response to public statements made by activists or other shareholders, including during quiet periods; (ii) any shareholder initiating a public campaign should immediately disclose to the issuer concerned the material information sent to other shareholders (and publish its projects and proposals), and prior to launching any such campaign the shareholder should make an effort to initiate a dialogue with the issuer; and (iii) issuers should establish a regular dialogue between their board and shareholders (if necessary through a lead independent director) on the main issues of concern to shareholders, including, inter alia, with respect to strategy and ESG performance matters.

The dynamism of shareholder activism is also largely fuelled by the growing impact and consideration for ESG-related issues, which results in new purposes and protagonists of activist campaigns. Listed companies now regularly face activist campaigns relating to ESG issues, which are presented in specific proposals and no longer exclusively carried out by “traditional” activist investors but also by NGOs, specialised funds, etc, using procedures similar to those of traditional activist campaigns.

Development of “Say-on-Climate” Resolutions

So-called say-on-climate resolutions (ie, resolutions put on the agenda of a shareholder general meeting by the board or certain shareholders and relating to the company’s environmental strategy or policy) are becoming more frequent. Institutional investors and proxy advisors are following this matter with growing attention; Institutional Shareholder Services (ISS) and Proxinvest have integrated it for the first time into their 2022 French voting policy.

More and more boards of directors are spontaneously submitting their own say-on-climate resolution to the general meeting, sometimes as a way to pre-empt any activist attempt in this respect. In 2022, the general meetings of 11 SBF 120 companies (including TotalEnergies, EDF, Engie, Amundi and Carrefour) were consulted on say-on-climate resolutions presented by their boards of directors.

However, activists take advantage of all legal means provided by French corporate law to influence company strategies by submitting their own say-on-climate resolutions, thereby creating tensions with the boards of directors and executive management of the targeted companies.

In 2023, 16 shareholders of Engie filed a request to include a climate resolution on the agenda of the shareholder general meeting to amend the articles of association and provide for the organisation of a vote every three years on the climate

strategy and every year on the progress of its implementation. This resolution was ultimately defeated after the board of directors called for a vote against it.

In 2022, the board of directors of TotalEnergies submitted its own climate-related resolution to the general meeting and refused to submit a say-on-climate resolution presented by activist investors in order to amend the articles of association and provide that the management report submitted to the general meeting shall set forth the company's strategy to align its activities with the objectives of the Paris Agreement.

Such requests by activists for ESG strategy-related resolutions have raised legal debates on the principle of hierarchy of the decision-making bodies within French companies (ie, whether the shareholders would infringe on the legal powers and authority of the board to determine the company's ESG strategy).

Given the importance of the matters at stake, numerous calls have been made to introduce a legal say-on-climate regime in the same manner as the legal say-on-pay regime was introduced a few years ago. The French Treasury has set up a dedicated working group within the *Haut Comité Juridique de la Place Financière de Paris* (HCJP) to consider this reform. In its report of January 2023, the HCJP concluded that no legislative or regulatory modification is necessary to allow the development of climate-related resolutions but encouraged the adoption of soft law recommendations to provide for the principle of such resolutions and their general framework.

In March 2023, the AMF invited listed companies to reinforce their communication regarding their climate strategy to their shareholders without awaiting the full implementation of the CSRD's framework and to present it during each general meeting by including the related items on the agenda for debate. It also considered that it would be appropriate, in due course and under conditions to be defined by law, for this information to be submitted to shareholders for formal approval, in the same manner as the annual financial statements.

Executive Compensation Under Continuous Scrutiny

Listed companies have been subject to increasingly stringent mandatory obligations and soft law recommendations with respect to the compensation of their board members and senior executive officers (chairman of the board, chief executive officer, deputy-chief executive officers, management board members and, for SCAs, general managers), including the say-on-pay rules, pursuant to which:

- the annual (ordinary) shareholder meeting shall approve annually the compensation policy of the company submitted by the board ("ex ante vote");
- detailed information on the individual and collective attributed compensations shall be presented to the following annual (ordinary) shareholder meeting ("ex post vote") and the compensation finally attributed to the board members together with that of all the senior executive officers shall also be presented to this following annual shareholder meeting; failing approval, the compensation of the board members for the current fiscal year may not be paid until the next shareholder meeting approves a revised compensation policy; and
- the compensation policy and attributed compensations shall be publicly disclosed by the company (including in its annual corporate governance report) as well as the shareholder

vote thereon. In addition, listed companies shall annually disclose certain comparisons between their senior executive officers' compensation and their employees' average and median compensation.

Despite the successful implementation of this detailed legal framework, the matter of executive compensation remains subject to close scrutiny and concerns by the investors and proxy advisors and regularly gives rise to debates. As an example, in 2022, the announcement of the compensation package of Carlos Tavares, CEO of Stellantis, raised significant public debates in the economic and legal communities, and France President Emmanuel Macron even described this remuneration as "excessive" and called for new European regulation on the compensation of large companies' senior executives.

According to Proxinvest, between 2014 and 2021, the compensation of the senior executive officers increased by 83.8%.

Inclusion of ESG Performance Criteria in Executive Compensation

As noted by the AMF in its 2022 Corporate Governance report, there is also a trend towards the integration of ESG performance criteria in the determination of the senior executive officers' compensation. According to the November 2022 barometer of the *Institut Français des Administrateurs* (IFA), 95% of the CAC 40 companies have now integrated at least one climate criteria into the annual variable short-term and/or long-term compensation of their senior executive officers.

This trend is in line with the latest version of the AFEP-MEDEF code published in November 2022, pursuant to which the variable compensation of the CEO of any French-listed company referring thereto shall be based on several ESG performance criteria (including at least one climate-related criteria).

Extension of Gender Equality Obligations to Top Management

In France, since 2011, the legislative framework resulting from Law No 2011-103 of 27 January 2011 on the balanced representation of women and men on boards of directors and supervisory boards (*loi Copé Zimmermann*) provides that, in listed and large companies, the proportion of board members of each gender may not be less than 40%.

At the European level, a new directive on gender balance on corporate boards was adopted in November 2022. By 2026, listed or large companies will need to ensure that the under-represented gender represents at least 40% of the non-executive directors or 33% of all the directors. Although French quotas remain higher than those of the European directive, the latter will have an impact on certain companies listed in France but whose registered offices are abroad and to which French law on gender equality is therefore not applicable (eg, Airbus).

The obligations for equal representation of each gender have also been recently extended by French Law to the top senior management of large companies.

The AFEP-MEDEF Code already recommended that the board of directors determines gender diversity objectives for the top senior management; these objectives and the progress on the achievement thereof shall be publicly described in the annual report.

In December 2021, the French legislature passed a new law requiring a minimum representation of

each gender in executive officer positions (*cadres dirigeants*) and executive or similar committees for all French companies employing at least 1,000 employees. The proportion of each gender shall be at least 30% as from 1 March 2026 and 40% as from 1 March 2029.

In 2022, the average proportion of women in executive committees of the SBF 120 companies was 27,41%, an increase of 2% over the previous year, but still below the minimum proportion required by law as from 2026 (30%).

Potential Introduction of Multiple Voting Rights in Listed Companies

Multiple voting shares in French listed companies are currently prohibited (only double voting rights are authorised and strictly regulated).

However, in September 2022, the HCJP expressed a favourable opinion on the introduction into French law of multiple voting rights in listed companies for a temporary period after their IPO and subject to certain restrictions (beneficiaries, maximum number, duration, shareholder resolutions to which the multiple voting rights might apply).

Such a proposal is inspired by the United States model and reflects the need to safeguard the competitiveness of the Paris financial centre (following the introduction of multiple voting rights on the London Stock Exchange) and the willingness to attract founders of high-growth companies to list their companies on the Paris regulated market.

At the European level, the adoption of the European Commission's proposal for a directive on multiple vote share structures in companies that seek the admission to trading of their shares on an SME growth market is expected in the course of 2023.

GERMANY

Law and Practice

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Contents

1. Introductory p.150
1.1 Forms of Corporate/Business Organisations p.150
1.2 Sources of Corporate Governance Requirements p.150
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.151

2. Corporate Governance Context p.152
2.1 Hot Topics in Corporate Governance p.152
2.2 Environmental, Social and Governance (ESG) Considerations p.152

3. Management of the Company p.153
3.1 Bodies or Functions Involved in Governance and Management p.153
3.2 Decisions Made by Particular Bodies p.154
3.3 Decision-Making Processes p.155

4. Directors and Officers p.156
4.1 Board Structure p.156
4.2 Roles of Board Members p.157
4.3 Board Composition Requirements/Recommendations p.157
4.4 Appointment and Removal of Directors/Officers p.158
4.5 Rules/Requirements Concerning Independence of Directors p.159
4.6 Legal Duties of Directors/Officers p.159
4.7 Responsibility/Accountability of Directors p.159
4.8 Consequences and Enforcement of Breach of Directors' Duties p.160
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.160
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.161
4.11 Disclosure of Payments to Directors/Officers p.162

5. Shareholders p.163
5.1 Relationship Between Companies and Shareholders p.163
5.2 Role of Shareholders in Company Management p.163
5.3 Shareholder Meetings p.164
5.4 Shareholder Claims p.165
5.5 Disclosure by Shareholders in Publicly Traded Companies p.166

6. Corporate Reporting and Other Disclosures p.167
6.1 Financial Reporting p.167
6.2 Disclosure of Corporate Governance Arrangements p.167
6.3 Companies Registry Filings p.167

7. Audit, Risk and Internal Controls p.168
7.1 Appointment of External Auditors p.168
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.168

POELLATH is an internationally operating German law firm of more than 180 lawyers and tax advisers in Berlin, Frankfurt and Munich, providing high-end legal and tax advice. The firm advises on all transaction-related areas, including corporate, M&A, private equity, funds, real estate, private clients, succession planning and tax-related matters. POELLATH's corporate advice includes corporate law and group company law, reorganisations, capital market rules, corporate litigation and compliance. POELLATH advises publicly listed and private companies on preparing and conducting their general and shareholder meetings on all matters, including mergers, spin-offs and hive-downs, conversions of legal form, and on all corporate advisory matters related to corporate governance. A further core area is public takeovers with subsequent corporate integration. Key clients include Deutsche Telekom AG, shareholders of Porsche Automobil Holding SE, PUMA SE, Wacker Neuson SE, Eckert & Ziegler Medizintechnik, Nemetschek SE, GERRY WEBER, Münchener Hypothekenbank, BayWa, Giesecke+Devrient, Fiege Group, KME Group and Groz-Beckert.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

German law differentiates between capital companies and partnerships. The following chapter will focus on capital companies, as these are the most important and regulated forms of companies in Germany.

Capital Companies

Capital companies are legal entities where the liability is limited to the assets of the company – ie, the shareholders' liability is limited to what they have invested in the company. The most common legal forms of capital companies are the limited liability company (*Gesellschaft mit beschränkter Haftung* or GmbH) and the stock corporation (*Aktiengesellschaft* or AG). Other forms of capital companies are the European stock company *Societas Europaea* or SE) and the partnership limited by shares (*Kommanditgesellschaft auf Aktien* or KGaA).

The KGaA is a capital company, but also has some elements of a partnership.

Partnerships

Partnerships are characterised by the personal liability of the partners. The most popular legal form of a partnership is the limited partnership (*Kommanditgesellschaft* or KG), consisting of limited partners whose liability is limited to a certain amount agreed and disclosed in the commercial register, and general partners with unlimited liability. However, the general partner may have the legal form of a capital company, thereby limiting its liability.

German law also acknowledges the partnership under civil law (*Gesellschaft bürgerlichen Rechts* or GbR) and the general partnership (*Offene Handelsgesellschaft* or OHG), with unlimited liability of their partners.

1.2 Sources of Corporate Governance Requirements

The primary sources for corporate governance requirements for capital companies in Germany (GmbH, AG, KGaA, SE) are:

- the German Limited Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* or GmbHG);
- the German Stock Corporation Act (*Aktiengesetz* or AktG);
- the European and German acts on SEs (in particular the European SEVO and the German SEAG);

- the German Commercial Code (*Handelsgesetzbuch* or HGB);
- the Reorganisation of Companies Act (*Umwandlungsgesetz* or UmwG);
- the German Securities Acquisition and Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz* or WpÜG);
- the Market Abuse Regulation (*Marktmissbrauchsverordnung* or MAR); and
- the Securities Trade Act (*Wertpapierhandelsgesetz* or WpHG).

Beyond this, the German Corporate Governance Code (*Deutscher Corporate Governance Kodex* or DCGK) sets out further corporate governance rules for listed companies, which differentiate between recommendations and suggestions. In 2020, the DCGK introduced the category of principles which precede the recommendations and suggestions regarding a certain subject matter and outline the fundamentals of the applicable law.

In 2022, the DCGK was amended, substantiating some ESG aspects as well as the guidelines on internal controlling in response to new legislation on financial integrity.

Moreover, non-governmental regulations such as applicable listing rules enacted by the stock exchanges also establish corporate governance requirements.

Certain industry sectors (eg, banks) are subject to further regulation with respect to, inter alia, their corporate governance.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Shares of an AG, SE and, less commonly, a KGaA may be listed on a stock exchange. The primary source for corporate governance requirements concerning listed AGs and KGaAs, as well as (to a lesser degree) SEs, is the AktG, as it differentiates between rules for listed and non-listed companies. Its requirements are mandatory. The HGB, WpHG, WpÜG, the European and German Securities Prospectus rules (the European WPVO and the German WpPG), the Stock Exchange Act (*Börsengesetz* or BörsG) and the MAR provide for further mandatory regulation in relation to, inter alia, listed companies' corporate governance.

To promote a high corporate governance standard, the DCGK contains corporate governance standards in the form of recommendations and suggestions for listed companies with a two-tier corporate governance system; however, the rules of the DCGK shall also be applied correspondingly by listed companies with a one-tier corporate governance system (see **3.1 Bodies or Functions Involved in Governance and Management**). The DCGK is not enacted by the legislature, but by the German Corporate Governance Commission and is therefore not a statute or an ordinance, but rather "soft law", so the standards set in the DCGK are principally voluntary. Recommendations shall be complied with and, if not, deviations have to be explained and disclosed (principle of "comply or explain") in a declaration of compliance (*Entsprechenserklärung*), to be resolved upon annually by the responsible corporate governance bodies of the listed company.

The declaration of compliance is to be included in the declaration on corporate governance, which itself is part of the management report. The issuance of the declaration of compliance is obligatory. Deviations from suggestions are allowed without disclosure. In practice, listed companies seek to comply with the standards

set out in the DCGK, in particular the recommendations.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Sustainability, ESG and Supply Chain:

The topic of sustainability as well as social and environmental responsibility has become increasingly significant, resulting in more specific and extensive expectations and legislation on this matter, both at national and EU level. In particular, the EU Corporate Sustainability Reporting Directive (CSRD) as well as the German Supply Chain Act came into force in January 2023 (see **2.2 Environmental, Social and Governance (ESG) Considerations**). Also, the revised version of the DCGK which became effective in June 2022 extends the corporate duties in connection with environmental and social sustainability-related issues.

Virtual Shareholders' Meetings

Following the expiry of the COVID-19 law and its provisions on virtual general meetings of AGs and SEs as well as reliefs on passing shareholders' resolutions in writing in GmbHs, new legislation has been passed and entered into force on 20 July 2022. It states the general possibility of holding virtual general meetings for AGs or SEs on the basis of a corresponding provision in their articles of association, or virtual meetings for GmbHs on the basis of shareholder consent (see **5.3 Shareholder Meetings**).

Digitalisation

The laws implementing Directive (EU) 2019/1151 regarding the use of digital tools and processes in company law became applicable in August 2022. The provisions thereof offer the possibility, for example, to found GmbHs online via virtual notarial certification and to make trade register excerpts free of charge.

Corporate Codetermination

As envisaged by the German governing parties in their coalition agreement in 2021, a reform to tighten corporate codetermination rules (see **3.1 Bodies or Functions Involved in Governance and Management** and **4.1 Board Structure**) is expected to be on the agenda in the course of the current legislative term. However, it is still unclear when concrete draft legislation will be presented.

Dual Class Shares

In contrast to the current legal situation in Germany, there are plans to permit dual class shares under certain circumstances and some further reliefs to enter the capital markets as well as to seek capital for start-ups and growing companies in the future. However, it remains to be seen how and to what extent this will be implemented.

2.2 Environmental, Social and Governance (ESG) Considerations

Under the HGB, larger listed capital companies with more than 500 employees are under the duty to issue a non-financial declaration that expands their management report. This declaration has to briefly describe the business model of the company. Moreover, it has to refer to other aspects of corporate social responsibility – at least to environment-related, employee-related and social matters as well as to the respect of human rights and the fight against corruption and bribery.

The new Corporate Sustainability Reporting Directive (CSRD) came into force on 5 January 2023 and must be implemented into national law until 6 July 2024. Aiming to create a culture of transparency about companies' impact

on people and the environment, the new CSRD modernises and strengthens the rules on ESG reporting. The goal is to bring corporate sustainability reporting in line with the EU's ambition to become the first climate-neutral continent by 2050.

The scope of the CSRD is significantly wider compared to the previous scope of the non-financial declaration. In future, all companies listed on a regulated EU market and non-capital-market-oriented companies that exceed two of the following three criteria will be affected:

- EUR40 million annual turnover;
- EUR20 million balance sheet total; and
- an average of at least 250 employees.

The CSRD expands the reporting requirements to include further information on environmental, social and governance matters in addition to the already-known aspects concerning environmental, labour and social matters, respect of human rights and the fight against corruption and bribery.

ESG criteria are becoming increasingly more important, and not only in the voting guidelines of voting advisors. In June 2021, the federal government passed the so-called Supply Chain Act (*Lieferkettensorgfaltspflichtengesetz)*, intended to implement the UN Guiding Principles on Business and Human Rights and aiming to prevent the violation of human rights by companies. Therefore, it obliges companies to respect human rights as well as the environment throughout the global supply chain, and to remedy violations.

For this purpose, companies must establish an appropriate risk-management system and conduct a risk analysis for themselves and suppliers. The first is ensured by the appointment of an internal officer for monitoring the system. Additionally, companies must establish a procedure for filing complaints concerning human rights violations. Finally, companies must publish an annual report on their compliance containing fulfilment of their obligations under the Supply Chain Act. The law came into force on 1 January 2023 for companies in Germany with at least 3,000 employees, and will come into force on 1 January 2024 for companies with at least 1,000 employees.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

Management Board

The predominant board structure of an AG and an SE follows the two-tier corporate governance system, with a management board (*Vorstand)* managing and representing the company, and a supervisory board (*Aufsichtsrat)* supervising the management board, in each case accompanied by the third corporate body, the general meeting (*Hauptversammlung*). The management board manages the company under its own responsibility and at its own discretion. It is not subject to any instructions from the supervisory board or the general meeting.

However, the management board is subject to the prior approval of the supervisory board for certain business transactions and measures, either foreseen in the articles of association of the company or by the supervisory board itself – eg, in the rules of procedure for the management board.

Administrative Board

A one-tier corporate governance system with one board primarily known in other jurisdictions is only allowed in Germany within an SE. The board is called the administrative board (*Verwaltungsrat)*, and consists of executive and non-executive board members. The administrative board is responsible for the management and supervision of all material company matters (*Oberleitung)* as well as the determination of guidelines for the SE's business, and appoints managing directors (*Geschäftsführende Direktoren*), who are responsible for the day-to-day management of the company.

The managing directors may be members of the administrative board if and to the extent that the majority of the members of the administrative board continue to be non-executive. The administrative board is entitled to issue internally binding instructions to the managing directors.

General Partner

The peculiarity of a KGaA is that the general partner is responsible for the management. The general partner, being a shareholder of the KGaA, may be one or more natural persons or, more common in practice, a capital company itself – eg, a GmbH, AG or SE. The corporate governance system of such a capital company is to be differentiated from the corporate governance of the KGaA.

The corporate governance of the general partner company follows its applicable principle. The KGaA has in any case a supervisory board that is responsible for the supervision of the management, but in the case of a capital company as general partner it is responsible for neither the appointment, dismissal and service contracts of the management of the general partner nor for the determination of the financial statements.

The general meeting of an AG, SE and KGaA has no corporate governance powers.

Managing Directors

A GmbH generally has managing directors (*Geschäftsführer)* and the shareholders' meeting (*Gesellschafterversammlung)*, but no statutorily required supervising body. The managing directors are responsible for the management and representation of the company. In principal, they decide autonomously.

However, the shareholders' meeting is – in contrast to the situation in an AG – the supreme decision-making body of the GmbH, and has the authority to issue internally binding instructions to the managing directors. In a GmbH, a voluntary supervisory or advisory board may be implemented. Apart from this, a supervisory board is to be installed only in the case of codetermination (see **4.1 Board Structure**).

3.2 Decisions Made by Particular Bodies

Management Board

In an AG and a two-tier system SE, the management board responsible for the management of the company decides on any and all business transactions and measures within and outside the ordinary course of business under its own responsibility and discretion. However, material measures within and measures outside the ordinary course of business are subject to the prior approval of the supervisory board. For this purpose, applicable law provides that a catalogue containing those approval rights has to be established, either by the general meeting in the articles of association or, alternatively and – in practice – more relevant, by the supervisory board itself in the rules of procedure for the management board, which is an important part of supervising the management board.

Besides the supervision of the management board, the supervisory board is responsible for:

- the appointment and dismissal of the members of the management board;
- their service contracts; and
- the review and determination of the financial statements.

Administrative Board

In a one-tier system SE, the administrative board is responsible for fundamental management issues, such as long-term business goals, the organisational structure, and the strategy and general guidelines of the SE, as well as the budgeting; whereas the managing directors are "only" responsible for the day-to-day management. The administrative board has the authority to issue internally binding instructions to the managing directors.

General Meeting

Only selected decisions are reserved by law for the general meeting of an AG and an SE. With respect to the annual ordinary general meeting, such decisions include the appropriation of profits, the appointment of the auditor, the formal approval of action for members of both the management board and supervisory board, and the vote on the annual remuneration report; Fundamental, extraordinary decisions include:

- the election and removal of the supervisory board members;
- amendments to the articles of association; and
- resolutions on restructuring measures and the sale of substantially all of the corporation's assets, as well as on corporate agreements (profit and loss pooling agreements).

Managing Directors

Managing directors of a GmbH can principally make day-to-day management decisions without consulting the shareholders. However, as the shareholders' meeting is the supreme body, a broader catalogue of decisions is reserved by law for the shareholders' meeting of a GmbH than for a general meeting of an AG: all decisions that the ordinary general meeting of an AG has to take plus the review and determination of the financial statements and all fundamental, extraordinary decisions of the general meeting of an AG, as well as the right to instruct the managing directors.

3.3 Decision-Making Processes

Management Board

The management board of an AG and a two-tier system SE generally decides in physical or electronically set-up meetings, if a certain quorum of – most of the time – more than half the members of the management board are present or represented, by way of resolution, generally to be passed by a simple majority. However, qualifying majority requirements can be set – eg, in the rules of procedure for the management board. In practice, it is recognised and common that members of the management board are allocated certain individual responsibilities as part of their department (*Ressort)*.

Decisions within each department are made by the responsible, single member of the management board, unless such decision is of material nature, in which case a resolution of the management board is necessary. This also applies where another member of the management board so requests. Finally, the management board may form committees for specific tasks, although this is not that common in practice.

The same decision-making process applies (more or less) to managing directors of a one-tier system SE and a GmbH.

Supervisory Board

The supervisory board of an AG, a two-tier system SE and a KGaA decide by way of resolution, generally with a simple majority. However, the articles of association or the rules of procedure for the supervisory board may foresee qualifying majority requirements. Supervisory board meetings shall be held as physical meetings from the statutory starting point.

Electronically set-up meetings as well as mixture forms are permissible. Supervisory board members not present in a meeting may not be represented by third persons or other supervisory board members, but can only give a written voting declaration (*Stimmbotschaft*). The meeting has a quorum if the majority of members are present – at least three.

The supervisory board is entitled to form committees from within itself – eg, an audit committee and a nomination committee. The DCGK expressly requires the formation of these two committees for listed companies. Committees are generally responsible for preparing supervisory board topics and consummating resolutions passed by the supervisory board. Sometimes, committees are also entitled to resolve instead of the supervisory board.

However, this is not allowed in statutorily foreseen topics – eg, upon the remuneration and service contracts of members of the management board. Rules applying to the supervisory board in a two-tier system also have to be adhered to by the administrative board in a one-tier system SE.

4. Directors and Officers

4.1 Board Structure

Management Board

There is no legally predefined structure for the management board of an AG or two-tier system SE, nor for the managing directors of a one-tier system SE or GmbH. The management board can consist of one or more natural persons, unless the articles of association require a minimum number of members; the same applies to the number of the managing directors.

Supervisory Board

The supervisory board of an AG, KGaA and a two-tier system SE, and the administrative board of a one-tier system SE, has to consist of at least three members, or a higher number up to nine, 15 or 21 members, depending on the registered share capital of the corporation, to be set in the articles of association.

If an AG, KGaA or GmbH exceeds the threshold of, generally, 500 German employees, one third of the supervisory board members of the company must be employee representatives – ie, the one-third participation (*Drittelbeteiligungsgesetz* or DrittelbG). In this case, the number of supervisory board members must be divisible by three. If an AG, KGaA or GmbH and its controlled companies exceed, generally, 2,000 German employees in total, the supervisory board must consist of 50% employee representatives – ie, the parity codetermination (*Mitbestimmungsgesetz* or MitbestG). In this case, the minimum number of supervisory board members is 12, and beyond this depends on the total number of German employees.

German codetermination rules do not apply to the SE. Instead, when incorporating an SE, an agreement on the participation of employees

in the SE (the so-called employee participation agreement) has to be negotiated with the special negotiating body, which is established particularly for such negotiation, representing employees from the German company, its subsidiaries and branches that are in EU and EEA member states other than Germany. The rules on codetermination are part of the agreement, with the general principle that the level of codetermination of the German company used to incorporate the SE shall be maintained (freezing of codetermination prior to and after principle) – eg, if no codetermination exists and needed to exist prior to the incorporation of the SE, then no codetermination would need to be agreed upon in the employee participation agreement for the SE, etc.

4.2 Roles of Board Members

The applicable law does not predefine roles for members of the managing bodies. One member of the management board can be and usually is nominated as chairman or spokesperson. Apart from this, it is common for the tasks and duties of the management board and managing directors to be divided between them in several departments, either functional or operational divisions. Thereby, names like CEO, CFO and COO are generally attached to the members on their business cards, the website, and in the email footer; however, these are neither statutorily foreseen nor do they trigger any special further rights or obligations.

With respect to the supervisory board of an AG, and a two-tier system SE or an administrative board of a one-tier system SE, only the following rules have to be considered. Generally, each member has the same rights and duties, and must be familiar with the relevant business sector of the company. However, according to applicable law, boards of listed companies must have two members with certain skills, one with accounting expertise and the other with auditing expertise.

4.3 Board Composition Requirements/Recommendations

Management Board/Managing Directors

Beyond the requirements set out in **4.1 Board Structure** and **4.2 Roles of Board Members**, there are no other statutory rules governing the composition of the management board of an AG or a two-tier system SE, nor of the managing directors of a one-tier system SE or GmbH. However, if such a company is listed on a stock exchange as well as parity codetermined and consists of more than three members as of 1 August 2022, at least one new member must be female and one must be male.

With respect to the management board of an AG, and a two-tier system SE or an administrative board of a one-tier system SE, that is listed on a stock exchange or codetermined, the supervisory board must determine a target percentage for women on the management board and the management board for the second/third line management as well as deadlines by when such percentage is to be reached. In the case of a set target of zero, the management board must justify this in a clear and comprehensive manner. If at the time of the determination the percentage of women on the management board is below 30%, the target percentage may not be lower than the present percentage.

These corporations must include a declaration on corporate governance in their management reports. The DCGK recommends taking diversity into account when composing the management.

Composition of Supervisory Boards

In AGs, SEs and KGaAs that are parity codetermined and listed on a stock exchange, the supervisory board (or, in the case of a one-tier system SE, the administrative board) must be composed of at least 30% women and at least 30% men. The minimum percentage must be complied with by the shareholder and employee representatives on the board in its entirety. Furthermore, corporations that need to fulfil the aforementioned gender criteria must include information on whether the company has complied with the portion requirements for the appointment of women and men as supervisory board members in their declaration on corporate governance.

With respect to the supervisory board of an AG, and a two-tier system SE or an administrative board of a one-tier system SE, that is listed on a stock exchange or codetermined, the supervisory board must also set a target for women on the supervisory board as well as deadlines by when such a target is to be achieved. With regard to a target of zero or below 30%, the same applies to the supervisory board as to the management board as described above.

At least one member of the supervisory board must have expertise in the field of accounting and at least one other member of the supervisory board must have expertise in the field of auditing. Sufficient expertise can, for example, be assumed for:

- financial directors;
- expert employees from the fields of accounting and controlling analysts; and
- long-standing members of audit committees or works council members who have acquired this ability in the course of their work through further training.

The DCGK recommends, among other matters, that the supervisory board determines concrete objectives regarding its composition and prepares a profile of skill and expertise for the entire board while taking diversity into account. The profile of skill and expertise shall also comprise expertise regarding sustainability issues.

It is recommended that both are taken into account for the supervisory board's proposals to the general meeting. The DCGK further recommends that a certain number of members of the supervisory board as well as certain members – eg, the chairperson – are independent (see **4.5 Rules/Requirements Concerning Independence of Directors**). The implementation status of the objectives and the profile of skill and expertise as well as the number of independent members deemed to be appropriate by the supervisory board are to be disclosed in the corporate governance report in the form of a qualification matrix.

4.4 Appointment and Removal of Directors/Officers

In an AG and an SE, the respective supervisory or administrative board is responsible for appointing and generally dismissing the members of the management board or the managing directors. The maximum term of office is five years in an AG and six years in an SE; a reappointment or extension is principally permitted.

The members of the supervisory and administrative board are appointed by the general meeting, for a maximum term of office of approximately five years in an AG and six years in an SE. Reappointment is permitted. Dismissal could happen by resolution of the general meeting with a majority of at least three quarters of the votes cast, unless the articles of association provide otherwise. Employee representatives on the

supervisory board in the case of codetermination are generally appointed by employee elections.

The appointment and dismissal of the managing directors of a GmbH is, in principle, the responsibility of the shareholders' meeting. The term of office may be indefinite.

4.5 Rules/Requirements Concerning Independence of Directors

Management Board

The members of the management board of an AG are subject to a duty of loyalty to the company, must observe the best interests of the company, and are bound by a non-compete obligation for the duration of office. They must disclose conflicts of interest to the supervisory board without undue delay. The DCGK also makes statements to that effect. In certain situations, members of the management board should thus either abstain from casting votes or not even participate in the meeting or the relevant topic.

Supervisory Board

The members of the supervisory board of an AG and a two-tier system SE and of the administrative board of a one-tier system SE are also bound by a duty of loyalty, but there are no mandatory statutory provisions that require and define independence. However, a few restrictions aiming at independence prohibit an individual from becoming a member of the supervisory or administrative board – eg, where the individual is part of the management of a subsidiary of the company. Nevertheless, the DCGK requires a certain degree of independence to avoid conflicts of interest.

In this respect, the supervisory board shall determine an appropriate number of independent members. The DCGK gives indicators for determining the independence of members of the supervisory board. These include personal or business relationships with the company, the management board, controlling shareholders and major competitors that may cause a substantial or not merely temporary conflict of interest.

4.6 Legal Duties of Directors/Officers

Members of management bodies must conduct the company's affairs with the due care of a prudent and diligent businessman, in particular in accordance with the applicable laws and the articles of association (duty of legality, including and of ever-increasing importance the duty to establish and maintain an effective compliance management system). In the case of entrepreneurial decisions, the so-called business judgement rule applies in order to eliminate hindsight bias when legally evaluating the management bodies' past conduct. This means that members of the management board may be exempt from liability if they had reasonably assumed that they were acting on the basis of adequate information and in the best interests of the company.

The same applies to the members of the supervisory and administrative board. However, their differing tasks and roles in the corporate governance of the respective company lead to a different emphasis of duties.

4.7 Responsibility/Accountability of Directors

In principle, members of management and supervising bodies owe their duties primarily to the company; they always have to act in the best interests of the company and its group. However, the interests of the company include, to a certain extent, the interests of all stakeholders (such as creditors and employees) of the company (the

German "stakeholder model" in contrast to the Anglo-Saxon "shareholder model").

4.8 Consequences and Enforcement of Breach of Directors' Duties

In an AG and SE (with a few exceptions in special statutory rules – eg, in the event of an insolvency, and in the context of wilful misconduct), creditors and shareholders cannot enforce a breach of duties of members of management and supervising bodies. The members of the bodies are rather jointly and severally liable in the internal relationship towards the company due to their joint responsibility. Thus, individual members of a management and supervising body may not alleviate themselves from liability because a certain task or responsibility was delegated to a different member internally.

Furthermore, such a breach may lead to a dismissal and, with respect to the management members, a termination of their service contract.

In principle, the supervisory board is responsible and – according to case law – even has a duty to assert damage claims to the management board members. The company may waive its damage claims or enter into settlement arrangements on these claims only if three years have lapsed since the claim arose and the general meeting resolved thereupon without a minority of the shareholders (at least 10% of the share capital) raising an objection.

Where members of the supervisory board culpably breach their duties, the management board is responsible for pursuing possible damage claims against the supervisory board members jointly and severally.

Claims Against Members of Corporate Governance

The rights and obligations on asserting claims against members of corporate governance bodies in an AG, SE and KGaA are independent of whether or not the members of these respective bodies have been discharged. Another particular consequence of a breach of duty in a listed company is that the company may be obliged to disclose it to the capital market by way of ad hoc notification.

In the case of a GmbH, the consequences of a breach of the duties of managing directors are, to a great extent, comparable to an AG. In general, the managing directors, like the management board members, are not directly liable to the creditors of the company. The shareholders' meeting has the right to pursue damage claims and to decide about the dismissal of managing directors and the termination of the service contract.

In contrast to the situation in the AG, if the shareholders' meeting has discharged the managing director knowing the facts underlying such a breach, the discharge leads to an exclusion of liability.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Certain special law remedies and, in the case of wilful misconduct, general civil law remedies, exist. From the company's point of view, these do not generally extend claims any further than those under corporate law. Since shareholders do not have a direct claim against the members of management and supervising bodies under corporate law, in certain situations (eg, capital market fraud) general civil law remedies may provide an opportunity for claims of shareholders.

However, the courts have traditionally been cautious in recognising such claims.

Liability

The liability of a member of a management and supervising body in an AG, SE and KGaA cannot be limited, as this would in particular qualify as an impermissible waiver by the company upfront – ie, prior to the expiry of the three-year period (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**). However, D&O insurance for the members of the management and supervising body is permissible and common in practice in order to protect them against risks arising from their professional activities for the company. Premiums are generally paid by the company, although members of the management board of an AG, SE and KGaA are obliged to bear a deduction of at least 10% of the damage to one-and-a-half times their annual fixed salary at maximum.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Remuneration of the Management Board

The remuneration of the management board members of an AG and a two-tier system SE is resolved by the supervisory board and contractually agreed upon in the service contract.

In listed companies, the supervisory board has to determine the principles of the remuneration of the members of the management board in a remuneration system, which is subject to approval by the general meeting upon its introduction and any material changes thereto, at least every four years. However, the resolution on the approval is non-binding and thus has no effect on the legitimacy of the remuneration. Nevertheless, if the general meeting does not approve the remuneration system, a reviewed remuneration system has to be presented at the next annual general meeting for approval.

Contents

With respect to the contents of the remuneration system, the AktG only requires a few elements to be included in every remuneration system (eg, a maximum total remuneration of the management board) but provides for further rules with respect to its contents relating to different aspects of the remuneration of the management board if those aspects are foreseen in the remuneration system. However, the DCGK makes several recommendations with respect to criteria to be described in the remuneration system – eg, the ratio between the fixed remuneration and the variable remuneration based on short- and long-term incentives, as well as the performance and non-performance indicators for determining payment of variable remuneration.

The supervisory board then determines the actual remuneration of each member of the management board based on the remuneration system. The supervisory board and the management board have to prepare a remuneration report regarding the past financial year, which is subject to a non-binding approval by the annual general meeting. Neither the resolution on the remuneration system nor the resolution on the remuneration report can be objected to by means of a contesting action or an action for annulment by a shareholder.

Restrictions

As regards restrictions on the remuneration of the members of the management board, the AktG requires that the overall remuneration of individual members of the management board is appropriate in relation to their tasks and performance as well as the economic situation of the company. In addition, the supervisory board

must ensure the customary remuneration is not exceeded. Further, the remuneration in listed companies has to be aimed at a sustainable and long-term-oriented development of the company, and variable remuneration should be granted based on long-term incentives accordingly.

If the supervisory board culpably disregards the statutory requirements when determining the remuneration for the management board, it may be held liable for damages.

Characteristics

The DCGK makes further recommendations with respect to the characteristics of the remuneration. For example, it recommends that the variable remuneration based on long-term incentives exceeds the one based on short-term incentives. Variable remuneration shall be predominantly invested in shares of the company or granted as share-based remuneration.

The DCGK further recommends that payments to members of the management board due to early termination of their activity do not exceed twice the annual remuneration (severance cap) and do not constitute remuneration for more than the remaining term of the contract. Another suggestion is that change-of-control clauses should not be agreed upon.

Supervisory Board

The remuneration of the supervisory board members may be specified in the articles of association or granted by the general meeting. It should be appropriate in relation to the tasks of the members of the supervisory board and the company's economic situation. In listed companies, the general meeting has to resolve on the remuneration of the supervisory board members at least every four years, also in a non-binding manner, with the resolution including or referencing the same details that are to be included in the remuneration system of the management board with respect to the remuneration of the supervisory board members, if applicable. The DCGK further recommends taking into consideration the status as chair or deputy chair of the supervisory board or committee in this context. It is suggested that the supervisory board remuneration be a fixed remuneration.

Managing Directors and General Partners

In a GmbH, the remuneration of managing directors is the responsibility of the shareholders' meeting, which must not adhere to any restricting rules.

In a KGaA, the general partners generally receive no remuneration for their activities, but are entitled to receive a fee for taking over the liability of the KGaA vis-à-vis third parties. In the case of a capital company as general partner, the remuneration of its management members is to be set according to the rules applying to the respective legal form of such a capital company.

4.11 Disclosure of Payments to Directors/Officers

All capital companies are required to disclose the total remuneration of the management board in the annual financial statements. An exception is made only for capital companies that fulfil at least two of the following criteria (small capital companies):

- the balance sheet total does not exceed EUR6 million;
- the sales revenues within the last 12 months amount to less than EUR120 million; and
- the company employs, on an annual average, fewer than 50 employees.

In a listed company, the features of the remuneration system must be described (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**). The remuneration system has to be published on the company's website for the duration of the application of the remuneration system – however, at least for ten years. In addition, the management board and the supervisory board of a listed company must disclose certain information, such as the fixed and variable remuneration paid to each member of the management and the supervisory board, in the annual remuneration report. The remuneration report is also published on the company's website for at least ten years. The AktG requires the remuneration report to be audited.

The AktG also requires ad hoc and annual disclosure of related party transactions, including transactions of the company with its various members of corporate bodies.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The purpose of the company is determined by its shareholders in the articles of association. The shareholders can only exert influence on the decision-making process by way of resolutions. The general meeting of an AG, SE and KGaA has fewer rights and powers than the shareholders' meeting of a GmbH, in particular due to their ability to instruct the managing directors (see **3.2 Decisions Made by Particular Bodies**).

Furthermore, the shareholders have fiduciary duties towards the company and the other shareholders, and so have to promote the purpose of the company and may not act to its detriment.

5.2 Role of Shareholders in Company Management

The involvement of the shareholders in the management of a company differentiates according to the legal form of the company.

AGs, SEs and KGaAs

In an AG, SE and KGaA, the general meeting is entitled to appoint the members of the supervisory and administrative board, generally by simple majority, and to dismiss them by 75% of the share capital represented. However, the members of the management board and the managing directors in a one-tier system SE are appointed by the supervisory board, respectively the administrative board. The general meeting cannot instruct the supervisory or administrative board, or the management board.

If the management board so requires, the general meeting is entitled to resolve upon management affairs. In practice, such requests do not happen often. Apart from this, the general meeting does not have any influence on the management.

Listed Companies

Listed companies also do not engage with their shareholders, in particular not outside the general meetings. In preparing such meetings, the CEO has calls with shareholder representatives and potential proxy voters, but abstains from providing them with any information that has not already been disclosed in the invitation or that the CEO does not intend to disclose in the general meeting to all other shareholders. However, the DCGK suggests that the chairman of the supervisory board should, to an appropriate extent, be in regular conversation with investors on supervisory board-related issues.

Non-listed Companies
Conversely, non-listed companies typically do engage with their shareholders.

GmbH
In a GmbH, the involvement of the shareholders in the management is also statutorily more extensive. In contrast to the AG, the shareholders' meeting resolves upon the appointment and dismissal of the managing directors and on the conclusion of their service agreements. Also, the shareholders of the GmbH are able to direct the managing directors to take or refrain from taking certain actions in the business by way of internally binding instruction.

5.3 Shareholder Meetings
Annual General Meetings
An annual general meeting is mandatory in an AG and KGaA within the first eight months of a financial year, and in an SE within the first six months of a financial year. The annual meeting has to resolve upon the ordinary topics (see **3.2 Decisions Made by Particular Bodies**) and upon the remuneration system, the latter resolution being non-binding (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**). Further extraordinary topics on fundamental decisions can also be put on the agenda of the annual general meeting, or can be passed in an extraordinary general meeting.

Apart from this, general meetings are to be convened if necessary for the welfare and going concern of the company. The general meeting has to be convened no later than 30 days prior to the date of the general meeting, or no later than 36 days prior to the meeting if shareholders are required to register for the general meeting. In an AG and a two-tier system SE, the convening is generally the obligation of the management board, or exceptionally the supervisory board. Within a one-tier system SE, the administrative board is responsible for the convening.

However, shareholders whose share is equivalent to at least 5% of the registered share capital may also demand the convening of a general meeting. Shareholders whose share in the share capital is that high or corresponds to a nominal stake of EUR500,000 may demand that certain additional items are put on the agenda. The demand has to be received by the company 24 days prior to the general meeting at the latest, or no later than 30 days prior to the general meeting for listed companies.

Virtual General Meetings
In reaction to the COVID-19 pandemic, the German legislature has temporarily allowed AGs, SEs and KGaAs to hold virtual general meetings – ie, by way of audio and video streaming and carrying out submissions of votes either electronically or in written form, even where the articles of association do not provide for such meetings. Upon expiry of this temporary COVID-19 law in August 2022, the German Parliament passed a new law introducing virtual general meetings – ie, meetings without the physical presence of the shareholders or their proxies at the location of the general meeting, as a permanent option and alternative to the physical general meeting. However, pursuant to the new provisions, virtual general meetings require a corresponding provision or authorisation in the articles of association as of 31 August 2023. Such provision or authorisation may only be set for a maximum term of five years.

Annual General Meeting Invitation
The invitation has to fulfil a lot of formalities, such as setting out the business name and seat of the company, the time and place of the general meeting, and the agenda. For listed compa-

nies, the invitation has to provide further information – eg, about the rights of the shareholders in respect of the general meeting.

Votes and Resolutions

Unless stipulated otherwise in the articles of association, the general meeting should be held at the seat of the company. Resolutions may not be taken by written consent, but the articles may provide that shareholders can cast votes in written form. Shareholders may be represented by a proxy/proxy voter at the general meeting, or may exercise their rights via electronic communication; the latter option is only available if the articles of association allow this form of attendance and voting.

In listed companies, each resolution adopted by the general meeting is to be recorded in the minutes of the meeting prepared by a notary public. For non-listed companies, it is sufficient to have the minutes signed by the chairman of the supervisory board as long as no resolutions are adopted for which applicable law requires a majority of 75% of the votes cast or a greater majority.

GmbHs

In a GmbH, the regulations in respect of the shareholders' meeting are not as strict as in the AktG for AGs, SEs and KGaAs. Resolutions generally have to be passed in a meeting of the shareholders, but can also be made in writing based on a corresponding provision in the articles of association or provided that all shareholders agree in text form. The shareholders' meeting generally has to be convened by the managing directors by registered letter.

In the case of a meeting, the invitation must be sent at least one week before the meeting, and the agenda of the shareholders' meeting has to be announced in the invitation. However, these formalities on the invitation can be waived or amended in the articles of association.

There are no special requirements for the holding and conducting of shareholders' meetings. Shareholders may submit their vote in writing or may grant proxy. It is also permissible to hold virtual meetings via electronic communication based on a corresponding provision in the articles of association or provided that all shareholders agree in text form.

5.4 Shareholder Claims

Shareholders generally do not have any direct claims against members of corporate governance bodies (see **4.8 Consequences and Enforcement of Breach of Directors' Duties** and **4.9 Other Bases for Claims/Enforcement Against Directors/Officers**).

Appealing Resolutions

Any shareholder who holds only "one" share may appeal resolutions (*Anfechtungs- und Nichtigkeitsklage)* of the general or shareholders' meeting for breach of law or the company's articles of association. Another objection shareholders can try to bring forward in such lawsuits is the violation of the (majority) shareholder's duty of good faith. As these duties are not statutorily defined, the chances of success are based on case law. The defendant is the company, not the other shareholder/shareholders who has/have voted in favour.

By filing such objection and voidance claims in court, minority shareholders can block the completion (ie, entry into the commercial register) of, for example, corporate and integration measures. Registration will take place when the minority shareholders' court challenges are overcome by a so-called release proceeding, which

the company must file (*Freigabeverfahren)*. The company will particularly prevail in the release proceeding and thereby achieve registration in the commercial register if minority shareholders cannot prove that they hold more than a nominal value of EUR1,000 of the registered share capital of the company since the announcement of the convocation of the general meeting.

If in the context of a resolution the company or a majority shareholder has to offer to acquire shares of minority shareholders at fair value based on an IDW S1 valuation, those resolutions cannot be objected to (any more) with the argument that the valuation is too low. However, minority shareholders are entitled to challenge the adequacy of the price in court in a special shareholder compensation proceeding (*Spruchverfahren*).

Appointing a Special Auditor

Shareholders can request (by demanding either an invitation of an extraordinary general meeting or the adding of a topic on the agenda, see **5.2 Role of Shareholders in Company Management**) that the general meeting shall – with a simple majority of the votes cast – appoint a special auditor (*Sonderprüfer)* to analyse statutorily specified decisions of the executive and supervisory board. If the general meeting rejects the motion to appoint a special auditor, and if facts and circumstances justify severe breaches of tasks and duties by the management, minority shareholders who together hold 1% of the registered share capital or a nominal value of at least EUR100,000 can file for the appointment of the special auditor in court.

Damage Claims

Minority shareholders may influence the assertion of damage claims against management and supervisory board members following breaches of tasks and duties if, in a first instance, the general meeting resolves with a simple majority to assert such claims. Minority shareholders who together hold 10% of the registered capital or a nominal value of at least EUR1 million can then judicially file for the appointment of a special representative (*besonderer Vertreter)* to assert these claims. Minority shareholders who together hold 1% of the registered share capital or a nominal value of EUR100,000 or more can also apply in court for admission to assert these claims of the company in their own name.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Shareholders of listed companies have to notify the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or BaFin) and the issuer if their direct and/or indirect holdings exceed or fall below certain thresholds (3%, 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75%) and if their positions in financial instruments relating to shares exceed or fall below the aforementioned thresholds (except for the 3% threshold). The notification is to be published by the issuer and can be viewed on its website at any time. Shareholders of listed companies who directly or indirectly hold at least 10% must notify the issuer of the objectives pursued with the acquisition and the origin of the funds used within 20 trading days of reaching or exceeding this threshold.

According to the Money Laundering Act (*Geldwäschegesetz* GWG), which implements the EU Anti-Money Laundering Directive, companies need to disclose their beneficial owner(s) in the transparency register, irrespective of whether their shares are publicly traded or not.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Except for small partnerships, companies have to prepare an annual financial statement. Capital companies additionally have to prepare a management report, unless the company is a small company (based on the criteria set out in **4.11 Disclosure of Payments to Directors/Officers**). The annual financial statements and the management report differ in that the annual financial statements are primarily for presentation purposes, whereas the management report is more of an analysis and commentary.

The management report includes information on the risk profile of the company and its risk management system. For large listed companies, the HGB requires a declaration on corporate governance and a non-financial declaration including statements on environmental, social and labour-related concerns, among other matters.

In addition to preparing the annual financial statements and the management report, listed companies are also required to prepare and publish a half-year report. Some stock exchanges may require further reporting with respect to a certain market segment.

Certain industry sectors – for example, banks and other financial institutions – are subject to further reporting requirements.

6.2 Disclosure of Corporate Governance Arrangements

The declaration on corporate governance includes information on how the management board and the supervisory board conducted their duties, and also has to address other issues, such as whether quotas for female members of the management and supervisory board have been met, and whether or not the company has a diversity concept (see **4.3 Board Composition Requirements/Recommendations**). Furthermore, listed companies have to publicly declare each year whether they comply with the DCGK (see **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**). The declaration is part of the declaration on corporate governance and must be published on the website.

As described, the remuneration system as well as the remuneration report must be published on the company's website for at least ten years. Further, the principal features of the management remuneration system and the remuneration of the management board and the supervisory board must be disclosed in the annual financial statement and in the management report thereto.

The annual financial statement also has to include information on related party transactions that were not at arm's length. Certain related party transactions must also be disclosed on an ad hoc basis.

6.3 Companies Registry Filings

A company must in particular file the following with the commercial register (*Handelsregister)*:

- the articles of association, including the company's business name and legal form, registered seat, purpose of the enterprise and registered share capital;
- the names of the legal representatives, their place of residence and dates of birth;
- if existent, the name and place of residence of authorised officers (*Prokurist)*;
- in an AG and SE, a list of supervisory and administrative board members;

- in a GmbH, a list of shareholders; and
- subsequent amendments to the above-mentioned points.

Those filings are publicly available at www.handelsregister.de, which contains all entries in the commercial register filed since 2007.

The entry in the commercial register is constitutive in certain cases (eg, foundation, mergers or changes of legal form of the company), which means the measure will only become effective upon its entry in the commercial register. In other cases, failures to make filings may result in a fine from the registry court.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

A company has to appoint an external auditor unless it is a small company (based on the criteria set out in **4.11 Disclosure of Payments to Directors/Officers**). The key requirements governing the relationship between the company and the auditor are set out in the HGB. The auditor is appointed by the general or shareholders' meeting. In an AG and two-tier system SE, the supervisory board is responsible for issuing the actual audit mandate; while in a one-tier system SE it is the administrative board, and in a GmbH it is the managing directors.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

In an AG, SE and a KGaA, the management board must install a system to detect and monitor risks to the continued existence of the company. However, it is best practice to maintain several systems and refined rules (for example, through reporting lines and codes of conduct) to ensure internal compliance and effective risk management. Specifically, the management board of a listed company is required by law to establish an internal control and risk management system. The supervisory board will review the existence and effectiveness of such measures. Managing directors of a GmbH are also expressly obliged to take measures for the early detection of a crisis.

According to German case law, effective compliance management systems are also required in order to fulfil the duty of care owed to the company.

Trends and Developments

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POELLATH

POELLATH is an internationally operating German law firm of more than 180 lawyers and tax advisers in Berlin, Frankfurt and Munich, providing high-end legal and tax advice. The firm advises on all transaction-related areas, including corporate, M&A, private equity, funds, real estate, private clients, succession planning and tax-related matters. POELLATH's corporate advice includes corporate law and group company law, reorganisations, capital market rules, corporate litigation and compliance. POELLATH advises publicly listed and private companies on preparing and conducting their general and shareholder meetings on all matters, including mergers, spin-offs and hive-downs, conversions of legal form, and on all corporate advisory matters related to corporate governance. A further core area is public takeovers with subsequent corporate integration. Key clients include Deutsche Telekom AG, shareholders of Porsche Automobil Holding SE, PUMA SE, Wacker Neuson SE, Eckert & Ziegler Medizintechnik, Nemetschek SE, GERRY WEBER, Münchener Hypothekenbank, BayWa, Giesecke+Devrient, Fiege Group, KME Group and Groz-Beckert.

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Introduction

Digitalisation and environmental, social and governance (ESG) remain the dominant topics in recent legislation on corporate governance. The experiences from the COVID-19 pandemic and the accompanying digitalisation have had a significant influence on new legislative developments. In particular, the German legislature has adopted an act introducing virtual general meetings as a permanent option. The growing importance of ESG matters in the context of corporate governance has reached its peak to date. The EU Corporate Sustainability Reporting Directive (CSRD) and the German Supply Chain Act (*Lieferkettensorgfaltspflichtengesetz)* reflect their growing influence. In addition, the EU Whistle-blowing Directive has recently been implemented in Germany, and reform efforts on German codetermination law are under discussion. This article will shed light on these recent trends and developments.

Virtual General Meetings

General meetings of the shareholders (*Hauptversammlung)* of a stock corporation (*Aktiengesellschaft* or AG) and a European stock corporation (*Societas Europae* a or SE) were required to be held physically prior to the COVID-19 pandemic. Due to and during the pandemic, the federal government statutorily permitted these companies to hold their general meetings entirely virtually. These temporary COVID-19 rules expired at the end of August 2022.

Since the format of the virtual general meeting has met with a positive response in practice, and digitalisation is advancing in all areas of law, the possibility of virtual general meetings has been introduced as a permanent alternative to physical general meetings under a new law which became effective in July 2022.

Requirements

In contrast to the temporary COVID-19 rules, the legislature has adjusted the rules for virtual meetings towards those for physical general meetings, aiming to secure an equivalent level of shareholder rights as is foreseen for physical general meetings. Therefore, virtual general meetings are only permissible if essential shareholder rights are granted, in particular the right to speak and to ask questions under certain conditions.

Further, virtual general meetings require a corresponding provision or authorisation in the articles of association, which needs to be resolved by the shareholder meeting with a 75% majority. Such provision or authorisation may only be set for a maximum term of five years. Without such basis in the articles of association, virtual gen-

eral meetings will no longer be possible as of 1 September 2023.

In consummating a virtual general meeting, the management board has flexibility, in particular on how to allow shareholders to address questions. The management board may either decide that shareholders may ask questions during the general meeting as is foreseen for physical meetings, or that shareholders must send their questions up to three days prior to the general meeting. In the latter case, the company has to answer these questions up to one day prior to the general meeting at the latest, and shareholders may then ask follow-up questions on the company's answers or questions on new matters during the general meeting.

Acceptance in practice

During the legislative process, the framework conditions for virtual general meetings had already been the subject of intense debate, accompanied by numerous critical statements from among representatives of both shareholders and companies. While shareholder representatives feared inappropriate restrictions on the right to speak and to ask questions (and thus the lack of a general debate and sufficient interaction), company representatives, on the other hand, expressed concerns regarding the potentially excessive use of the shareholders' rights to speak and to ask questions (leading to very long general meetings and extensive organisational effort).

In the course of the current general meeting season, the resolution on authorisations for conducting virtual general meetings via amendment of the articles of association is on the agenda of the vast majority of AGs and SEs, particularly listed ones. However, various influential proxy advisers declared in their voting guidelines the acceptance of authorisations for conducting virtual general meetings only under certain conditions. In response, many listed companies refrained from using the maximum term of five years permitted by law, and instead limited the authorisation to two years initially, with commitment by the management to carefully decide in each case whether to make use of the authorisation, particularly taking into account the protection of shareholders' rights and aspects of health protection, efforts and costs, and sustainability considerations.

In practice, it remains to be seen whether the criticism regarding shareholders' rights is justified, and how companies will deal with virtual general meetings in the coming years.

Corporate Sustainability Reporting Directive (CSRD)

The EU aims to become the first climate-neutral continent by 2050. Against this background, it adopted a new Corporate Sustainability Reporting Directive (CSRD) which came into force on 5 January 2023 and that must be implemented into national law by 6 July 2024.

Scope

Currently, large listed companies have to issue a non-financial declaration addressing aspects related to environmental, labour and social issues, respect for human rights and the fight against corruption and bribery. The scope of the CSRD is considerably wider. In future, all companies listed on a regulated EU market will be affected, as will non-capital-market-oriented companies that exceed at least two of the following three criteria:

- EUR40 million annual turnover;
- EUR20 million balance sheet total; and
- an average of 250 employees.

From 2026, capital market-oriented small and medium-sized companies will also be required to issue a sustainability report.

Sustainability reporting

The CSRD aims to expand the reporting requirements to include additional information on ESG issues. This is intended to increase the influence of the reporting company on sustainability aspects as well as, vice versa, the impact of sustainability aspects on the development and performance of the reporting company. The reporting obligation is mandatory. The European Commission is currently developing reporting standards for sustainability reporting (ESRS) which are expected to be adopted in June 2023. With these standards, the EU intends to specify the requirements for future reporting.

Supply Chain Act

Implementing the UN Guiding Principles on Business and Human Rights, the German legislature passed the so-called Supply Chain Act in June 2021. According to this law, companies must observe compliance with human rights and environmental standards throughout the global supply chain, and must remedy any breaches. The law came into force on 1 January 2023 for companies with at least 3,000 employees, and will come into force on 1 January 2024 for companies with at least 1,000 employees.

Compliance with human rights and environmental standards

Companies must ensure compliance with human rights in their own business operations as well as vis-à-vis their direct suppliers. This obligation only applies to indirect suppliers if the company has substantiated knowledge of human rights violations. In order to comply, companies must:

- set up an appropriate risk management system;
- conduct a risk analysis for themselves and their suppliers;
- appoint an internal representative to monitor the risk management system;
- set up complaint possibilities regarding alleged human rights violations;
- carry out a risk analysis on an ad hoc basis, but at least once a year; and
- publish an annual report on compliance with their due diligence obligations under the Supply Chain Act.

Breaches

If breaches are identified – eg, in the case of child labour or forced labour – companies must take remedial action. This may also require termination of the business relationship with a particular supplier. The Federal Office of Economics and Export Control (BAFA) will monitor compliance with the obligations under the Supply Chain Act. Breaches will be punished by means of a fine. The fine can be up to EUR8 million or 2% of the annual turnover for companies with more than EUR400 million. Public authorities must take compliance with these obligations into account when awarding contracts.

Additional work and expenses for companies

As a result of these newly created obligations and the corresponding increase in responsibility, the Supply Chain Act will lead to additional work and expenses for companies. As a preventative measure, companies affected in the future should include appropriate clauses in the supply chain contracts with their suppliers regarding the obligation to respect human rights. In addition, companies should agree on certain codes of conduct with their suppliers.

Outlook

In practice, it remains to be seen whether the Supply Chain Act will actually have the desired effect in terms of improving human rights and environmental aspects along supply chains. In February 2022, the EU Commission presented a draft EU Corporate Sustainability Due Diligence Directive (CSDDD) with even stricter regulations than under German law, and with, inter alia, a broader scope and claims for damages deriving from violation of sustainability obligations. The CSDDD is currently in the middle of the EU legislative process and its scope and punitive approach is heavily discussed. In any case, a further expansion of the regulations concerning compliance with human rights and environmental due diligence obligations is to be expected in the future.

Further ESG-Related Recommendations Under the DCGK

With the last reform of the German Corporate Governance Code (DCGK) in 2022, new recommendations for listed companies were introduced, taking into account the growing importance of environmental and social sustainability. However, since the DCGK is not statutory law but rather "soft law", this recommendation is not binding but can be deviated from (principle of "comply or explain").

According to the revised DCGK, the internal control and risk management system shall be geared towards sustainability-related concerns. Further, the company strategy shall provide information on how the economic, ecological and social objectives are to be implemented in a balanced manner, while corporate planning shall include sustainability-related objectives in addition to financial objectives. The management board shall, among other things, systematically identify and assess the risks and opportunities for the company associated with social and environmental factors, as well as the social and environmental impacts of the company's activities.

Additionally, the supervisory board shall monitor certain sustainability aspects, while its competence profile shall include expertise on sustainability issues of importance to the company. In addition, the professional qualifications of the members of the audit committee of the supervisory board shall be expanded to include knowledge and experience in sustainability reporting, and be provided in the corporate governance statement.

Legal Protection for Whistle-blowers

While the role of whistle-blowing in a functioning compliance management system and the importance of legal protection for whistle-blowers have been recognised in other jurisdictions (in particular the USA) for decades, it remains a highly controversial legal policy issue in Germany.

Apart from sector-specific rules for certain companies, in particular in the area of financial services, there has been only little precise legislation on the integration of whistle-blowing systems into corporate governance so far. For listed companies, the DCGK recommends in a general sense that employees be given the opportunity to report, in a protected manner, suspected breaches of law within the enterprise.

EU Whistle-blowing Directive

In October 2019, the EU adopted a directive on the protection of persons reporting on breaches of EU law (Directive (EU) 2019/1937), aiming to establish a comprehensive legal framework for whistle-blower protection and for safeguarding the public interest at the EU level. Member states are required to provide whistle-blowers working

in the public and private sectors with effective channels to confidentially report breaches of EU law in the areas of, inter alia:

- environmental protection;
- public procurement;
- financial services;
- product and food safety;
- data privacy; and
- consumer protection.

Thereby, the directive further aims to create a robust system of protection against retaliation for whistle-blowers.

Implementation into German law

Even though the implementation of the EU Whistle-blowing Directive into national law was due in December 2021, the German legislature only recently adopted the Act on Whistle-blower Protection (*Hinweisgeberschutzgesetz)*, presumably becoming effective in June 2023. The German Act on Whistle-blower Protection introduces a comprehensive duty to establish internal whistle-blowing systems for all companies with 50 or more employees, and goes beyond the material scope of the underlying EU Directive, which is limited to breaches of specific EU law. It aims to promote the legal protection of whistle-blowers against retaliation (eg, discrimination, dismissal, warning notice, denial of promotions), including potential civil damage claims with a reversal of proof and public sanctions.

This was preceded by an intense public and parliamentary debate on the details of the implementation. The draft bill faced criticism, in particular regarding the potential bureaucratic and financial burden for small and medium-sized companies and the initially intended duty to establish anonymous reporting channels, which is no longer foreseen in the final bill.

Corporate Codetermination

Corporate codetermination – ie, the representation of employees on supervisory and administrative boards – is among the most frequently discussed corporate governance topics in recent times.

Employee involvement procedure in cross-border reorganisations

With implementation of the EU Directive on cross-border conversions, mergers and divisions ((EU) 2019/2121), the German Parliament enacted new rules strengthening the rights of employees in the course of cross-border reorganisations. According to the new law, which became effective on 31 January 2023, capital companies are also obliged to conduct employee involvement procedures in the case of cross-border conversions and divisions into Germany ("inbound"). This was previously only the case for foundations of a European Stock Corporation (Societas Europaea, SE) or for cross-border mergers.

The employee involvement procedure requires the election of a (international) special negotiating body by the employees of all involved companies and their subsidiaries, followed by negotiations between the management and the special negotiating body on the participation of the employees in the future company. The duty to conduct such employee involvement procedure applies where:

- the cross-border reorganisation would cause the reduction of existing codetermination rights;
- the cross-border reorganisation would lead to disadvantageous treatment of foreign employees; or
- the company involved in Germany employs a number of employees corresponding to at

least four fifths of the threshold for codetermination in the exit state (the "four-fifths rule").

Within four years after effecting a cross-border reorganisation, existing participation rights of employees of the company that evolved from the cross-border reorganisation are protected by the duty to conduct employee involvement procedures, again in cases of subsequent domestic reorganisation measures.

In practice, compliance with these new rules will require significant efforts from companies in terms of timing and planning of cross-border reorganisation measures.

Potential reform to tighten German codetermination law

Under German law, there are two different kinds of employee representation in supervisory boards of capital companies – the so-called codetermination (*unternehmerische Mitbestimmung*). If a capital company exceeds the threshold of 500 German employees, one third of the supervisory board members must be employee representatives (ie, one-third participation). If a capital company and its controlled companies exceed 2,000 German employees, the supervisory board must consist of 50% employee representatives (ie, parity codetermination).

In their coalition agreement dated 7 December 2021, the current governing parties envisaged tightening German codetermination law with the goal of preventing abusive avoidance of codetermination rights. Currently, the coalition agreement focuses on the following two aspects.

- It is intended to close the current legal "loophole" regarding the attribution of employees within the group in terms of one-third codetermination rules. Whereas under the status quo employees of an affiliated company are only attributed to the controlling company, in the case of either an existing domination agreement or the legal integration of the dependent company into the controlling company, the attribution of employees to the controlling company shall be extended to cases of de facto control, irrespective of an underlying company agreement or integration (as is already the case in terms of parity codetermination rules).
- The federal government intends to address the so-called freezing effect in the context of foundations of SEs, which currently allows the perpetuation of the existing codetermination level (or the lack thereof) at the time of the foundation of the SE, even if the number of employees within the SE or the group later exceeds the relevant thresholds ("before and after principle"). However, it remains unclear how this shall be implemented, in particular since profound legal changes would only be possible at the EU level and would require the broad consensus of the EU member states, which is not currently foreseeable.

Furthermore, there have been legislative initiatives and statements in the election programmes of individual parties proposing, for example:

- extension to companies with a foreign legal form but seat in Germany;
- the reduction of the relevant thresholds (ie, number of employees); and
- the inclusion of foundations with operative business within the scope of codetermination.

Even though the statements contained in the coalition agreement remain rather vague and there is no legislative draft yet, it is to be expected that the reform will be put on the agenda in the course of the current legislative term. The

envisaged intensification of the codetermination law would potentially affect many medium-sized, owner-led companies in Germany and might trigger the need for anticipatory action from a company's perspective.

GHANA

Law and Practice

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Contents

1. Introductory p.180
1.1 Forms of Corporate/Business Organisations p.180
1.2 Sources of Corporate Governance Requirements p.180
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.181

2. Corporate Governance Context p.182
2.1 Hot Topics in Corporate Governance p.182
2.2 Environmental, Social and Governance (ESG) Considerations p.183

3. Management of the Company p.184
3.1 Bodies or Functions Involved in Governance and Management p.184
3.2 Decisions Made by Particular Bodies p.184
3.3 Decision-Making Processes p.185

4. Directors and Officers p.185
4.1 Board Structure p.185
4.2 Roles of Board Members p.185
4.3 Board Composition Requirements/Recommendations p.185
4.4 Appointment and Removal of Directors/Officers p.186
4.5 Rules/Requirements Concerning Independence of Directors p.186
4.6 Legal Duties of Directors/Officers p.187
4.7 Responsibility/Accountability of Directors p.188
4.8 Consequences and Enforcement of Breach of Directors' Duties p.188
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.188
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.189
4.11 Disclosure of Payments to Directors/Officers p.189

5. Shareholders p.189
5.1 Relationship Between Companies and Shareholders p.189
5.2 Role of Shareholders in Company Management p.190
5.3 Shareholder Meetings p.190
5.4 Shareholder Claims p.191
5.5 Disclosure by Shareholders in Publicly Traded Companies p.192

6. Corporate Reporting and Other Disclosures p.193
6.1 Financial Reporting p.193
6.2 Disclosure of Corporate Governance Arrangements p.194
6.3 Companies Registry Filings p.194

7. Audit, Risk and Internal Controls p.194
7.1 Appointment of External Auditors p.194
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.194

Addison Bright Sloane is a full-service business law firm based in Accra, Ghana. The firm has provided tailored services to businesses in Ghana and overseas requiring the expertise of a law firm with in-depth knowledge of both the African business landscape and the global business environment. The firm's team of commercial and corporate law practitioners comes with a diverse and rich corporate law practice portfolio across various industry sectors. The firm is the partner of choice for a top-tier City of London law firm and regularly collaborates with it and other global law firms on a number of high-profile transactions. Addison Bright Sloane regularly advises corporate clients on complex transactions. The firm has carved a niche for itself in ESG, infrastructure and projects, energy, technology, environmental law, private equity, banking and finance law as well as dispute resolution (including international ADR).

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1. Introductory

1.1 Forms of Corporate/Business Organisations

The principal forms of corporate/business organisations in Ghana are the following.

Partnerships

A partnership is an association of two or more individuals incorporated to carry on business jointly for the purpose of making profits. Partnerships are governed by the Incorporated Private Partnership Act, 1962 (Act 152).

Companies

One or more persons may form a company. Companies are governed by the provisions of the Companies Act, 2019 (Act 992). A company may be limited by shares, limited by guarantee or unlimited. It could be public, private or an external company.

Unincorporated Association

This is a registered association under the Companies Act, 2019 of individuals that have come together for a common purpose. Unlike companies, unincorporated associations lack a distinct separate existence.

1.2 Sources of Corporate Governance Requirements

The principal legislation in this area is the Companies Act, 2019 (Act 992). This new Act, replacing the Companies Act, 1963, represents a significant step forward in corporate governance standards for companies operating in Ghana. The Incorporated Private Partnership Act, 1962 (Act 152) (as amended) provides for the incorporation and registration of partnerships. It requires partnerships, inter alia, to keep proper books of accounts of their operations. The Corporate Insolvency and Restructuring Act, 2020 (Act 1015) provides the regulatory framework for distressed companies through stipulated systems for temporary management and restructuring of the otherwise distressed outfit.

More industry specific legislation includes:

- the Securities Industry Act, 2016 (Act 929) and the Securities and Exchange Commission Regulation, 2003 (LI 1728) (Act 929): the Act establishes the Securities and Exchange Commission (SEC), with its mandate to regulate, innovate and promote the growth and development of an efficient, fair and transparent securities market;

- the Banks and Specialised Deposit-taking Institutions Act, 2016 (Act 930) and the Insurance Act, 2021 (Act 1061), and their respective regulations;
- the Professional Bodies Registration Act, 1973 (NRCD 143);
- the Statutory Corporations Act, 1964 (Act 232);
- the Ghana Investment Promotion Centre Act, 2013 (Act 865); and
- the Stock Exchange (Ghana Stock Exchange) Listing Regulations, 1990 (LI 1509).

Additionally, there are a plethora of best practices often adhered to by companies that have been embedded into Ghana's corporate governance system over the years. For instance, internal auditors play a vital role in the corporate governance process even though companies are not required by law to hire them. Most of these best practices crystalised into statute when the new Companies Act, 2019 was passed. Internal audits serve as internal checks of a company, including its management and accountability procedures.

Similarly, the Companies Act, 2019 specifies a range of persons that qualify to act as a company secretary. However, most companies prefer qualified lawyers in good standing with the Ghana Bar Association to act as such. These practices help to ensure adherence to existing legislation and regulations.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Public companies are required to publish their audited financial statements, depicting the fiscal performance of the company and listing its majority shareholders at the end of each financial year. Only a public company may invite the public to acquire shares. A public company may only do so after filing its prospectus with the Registrar.

This requirement is strict, and consequently, any invitation made to the public in violation thereof constitutes an offence and offending persons could be criminally liable. In addition, the SEC has issued some guidelines to aid the process of issuing securities to the public, including that:

- the proceeds of any public offer/rights issue are to be used in strict accordance with the purpose(s) indicated in the offer document;
- the SEC will continue to undertake post-IPO/post-rights issue inspections to ascertain whether proceeds of the IPO/rights issue have been/are being utilised as indicated in the offer document; and
- issuers are required to disclose all fees to be paid out to persons or bodies in pursuance of the IPO/rights issue.

Further to this, characteristically, directors of public companies are voted or elected into office at a general meeting of the company. At the first annual general meeting (AGM) of a public company, by law, all directors save an executive director) must retire. Following this, at all subsequent general meetings of the company, one third of the directors must retire on a first-come, first-go basis.

Public companies are also prohibited from extending loans, granting guarantees or providing security for loans to directors of the company or a director of an associated company.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Corporate governance rules and regulations are mainly contained in the Companies Act, 2019 (Act 992), which vests in the Registrar of Companies the power to ensure compliance with its provisions. First and foremost, every entity must be registered with the Registrar of Companies to be a legitimate corporate entity. The proposed name of the Company must not be misleading or undesirable and must include either of the following suffixes: limited company (ltd), public limited company (plc), limited by guarantee (lbg), public unlimited company (pub), private unlimited company (purc).

All companies must have at least one shareholder and not more than 50 shareholders for private companies. The biodata of beneficial owners of all registered companies must be provided to the Registrar of Companies (see the Ghana Trends and Developments chapter on the subject of beneficial ownership in this guide).Every company is required to have at least two directors who must qualify to be directors and consent in writing to act as such before their appointment (see **4.1 Board Structure** for more on directors).

To enhance corporate governance in the country, directors are required to act in the best interest of a company as a whole, function to preserve the company's assets, and generally act to further the business and promote the purposes for which the company was formed. The law enjoins them to do this in a faithful, diligent, careful manner such as is expected from an ordinary skilful director in given circumstances.

From Act 992, directors are further enjoined to have regard to:

- the likely long-term consequence of any decision they make;
- the impact of the operations of the company on the community and the environment; and
- the desirability of the company maintaining a reputation for high standards of business conduct.

A director who commits a breach of any of these duties is liable to some form of sanction, including:

- compensating the company for any loss resulting from the breach;
- accounting for profits realised from the wrongful transaction; and
- the recession of the offending contract.

In addition to directors, the rules require every registered company to have other officers, such as an suditor, secretary, and also provides mechanisms for ensuring that officers and directors are accountable to shareholders, for example through the holding of AGMs (See **4. Directors and Officers**).

Acts Pertaining to Governance

Act 992 prescribes that companies should file annual returns once every year with the Registrar of Companies. Companies must maintain audited accounts, financial statements and reports (see **6.1 Financial Reporting**). With a view to preserving and maintaining the stated capital of the company, the Act further characterises certain transactions as major transactions (see **3.2 Decisions Made by Particular Bodies**). A special resolution by the members of the company is required to authorise such transactions.

Additionally, the central bank in accordance with Section 56 of the Banks and Specialised Deposit-taking Institutions Act, 2016 (Act 930)

published additional corporate governance directives in March 2018, establishing that:

- the term of office of a managing director or chief executive officer (MD/CEO) of a regulated financial institution shall not be more than four years and may only be renewed for an additional two terms;
- financial institutions are required to give an indication to the Bank of Ghana (BOG) of their achievements in terms of corporate governance goals within 120 days of the end of a financial year; and
- former officials of theBOG are prohibited from serving as directors of banks until the expiration of two years from their departure from the central bank.

The BOG also promulgated rules relating to persons who are not "fit and proper". Persons deemed so are proscribed corporate governance involvement.

2.2 Environmental, Social and Governance (ESG) Considerations

There is no obligation on companies to routinely report on environmental or social issues.

The Environmental Protection Agency Act, 1994 (Act 409) does, however, require a company to submit an environmental impact assessment report to the Agency, reporting on activities that might negatively impact the environment.

In addition, the Ghana Carbon Registry has recently been set up to receive, process, record and store data to be utilised for a range of purposes, including collecting and tracking transactions from mitigation activities at various levels.

The eligibility criteria for a project at the Ghana Carbon Registry establishes that:

- the project should be in the Nationally Determined Contributions (NDCs) programmes of action;
- the project should be part of the conditional NDCs programmes of action;
- the project should be in the whitelist (he whitelist contains eligible automatically additional technologies that are available for internationally transferred mitigation outcomes (ITMOs)) transactions at any given time; and
- the project should meet the criteria of the buyer.

The NDCs are programmes of actions which focus on minimising emissions, conserving the forest and dealing with climate change issues.

Regarding harmful emissions, the requirements are that any mitigation activity employed by a company that falls outside the scope of Ghana's NDCs programme may still be eligible to participate in the programme if:

- the related activity is covered by the latest National Greenhouse Gas Inventory prepared under the applicable Intergovernmental Panel on Climate Change (IPCC) Guidelines; and
- the activity is agreed upon by the participating acquiring party.

Finally, under Section 128 of Act 992, directors are also required to circulate to the members of the company the company's financial statements, a report by the directors and a report by the auditors. The financial report must include the emoluments of the directors and pensions of present and past directors. The directors' report must contain certain details such as the state of affairs of the company and corporate social responsibility.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The law provides that a company shall act through its shareholders in a general meeting or its board or through officers or agents appointed by either the board or the shareholders as per Section 144 of the Companies Act, 2019 (Act 992).

Members (Shareholders)

A person can become a member of a company by subscription, agreement, transfer of shares and by operation of law. Members of a company need not necessarily be natural persons. A member's right may be personal or collective.

Board of Directors

Being the body to whom the members (shareholders) of the company have entrusted the affairs of the company, the board constitutes the overarching team charged with ensuring the overall health and success of the company. Directors are appointed to direct and administer the business of the company. Unless a company's constitution stipulates otherwise, the business of a company is managed by its directors or their delegates.

Officers

Act 992 defines an officer in relation to a body corporate to include any director, secretary, or employee of that body corporate, receivers and managers whose appointment is authorised by the company and duly appointed liquidators.

3.2 Decisions Made by Particular Bodies

Shareholders

A company acts through its members at a general meeting. The meeting may be an AGM or an extraordinary general meeting. Members in a general meeting are responsible for:

- the declaration of dividends recommended by directors;
- the appointment and removal of directors;
- effecting alterations to a company's constitution;
- fixing remuneration of auditors; and
- the appointment and removal of auditors.

In addition, "major transactions" require shareholder approval. Major transactions, as characterised by Act 992, are:

- the acquisition of, or an agreement to acquire, whether contingent or otherwise, assets, the value of which is more than 75% of the value of the assets of the company before the acquisition;
- the disposition of, or an agreement to dispose of, whether contingent or otherwise, assets of the company the value of which is more than 75% of the value of the assets of the company before the disposition; or
- a transaction that has or is likely to have the effect of the company acquiring rights or interests or incurring obligations or liabilities, including contingent liabilities, the value of which is 75% of the value of the assets of the company before the transaction.

Board of Directors

The following decisions are taken by the board:

- deciding the company's major policies;
- ensuring and monitoring the financial integrity of the company;
- determining the company's capital structure;
- setting compensation for management; and
- proposing dividends payable per share.

These duties are to be performed by all or some of the directors on behalf of the entire board and for the company. Act 992 stipulates that the board acting within its powers is not bound by the instructions of the members in a general meeting. Minutes of its meetings are to be taken and kept and must be signed by the chairperson of the board.

3.3 Decision-Making Processes

The rules regulating decisions made by directors are usually found in a company's constitution and these include the requirements for meeting and voting, and the stipulated quorum for a directors' meeting. Decisions of the board are made at meetings by majority vote. Act 992 allows decisions to be made by directors without the necessity of attending a board meeting. In such instances, a written resolution signed by all directors shall be valid and effectual as if same was made at a duly convened meeting.

Decisions (crystallised into a resolution) are taken by members of a company at general meetings and all members are eligible to attend general meetings and vote at such meetings. Resolutions passed at general meetings are binding on all members as well as the company itself. General meetings may be convened by directors, members or the Registrar. A member is entitled, upon notice to the company, to appoint a proxy to attend and vote on their behalf at a meeting.

4. Directors and Officers

4.1 Board Structure

In contrast to some jurisdictions that have a supervisory board as well as a management board, boards in Ghana are based on a single-tier structure. A board may consist of both executive and non-executive directors who manage the business of the company and are appointed for a fixed term. The minimum number of directors in any company, whether public or private, is two with no maximum specified.

In the case of a vacancy (that is, a director is absent and cannot fulfil their duties), the remaining directors can continue to act, except where their number is reduced to one (or below the minimum number required by the company's constitution).

It is not mandatory for directors to hold company shares unless the constitution of the company specifies otherwise. Directors may appoint substitute and alternate directors, who must abide by the requirements set out in Act 992 and the company's constitution, and at least one director must be ordinarily resident in Ghana at all times.

4.2 Roles of Board Members

Board members are not given specific roles, however, in practice, directors could take on specific tasks. For example, they could serve on sub-committees of the board, as these are designated committees (handling specific issues such as audit, risk and governance), directors would be functioning within the role assigned to them in that committee.

4.3 Board Composition Requirements/Recommendations

The Companies Act, 2019 (Act 992) requires that each board has a minimum of two directors. The Act recognises various categories of directors, including substitute directors, alternate directors, executive directors and managing directors. The board must have a company secretary who, though not a director (excepting cases where a director doubles up on the role), works with the board to navigate the corporate

governance framework and ensure the company adheres to it.

Finally, the board includes a chairperson. This is a director who is appointed by the other directors to lead the board and preside over meetings.

It is a worthwhile recommendation to maintain a mix of professionals in the board's composition. For instance, accountants/financial types, lawyers, at least one relevant industry specialist, and those with experience in the human resources or IT sectors. For efficiency and attention to detail, board committees are useful. Another recommendation is for the board to have an uneven number to avoid a gridlock. Where an even number exists, the chairperson is usually given a casting vote.

4.4 Appointment and Removal of Directors/Officers

Directors are appointed by members at a meeting (except where there is a single member situation) and are removed at the AGM. Act 992 states that directors are appointed by shareholders and also stipulates that "the constitution of a company may also provide for the appointment of a director/directors by a class of shareholders, debenture holders, creditors, employees or any other person". Prior to their appointment, prospective directors must declare:

- that within the preceding five years, they have not been charged with or convicted of an offence involving dishonesty or fraud;
- that they have not been a director or senior manager of a company that has become insolvent; and
- that they have not been charged with or convicted of a criminal offence relating to the incorporation and promotion of a company.

A company can remove any or all directors from the board if they have been disqualified from acting in that capacity. Directors are removed by ordinary resolution at a general meeting by the shareholders. Regarding public companies, the law requires a mandatory retirement of one third of the board annually on a first-come, first-go basis.

Act 992 stipulates that a "resolution to remove the director shall not be moved at a general meeting unless notice of this resolution has been given to the company a minimum of 35 days before the meeting at which the resolution is to be moved" (Section 176, Act 992). The board may remove the company secretary, without prejudice to the secretary's right to damages where a breach of contract is occasioned in so doing.

4.5 Rules/Requirements Concerning Independence of Directors

Directors must disclose to the company any potential conflict of interest between themselves and the company. Such information, disclosed in writing or at a meeting of the board, will be recorded in the Interests Register. Failure to make this disclosure attracts a fine of 250 to 500 penalty units (one penalty unit is equal to USD1.1/GHS12 at time of writing). Act 992 further requires directors to exercise independent judgement. In addition, they are precluded from use of their positions or company's money/property except for the prescribed usage listed in Act 992 or the company's constitution.

Further, directors may not utilise confidential information obtained in their capacity for personal gain, and must not be (in)directly beneficially interested in a business which competes with that of the company, nor have personal (in)

direct interests in any contract or transaction other than those provided for in the Act 992.

Accordingly, unless a company consents (and superseding any company constitution that so allows), a director shall not place themselves in a position in which their duty to the company potentially conflicts with their personal interest(s) or duties to other persons. The law makes exceptions: the duty of a director to avoid conflict is not infringed if they have the board's consent, have fully disclosed their interests early on, and not voted in any board meetings pertaining to the decision in which the director does have an interest. Provided they have the company's consent, a director may enter into a potential conflict of interest relationship to the company, notwithstanding potential legal fallouts, for example a derivative action.

Regardless of its public or private status, consent by the company is mandatory in this context. In private companies, this can be done when there are no provisions in the company's constitution prohibiting authorisation. For public companies, authorisation can be given if the company's constitution permits the board to authorise the action.

4.6 Legal Duties of Directors/Officers

Directors

Directors stand in a fiduciary relationship towards the company. As they hold a position of trust, directors are expected to act in good faith and in the best interest of the company at all times. This involves preserving the company's assets as well as furthering the company's business interests. For instance, they are prohibited from taking the company's assets for personal benefit.

The standard expected of directors encompass the necessity to consider the consequences of any actions they take, and maintain high standards and a good brand reputation. According to the Second and Third Schedules of the Companies Act, 2019 the directors shall manage the business of the company. During the pre-incorporation stage, they are authorised to make payments from the company's coffers for all expenses incidental to promoting and registering the company.

Directors exercise the powers of the company, including borrowing money, charging property and the issuance of debentures. Directors are entitled to enter into a contract with the company, notwithstanding the need to maintain independence as provided in Section 192 of Act 992. The Act further states that such contracts cannot be avoided nor shall a director be made to account for profit from it, merely for the director being in a fiduciary relationship with the company.

The board may appoint one among them to any other office in the company, including that of managing director, save the office of auditor. The directors can also revoke that appointment.

Secretaries

To qualify as a company secretary, an appointee should have obtained a professional qualification that provides them the relevant experience and knowledge to execute their duties. Such an appointee should either be enrolled to practice and be in good standing as a barrister or solicitor in Ghana, be a member of a professional body or have the requisite academic qualifications necessary for the role. Alternatively, they should have held office prior to the appointment, as a company secretary trainee or have worked

under the supervision of a qualified company secretary for at least three years.

Moreover, an appointee in good standing of either the Institute of Chartered Accountants Ghana, the Institute of Chartered Secretaries and Administrators qualifies to be a company secretary. Unless the company's constitution provides otherwise, the company secretary shall be appointed by the directors. The statutory duties of the company secretary include:

- assisting the board to comply with the constitution of the company; and
- keeping the books and records, ensuring the meeting minutes are properly recorded as required by the Act, prepares and issues notices in the name of the company.

4.7 Responsibility/Accountability of Directors

The directors are accountable to various stakeholders, namely, the company as an entity, the shareholders, and the Registrar General. The Companies Act, 2019 (Act 992), provides that directors hold a fiduciary relationship with the company and are mandated to act in the company's best interest. They must also consider the impact of their actions on the shareholders, the employees of the company, the community at large and the environment.

When appointed by a special class of members, employees or creditors, directors may "give special but not exclusive consideration" to their interests as well (Section 190.) Directors are also accountable to the Registrar General's Department, as they can be penalised for misrepresenting themselves or for providing false information. Finally, they can also be prosecuted for criminal offences they either were responsible for, had knowledge of or were complicit in.

4.8 Consequences and Enforcement of Breach of Directors' Duties

When a director breaches their duties, the director and any other person who knowingly committed the breach must compensate the company for any loss the company suffers as a result. The director shall also disclose any profits made from the wrongful transaction. Finally, the company reserves the right to terminate any transaction or contract entered into between the director and the company, in breach.

Where there has been a breach, the company or member of a company (ie, shareholders) can institute legal proceedings to enforce liabilities, restrain a threatened breach or by recovering property from the director. A company can do the above on the authority of the board of directors, a receiver and manager or liquidator, or via an ordinary resolution of the company which has been agreed to by the members. A legal challenge can also be brought in the form of a representative action by a class of shareholders with leave of court.

Another legal option open to shareholders and directors is a derivative action. After seeking leave from the court, any of the above parties can bring a derivative action in the name of the company against any party (including another director of the company). Wilfully providing a false statement to the Registrar General is an offence liable to a fine.

The enforcer of these sanctions is the Registrar of Companies.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

A director's liability for their actions can be limited to the extent they comply with the company's constitution, the Companies Act, 2019 and by

generally performing their duties to the best of their ability.

A director's failure to live up to their responsibilities may open them to legal liabilities. The following are some basis for a directors' liability:

- breaching of fiduciary interest;
- failing to act in the company's best interest;
- failure to adhere to the company's constitution;
- acting outside the limits of their power;
- making biased decisions;
- failing to disclose potential conflicts of interests or placing themselves in potentially conflicting positions without the company's consent; and
- making false declarations to the Registrar General.

Subject to the above, shareholders, other directors (via derivative action) or the company itself can institute legal proceedings against directors.

4.10 Approvals and Restrictions Concerning Payments to Directors/ Officers

Shareholders fix the remuneration for directors. Aside from their allowances, directors are entitled to be reimbursed for expenses incurred in the process of executing their duty as directors (attending meetings on the company's behalf or other company related business). Furthermore, a company's constitution may cater for compensation, including insurance benefits, where the tenure of a director is terminated.

In the case of a director losing their office, compensation must first be approved by the shareholders.

In the event of a takeover, if a director (who owns shares) is offered a higher price for their shares than other shareholders, the director must ensure that this fact is included in the notification sent to other shareholders.

Finally, compensation for directors is subject to income tax.

4.11 Disclosure of Payments to Directors/Officers

Companies must issue financial statements, which include an auditor's report. Amongst other things, the financial statements must disclose information on how much the directors are paid, along with any pension entitlements, and the emoluments of past and present directors in respect of loss of office.

Directors' fees must also be disclosed to the tax authorities (the Ghana Revenue Authority) as an income.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Act 992 specifies that a shareholder is a member of the company. As a result, shareholders collectively own the company, which confers on them the right to appoint directors. Membership of a company registered with shares continues until a valid transfer of the shares held by the specific member is registered by the company. Shares are transferred by operation of law to another person or forfeited for non-payment of calls, or on death of a member.

Shareholders have the right to attend and vote at AGMs. Subject to the company's constitution, the right to vote may depend on whether mem-

bers have paid any sums of money required in respect of the shares allocated to them. Companies are also required to keep a register of members within the jurisdiction; this will be managed by the company secretary and includes the names, addresses and, where relevant, a statement of shares held by each member.

Shareholders can act for the company through general meetings, alongside the board of directors, officers and agents. Notably, unless the constitution of a company provides otherwise, the board of directors is not bound to comply with the directions of the shareholders. Furthermore, shareholders may act in a matter if the members of the board are disqualified, stuck in a deadlock, or otherwise. They may institute legal proceedings in the name of the company if the board of directors neglects to do so, can ratify or confirm an action taken by the board of directors, and can make recommendations to the board of directors.

5.2 Role of Shareholders in Company Management

Shareholders may exercise the powers given to them in the company's constitution with regard to company management. However, except as specified in the company's constitution, the board of directors largely manages the business of the company. Shareholders have the right to attend the company's general meeting and speak and vote on resolutions at the meeting; they also have the power to appoint and remove auditors and directors. In the event of a company winding up, shareholders must pay the balance of the shares they hold in accordance with the terms of the agreement under which the shares were issued.

In the event of a winding up, shareholders are required to contribute funds sufficient for the payment of debts and liabilities of the company and for the expenses of winding up. According to Section 40 of Act 992, past members are not liable to contribute to the latter unless a court finds that the existing members are unable to satisfy the required contributions.

In the general management of the enterprise, shareholders have the power to approve "major transactions" (see **3.2 Decisions Made by Particular Bodies**). Companies can only enter these transactions if approved by special resolution of the shareholders. Should any shareholder vote wholly against the transaction, that shareholder is entitled to have their shares bought, if they elect to sell. Shareholders can also approve compensation and retirement packages for auditors and directors.

5.3 Shareholder Meetings

AGMs are mandatory. Companies must hold an AGM each year, and designate it as such, so as to distinguish it from any other meetings held that year. AGMs must be held each year and not more than 15 months apart. However, if the company's auditors and members (those entitled to attend and vote) agree in writing that the AGM shall be dispensed with in a given year, the company is allowed to waive the meeting for that year; if the meeting is not held due to the above reason, the Registrar of Companies may give directions as they deem fit.

Where meetings are called, 21 days prior notice must be given. The business of a meeting must be stated in the notice. Unless a company's constitution says otherwise, shareholders are entitled to attend and vote at general meetings.

New Companies

A newly incorporated company has up to 18 months within which to hold the first AGM. Such

AGM must be held at least 21 days after the company's financial statements and the reports of the directors and auditors on the financial statements of the company have been sent to members and debenture holders of the company. These financial statements and reports shall be presented at the meeting.

When a company passes a resolution postponing the date of the AGM, a copy of said resolution must be forwarded to the Registrar. If an AGM is not held in accordance with the aforementioned conditions, the company is liable to pay an administrative penalty of 150 penalty units to the Registrar. Further, unless a company's constitution states otherwise, members are entitled to vote by proxy. If it is unfeasible to conduct or call a meeting in the manner prescribed by the company's constitution, either a director, member or the Registrar may apply to the court to conduct the meeting in a manner the court considers fit.

Shareholders

Shareholders are also entitled to attend extraordinary general meetings. Extraordinary meetings are convened at the board's discretion, as well as when there are not enough directors within the jurisdiction capable of acting to form a quorum. Unless a company's constitution states otherwise, these meetings will be held in Ghana.

Minutes and Electronic Meetings

Section 166 of Act 992 provides that the minutes of general meetings shall be recorded in a book reserved specifically for that purpose. Minutes should be signed by the chairperson of the meeting (where a company defaults in this directive, the company and each officer therein is liable to pay the Registrar a penalty of 250 units).

A company shall circulate meeting resolutions and supporting circulars to members. The proceedings at these meetings are governed by the Companies Act, 2019 except for those sections in which provisions are made for governance by the company's constitution.

All meetings of the company can be conducted electronically. Similarly, the books and registers subject to inspection can be maintained in either electronic or manual format. The Registrar General has provided guidelines for the conduct of virtual AGMs of companies of which notice must be submitted to the head office in Accra or any of the regional offices. Notices of such meetings must be sent to every member electronically in accordance with the provisions of each company's constitution.

5.4 Shareholder Claims

A director's failure to live up to their responsibilities establishes a basis for claims against them. The basis for claims include:

- breaching their fiduciary interest;
- failing to act in the company's best interest;
- failing to adhere to the company's constitution;
- acting outside the limits of their power;
- making biased decisions;
- failing to disclose potential conflicts of interests or placing themselves in potentially conflicting positions without the company's consent; and
- making false declarations to the Registrar General.

Subject to the above, shareholders can institute legal proceedings against the directors. They can also bring a representative action against the directors or apply for the leave of court to bring a derivative action.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Shareholders are not obliged to make general public disclosures of their holdings. However, they are required by tax laws to make disclosures of their earnings from investments in companies to the Ghana Revenue Authority for taxation purposes. Shareholders typically pay 8% income tax on their dividends.

Foreign directors are required to pay this too, unless their country has a dual-tax treaty with Ghana, in which case they may pay a reduced level of income tax. If the shares of a shareholder (or a group thereof) in a publicly traded company amounts to 35% or more of the total shares, they must disclose this to the remaining shareholders. It should also be noted that the names of majority shareholders are usually included in the mandatory publication of the notes to the audited financial statements of public companies.

The general threshold is that a person who has direct or indirect interest of 10% or greater in a company must be registered as a beneficial owner. For companies operating in the high-risk sectors, the threshold for reporting beneficial ownership is 5%.

Act 992 provides that every company is required to keep a register of members and beneficial owners and to furnish the Registrar General with the particulars of its members first at registration and subsequently to do so on an annual basis in its annual returns filed with the Registrar General. In the annual returns, the company is also required to indicate which of the beneficial owners are politically exposed persons.

The objective of providing particulars of beneficial owners, as well those who might be politically exposed persons, is to promote good governance and accountability in companies, to support efforts to minimise and ultimately eradicate the risk of money laundering, and consequential ills such as, financing of terrorism, financing the proliferation of weapons of mass destruction and other transnational organised crimes. The strategy also seeks to stem the flow of tainted monies into Ghanaian companies.

Section 13 of Act 992 provides that an application for incorporation of a company must include particulars of all persons who are beneficial owners. Where the persons who are recorded as shareholders of the company are not the beneficial owners of the shares, the company is required under Section 35 to also record the particulars of the beneficial owners of the shares in the Register of Members and to furnish the Registrar of Companies with these particulars within 28 days after being entered in the Register of Members. Particulars of beneficial owners are also to be provided in the company's annual returns filed pursuant to Section 126 of Act 992.

The Ghana Stock Exchange (GSE) requires shareholders in listed companies to release information to the public relating to their stock holdings at least 48 hours after the transaction occurs. The GSE's Listing Rule 55 stipulates:

- a person irrespective of nationality who purchases or sells shares in a listed company shall inform the market when their holding attains, exceeds or falls below each 5% threshold, starting from 10% through 15% and 20% up to 50% plus one share; and
- the disclosure shall be made in a press release to the market not later than 48 hours after the transaction.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Section 128 of Act 992 provides that directors are required to send three reports each year to members and debenture holders of the company. These reports are:

- the directors' report;
- financial statements; and
- the auditor's report.

The Directors' Report

This is prepared by the directors and covers principally the company's corporate governance arrangements, the performance of the company during the year under review, and the outlook for the coming year. The corporate governance structures include organisation charts, committees of the board, profiles of board members, capacity-building initiatives for the directors and significant board decisions during the year. The business performance section covers the general economic environment, economic issues which impacted the company's performance, the performance of the company during the year and an outlook for the coming year.

The report shall discuss any changes in the business of the company (or of its associated companies), and also list the details of any subsidiary companies of the holding company. Inversely, if the company in question is a subsidiary, the report shall state details of the holding company. The report also discusses the corporate social responsibility activities of the company and the expenditures of such programmes for the year.

The report must be approved by the board of directors and signed by two of them.

Company's Financial Statements

Directors prepare this in accordance with International Financial Reporting Standards (IFRS). These financial statements are:

- the statement of financial position;
- the statement of comprehensive income (including profit and loss);
- the statement of changes in equity;
- the statement of cash flows; and
- the summary of significant accounting policies and other explanatory notes to the accounts.

Consolidated financial statements must also be prepared for companies with subsidiaries (Section 131 of Act 992). Consolidated financial statements include statements on the company's financial position, consolidated comprehensive income, consolidated changes in equity, consolidated cash flows and notes about the consolidated financial statements.

The statements must give a true and fair overview of the profit and loss, comprehensive income statements and the general state of affairs within the company. Both the financial statements and the consolidated financial statements must follow the guidelines given in the Sixth Schedule of the Act.

The Auditor's Report

This is prepared by external auditors in accordance with international standards on auditing, as adopted by the Institute of Chartered Accountants, Ghana.

It is a report on the accuracy, completeness and fairness of the company's accounting records and financial statements, and must include specified items, such as whether the auditors received the necessary information and expla-

nations for their audit, whether in the opinion of the auditors the accounts have been prepared according to the IFRS, whether they are true and fair representations of the underlying accounting records, and whether the auditor was independent of the company under audit.

6.2 Disclosure of Corporate Governance Arrangements

Corporate governance arrangements are disclosed as part of the regulatory reports expected from companies. See **6.1 Financial Reporting**.

6.3 Companies Registry Filings

Companies are required to file annual returns with the Registrar of Companies. A notice that a company has filed its returns will be published in the Companies Bulletin published by the Registrar of Companies. There are no stipulations requiring the Registrar to make the returns themselves publicly available, but they are available for inspection.

Financial statements must not be published unless they have been approved by the board of directors and signed by two directors, and unless the directors' and the auditor's reports have been attached to them.

Publicly listed companies are additionally required to file their financial statements with the SEC and publish a summary of financial performance quarterly in national newspapers.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

It is mandatory for a company to have an auditor. Where a company fails to appoint an auditor and continues to operate under default for a period beyond three months, the Registrar General is mandated to appoint one for that company. An appointed auditor must expressly consent to the appointment. Such a person or corporate entity must meet a set of qualification criteria.

The relationship between an auditor and the company is set out in Act 992. Once appointed by an ordinary resolution of shareholders, the auditor can be maintained for up to six years. Once disengaged, the same auditor cannot be appointed by that company until after another six years elapses.

A duty is placed on auditors to avoid conflict of interest situations in much the same way as directors. Primarily, the auditor must ensure that in carrying out their duties, their personal judgement is not impaired by the existing relationship with or interest in the company or any subsidiary of the company.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The existence of a registered constitution with prior approved checks and balances operates to mitigate or regulate risks in the management of companies. Whilst not mandatory for a company to register a customised constitution, a company has the option to do so. However, where it chooses not to customise its constitution then the standard constitution set out in Act 992 becomes a default constitution. A constitution would ordinarily regulate such important matters as the numbers and meetings of directors, stipulate the dividend policy of the company and such other important matters.

It so often happens that a cause for division among members of a company is with the payment of dividends. The cause of the division often emanates from the dual involvement of

both the directors and the shareholders in the declaration and payment of dividends. Directors make the initial determination of whether or not dividends are payable in a given financial year and shareholders approve or confirm the dividend payment by ordinary resolution.

It is also required that certain resolutions obtain the court's blessing subsequent to having been passed by the company. Thus, for transactions such as the reduction of the stated capital of the company, or the reduction of the unpaid liability on any shares, the return to shareholders of any assets, or the cancellation of any shares (which requires altering the constitution), the resolution after being passed would have to be further confirmed by a court on application by the company.

Possible Criminal Implications

Directors have to conduct company business with the knowledge at all times that their actions could criminally implicate the company, and further, that liability can attach to the company just as much as it would to a human. The scope of this risk becomes even more compelling when one takes into account the fact that the company would not be absolved of liability on the basis that a director (or shareholder or managing director) had acted fraudulently or forged documents in furtherance of the intent on the blind side of the company. Notwithstanding, this must be juxtaposed with the related understanding that not all acts of directors can implicate the company.

Thus, only where the board, shareholders (in a meeting) or the managing director has specifically authorised the particular officer (director) so to act, would the malfeasance of that director (or officer) be attributed to the company. At a minimum, the individual director must be able to show some express communication assigning the authority to them at some point so to act, prior to undertaking the action. Consequently, it is in the interest of the board not to leave the status of any individual as to whether or not that individual is a director in limbo.

Ambivalence

By implication of this vicarious liability, any ambivalence carries with it the potential attendant risk of implicating the company. Moreover, it is a legal requirement also that a company has a minimum of two directors with at least one resident within the country at any given time. The requirement operates to preclude the volatile but plausible situation where all the directors are out of the country and the company is left to run without the proper corporate governance oversight expected from directors.

The law prescribes strict rules regarding the appointment, removal and (in the case of public companies) rotation of directors. This guards against the capricious usage of the power of appointment and removal to further selfish interests.

Company Wellbeing

The managerial and oversight powers of directors are by no means unfettered. As discussed earlier (see **3.2 Decisions Made by Particular Bodies**), there is a limitation on the powers of directors in the areas of borrowing, lending and contributions, as well as with the issuance of new or unissued shares, and entering into major transactions. Directors can only get such transactions done subject to a resolution of the company.

To further buttress the elimination of potential conflict areas between the individual interests of directors and the company's wellbeing, the law strictly prohibits advancing loans to direc-

tors of public companies. The law categorically stipulates: “A public company shall not grant a loan to a person who is a director or a director of an associated company or enter into a guarantee or provide a security in connection with a loan made to that person by any other person” (Section 328 (1) of Act 992). This restriction is somewhat relaxed for private companies which only need to specify the fact in the note to the financial statements of the company.

Certainly, the balancing act of managing risk while handling the affairs of a company can be dicey. Consequently, the courts may in given circumstances grant a reprieve. For instance, where a director has acted honestly, then despite the occurrence of a breach in the execution of their duty, the court may either partially or wholly absolve the director of liability.

Trends and Developments

Contributed by:
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Addison Bright Sloane is a full-service business law firm based in Accra, Ghana. The firm has provided tailored services to businesses in Ghana and overseas requiring the expertise of a law firm with in-depth knowledge of both the African business landscape and the global business environment. The firm's team of commercial and corporate law practitioners comes with a diverse and rich corporate law practice portfolio across various industry sectors. The firm is the partner of choice for a top-tier City of London law firm and regularly collaborates with it and other global law firms on a number of high-profile transactions. Addison Bright Sloane regularly advises corporate clients on complex transactions. The firm has carved a niche for itself in ESG, infrastructure and projects, energy, technology, environmental law, private equity, banking and finance law as well as dispute resolution (including international ADR).

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Contemporary Trends in Corporate Governance in Ghana

Corporate governance is an ever-changing system of rules and practices designed to assist companies to achieve their objectives through efficient management and control of the company's operations. The passage of the Companies Act, 2019 (Act 992), the issuance of directives by regulatory bodies such as the Registrar of Companies, the Bank of Ghana (BOG), and the Securities and Exchange Commission have ushered in a new era of corporate governance rules designed to modernise the management of companies in the country. These regulations comprise provisions for the use of technology in company regulatory matters, increased duties for directors, acknowledgment of minority rights of shareholders, amongst others. This article will discuss the prominent trends and developments in the corporate governance space, for the most part occasioned by the passage of Act 992.

Any discussion of the most notable developments and trends in corporate governance in Ghana must include the following.

Establishment of the Office of the Registrar of Companies

Harkening back to the original intent of the drafters of Ghana's first Companies Code 1963, the country now has a new statutory body, namely, the Office of the Registrar of Companies and a separate office of the Registrar General. The Office of Registrar of Companies (headed by the Registrar of Companies) is responsible mainly for the registration and regulation of all types of businesses in Ghana. The Office also oversees the registration of business names, registration of partnerships, and the appointment and regulation of company inspectors. This is now distinguished from the responsibilities of the Registrar General's Department, which is now purely dedicated to the registration of intellectual property rights, marriages and administration of estates. Additionally, it functions as the Official Liquidator of Companies, and manages the finances and fixed assets of the Office of the Registrar. The Registrar is appointed by the President of Ghana and performs his functions with the assistance of a governing board. The Registrar, in addition to their duties, is expected to issue guidelines periodically to companies on the conduct of their operations.

The Office of the Registrar has been created in accordance with Act 992. In March 2022, the first governing board of the Office of the Registrar of Companies was sworn into office, tasked with the responsibility to ensure the effective functioning of the Office of the Registrar. A member of the governing board undertakes to act with loyalty and good faith as a director under the Act. In addition, a member of the board shall hold office for a period of four years and is eligible for re-appointment for another term only.

Following this, in July 2022, the President of Ghana officially launched the Office of the Registrar of Companies (ORC). The government has clarified that the debut of the ORC does not render nugatory the function of the former Registrar General's Department. The ORG operates as an autonomous body.

Enhanced Corporate Governance Requirements for Directors

The role of directors has come under immense scrutiny following the collapse of a number of banks and non-bank financial institutions in the country. This compelled the regulator, the BOG, to issue the current corporate governance directives for banks and non-bank financial institutions, which brought in much needed institutional changes.

Further to this, the BOG issued a Ghana Corporate Governance Disclosure Directive (May 2022), which applies to regulated financial institutions (RFI). The objectives of this Directive are as follows:

- to enhance transparency and market discipline;
- to enhance the accountability of the RFI to their stakeholders;
- to assess the effectiveness of RFIs' corporate governance practices and their risk profiles;
- to promote public confidence and trust in RFIs; and
- to amend all disclosures required in the RFIs' Annual Reports.

Similarly, the Securities and Exchange Commission (SEC) has issued directives governing the conduct of the affairs of publicly listed companies.

Act 992 and other corporate governance rules have raised the qualifying criteria, duties and liabilities of persons appointed as directors of companies. The objective is to weed out persons whose involvement could be inimical to the growth of enterprises, or at a minimum keep their actions in check. For instance, in addition to the qualification requirements for directors under the Companies Act 2019, the BOG has set out additional criteria for directors and key management personnel of banks and other financial institutions. Under the Bank's directive, a person appointed as a director must be a fit and proper person. "Fit and proper" means the person is suitable to hold the particular position as regards:

- the probity, competence and soundness of judgement of that person for purposes of fulfilling the responsibilities of that person;
- the diligence with which that person fulfils or is likely to fulfil those responsibilities;
- whether the interest of depositors or potential depositors of the entity is threatened, or likely to be, in any way threatened by the person holding that position; and
- that the integrity of the person is established and the qualifications and experience of the person are appropriate for the position in the light of the business plan and activities of the

entity, which they serve, or are likely to serve, taking into account the size, nature and complexity of the institution.

In addition to previously existing responsibilities, stringent liabilities underpin the performance of directors' duties to ensure proper management and accountability of directors towards companies. The extent of the power exercised by directors is also circumscribed by Act 992 and made subject to the constitution of the company. For example, without a prior resolution of the company, directors may not issue new or unissued shares or contribute to any charitable fund other than a pension fund. Similarly, a contract or transaction classified as a "major transaction" under Act 992 requires a special resolution of shareholders before its execution by the company's directors. A director is liable for breach of their duties. Such liability includes compensating the company for any loss occasioned to it. Moreover, Act 992 precludes any attempt to exclude such liability either through express provisions in the company's constitution or by agreement between a director and the company.

Recently, the Institute of Directors, Ghana, in partnership with Bank of Ghana and other key stakeholders launched the newly created National Corporate Governance Code 2022, which will serve as a unified national corporate governance reference for all stakeholders both in the public and private sectors in the country. The National Corporate Governance Code seeks to act as a comprehensive convergent document for the different currently existing industry- and sector-specific standards and in conformity with international best practices.

Enhanced Qualification of Company Secretaries

As part of the corporate governance enhancement provisions under Act 992, companies are required to appoint only duly qualified persons to serve as company secretaries. This is a break from the previously existing situation where directors had the latitude to appoint any person they deemed fit with no recourse or reference to set criteria. Going forward, appointing authorities must have regard to minimum qualification metrics when making such appointments. However, both companies and individuals can serve as secretaries except that the specific individual appointed (from the company for instance) must meet at least one of the following criteria:

- holding a tertiary level education with a corporate secretary bias;
- previous service under a qualified company secretary for at least three years; or
- being a member in good standing of the Institute of Chartered Secretaries (Ghana), the Institute of Chartered Accountants (Ghana), or has been enrolled to practice as a solicitor or barrister in Ghana.

The predominant practice is for most companies, particularly SMEs and large corporations, to opt for a qualified lawyer to fill this role in spite of the above breadth of qualifying criteria.

The Concept of Beneficial Ownership

This is a new concept, without any historic antecedence. It has evolved out of the government's drive to stem systemic corruption and money laundering. This is designed to improve transparency in company profiling with a view to ascertaining persons actually controlling a company. It has been a common practice in Ghana for companies to hide the actual owners and instead present ostensible sharehold-

ers for a range of reasons. Under penalty of law, this new development makes it mandatory for registered companies to make available to the Registrar of Companies the bio data of actual owners, "beneficial owners" under Act 992, and indicate persons considered "politically exposed persons". A beneficial owner is an individual:

- who directly or indirectly ultimately owns or exercises substantial control over a person or company;
- who has a substantial economic interest in or receives substantial economic benefits from a company whether acting alone or together with other persons;
- on whose behalf a transaction is conducted; or
- who exercises significant control or influence over a legal person or legal arrangement.

The definition of a "politically exposed person" includes a person who is or has been entrusted with a prominent public function in Ghana, a foreign country or an international organisation.

There are different types of thresholds, depending on the sector the company is in and the type of person the beneficial owner is. The general threshold is that a person who has direct or indirect interest of 10% or greater in a company must be registered as a beneficial owner.

Major Transactions

Additionally, there is a new requirement for shareholders to approve certain intended steps and decisions taken by the board before they come into effect. This contrasts with the previous pattern of keeping shareholders out of the day-to-day running of the affairs of the company. The current trend is to involve as much as possible, the owners of the company in the taking and implementation of significant steps. These types of decisions are classified as "major transactions" under Act 992. The idea, inter alia, is to enhance corporate accountability, mitigate losses and safeguard the assets of companies. The Act defines a "major transaction" as the acquisition or the agreement to acquire assets the value of which is more than 75% of the value of the assets of the company, or the disposition or agreement to dispose of assets the value of which is more than 75% of the value of the assets of the company, or a transaction where the company acquires rights or interests, or incurring obligations and liabilities the value of which is more than 75% the value of the assets of the company. A shareholder who voted against a resolution to undertake a "major transaction", which resolution is passed in any event, has the option to request the company to buy them out.

Minority Rights

Act 992 grants specific remedies for minority shareholders who feel oppressed. In addition to the option open to a shareholder to have their shares bought out after a vote on a major transaction (as discussed above), a dissenting shareholder on a matter has the right to institute legal action in situations where they feel oppressed. Moreover, where the company has done or threatens to undertake an action, which tends to discriminate against or is unfairly prejudicial to some of the shareholders, such shareholders may be entitled to a cancellation of such action by court order.

Further, to curtail dissension and prolonged litigation, Act 992 allows shareholders to opt-out of the company where a company amends its constitution to vary the previous objects or business of the company. This also applies where a special resolution is passed approving a major transaction or an arrangement for a merger and

acquisition or the variation of a class of shares is undertaken (against the shareholder's will). The option for a buy-out allows minority shareholders to utilise remedies under Act 992 to protect their investments. No longer will minority shareholders who wholly vote against resolutions for matters specified above continue to hang on with dissatisfaction and acrimony.

Additionally, minority shareholders have the option to enforce their rights through derivative actions. They may apply to the court for leave to institute proceedings in the name of the company or on its behalf to enforce their rights or recover the company's assets. Derivative actions present an existential avenue accessible by minority shareholders to hold the directors of the company accountable for their actions by leveraging the courts.

Electronic and Digital Transformation

As part of the government of Ghana's policy to digitise the economy, state institutions are mandated to employ digital transformation tools in the discharge of their duties. Thus, Act 992 empowers the Registrar of Companies to authorise certain transactions electronically through a digital platform approved by the Registrar. Some activities that can be done electronically include:

- the incorporation or registration of a company;
- the reservation of a company name;
- the filing of particulars;
- the filing of annual returns and financial statements;
- the keeping and maintenance of a register;
- the inspection of a register;
- the registration of debentures;
- the transfer of debentures;
- the registration of charges;
- the service of a notice of the document;
- searches on a company register; and
- payment of fees

These services and many others show the commitment of the Registrar to provide services through electronic platforms for companies.

Sundry Developments

Impact of the government's Domestic Debt Exchange Programme

On 5 December 2022, the government of Ghana announced a Domestic Debt Exchange Programme (DDEP) which affects government of Ghana bonds listed on the Ghana Fixed Income Market. To address the country's ongoing economic crisis, the government of Ghana invited eligible bondholders of government bonds to voluntarily exchange old bonds for new bonds with extended maturities and new coupon rates. This programme is anticipated to affect many corporate entities particularly financial institutions and market operators in many ways including liquidity, operational revenue and growth prospects. In the wake of such a major transaction, directors of companies likely to be affected by the DDEP need approval from shareholders before participating in the programme.

Pursuant to the DDEP, the BOG and the SEC have proposed support to institutions or companies which participate in the programme and require some forbearance regarding capital and other regulatory requirements. Moreover, granted the obvious impairment impact on banks, the minimum capital adequacy ratio, which previously stood at 13% of stated capital, was reduced to 10% by the central bank.

Clean-Up of Companies Register

Under the Companies Act, 2019, it is mandatory for companies to file their annual returns with other enclosed documents specified by law with

the Registrar of Companies or to file a notice of change of its principal place of business. A company that fails to file its annual returns is liable, together with the officers of the company, to an administrative penalty of 25 penalty units for each day of the period of default. (A penalty unit is GHS12, which is equivalent to USD1.10 as at 3 April 2022). Additionally, a company that fails to file its annual returns will be struck off the Register of Companies. The implication of a company being struck off the Register of Companies means that the company would be deemed dissolved and no longer in existence.

In March 2021, as part of its regulatory duties, the Registrar of Companies issued a notice to the public that it would commence a clean-up exercise to rid the Register of Companies of dormant companies. According to the Registrar, there were approximately 740,000 dormant companies registered from 1963 to 2011 on the database of the Registrar General's Department. Some of these companies had not filed their annual returns with the Department or other regulatory filings required by law for years. As part of the exercise, the Registrar published the list of companies deemed dormant or those that had defaulted in filing their annual returns on the website of the Registrar General's Department and in the national newspapers, and gave them a three-month moratorium to submit all the mandatory filings. The purpose of this exercise by the Registrar was to ensure the accuracy and sanctity of the Department's database.

It is noteworthy that as of January 2022, the Registrar General's Department had removed the names of 2,788 companies from the Companies' Register. These included 1,374 companies limited by shares, 978 companies limited by guarantee (churches, social enterprises, associations, unions, schools, etc), 41 external companies and 395 companies that opted for delisting.

In early 2023, the Office of the Registrar of Companies began the process of striking off business names which have lapsed from the Business Names Register for defaulting in their annual renewals in line with Section 5A (2) of the Registration of Business Names Act, 1962 (Act 151). The aim was to avoid such business names remaining in the public domain and for anyone interested in using them to do so after they have been struck off the Business Name Register.

Enhanced Corporate Insolvency Rules

Lately Ghana's corporate governance has welcomed a new entrant: the Corporate Insolvency and Restructuring Act, 2020 (Act 1015). This Act has ushered in an exciting and modern approach to insolvency aimed at rescuing companies in distress. This is timely as Ghana and the rest of the world battle an economic downturn due to the COVID-19 pandemic, amongst others.

As certain businesses continue to struggle to stay afloat, the need to salvage otherwise viable businesses whilst securing creditor co-operation has taken centre stage – hence the wisdom in enacting Act 1015.

Act 1015 covers virtually all industry types, except those classified as special industries such as banks and insurance companies. The highlights of the new Act include:

- the provision for administration or restructuring as an essential tool for companies in distress to continue in existence as a going concern;
- the provision of temporary management of the affairs, business and property of a distressed company; and

- in appropriate cases, the placement of a temporary freeze on the rights of creditors and claimants against the company.

These remedies were previously unavailable under the Bodies Corporate (Official Liquidation) Act, 1963 (Act 183), which only catered for winding-up procedures in situations where a company's liabilities exceeded its assets or was unable to pay its debts.

The measuring yardstick for insolvency remains the ability or otherwise of a company to meet its financial obligations when they fall due. Act 1015 allows a distressed company some protection to reorganise its affairs without being burdened with the threat of liquidation from its creditors. The administration of a company begins when an administrator is appointed. Only a natural person can be appointed as an administrator and must be duly qualified as an insolvency practitioner. The next stage after administration is for creditors of the company to execute a restructuring agreement. The restructuring officer (RO) has the responsibility to implement the restructuring agreement with appropriate notifications to the creditors and the Registrar of Companies. The restructuring agreement provides for the terms and conditions of the restructured debt such as moratorium period and payment plans.

Another novelty introduced by the Act is the regime for insolvency practitioners as well as the insolvency division at the Office of the Registrar of Companies. Previously, there was no professional regulator or standards for insolvency practice. As a basic prerequisite, a person is qualified to be an insolvency practitioner if that person is a chartered accountant, lawyer or banker who is in good standing with their professional association. The Registrar of Companies must also certify or license an individual as such. The law further requires practitioners to have the requisite professional indemnity insurance to enable them to practise as an insolvency practitioner. In December 2021, the Ghana Association of Insolvency Advisors (GARIA) and the Office of the Registrar of Companies ushered in the first batch of insolvency practitioners to help in the administration of businesses, properties and affairs of distressed companies in the country.

In the same vein, GARIA has this year inducted the second batch of insolvency practitioners as part of the Office of the Registrar of Companies' objective to respond to the local needs of distressed companies. Plans are underway to ensure that the ORC is self-financing to enable it to carry out its mandate, which includes the establishment of the Insolvency Services Division.

The Insolvency Services Division was created under Act 1015 to regulate insolvency practice, oversee the administration, restructuring and insolvency proceedings of companies, and make recommendations to the Registrar on any changes deemed necessary to the relevant laws on insolvency in Ghana.

Another important feature of Act 1015 is the introduction of cross-border insolvency procedures. Cross-border insolvency proceedings have been established to promote co-operation between a court and other competent authorities of Ghana and that of foreign states involved in cases involving both or multiple countries. The provisions in the Act are reflective of the United Nations Commission on International Trade Law (UNCITRAL) model law on cross-border insolvency. It allows for the recognition of foreign insolvency proceedings and reliefs. Operationally, a foreign representative can apply for the commencement of insolvency proceedings in

Ghana and participate in proceedings regarding a debtor or creditor.

Conclusion

The corporate governance space continues to be an active space admitting novel ideas and systems. The aforementioned are by no means exhaustive, representing instead, important highlights in an ever-changing corporate legal landscape. What remains certain is the intent of various regulatory bodies to continue to improve corporate governance in Ghana through ushering new standards to improve efficiency overall.

GIBRALTAR

Law and Practice

Contributed by:
Adrian Pilcher, Stuart Dalmedo, Jake Collado and Louise Anne Turnock
ISOLAS LLP

Contents

1. Introductory p.210
1.1 Forms of Corporate/Business Organisations p.210
1.2 Sources of Corporate Governance Requirements p.210
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.211

2. Corporate Governance Context p.212
2.1 Hot Topics in Corporate Governance p.212
2.2 Environmental, Social and Governance (ESG) Considerations p.212

3. Management of the Company p.212
3.1 Bodies or Functions Involved in Governance and Management p.212
3.2 Decisions Made by Particular Bodies p.213
3.3 Decision-Making Processes p.214

4. Directors and Officers p.215
4.1 Board Structure p.215
4.2 Roles of Board Members p.215
4.3 Board Composition Requirements/Recommendations p.216
4.4 Appointment and Removal of Directors/Officers p.216
4.5 Rules/Requirements Concerning Independence of Directors p.216
4.6 Legal Duties of Directors/Officers p.217
4.7 Responsibility/Accountability of Directors p.217
4.8 Consequences and Enforcement of Breach of Directors' Duties p.217
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.218
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.218
4.11 Disclosure of Payments to Directors/Officers p.218

5. Shareholders p.219
5.1 Relationship Between Companies and Shareholders p.219
5.2 Role of Shareholders in Company Management p.220
5.3 Shareholder Meetings p.220
5.4 Shareholder Claims p.221
5.5 Disclosure by Shareholders in Publicly Traded Companies p.221

6. Corporate Reporting and Other Disclosures p.221
6.1 Financial Reporting p.221
6.2 Disclosure of Corporate Governance Arrangements p.223
6.3 Companies Registry Filings p.224

7. Audit, Risk and Internal Controls p.225
7.1 Appointment of External Auditors p.225
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.226

ISOLAS LLP is a leading international law firm with its headquarters in Gibraltar. Established in 1892, it is Gibraltar's oldest law firm. The firm's lawyers bring disciplined and effective management to large, structured deals, whilst also remaining flexible and open to innovative opportunities. Delivering commercial solutions for clients across a range of industry sectors and jurisdictions, the team not only understands the company law framework, but also brings an international perspective that accommodates the common cross-border nature of global business transactions. ISOLAS also covers the full range of fiduciary duties, including directors' liabilities, responsibilities and corporate governance, procurement and outsourcing, employment, company secretarial, and joint-venture arrangements. With a reputation for combining expert legal advice with commercial pragmatism, ISOLAS is known to be practical and confident in the advice it gives. Truly independent, ISOLAS offers clients the benefits of commitment, continuity and the close personal interest expected of a long-established firm.

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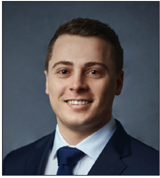

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Corporate vehicles in Gibraltar may take various forms. These include:

- foundations;
- limited partnerships;
- protected cell limited partnerships;
- limited liability partnerships;
- companies limited by guarantee (with or without a share capital);
- companies limited by shares;
- protected cell companies; and
- unlimited companies.

As each form of corporate vehicle contains its own unique set of characteristics, the most suitable vehicle for a particular use-case will depend on various factors, such as the nature of the underlying business activity or reasons for the establishment of the vehicle (eg, asset protection or succession planning).

Companies limited by shares are by far the most common form of corporate vehicle in use in Gibraltar. These may be set up as a private company (in which case the company's shares or debentures are not allowed to be offered to the general public) or as a public company (in which case the company's shares or debentures are allowed to be offered to the general public).

1.2 Sources of Corporate Governance Requirements

The principal sources of corporate governance requirements for companies in Gibraltar are the following.

Companies Act 2014

The Companies Act 2014 is the principal statutory instrument governing the formation, operation and dissolution (excluding companies in compulsory liquidation) of companies in Gibraltar.

Financial Services Act 2019

The Financial Services Act 2019 (FSA) and its accompanying sector-specific Regulations establish Gibraltar's regime for financial services and securities law. The FSA applies to any person who carries on a regulated activity in or from within Gibraltar. The FSA also establishes the restrictions that apply to an offering of securities to the public made in or from Gibraltar.

The FSA and its accompanying Regulations came into force on 15 January 2020, following the largest-ever reform programme of Gibraltar's financial services legislation, and provide a modern legislative framework for all financial and professional service sectors in Gibraltar.

The reform consolidated approximately 90 pieces of legislation within an enhanced, more accessible and modernised structure, which introduces cross-sectoral terminology and powers for the Gibraltar Financial Services Commission (GFSC), aimed at ensuring consistency across all regulated activities.

The Regulations complement the new structure, concepts and terminology of the FSA by consolidating prudential business conduct and other requirements applicable to each financial service industry within respective sets of sector-specific Regulations.

Common Law

Common law relates to the body of uncodified laws based on legal precedents established by the courts.

The common law and the rules of equity from time to time in force in England and Wales apply to Gibraltar, subject to any modifications or exclusions made by Her Majesty in Council, an Act of the UK Parliament or an Act passed by the Gibraltar Parliament pursuant to the Gibraltar English Law (Application) Act 1962.

While Gibraltar's legal system is based on that of England and Wales, Gibraltar's statute law has developed differently in so far as the Gibraltar Parliament has enacted and amended laws to suit Gibraltar's own particular requirements. Accordingly, it is important to note that English common law is not binding in Gibraltar but can be a highly persuasive authority in Gibraltar legal proceedings where the statutory background is sufficiently similar.

The fiduciary duties that directors owe to a company, for example, are products of common law and are not codified in statute.

Insolvency Act 2011

The Insolvency Act 2011 contains provisions relating to the insolvency and winding up of companies in Gibraltar.

Corporate Governance Code for Collective Investment Schemes

In 2013, the Gibraltar Funds and Investments Association (GFIA) introduced a Code of Conduct for Collective Investment Schemes (the "Code"), which was meant to address best practices in the context of experienced investor funds and private funds.

The Code captured existing accepted principles of good practice and guidance, and further developed these principles by capturing Gibraltar-specific issues such as the governance of self-managed funds and oversight of experienced investor funds structured as protected cell companies.

As well as dealing specifically with the role and responsibilities of a fund director, the Code seeks to set out directors' duties during each stage of the life cycle of a typical fund, and defines what is expected in respect of the effective oversight and supervision of service providers to the fund. It also covers specific elements of the composition of a fund's board and its collective skill set.

In 2018, through a specific addendum to the Code, Gibraltar became the first jurisdiction in the world to issue specific standards for the structure of crypto funds, including corporate governance, risk management, valuation, custody, safekeeping and security, and a host of other important touchpoints (the Corporate Governance Code for Gibraltar Crypto Funds). Following the success of the first edition of the Corporate Governance Code for Gibraltar Crypto Funds, an updated second edition was published in March 2022.

It is important to note, however, that the Code is not legally binding and operates under the principle of "comply or explain" – which is to say, the Code is not there to say how something must be done. The Code is there to encourage licensees to consider certain issues and, where the licensee feels that those issues are better dealt with in a different fashion, to document their thought process.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

In addition to the requirements discussed in **1.2 Sources of Corporate Governance Requirements**, companies with shares that are publicly traded must also comply with the EU Market

Abuse Regulation, which continues to apply in Gibraltar, subject to certain amendments introduced under the Financial Services (Market Abuse) (Amendment) (EU Exit) Regulations 2020 in order to address deficiencies and to ensure that the EU Market Abuse Regulation is able to operate effectively under Gibraltar law following Gibraltar's withdrawal from the EU.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

By virtue of the Sanctions Act 2019 (the "Act"), international sanctions have effect in Gibraltar. Such measures include the application of:

- EU sanctions;
- UN Security Council sanctions;
- any restrictive measures imposed by means of a designation within the meaning of the UK Terrorist Asset-Freezing etc. Act 2010;
- any restrictive measures imposed by an organisation that is notified by the government by notice published in the Gazette; and
- any restrictive measures imposed by the UK under the Sanctions and Anti-Money Laundering Act 2018.

The Act therefore provides for the automatic recognition and application of any restrictive measures imposed by the UN, the UK and the EU. The implementation of such measures has had quite an impact on corporate governance, particularly since the recent events in Ukraine, and particularly for the legal and corporate service providers industry. When dealing with a Russian individual or corporation, or any person or entity connected with Russia, for example, service providers in Gibraltar have to navigate the different sanctions regimes imposed by the UN, the UK and the EU.

Additionally, the rise of environmental, social and governance (ESG) initiatives has seen an increasing number of firms taking measures to reduce their carbon footprint and in turn increase their economic sustainability in order to remain attractive in the legal market. ESG standards are a criteria used to ascertain the sustainability of the non-financial impact of investments. Firms have dedicated themselves to organising and setting up ESG teams in order to assist with the navigation of ESG disclosure requirements, which we are moving towards. See **2.2 Environmental, Social and Governance (ESG) Considerations**.

2.2 Environmental, Social and Governance (ESG) Considerations

Under the Companies Act, a large company (as defined within the Companies Act) which is a public-interest entity is required to issue a non-financial information statement within the directors' report. The information required by the statement must include information relating to:

- environmental matters (including the impact of the company's business on the environment);
- the company's employees;
- social matters;
- respect for human rights; and
- anti-corruption and anti-bribery.

The statement must also provide brief details of the company's business model.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies involved in the governance and management of a Gibraltar company can

be broken down into shareholders, the board of directors and the secretary.

Shareholders

A company must have at least one registered shareholder, who may be either a natural person or a body corporate. A person, having agreed to become a shareholder, becomes a shareholder of a company upon their name being entered in the company's register of shareholders.

There is no limit on the maximum number of shareholders that a private company can have. The Companies Act had previously restricted private companies to a maximum of 50 shareholders. However, this restriction has since been removed, and private companies can therefore consist of an unlimited number of shareholders without the need to be registered as a public company.

The company must record the details of the new shareholders in the register of shareholders.

Board of Directors

Directors are appointed to direct, control and supervise the activities and affairs of a company. Directors are a connecting line between the company and third parties. By definition, a director "includes any person occupying the position of director by whatever name called". This definition is wide in order to include those who are effectively dealing with the affairs of the company, but who do not bear the title "director". It also ensures that there is no legal distinction between executive directors and non-executive directors, although differences will usually be found in the roles they perform.

The conducting of board meetings is generally not covered by the Companies Act. The main statutory provisions affecting board meetings concern minutes of board meetings being kept and disclosure by directors of interests in contracts. The rules for conducting board meetings largely depend on the company's articles of association, thus giving a company great flexibility. For example, Gibraltar law does not prevent board meetings from being held anywhere in the world nor does it prevent directors from participating in board meetings through electronic means. However, a company must seek tax advice when doing so in order to mitigate any potential tax consequences.

Secretary

Every company incorporated in Gibraltar must appoint a secretary. Both natural persons and corporate bodies are eligible to be appointed as a secretary. If a corporate body is undertaking this function, it must ensure that it is licensed by the GFSC in order to undertake such services. In the case of a public company, the secretary must have specific knowledge and experience to discharge the functions of company secretary.

3.2 Decisions Made by Particular Bodies

The board of directors of a company is appointed to direct, control and supervise the activities and affairs of a company. Accordingly, the articles of association ordinarily empower the directors to exercise all decision-making powers of the company which are not required, by the Companies Act or by the articles of association, to be exercised by the shareholders.

The Companies Act prescribes a number of matters that are reserved to the shareholders, and that can only be passed by a shareholders' resolution. These include:

- a special resolution (as further discussed in **5.3 Shareholder Meetings**) being required to re-register a company as a public company;

- a special resolution being required to approve the terms of a proposed contract to purchase the company's own shares or to vary, revoke or renew this authority;
- a special resolution being required to make a payment out of capital for the redemption or purchase of the company's shares;
- at least an ordinary resolution (as further discussed in **5.3 Shareholder Meetings**) being required to issue, at a discount, shares in the company of a class already issued;
- a special resolution being required to authorise a reduction of the company's share capital; and
- a special resolution being required to dispense with the requirement to hold annual general meetings (as further discussed in **5.3 Shareholder Meetings**).

While the statutory requirements cannot be overridden by a company's articles of association, in some instances the Companies Act allows the company to delegate some of these matters to the board of directors under its articles of association. For example, under the Companies Act, changes to a company's articles of association must be approved by a special resolution, unless the articles of association provide otherwise.

3.3 Decision-Making Processes

Board of Directors

Board decisions are generally passed in the form of resolutions taken at board meetings. The decision-making process at board meetings is not covered by the Companies Act. The main statutory provisions relating to board meetings concern minutes of board meetings being kept and disclosure by directors of interests in contracts. Therefore, any meetings of directors are governed by the company's articles of association and by any rules made by the directors themselves by virtue of powers given to them by the articles of association. This gives companies great flexibility.

The articles of association will generally set out, among other things:

- the notice periods to be followed in respect of a directors' meeting;
- the process to be followed in cases where not all directors are physically present at the meeting; and
- the quorum and voting requirements.

In most instances, a board resolution will require a simple majority vote.

Gibraltar law does not prevent board meetings from being held anywhere in the world and allows directors to participate at board meetings through electronic means. However, there may be tax consequences for a company in doing so.

Where a company's articles of association allow, the board of directors may also pass a resolution in the form of a written resolution without the need to convene a physical board meeting.

Shareholders

There are three types of resolutions which shareholders can validly pass.

Extraordinary resolution

An extraordinary resolution is a resolution that has been passed by a majority of not less than 75% of those shareholders who, being entitled to do so, vote in person or, where proxies are allowed, by proxy, at a general meeting of which seven days' notice (unless the articles of association require otherwise), specifying the terms of the resolution and the intention to propose the resolution as an extraordinary resolution, has been given.

Special resolution
A special resolution is a resolution which has been passed by whatever majority is required for the passing of an extraordinary resolution for which not less than 21 days' notice has been given.

Ordinary resolution
An ordinary resolution is a resolution which has been passed by a simple majority at a general meeting of which seven days' notice is given (unless the articles of association require otherwise). Anything that may be done by ordinary resolution may also be done by special resolution.

Written resolutions
It should be noted that, under the Companies Act, anything that can be done by a resolution of the shareholders of a company in a general meeting can be done without a meeting by means of a written resolution signed by all the shareholders of a company, provided the articles of association allow this. However, written resolutions must be passed by the unanimous consent of shareholders, rather than the specific majority that would ordinarily be required at a general meeting.

4. Directors and Officers

4.1 Board Structure
Under the Companies Act, every company must have at least two directors, except in the case of a private company, which must have at least one director. There is no statutory maximum number of directors, although a company may make provision for a maximum number of directors within its articles of association. A sole director of a company cannot hold the position of company secretary of the same company.

There are no formal requirements or qualifications to become a director and it is possible for both natural persons and corporate bodies to be appointed as directors. There is also no legal requirement for a company to appoint a natural person as its director, so, in effect, a company can be managed and controlled by a sole director that is constituted as a body corporate. The foregoing is subject to the company not being one which is licensed, authorised, recognised or registered by the GFSC to undertake a restricted or controlled activity. The auditor of a company cannot be a director or secretary of that company.

Directors may but are not required to hold a share qualification, so it is not a requirement to hold one or more shares in order to qualify as a director.

4.2 Roles of Board Members
The Companies Act does not predefine the role for each of the board members. Typically, the board will include any number of executive directors who have management responsibilities and who perform operational and strategic business functions such as managing people and looking after business assets. One executive director can be, and usually is, nominated as chairperson. The chairperson presides over the board discussions and usually has a casting vote (unless the articles of association provide otherwise).

The board may also contain non-executive members. The non-executive director's role is to provide a creative contribution to the board by providing independent oversight and constructive challenge to the executive directors. However, it is important to note that under Gibraltar law there is no distinction between executive and non-executive directors. As a consequence,

non-executive directors have the same legal duties, responsibilities and potential liabilities as their executive counterparts.

4.3 Board Composition Requirements/Recommendations

See **4.1 Board Structure**.

4.4 Appointment and Removal of Directors/Officers

A company is required to file at Companies House a return in the prescribed form containing particulars specified in the register of directors and a notification of any change among its directors, or of any of the particulars contained in the register, within 14 days from:

- the appointment of the first directors of the company; or
- a change of directors or of any of the particulars contained in the register.

Therefore, in effect, a company has 14 days from the date of its incorporation to provide Companies House with particulars of its first directors.

Subsequent directors are appointed in accordance with the company's articles of association. Under the model articles, any person willing to be appointed as a director, and permitted by law to do so, can be appointed by ordinary resolution of a general meeting or by resolution of the directors. Removal is again a matter for the company's articles of association but it would be expected that such a decision would require a resolution of a general meeting.

4.5 Rules/Requirements Concerning Independence of Directors

Independence

There are no legal requirements regarding the independence of directors under Gibraltar law. However, where a company is undertaking an activity which is deemed to be restricted or controlled under the financial services regulatory framework, and consequently regulated by the GFSC, the GFSC would expect the firm to be able to explain the basis for the number of independent non-executive directors appointed. The GFSC has established the following criteria, which should be considered when assessing the independence of individuals:

- any financial or other obligation the individual may have to the undertaking or its directors;
- whether the individual is or has been employed by the undertaking or a group entity in the past;
- whether the individual is (individually or as part of another organisation) or has been a provider of professional services to the undertaking in the recent past;
- whether the individual is or represents a significant shareholder;
- circumstances where the individual has acted as an independent non-executive director of the undertaking for extended periods;
- any additional remuneration received in addition to the director's fee, related directorships or shareholdings in the undertaking; and
- any close business or personal relationship with any of the undertaking's directors or senior employees.

Where factors are identified which could suggest threats to independence, the board should consider and discuss whether the individuals are indeed independent and document their considerations in the board minutes.

Firms should re-assess the independence of the board and the individuals on the board periodically and should document and minute how

the firm has considered these issues and has applied good practice.

Conflicts of Interest

Directors are subject to a fiduciary and common law duty not to put themselves in a position where their personal interests and duty to the company conflict, unless given consent by the company, and a director must not make a profit from their position unless authorised by the company to do so.

Similarly, the Companies Act imposes a statutory duty on directors to declare the nature and extent of any direct or indirect interest they may have in a contract or proposed contract to be entered into by the company. A director's failure to declare any interest in any contract or proposed contract to be entered into is an offence, and the director would be liable to a fine.

4.6 Legal Duties of Directors/Officers

Director and officer duties in Gibraltar are not codified under the Companies Act. Instead, they are imposed by virtue of the English common law and the equitable and fiduciary duties that were in place prior to the introduction of the UK Companies Act 2006. Broadly, these include the following duties:

- to act bona fide in the best interests of the company;
- to act for proper purposes and not act for collateral or improper purposes;
- to exercise independent judgement;
- to avoid conflicts of interest; and
- to exercise reasonable skill and care.

The Companies Act and other statutory instruments, as well as a company's memorandum and articles of association, also impose additional duties and obligations on directors. For example, the Companies Act imposes a statutory duty on directors and officers to file certain returns with the Registrar of Companies (as further discussed in **6.1 Financial Reporting** and **6.3 Companies Registry Filings**).

4.7 Responsibility/Accountability of Directors

As discussed in **4.6 Legal Duties of Directors/Officers**, directors' general duties are largely derived from equitable principles as well as common law rules. The duties of directors have therefore evolved though decisions of the courts, which have held directors to be in a fiduciary relationship with the company and therefore to owe it fiduciary duties. The courts have considered directors to be in a special position of trust in relation to the company, similar to that of trustees.

While directors' duties are owed to the company, that is not to say that directors are not required to take into account the interests of anyone other than the company when discharging their duties. For instance, in order to act in the best interests of the company as a whole, directors should have regard to the interests of key stakeholders, such as employees, suppliers and customers.

Directors owe their duties to the company rather than to the shareholders, creditors or other directors of the company. A director may, however, owe duties to the creditors of the company rather than to the shareholders in an insolvency scenario.

4.8 Consequences and Enforcement of Breach of Directors' Duties

As directors' duties are owed to the company, this means that the company itself (acting through the board of directors) must take action against a director for breach of these duties, as

any wrong is committed against the company itself. This principle was established in the leading case of Foss v Harbottle (1843) 2 Hare 461, where it was held that a wrong done to the company may be vindicated by the company alone.

The Companies Act does, however, establish an exception to this rule. See further detail in **5.4 Shareholder Claims**.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

In addition to a claim for breach of duty, as previously discussed, directors may be held liable for breaches of their statutory duties and obligations, such as those imposed under the Companies Act, the Insolvency Act and the financial services regulations (if applicable) which may, in certain instances, result in criminal penalties being imposed.

Under the previous Companies Act 1930, any provision in the articles of the company, or in any contract with the company, or otherwise, exempting any director, manager, officer or auditor of the company from, or indemnifying them against, any liability which would otherwise attach to them in respect of any negligence, default, breach of duty or breach of trust of which they may be guilty in relation to the company, was void. However, the Companies Act now clarifies that only indemnities provided by the company itself are void and further allows a company to purchase insurance for any director against any such liability.

The Companies Act also allows companies to indemnify their directors against any such liability incurred in defending any proceedings, whether civil or criminal, in which judgment is given in their favour or in which they are acquitted.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The Companies Act does not require any specific approvals in relation to a director's service contract. A director's service contract must therefore be approved in the same manner as any other commercial matter – ie, approved by the board, having regard to their duties and obligations to the company. Failing to obtain proper approval for such actions would result in the relevant appointments not taking effect.

Under the Listed Companies (Members' Rights) Regulations 2011, a listed company (that is, a company which has its registered office in Gibraltar and whose shares are admitted to trading on a regulated market situated or operating within the EU) must establish a remuneration policy as regards its directors, which must be approved at a general meeting and may only remunerate its directors in accordance with the remuneration policy.

Listed companies may derogate from the remuneration policy only in exceptional circumstances, and provided always that the policy includes procedural conditions by which such a derogation can take place and specifies the elements of the policy from which a derogation is possible.

The directors' remuneration policy is a binding policy and must be approved by the shareholders at least once every four years.

4.11 Disclosure of Payments to Directors/Officers

The Companies Act does not require the public disclosure of director remuneration.

Listed companies are required under the Listed Companies (Members' Rights) Regulations

to prepare a remuneration report providing a comprehensive overview of the remuneration, including all benefits, in whatever form, awarded or due during the most recent financial year to individual directors, including to newly recruited and to former directors, and to make this report publicly available on the company's website, free of charge, for a period of ten years, beginning on the date it is first made public.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Shareholders provide some or all of the financial backing for a company. In exchange for investing in the company, a shareholder may receive a dividend and may also benefit from capital appreciation of the value of their shares. The money produced by the sale of shares enables the company to commence and continue its business.

Under Gibraltar law, a company has its own legal personality, which is separate from that of its shareholders. Shareholders will therefore only be liable for losses incurred by the company up to the value (if any) unpaid on their respective shares. It must be noted, however, that the concept of "piercing the corporate veil" is recognised in Gibraltar, and there may be certain instances whereby the company's separate legal identity will be set aside by the courts and the shareholders may become personally liable for the debts and liabilities of the company. For instance, courts will look behind the veil in cases of fraud or deliberate breaches of trust. In these cases, the courts ensure that an appropriate remedy is available against the individuals who have committed a wrong using a company they control.

The Companies Act establishes that the provisions of a company's constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe those provisions. Therefore, the shareholders' relationship with the company is contractual. The rights of each shareholder will depend on the rights attached to their respective shares, and this will be set out in the company's articles of association.

In addition, shareholders may also elect to enter into a private shareholders' agreement to govern the terms on how they will behave in relation to the company. However, a shareholders' agreement is not compulsory. In addition, shareholders cannot be compelled to enter into a shareholders' agreement, and they may choose to do so only if it is in their interests. Therefore, while the articles bind all of the shareholders and the company, a shareholders' agreement would only bind the shareholders that are party to the agreement, and the usual remedies for breach of contract will be available if any of the parties commits a breach of its terms.

Shareholders' agreements may take many forms, and the need for them can arise in very different circumstances. The key benefit offered by a shareholders' agreement is that it is a private document which, in most cases, does not need to be made publicly available. A shareholders' agreement can therefore deal with private and personal matters which the shareholders prefer to keep off the public record. The articles of association, however, must be filed at Companies House and made available for public inspection. It must be noted, however, that shareholders' agreements must not include anything that fetters the company's powers to exercise its statutory duties.

Shareholders' agreements can also be useful to protect minority shareholders, as general contractual principles establish that all shareholders would need to approve a change to the agreement; whereas under the Companies Act, shareholder power is determined by a proportion of voting rights in the company.

5.2 Role of Shareholders in Company Management

Ordinarily, it is the board of directors that makes the day-to-day decisions affecting the company, and the articles of association normally govern how the directors exercise the powers of the company. The board of directors will involve the shareholders and call them to a meeting only when the need arises under the Companies Act – for example, because it is required to change the articles of association or to change the company's name.

Shareholders cannot simply overturn board decisions if they do not like the way in which the board is running the company. Instead, the shareholders have the right to appoint and remove directors from office in the articles of association. Therefore, the shareholders could remove the directors from office and replace them. In doing so, the shareholders should consider any potential employment or company law repercussions.

5.3 Shareholder Meetings

There are two types of meetings of shareholders of a company, namely:

- annual general meetings; and
- extraordinary general meetings.

On an annual basis, every company should hold a general meeting known as the company's annual general meeting, in addition to any other meetings in that year, and should specify the meeting as that in the notices calling it. Not more than 15 months should elapse between the date of one annual general meeting of a company and that of the next. However, as long as a company holds its first annual general meeting within 18 months of its incorporation, it need not hold it in the year of its incorporation or in the following year.

A company may, by special resolution, dispense with the requirement to hold annual general meetings. Therefore, the provisions of the Companies Act requiring that a company appoint an auditor or auditors at each annual general meeting shall be deemed to have no effect in respect of that company for such time and in respect of such years as the resolution shall have effect. This does not, however, circumvent the requirement placed on a company to appoint an auditor, but rather allows it to make a single appointment, without the requirement to review the appointment on a yearly basis.

Subject to the provisions of a company's articles of association, the Companies Act establishes the provisions that have effect as to meetings and votes. These include that:

- a meeting of a company, other than a meeting for the passing of a special resolution, may be called by seven days' notice in writing;
- notice of the meeting of a company should be served on every member of the company in the manner in which notices are required to be served by the articles;
- two or more members holding not less than one tenth of the issued share capital or, if the company does not have a share capital, not less than 5% in numbers of the members of the company, may call a meeting;

- in the case of a private company, one member, and in the case of any other company, three members, personally present, shall be a quorum;
- any member elected by the members present at a meeting may be chairman; and
- in the case of a company originally having a share capital, every member shall have one vote in respect of each share or each GBP10 of stock held by them, and in any other case every member shall have one vote.

Notice of a general meeting of a company must be given either in hardcopy form, in electronic form or by means of a website, or partly by one such means and partly by another.

5.4 Shareholder Claims

As discussed in **4.8 Consequences and Enforcement of Breach of Directors' Duties**, directors' duties are owed to the company and not to the shareholders or any other stakeholder. Therefore, the general rule is that the company itself (acting through the board of directors) must take action against a director for breach of these duties, as any wrong is committed against the company itself.

However, in limited circumstances, the Companies Act allows shareholders to bring a derivative action on behalf of the company to enforce the company's rights and to seek relief on behalf of the company. This is an exception to the Foss v Harbottle rule.

Permission of a court is not needed to bring a derivative action, but it is needed to continue an action. A derivative action can be brought by a shareholder to bring a claim against another shareholder or director, for example for transactions at an undervalue and any action about which they feel aggrieved.

Derivative actions can only be brought in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, or breach of duty/trust by a director.

A shareholder can also apply to a court on the grounds that the company's affairs are being conducted in a manner that is unfairly prejudicial to the members (or a percentage of them). Unfair prejudice claims are usually brought by minority shareholders in situations where they feel that their rights have been infringed by the majority shareholders or by the board of directors. The complaint may be based on past, present or even anticipated future events, and the court has expansive powers in this regard, including:

- the power to order the company to take or refrain from taking certain actions; and
- the power to order the company to amend its articles.

5.5 Disclosure by Shareholders in Publicly Traded Companies

There are no disclosure or other obligations on shareholders or ultimate beneficial owners in publicly traded companies.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Annual Return

Every company is required to deliver, at least once in every calendar year, an annual return to Companies House, setting out particulars relating to the company as specified in the Companies Act. The annual return is a snapshot of certain information relating to a company, which includes:

- the name of the company;
- the company's registered number;
- the company's registered office address;
- details of the company's directors and secretary; and
- details of the company's share capital, including its shareholders.

Companies are also required to provide in their annual return details of their main activity. There is a prescribed format for the annual return, which can be found in Schedule 5 of the Companies Act.

The Companies Act establishes a separate regime in respect of the filing of annual returns by collective investment schemes. If a company notifies Companies House that it is a collective investment scheme, licensed, authorised or otherwise regulated under the FSA, then in the case of such a collective investment scheme (which is not a private fund) the annual return can omit details of shareholders and shareholding and is only required to include the amount of authorised and issued share capital, respectively. All other particulars required under the annual return would still need to be completed. An experienced investor fund, for instance, could take advantage of this exemption.

In both of the aforementioned cases, the annual return must be delivered within 30 days after the date up to which the annual return is made.

Private funds are required to deliver an annual return in the prescribed format, although they must deliver the return within six months after the date up to which the annual return is made. In addition, the Companies Act requires private funds to deliver a statement of allotments, redemptions and purchase of own shares, together with every annual return. This in turn replaces the requirement for these types of collective investment schemes to deliver a return of allotment every time they make an allotment of shares and to notify Companies House every time they make a redemption. A collective investment scheme which is not a private fund (for instance, an experienced investor fund) is neither required to complete a statement of allotments, redemptions and purchase of own shares nor to inform Companies House of every occasion where it allots or redeems shares.

It should be noted that these exemptions only apply to collective investment schemes that avail themselves of the voluntary notification process to Companies House of their specific status. A collective investment scheme may choose not to make such a disclosure, and therefore to forfeit the rights to the exemptions afforded under the Companies Act.

Directors' Report and Accounts

The directors of a company are required to prepare an annual report for each financial year. Generally, this report should include the following details of the company:

- details of the company's likely future developments;
- what dividend (if any) is recommended for payment;
- a fair review of the development and performance of the business of the company (and its subsidiary undertakings, if applicable) during the financial year, as well as its position at the end of the year; and
- a description of the principal risks and uncertainties facing the company.

The Companies Act also prescribes the accounting principles to be observed in preparing the annual accounts, the layout of the balance sheet

and profit and loss account, and the content of the notes to the accounts.

Companies are classified as micro, small, medium or large, and the documents to be filed at Companies House vary according to their classification, as set out below.

- Net turnover (pro-rated if more than or less than a year):
  (a) micro – up to GBP632,000;
  (b) small – up to GBP10.2 million;
  (c) medium – up to GBP36 million; and
  (d) large – over GBP36 million.
- Balance sheet total (total assets):
  (a) micro – up to GBP316,000;
  (b) small – up to GBP5.1 million;
  (c) medium – up to GBP18 million; and
  (d) large – over GBP18 million.
- Average number of persons employed:
  (a) micro – up to ten;
  (b) small – up to 50;
  (c) medium – up to 250; and
  (d) large – over 250.

A company must fall within two of the three parameters (set out above) in the financial year in question and the preceding year, in order to be classified as small, medium or large. If a company exceeds or ceases to exceed the limits of more than one of the parameters, it will continue to qualify for the relevant year unless that continues to be the case in two consecutive years. If the financial year is the company's first, the conditions only need to be met in its first financial year:

- large companies are required to file full accounts, including the balance sheet, profit and loss account, notes, directors' report and auditors' report;
- medium companies are required to file the same accounts as for large companies, except that the profit and loss account may be in an abridged format; and
- micro and small companies are required to file an abridged balance sheet only.

Accounts may be filed in a number of primary currencies (such as British pound, US dollar, euro, Japanese yen and Swiss franc).

The relevant documents must be filed within 12 months of the financial year end. Special rules apply in the case of a company's first reporting period.

Different rules apply to companies that opt to prepare accounts in accordance with international accounting standards.

Defective accounts and directors' reports can be revised on a voluntary basis. Any revisions should be confined to the correction of those in which the previous accounts or report did not comply with the requirements of the Companies Act and the making of any consequential amendments.

6.2 Disclosure of Corporate Governance Arrangements

Under the Companies Act, a "mainstream company" whose securities are admitted to trading on a regulated market is required to include a corporate governance statement in its annual directors' report, and that statement must be included as a specific section of the directors' report and must contain at least a reference to the following, where applicable:

- the corporate governance code to which the company is subject;

- the corporate governance code which the company may have voluntarily decided to apply; and
- all relevant information about the corporate governance practices applied beyond the requirements under Gibraltar law.

A "mainstream company" is defined under the Companies Act as a company which is neither a public company limited by shares or by guarantee nor a private company limited by shares or by guarantee, and that is neither:

- a non-profit-making company;
- a licensed or authorised bank; nor
- a licensed insurance company.

6.3 Companies Registry Filings

In addition to the annual return and annual account filing obligations described under **6.1 Financial Reporting**, companies are also required to deliver certain information to Companies House when particular changes occur within a company. Examples of event-driven filings include:

- changes to the articles of association;
- a change of company name;
- allotment of shares;
- giving, varying, revoking or renewing a director's authority to allot relevant securities;
- the making of a statutory declaration by the directors of the company to give financial assistance;
- a purchase of the company's own shares through financial assistance;
- consolidating, dividing, converting, re-classifying, subdividing, redeeming, cancelling or re-converting stock into shares;
- increasing the share capital beyond the registered capital;
- any change in any member of particulars entered in respect of any member on the register of members;
- re-denominating any of the company's share capital;
- creation of a mortgage or change by the company;
- the acquisition of any property that is subject to a change of any kind;
- changing the registered office of the company;
- dispensing with the requirement to hold an annual general meeting;
- the passing of any special resolutions or extraordinary resolutions;
- a change among the company's directors or in any of the particulars contained in the register of directors;
- a change among the company secretaries or in any of the particulars contained in the register of secretaries;
- a change to the company's accounting reference period; and
- making a statutory declaration on the appointment of a voluntary liquidator.

The Companies Act applies various filing dates, depending on the event which triggered a filing requirement. In the majority of cases, the Act imposes a 30-day filing period. A mainstream company's accounts must be filed with Companies House once for each financial year of a company. The period allowed under the Companies Act for delivering its financial accounts is as follows:

- for a private company, 12 months after the end of the relevant financial year; and
- for a public company, ten months after the end of the relevant financial year.

Failing to comply with the accounts filing requirements before the end of the relevant period means that the company and every officer of the company who is in default is guilty of an offence and liable to pay a fixed penalty, determined as follows:

- if more than 12 months but not more than 24 months after the end of the financial period to which they relate, a fee of GBP125 will be incurred; or
- if more than 24 months after the end of the financial period to which they relate, a fee of USD175 will be incurred.

Under the provisions of the Companies Act, annual returns must also be filed within 30 days after the first or only general meeting in the year, and the company must forward to the Registrar a copy signed by a director, by the manager or by the secretary of the company. Failing to comply with such requirements means that the company and every officer of the company who is in default shall be guilty of an offence and liable on summary conviction to a fine at Level 4 on the standard scale and a daily fine at Level 3 on the standard scale.

All documents filed with Companies House are publicly available.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Unless a company qualifies as a small company (as defined under the Companies Act), the shareholders must, at each annual general meeting, appoint an auditor or auditors to hold office until the next annual general meeting.

Prior to the first annual general meeting, the first auditors of the company may be appointed by the directors at any time before that meeting, and auditors so appointed shall hold office until that meeting. The auditors may be removed by the shareholders, who may appoint a replacement auditor.

If a company qualifies as a small company and certain other conditions prescribed under the Companies Act are met, the requirements of the Companies Act relating to the appointment of auditors and the audit of accounts in respect of the applicable financial year shall not apply to that company.

A company will be classed as a small company if it meets two of the following three parameters in the financial year in question and the preceding year. If the financial year is the company's first, the conditions only need to be met in its first financial year:

- it must have an annual turnover of not more than GBP10.2 million;
- it must have a balance sheet total of not more than GBP5.1 million; and
- its average number of employees must not be more than 50.

There are requirements that govern the relationship between the company and the auditor, including that:

- an auditor shall have a right of access at all times to the books and accounts and vouchers of the company;
- an auditor shall be entitled to require from the directors and officers of the company any such information and explanation as may be necessary for the performance of the duties of the auditors; and

- an auditor of the company shall be entitled to attend any general meetings of the company at which any accounts which have been examined or reported on by them are to be laid out before the company, and to make any statement or explanation they desire with respect to the accounts.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Under the Companies Act, the directors' report must contain a description of the principal risks and uncertainties facing the company. In addition, it must also contain a description of the principal risks relating to the non-financial information discussed in **2.2 Environmental, Social and Governance (ESG) Considerations** arising in connection with the company's operations and, where relevant and proportionate:

- a description of its business relationships, products and services which are likely to cause adverse impacts on those areas of risk; and
- a description of how it manages the principal risks.

GREECE

Law and Practice

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Contents

1. Introductory p.231
1.1 Forms of Corporate/Business Organisations p.231
1.2 Sources of Corporate Governance Requirements p.231
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.231

2. Corporate Governance Context p.233
2.1 Hot Topics in Corporate Governance p.233
2.2 Environmental, Social and Governance (ESG) Considerations p.233

3. Management of the Company p.234
3.1 Bodies or Functions Involved in Governance and Management p.234
3.2 Decisions Made by Particular Bodies p.235
3.3 Decision-Making Processes p.236

4. Directors and Officers p.237
4.1 Board Structure p.237
4.2 Roles of Board Members p.237
4.3 Board Composition Requirements/Recommendations p.238
4.4 Appointment and Removal of Directors/Officers p.238
4.5 Rules/Requirements Concerning Independence of Directors p.239
4.6 Legal Duties of Directors/Officers p.239
4.7 Responsibility/Accountability of Directors p.240
4.8 Consequences and Enforcement of Breach of Directors' Duties p.240
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.241
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.241
4.11 Disclosure of Payments to Directors/Officers p.242

5. Shareholders p.242
5.1 Relationship Between Companies and Shareholders p.242
5.2 Role of Shareholders in Company Management p.242
5.3 Shareholder Meetings p.243
5.4 Shareholder Claims p.243
5.5 Disclosure by Shareholders in Publicly Traded Companies p.243

6. Corporate Reporting and Other Disclosures p.244
6.1 Financial Reporting p.244
6.2 Disclosure of Corporate Governance Arrangements p.245
6.3 Companies Registry Filings p.245

7. Audit, Risk and Internal Controls p.246
7.1 Appointment of External Auditors p.246
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.247

Karatzas & Partners was founded in 1963. The firm's nine partners and 55 lawyers work from offices in Athens. From its establishment, the firm has been active in the fields of civil, company, commercial and financial law, serving both Greek and international clients. The firm specialises in banking and finance, capital markets, competition, energy, mergers and acquisitions, privatisation, project finance law, real estate and telecommunications, including litigation, both before courts and arbitral tribunals, in all fields. The firm and its lawyers have been routinely recognised, globally, for their expertise across all practice areas.

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KARATZAS & PARTNERS 60 YEARS

1. Introductory

1.1 Forms of Corporate/Business Organisations

The legal forms that business organisations usually take in Greece are currently the following:

- Greek Société Anonyme (SA) regulated by Law 4548/2018 on the reform of the Law of Sociétés Anonymes (the "Corporate Law");
- Greek private company regulated by Law 4072/2012 (IKE); and
- Greek limited liability company regulated by Law 3190/1955 (EPE).

There is also the general partnership (OE) regulated by Articles 249–269 of Greek Law 4072/2012 and the limited partnership (EE) regulated by Articles 271–284 of Greek Law 4072/2012.

1.2 Sources of Corporate Governance Requirements

Corporate Governance Requirements

Corporate governance requirements in Greece are either provided for by mandatory legal provisions (the vast majority of them in Greece being provisions transposing the relevant European directives and guidance published by European agencies and other non-regulatory bodies) or by certain soft law requirements included in suggestions and guidance published by the Hellenic Corporate Governance Council (HCGC), a non-profit company established with the joint initiative of the Athens Exchange (ATHEX) and the Hellenic Federation of Enterprises or by other non-regulatory international bodies (such as the Organisation for Economic Co-operation and Development). Occasionally, and most usually in cases of Greek corporates that belong to a multinational group of companies, corporate governance requirements are also provided for by internal rules adopted on the initiative of the foreign parent entity.

Application of Governance Requirements

The vast majority of corporate governance requirements apply to Greek corporates whose shares or other securities are listed on the regulated ATHEX market. Currently, only SAs can be listed on the ATHEX; therefore, such corporate governance requirements do not apply to partnerships, IKEs or EPEs.

Furthermore, the relevant corporate law provisions for IKEs and EPEs are mainly rules pertaining to the powers of the administrators and the partners' meeting, the non-compete obligation, restrictions to loans granted by the corporate to the administrators and the liability of the administrators.

Considering the above, the matters raised in this chapter will mainly focus on those corporate governance rules applicable to Greek SAs.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

The special corporate governance requirements applicable only to listed SAs are provided for by the following special rules.

- The provisions of the Corporate Law that are applicable only to listed SAs.
- Law 4706/2020 on corporate governance requirements applicable to Greek SAs (the "New Corporate Governance Law"), which entered into force on 17 July 2021 and replaced Law 3016/2002, providing for five main sets of obligations, namely:
  (a) the composition of the entity's board of directors;
  (b) the establishment of the board of direc-

tors' committees (audit, remuneration and nomination committees);
(c) the adoption of an internal regulation of operation;
(d) the establishment of an internal audit system and appointment of an internal auditor; and
(e) the establishment of (an) investors' and corporate announcements department(s).

- Article 44 of Greek Law 4449/2017 on the audit committee.
- Law 3556/2007 transposing Directive 2004/109/EC into Greek law (the "Transparency Law") on publication of an annual and interim management and financial report as well as adequate dissemination of regulated information by listed issuers.
- Regulation (EU) 596/2014 on market abuse (the "Market Abuse Regulation") regarding the mandatory blackout period for transactions by directors on the entity's securities certain days before the publication of financial statements as well as the directors' obligation to publicly disclose any such transaction and the obligation of the issuer to disclose price-sensitive information or safeguard the secrecy of such information before it is disclosed.
- The provisions of the ATHEX Regulation on the disclosure obligations of listed issuers.

Expanding on These Requirements

The provisions of the Corporate Law applicable to listed SAs mainly concern:

- the adoption of a remuneration policy and publication of a remuneration report on an annual basis;
- the enhanced disclosure process preceding a general meeting of shareholders;
- the special authorisation process for related party transactions; and
- the publication of an annual report in which, inter alia, information on the corporate governance code adopted by the relevant entity is included.

The ATHEX Regulation provisions to a large extent reiterate the mandatory disclosures under the Market Abuse Regulation and the Transparency Law, and add certain ad hoc disclosures in the case of corporate actions not otherwise captured by the disclosures provided for by Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market (the "Prospectus Regulation").

All the above-mentioned requirements are mandatory, including the adoption of a corporate governance code, albeit not its actual content. The corporate governance code must have been produced by a recognised, domestic or international, non-profitable organisation with direct or indirect representation of a sufficient number of capital markets participants, acknowledged as such by the Hellenic Capital Market Commission (HCMC) upon following a relevant formal process. The corporate governance code is implemented based on the "comply or explain" principle – ie, the relevant entity either fully adopts the code or elects to deviate from certain provisions.

In such a case, the issuer publicly reports the deviations on an annual basis by referring to them in the corporate governance statement included in its annual management report, which is published together with the annual financial statements of the issuer. Most Greek listed companies have adopted the code proposed by the HCGC (the "HCGC Code").

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Following the entry into force of the new provisions on corporate governance (on 17 July 2021) provided by the New Corporate Governance Law, the HCMC has issued a number of clarificatory circulars and guidance to clarify the technicalities of the new requirements and assist listed entities with enhancing and maintaining compliance with the corporate governance framework.

Further to the focus on the ongoing compliance of listed companies with the new corporate governance framework, sustainability remains at the top of the HCMC's business plan for 2023, which was approved by the board of directors of the HCMC with its decision No 1b/974/29.12.2022, on the basis of its strategic objectives for 2022–2027 published in 2022. The course of actions for 2023 include the mapping of the market and issuance of relevant clarificatory circulars, along with the continuous supervision of ESG disclosures in the annual financial statements of listed entities falling within the scope of Article 8 of Regulation 2020/852.

2.2 Environmental, Social and Governance (ESG) Considerations

The Athens Exchange joined the UN Sustainable Stock Exchanges (SSE) initiative in 2018 and has developed the "ESG Reporting Guide", not only for listed companies but also for companies that in general want to enhance investors reporting and performance measurement.

This non-mandatory guide aims to assist companies with identifying the ESG issues they should disclose and manage, based on their impact on long-term performance. It also offers practical guidelines on the metrics companies should use to disclose such information. The ESG Reporting Guide is based on practices outlined in international sustainability guidelines such as the SASB's industry-specific standards and reporting frameworks such as the Greek Sustainability Code, as well as on existing ESG disclosure practices in the Greek market.

The Greek Sustainability Code sets the framework with regard to non-financial data reporting, which follows the EU Guidelines on disclosure of non-financial information. It does not impose a new set of obligations, but merely responds, inter alia, to the requirements already included in the non-financial disclosure provided for by the Corporate Law and the Transparency Law with respect to listed issuers. It has four main areas of review (Strategy, Governance, Society and Environment) and 20 criteria thereunder, such as the review of any value chain achievement, CO2 emissions status and use of renewable energy sources and equal opportunities policy.

Pursuant to the New Corporate Governance Law, the internal regulation of operation of a listed SA must include the sustainable growth policy of the issuer, where this is required.

Following the entry into force of Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (the "Taxonomy Regulation"), public interest entities, including, inter alia, large listed SAs, which exceed on their balance sheet dates the criterion of the average number of 500 employees during the preceding financial year, and whose total assets exceed EUR20 million or whose total net sales exceed EUR40 million, must include in their management report, starting from the financial year 2021 onwards:

- a non-financial statement containing information on the proportion of their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable; and
- the proportion of their capital expenditure and the proportion of their operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable, as are further defined in the Taxonomy Regulation regarding management of the company.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

SAs

The principal bodies and functions involved in the governance and management of Greek SAs are the following.

Board of directors (BOD)

According to the Corporate Law, the BOD is entrusted with the general governance, management and representation of the SA. Its composition and activities vary depending on the business activity, shareholders structure and size of the SA. It must be noted that pursuant to the reform of the provisions applicable to Greek SAs, a one-member BOD is possible, provided that the relevant entity is not listed or a large or medium company.

General meeting of shareholders (GM)

The GM is the supreme decision-making body of Greek SAs. According to the Corporate Law, the decision-making power for certain matters is reserved with the exclusive competence of the GM (see **3.2 Decisions Made by Particular Bodies**).

Internal audit unit

One of the main duties of the internal audit unit is to monitor and review the implementation of the internal regulation of operation and the internal audit system of a listed SA, as well as its quality, sustainability and corporate governance mechanics, and its compliance with applicable laws and regulations. The head of the internal audit unit is appointed by the BOD, following a proposal from the audit committee. Such a person is supervised by the managing director of the listed entity and is operationally subject to the audit committee, and must remain independent and objective when discharging their duties.

Audit committee

The role of the audit committee is to assist the BOD by:

- monitoring the financial information, the effectiveness of the internal audit, quality sustainability and risk management system; and
- supervising and monitoring the statutory audit and all matters pertaining to the objectiveness and independence of the statutory auditors.

Due to the duties assigned to the audit committee, the law requires:

- all of its members to have sufficient knowledge of the business sector in which the company operates;
- its chairman to fulfil the independence criteria that independent directors must fulfil pursuant to the New Corporate Governance Law; and
- one of its members to have adequate knowledge and experience in auditing and accounting – this member should participate in all audit committee meetings regarding the approval of financial statements.

Remuneration committee

The New Corporate Governance Law provides for the establishment of a remuneration committee, comprising at least three non-executive directors, two of which must also fulfil the independence criteria of the New Corporate Governance Law. This committee submits proposals to the BOD regarding the entity's remuneration policy and the remuneration of the persons included in the remuneration policy, and provides its opinion on the information included in the annual remuneration report to the entity's BOD, prior to the submission of the remuneration report to the annual GM.

Nomination committee

Another requirement provided for under the New Corporate Governance Law is the establishment of a nomination committee, comprising at least three non-executive directors, two of which must additionally meet the independence criteria set out in the New Corporate Governance Law. The nomination committee is responsible for identifying persons suitable to become members of the BOD, based on the entity's internal regulation of operation and suitability policy, and for making the respective proposals to the BOD.

Other Companies

For other types of limited liability companies (EPEs, IKEs), the day-to-day management is delegated to one or more administrators – either partners or other third-party individuals. The administrators may act jointly or separately, according to the relevant provisions of their constitutional document. In the absence of any relevant provision, the management of the company is exercised jointly by all partners. Partnerships are typically managed by the partners that are personally liable.

For both limited liability companies and for partnerships, the supreme decision-making body is the partners' meeting.

3.2 Decisions Made by Particular Bodies

BOD decisions typically refer to any matter that falls within the day-to-day management of the relevant entity.

The matters for which decisions are subject to the exclusive competence of the GM are, according to corporate law, the following:

- amendments to the articles of association (AOA), including share capital increase and decrease, subject to certain exemptions;
- election of directors and statutory auditors, subject to certain exemptions;
- approval of overall administration by directors and discharge of auditors (this decision is part of the standard agenda of an annual general meeting);
- approval of the annual financial statements;
- distribution of annual profits, subject to certain exemptions;
- approval of remuneration and advance payments to directors, unless those are paid pursuant to the remuneration policy as adopted by the GM in the case of listed SAs;
- merger, demerger, conversion to another corporate type, revival, dissolution and extension of the company's duration, subject to certain exemptions;
- appointment of liquidators;
- approval of remuneration policy and acknowledgment of the annual remuneration report, in the case of listed SAs;
- authorisation of a related party transaction that was duly brought before the GM by the BOD in accordance with the relevant provisions of the Corporate Law;

- establishment of programmes for the acquisition of treasury shares;
- provision of financial assistance to a party to acquire own shares;
- establishment of employee shares' offering and stock option plans; and
- permission to directors to undertake competitive acts.

Similar matters are reserved by law for the partners' meetings, in other Greek corporate types.

Additional matters could be reserved for the GM and the partners' meeting, respectively, if this is provided for by the entity's constitutional document. In the case of partnerships, all actions of ordinary management are typically carried out either by all or some of their partners (as the case may be), who act separately, unless otherwise provided in the relevant constitutional document. Actions that fall outside the ordinary management are subject to the approval of the partners' meeting.

3.3 Decision-Making Processes

The decisions of the BOD are adopted either following a board meeting (held through physical presence or via a teleconference), or by having all directors sign a decision (or exchanging consensus on this through electronic means) without a meeting taking place, if this is permitted by the company's AOA.

According to the Corporate Law, the minimum quorum and majority voting requirements are no less than three directors present or represented in the relevant meeting (unless otherwise provided for by the law or the company's AOA) and simple majority of the directors present or represented at the meeting. There are cases where the company's AOA may require a unanimous decision, although not in the case of listed companies and other cases where supra-majority is required (for example, for change of use of proceeds raised from a share capital increase of a listed Greek SA).

Adopting Decisions

The GM decisions are adopted following a meeting (see **5.3 Shareholder Meetings**). According to the Corporate Law, the minimum ordinary quorum and majority voting requirements are 20% of the paid-up share capital and approval by simple majority of the votes present or represented at the relevant meeting, while increased quorum and majority voting requirements are 50% of the paid-up share capital and approval by two thirds of the votes present or represented at the relevant meeting. The matters for which an increased quorum and majority voting is required are:

- an increase of the shareholders' obligations, share capital increase (including establishment of shares' offering plans to employees and directors, and stock option plans) or decrease subject to certain exemptions;
- the abolition of the pre-emption right of existing shareholders in the case of a share capital increase;
- the provision of financial assistance to acquire shares;
- the issuance of warrants and convertible bonds;
- changes in the method of annual profits' distribution or distribution of shares or other titles instead of the minimum annual dividend or decrease of the minimum annual dividend;
- a merger, demerger or conversion to another corporate type; and
- the company's revival and dissolution.

Increased quorum and a supra-majority of 80% of the represented votes at the relevant meet-

ing capital is required in order for the minimum annual dividend not to be distributed at all. Participation by teleconference or other electronic means in the GM is possible, if this is permitted by the company's AOA or serious grounds justifying remote participation exist.

Subject to certain restrictions, in the case of non-listed SAs, GM resolutions (apart from the ones adopted in an annual general meeting) may be adopted without a meeting taking place. For other types of limited liability companies, unless otherwise provided for by law or the constitutional document of the relevant entity, the decisions of the partners' meeting require a simple majority.

4. Directors and Officers

4.1 Board Structure

According to the Corporate Law, the BOD consists of at least three and up to 15 directors (see **4.3 Board Composition Requirements/Recommendations**). The AOA may define the exact number of directors or a range within the limits of the law, or may cross-refer to the relevant provision of the Corporate Law.

The BOD can further delegate the management and representation powers to one or more individuals, directors or third parties, or to an executive committee, if such alternatives are provided for in the company's AOA.

4.2 Roles of Board Members

The Corporate Law does not provide for a role allocation to directors, although it refers to the duties of the chairman (all of them being merely administrative) and the vice-chairman. The company's AOA may provide for further role allocation; the same applies for certain BOD resolutions which delegate specific management and/or representation powers to certain directors.

The New Corporate Governance Law

Conversely, the New Corporate Governance Law provides for the distinction of executive and non-executive directors, as well as of independent directors (the latter being non-executive members who fulfil the independence requirements). It further provides that the executive directors are responsible for the application of the entity's strategy (as defined by the BOD) and consult on a regular basis with non-executive members on the suitability of this strategy.

In existing crises or risk situations, or where measures are reasonably expected to be taken that will adversely affect the financial position of the entity, the executive directors immediately inform the BOD and submit in writing their opinions and proposals. Non-executive directors (including independent ones) are assigned with:

- the monitoring and review of the entity's strategy and its application, and with the achievement of its objectives;
- ensuring the effective supervision of the executive directors; and
- reviewing and expressing their views on the executive directors' proposals.

Soft law requirements included in the HCGC Code provide even further clarity on the anticipated role of certain directors.

The HCGC Code refers to non-executive directors as the persons responsible for evaluating the executive directors' performance and deliberate on the executive directors' remuneration policy.

With respect to the BOD chairman, the New Corporate Governance Law provides that this position is held by a non-executive member of the BOD. If this is not the case, an independent vice-chairman must be appointed in the BOD.

4.3 Board Composition Requirements/ Recommendations

Further to the composition requirements discussed in **4.1 Board Structure** and **4.2 Roles of Board Members**, the New Corporate Governance Law provides that the number of independent non-executive directors must be at least one third of the total number of directors elected. The New Corporate Governance Law further provides that independent non-executive directors should number at least two, irrespective of the total number of directors. The independence criteria are listed in the New Corporate Governance Law (see **4.5 Rules/Requirements Concerning Independence of Directors**).

There are also recommendations on the BOD composition by the HCGC Code. In particular, the latter suggests that the BOD should consist of at least seven directors, the majority of them being non-executive directors and at least two executive directors, and should be assisted by two advisory committees comprising at least three members each: the nomination committee and the remuneration committee.

Special BOD composition requirements may also apply to specific types of companies due to the special regime to which they are subject (for example, Greek credit institutions, especially those that have been granted state aid through their recapitalisation by the Hellenic Financial Stability Fund (HFSF)).

4.4 Appointment and Removal of Directors/Officers

Electing Directors

Pursuant to the Corporate Law, directors are generally elected by the GM, unless the AOA also provide for the right of one or more shareholders to directly appoint directors. In such a case, the total number of appointees cannot be higher than two fifths of the total number of the directors to be elected by the GM. The shareholders that have exercised this right are not entitled to participate in the relevant voting at the GM. A directors' election by the GM requires ordinary quorum and majority voting.

The BOD of an SA under establishment is designated in the constitutional document of such an entity.

Removal and Re-election of Directors

The Corporate Law does not provide for a removal process for directors but does provide for the replacement process in cases where the director resigns, dies or otherwise withdraws from the position. In any of those cases and subject to the AOA providing for such alternatives, the BOD has the discretion either to replace them or to continue its operations without replacement, provided that the remaining directors do not number less than three.

Notwithstanding the above, there is one case where the Corporate Law provides for the removal of a director. In the case of serious grounds referring to the removal of an appointed director, they can be removed if a petition is filed before the competent court by shareholders representing at least 10% of the paid-up share capital.

Directors are generally freely re-elected, unless the AOA provide otherwise or the company has a different internal policy.

Substitute Directors

If the GM has elected substitute directors, then replacement is effected with those elected substitutes. If the resigned or otherwise withdrawn director has been directly appointed by a shareholder, then only the appointing shareholder has the right to remove them and replace them, accordingly.

4.5 Rules/Requirements Concerning Independence of Directors

The election of independent directors is mandatory only in the case of listed SAs, pursuant to the New Corporate Governance Law, or where the non-listed company's AOA have included such a requirement. The independence criteria that the independent director must fulfil when elected and throughout their tenure pursuant to the New Corporate Governance Law are the following:

- they must not directly or indirectly hold voting rights in the company exceeding 0.5% of the company's share capital; and
- they must not have dependence from the company and/or any affiliated company.

Dependence in this case is established, inter alia, where:

- the director receives any significant amount or other provision from the company or an affiliated company;
- the director or any person closely related to the director maintains or maintained during the last three financial years a business relationship with the company, an affiliate or a shareholder holding at least 10% in the company or an affiliate, which could affect the business activity of the company or any of the above persons; or
- the director or a person closely related to the director has served as a BOD member of the company or an affiliate for more than nine years in aggregate, or has served in a managerial position or has been employed or otherwise retained by the company or an affiliate during the last three financial years prior to their appointment.

With respect to potential conflicts of interest, the Corporate Law explicitly provides that directors are prohibited (unless the AOA provide otherwise or they have been granted relevant permission by the GM) to pursue acts that fall within the scope of the corporate purpose of the relevant entity. Furthermore, directors must not pursue own interests that go against the interests of the company, and if conflicts arise from specific transactions, they are obliged to timely and adequately disclose such conflicts to the BOD and abstain from the relevant voting.

4.6 Legal Duties of Directors/Officers

The principal duties of directors are:

- the duty of care, namely, to manage the corporate affairs so as to promote the best interests of the company;
- the duty to act in compliance with the law, the company's AOA and the lawful decisions of the GM;
- the duty to monitor the implementation of the decisions of the BOD and the GM;
- the duty to inform other directors on corporate affairs;
- the duty to keep the books and records as required by law;
- the duty to ensure that the annual financial statements, the annual management report, the corporate governance statement (where applicable) the consolidated financial statements and the remuneration report are pre-

pared and published in accordance with the applicable laws or international accounting standards, as the case may be; and
- the duty of loyalty, non-compete duty, and secrecy of commercially sensitive information and other ancillary obligations discussed under **4.5 Rules/Requirements Concerning Independence of Directors**.

The principal duties referred to above apply to all directors of the company. There are also other obligations undertaken by the directors pursuant to special laws and regulations (for example, the obligation to ensure that taxes and social security contributions will be paid).

4.7 Responsibility/Accountability of Directors

As discussed in **4.6 Legal Duties of Directors/Officers**, the directors' statutory duties are in principle owed to the company. Notwithstanding the above, there may be cases where the law itself requires that specific interests should be taken into account – for example, in the case of certain related-party transactions which are exempted from the authorisation process, for the exemption to apply the law requires that the contemplated arrangement is for the interest of the company and does not harm the interests of the non-related shareholders, including the minority shareholders (see **5.1 Relationship Between Companies and Shareholders**).

Direct liability of the directors vis-à-vis third stakeholders in the company is expressis verbis provided for by Greek Law 4738/2020 (Greek Bankruptcy Code), whereunder the civil liability of directors and other individuals engaged in the management of the company is provided, where they have caused the cessation of payments or have failed to take timely measures to rescue the company, restructure the existing debt or apply for its bankruptcy, to protect the interests of the company's creditors.

4.8 Consequences and Enforcement of Breach of Directors' Duties

In principle, the company can bring a claim against any of its directors, including individuals to which the BOD has delegated management and representation powers for breach of their duties. In such cases, the company is entitled to seek compensation from the directors for any damage suffered as a result of any relevant act or omission. The BOD is responsible for the timely, proper and diligent exercise of such company's claims against liable individuals. Where the BOD decides that no such claims should be filed, the BOD is required to provide explanations on such a decision to the shareholders.

Further safeguards are provided by law, as discussed in **5.4 Shareholder Claims**, in order to mitigate the risk of the BOD not taking action against a current or former director and/or other manager of the company.

Liability of Directors

Directors can be released from such liability if they can prove either that they exercised their duties with the diligence of a prudent businessman in similar circumstances, or that their actions and/or omissions:

- were based on a lawful decision of the company's GM; or
- relate to a reasonable business decision that was made in good faith, based on sufficient information for the specific circumstances and solely in the company's best interests.

The liability of directors is assessed based on various factual qualifications that are to be weighed on a case-by-case basis.

It should also be noted that the court may not hold the directors liable for acts or omissions on their part that are based on the suggestion or the opinion of an independent body or committee that operates within the company according to the provisions of the law.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Notwithstanding the claims that the company may raise against the directors, shareholders are also entitled to bring a claim against any of the company's directors for any direct damage individually suffered by the shareholders due to the breach of the duties of the directors on the basis of tort, pursuant to generally applicable Greek civil law provisions. The indirect damage suffered by the shareholders can be enforced through the company's action, as discussed in **4.8 Consequences and Enforcement of Breach of Directors' Duties**.

In certain circumstances, directors may also be subject to criminal penalties for other violations of the Corporate Law – for example:

- for knowingly making a false or misleading statement to the public;
- for knowingly preparing or approving incorrect or misleading financial statements; or
- for obstructing the conduct of an audit by statutory auditors or auditors appointed for the conduct of an extraordinary audit.

Criminal and/or administrative penalties are provided for by other special laws, particularly in relation to tax, labour, health, safety and environmental violations.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The Corporate Law provides for different approval requirements depending on the type of the remuneration and/or benefit payable to directors, as follows.

- Remuneration payable to the directors for the provision of services based on a special relationship (an employment agreement, a work contract or a mandate). The relevant payment is subject to a prior approval process under the related-party transactions process.
- Benefits payable to the directors from the company's net distributable annual profits. These are payable only if the company's AOA provides for such payment and after the relevant GM approval is obtained.
- All other types of remuneration or benefits that do not fall within any of the aforementioned cases and are not otherwise provided for by the company's AOA must be approved by the GM, unless they are paid in accordance with the framework outlined in the company's remuneration policy.
- Benefits in the form of offering of shares or stock options.

Further to the requirements mentioned above, a GM decision is also required to establish the shares/stock options plan. Failure to observe the approval process required for each type of payment would cause the payment to have been made in breach of the provisions of the Corporate Law and/or the company's AoA, as the case may be, and any amount received by the beneficiaries could be reclaimed.

In relation to the above, listed SAs are obliged by law to adopt a remuneration policy. The remuneration policy is approved by the GM and

applies at maximum for four years. In principle, it applies to the remuneration of directors and the general manager of an SA, but can be extended to other executives, if the company's AOA includes such provision.

Special and stricter rules on remuneration policies are imposed on regulated entities such as credit institutions and alternative investment fund managers.

4.11 Disclosure of Payments to Directors/Officers

Further to disclosure requirements provided under financial and accounting laws, regulations and standards, the Corporate Law provides that listed SAs should draw up a clear and understandable remuneration report. The remuneration report must provide a comprehensive overview of the remuneration, including all benefits in whatever form, awarded or due during the most recent financial year to each individual director, including to newly recruited and former directors, in accordance with the company's remuneration policy.

Further disclosure requirements may apply subject to the specific circumstances (for example, if authorisation is granted for a related party transaction, all relevant corporate documents are submitted to the Greek Commercial Registry and made publicly available). There are also special legal rules applicable to specially regulated entities, such as credit institutions.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The rights and obligations of a shareholder are provided for by law, the company's AOA and, if applicable, any other internal regulation. As a general rule, the legal status and liability of a shareholder remain at all times distinct from those of the company. Based on this, the shareholder's capital contribution is the maximum liability amount the shareholder owes for liabilities of the company.

Piercing the corporate veil has been accepted in Greek case law in very limited instances and on the basis of specific circumstances indicating abusive use of the corporate vehicle by a single shareholder; therefore, it cannot undermine the general principle mentioned above. Shareholders holding a controlling interest in the company are considered related persons with the company, and are, in principle, subject to certain prior approval and publicity requirements when transactions are entered into with the company and the controlling shareholder or legal persons controlled by the latter or other persons closely connected to it.

The above principle also applies to all other types of limited liability companies, as opposed to the general partners in partnerships who bear unlimited liability for the company's obligations and are held jointly liable with the company vis-à-vis third parties and authorities.

5.2 Role of Shareholders in Company Management

The shareholders of an SA do not themselves actively participate in the management of corporate affairs. When they hold a controlling or significant interest, they can elect the majority of the directors; therefore, they can choose to have persons that they trust run the company. Irrespective of which shareholder elects or appoints the directors (as the case may be), the latter owe duty of care and loyalty only to the company.

Shareholders participate in the decision-making process through the exercise of their voting rights in the GM. It is noted that shareholders representing at least 5% of the company's paid-up share capital can request that the BOD convene a GM to decide on any item of the agenda or request that additional items are included in the agenda of a GM that has already been convened by the BOD.

5.3 Shareholder Meetings

The ordinary GM of the company is held regularly once a year, at the latest by the tenth calendar day of the ninth month following the end of each financial year, with a minimum agenda to approve the financial statements of the previous financial year, resolve on profit distribution and appoint the statutory auditors of the company for the current financial year. Extraordinary GMs may be convened at the initiative of the BOD, whenever deemed necessary, in order to resolve on the matters that are reserved for the exclusive competence of the GM or for any other matter that the BOD may consider of such importance that requires the approval of the GM (eg, sale of a significant subsidiary of the company) or at the request of shareholders holding at least 5% of the company's share capital, in exercise of the minority rights provided under the Corporate Law.

The GM is convened by the BOD 20 full days prior to the date of the meeting through the publication of the invitation, which includes the items of the agenda, details of the place and time of the GM and rights that the shareholders may exercise within the 20-day period and during the meeting. In the case of non-listed companies, the above-mentioned formalities can be waived, in so far as all shareholders are present or represented at the relevant GM and do not object to the absence of convocation formalities. In the case of listed companies, the invitation to the GM is accompanied by draft decisions on the items of the agenda or comments by the BOD thereon. See **3.3 Decision-Making Processes**.

5.4 Shareholder Claims

Under the Corporate Law, directors are liable in principle vis-à-vis the company. Shareholders representing at least 5% of the company's paid-up share capital have the right to request that the BOD initiate litigation procedures against a member of the BOD that is in breach of their obligations vis-à-vis the company (see **4.7 Responsibility/Accountability of Directors** and **4.8 Consequences and Enforcement of Breach of Directors' Duties**).

Pursuant to the Corporate Law, shareholders have recourse against the company for compensation of direct damages suffered by the shareholder(s) in connection with GM decisions that have been annulled or could be annulled on the grounds provided for by the Corporate Law, including, inter alia, in cases where the decision has been made in a manner that does not comply with the law and/or the company's AOA, or where it is the result of abusive exercise of rights by the majority shareholder(s).

5.5 Disclosure by Shareholders in Publicly Traded Companies

Shareholders in listed companies are subject to certain disclosure obligations provided for by the Transparency Law and the Market Abuse Regulation.

In particular, pursuant to the Transparency Law, disclosure requirements are triggered when:

- a person reaches, exceeds or falls below 5%, 10%, 15%, 20%, 25%, one third, 50% and two thirds of their total voting rights; or

- a person holding more than 10% of the voting rights has an increase or a decrease of such percentage equal to or higher than 3%.

The voting rights that are indirectly controlled by a person in a listed company (eg, either based on a discretionary management agreement or a depositary agreement, or a discretionary proxy granted in view of a forthcoming GM, or because the shareholder is an entity controlled by such a person and other instances of Article 10 of the Transparency Directive on acquisition or disposal of significant holdings of voting rights) should also be taken into account when calculating the aforementioned thresholds. Such requirements are not affected if the company is party to a business combination. The respective shareholder has the obligation, within three days from the occurrence of an event described under the bullet points above, to inform the issuer and the HCMC about the percentage of the voting rights held as a result of such acquisition or disposal.

Disclosure includes the full chain of controlled undertakings, within the meaning of the Transparency Law, through which the voting rights in the issuer are effectively held.

Shareholders that also participate in the management of a listed company, or are otherwise considered as persons closely connected to a person in the company's management, must observe the transactions' reporting obligation under the Market Abuse Regulation. Enhanced disclosure obligations also apply in the case of transactions triggering the launching of a tender offer.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Further to any reporting requirements provided in the relevant financial accounting standards, SAs publish their annual financial statements (after their being approved by the BOD) and submit these for approval by the annual GM. The financial statements are accompanied by:

- a management report, which provides a full overview of the company's development and performance during the preceding financial year as well as of the main risks and uncertainties relevant to the company's business activities; and
- the report of the company's statutory auditor, to the extent required by applicable legislation, as further described in **7.1 Appointment of External Auditors**.

The management report includes both financial and non-financial metrics that are relevant to the company's business activity to the extent required for the coherent presentation of the company's development; whereas, for the purposes of the analysis included in the management report, notes or clarifications may be provided in relation to the figures included in the annual financial statements. Different requirements may apply depending on the size and type of the reporting entity.

Special Rules

Special rules apply with respect to the periodic financial reporting of listed SAs, pursuant to the provisions of the Transparency Law. Listed SAs are subject to the publication of an annual management report within four months of the end of each financial year, and a semi-annual report, within three months of the end of the respective

reference period. Both the annual and the semi-annual report are published by the company and remain publicly available for a period of at least ten years.

The aforementioned financial reports include the audited annual financial statements or semi-annual statements of the relevant period, as well as the management report and declarations by the chairman of the BOD, the chief executive officer, and a third BOD member ascertaining the accuracy and truthfulness of the financial statements and the management report.

Additional and more specialised reporting obligations apply to different categories of regulated entities, such as credit institutions and investment fund managers.

6.2 Disclosure of Corporate Governance Arrangements

The corporate governance arrangements that a listed SA has in place are publicly disclosed, to a certain extent, where the latter is obliged to issue a prospectus in accordance with the Prospectus Regulation and on an annual basis according to the minimum content of the corporate governance statement, which, according to the Corporate Law, forms part of the annual management report that is published together with the annual financial statements of the listed SA.

The corporate governance statement includes at least the following information:

- reference to the code of corporate governance that the company has adopted and applies, and where this document is made available to investors;
- information in relation to any corporate governance practices that the company applies further to what is mandatorily provided by applicable legislation;
- information based on the "comply or explain" principle on any deviation from the corporate governance code adopted by the company;
- a description of the main features of the internal control and risk management systems applied by the company in relation to the preparation of its financial statements;
- information on the composition and operation of the administrative, management and supervisory bodies of the company and respective committees; and
- a description of the diversity policy applied to the administrative, management and supervisory bodies of the company, indicatively relating to the age, gender, educational or professional background of its members, the objectives of the diversity policy and the way in which it was applied by the company during the reference period.

6.3 Companies Registry Filings

The establishment of all forms of corporate entities referred to in **1.1 Forms of Corporate/Business Organisations** is registered with the General Commercial Registry, which operates an electronic platform accessible to the public. Apart from the relevant entity's constitutional document (which is publicly available on the aforementioned electronic registry), different requirements apply as to the requisite corporate filings, depending on the corporate form of the relevant entity. As a general rule, where filings are required to be made with the General Commercial Registry, the respective documents become accessible to the public on the aforementioned electronic platform.

With respect to SAs, in particular, certain BOD and GM decisions are subject to publicity in order to develop their full legal effect and/or so

that they can be invoked vis-à-vis third parties. Corporate decisions that require publicity are the following:

- any amendment to the company's constitutional document;
- the election of the BOD and the granting of representation powers;
- the appointment of the statutory auditors of the company;
- any decision on the increase or decrease of the share capital;
- the certification of payment of the share capital;
- the approval of the annual and consolidated financial statements along with the BOD report and the auditor's report;
- the dissolution of the company;
- the judicial decision declaring the company null and void or in the case of initiation of bankruptcy proceedings or any other collective enforcement proceedings, as well as judicial decisions declaring as null and void or voidable a decision of the GM of shareholders;
- the appointment and replacement of the liquidators, as well as the liquidation financial statements and final financial statements; and
- the deletion of the company.

Further Publicity Requirements

Further publicity requirements are triggered in the context of, for example, requisite authorisations for related party transactions as well as for the various reports that may be required in relation to corporate actions, such as a share capital increase.

With respect to other company forms, as a general rule, corporate filings are required for any amendment in the constitutional document of the relevant entity, the appointment of an administrator, the granting of representation powers, and the approval of the annual financial statements.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The audit of the annual financial statements by an external auditor or auditing firm is mandatory in the case of, inter alia, listed SAs and other Greek corporate types which meet certain financial thresholds categorising them as medium or large entities according to the Greek Accounting Standards.

External auditors are appointed by the GM, in an SA, or by the partners, in other corporate forms.

Law 4449/2017

According to the relevant provisions of Law 4449/2017, external auditors are subject to business ethics principles that take into account their role in protecting public interest, their integrity and objectivity and the professional qualities and due diligence that they must present when providing the relevant services. External auditors are by law obliged to show professional scepticism when performing the audit, having in mind the possibility that there might be a material inaccuracy due to events or behaviours that indicate the existence of a mistake or fraud, irrespective of any previous experience the auditor may have with respect to the honesty and integrity of the company under audit and its management. Scepticism must especially be shown when reviewing the estimations made by the management on fair values, impairments, forecasts and future cash flows, and other matters related to the going concern.

The law also provides for the need to safeguard the external auditors' independence and to ensure that no conflicts of interests arise that would jeopardise their independence and objectivity. In this context, it is provided, inter alia, that the external auditor or principal partner of the auditing firm (as the case may be) may provide auditing services to the audited company for at maximum five consecutive years, and may repeat this only after the lapse of two consecutive years.

Listed SAs

In the case of listed SAs, the audit committee is the competent corporate body to monitor the external audit process, identify any problems encountered in the process and assist the auditors when performing their duties. The audit committee is also responsible for suggesting to the BOD the appointment of an external auditor following a tender process. It also monitors the efficiency of the internal control, the quality sustainability and risk assessment policies of the company, and its internal audit in relation to periodic financial reporting obligations.

Notwithstanding the above, the appointment of external auditors may also be required on an ad hoc basis, such as in the case of a share capital increase, for the certification of the payment of the increase, or for the provision of a fairness opinion in the case of a related party transaction to be entered into by a listed SA.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Pursuant to the relevant financial reporting standards and the provisions of the Corporate Law on the annual management report, the annual management report includes a description of the company's objectives and policies with respect to the management of the financial risk, the policy for hedging any significant transaction for which accounting hedging applies, and the company's report on credit risk, liquidity risk and cash flows risk. Apart from the above-mentioned requirements, there is no other provision outlining specific requirements applicable to directors in connection with risk management. To the contrary, the establishment of an internal audit system, including risk management and regulatory compliance systems and its monitoring by the audit committee (see **7.1 Appointment of External Auditors**), is explicitly included, pursuant to the New Corporate Governance Law, in the duties of the non-executive directors, in the case of listed SAs.

Notwithstanding the above, since the directors have, pursuant to the New Corporate Governance Law, the duty to pursue the enforcement of the long-term value of the company and the general corporate interest, such a duty must be understood as also including the obligation of the company's management to establish risk management policies and internal control systems in the more general context of promoting the company's interests and business activity.

INDIA

Law and Practice

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Contents

1. Introductory p.251
1.1 Forms of Corporate/Business Organisations p.251
1.2 Sources of Corporate Governance Requirements p.251
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.251

2. Corporate Governance Context p.252
2.1 Hot Topics in Corporate Governance p.252
2.2 Environmental, Social and Governance (ESG) Considerations p.254

3. Management of the Company p.256
3.1 Bodies or Functions Involved in Governance and Management p.256
3.2 Decisions Made by Particular Bodies p.256
3.3 Decision-Making Processes p.257

4. Directors and Officers p.257
4.1 Board Structure p.257
4.2 Roles of Board Members p.257
4.3 Board Composition Requirements/Recommendations p.258
4.4 Appointment and Removal of Directors/Officers p.258
4.5 Rules/Requirements Concerning Independence of Directors p.259
4.6 Legal Duties of Directors/Officers p.259
4.7 Responsibility/Accountability of Directors p.259
4.8 Consequences and Enforcement of Breach of Directors' Duties p.260
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.260
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.260
4.11 Disclosure of Payments to Directors/Officers p.261

5. Shareholders p.261
5.1 Relationship Between Companies and Shareholders p.261
5.2 Role of Shareholders in Company Management p.261
5.3 Shareholder Meetings p.262
5.4 Shareholder Claims p.262
5.5 Disclosure by Shareholders in Publicly Traded Companies p.263

6. Corporate Reporting and Other Disclosures p.264
6.1 Financial Reporting p.264
6.2 Disclosure of Corporate Governance Arrangements p.264
6.3 Companies Registry Filings p.265

7. Audit, Risk and Internal Controls p.265
7.1 Appointment of External Auditors p.265
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.266

Wakhariya & Wakhariya is a full-service international law firm, founded in 1998, which advises international companies doing business in India, USA, UK and East Africa on corporate, commercial, regulatory, compliance, governance and transactional matters. The firm specialises in providing critical, strategic and practical advice to international clients, which include Fortune 500 companies and lawyers from international law firms. The multi-dimensional practice broadly covers the following industry sectors: telecommunications and information technology, branded and generic pharmaceuticals, healthcare, oil and gas, renewable and sustainable energy, hotels and hospitality, textiles, civil aviation, professional services, food and beverages, metals and minerals, education and non-profit.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

There are four principal forms of business organisation in India, as set out below.

- Companies incorporated under the Indian Companies Act, 2013 (the "Companies Act" or the "2013 Act"), which include:
  - (a) a private limited company, which limits the number of shareholders and restricts the free transferability of shares;
  - (b) a public limited company, which may be listed on the Indian stock exchange and whose shares can be freely traded and transferred;
  - (c) a non-profit company, popularly referred to as a Section 8 company, whose objective is to promote arts, commerce, charity, education, science, social welfare and sports, and which intends to apply its profits, if any, to promoting its objects (it prohibits the payment of dividends to its members); and
  - (d) a one-person company, which has only one single shareholder (this is relatively new, introduced by the 2013 Act, and is not very popular yet).

Partnerships under the Indian Partnership Act, 1932 – partnerships are very popular with small traders and businesses and require a partnership deed to be registered or filed.

- Limited liability partnerships, under the Limited Liability Partnership Act, 2008 – these were principally introduced to help professional and service organisations form partnerships with limited personal liability for partners.
- Sole proprietorships, which are simply individuals doing business – this is the simplest form of business organisation and requires almost no registration or reporting for its formation.

1.2 Sources of Corporate Governance Requirements

India has always heavily regulated businesses. In the last decade, the emphasis has been more on regulation through self-reporting rather than licensing and approvals.

The principal sources of governance are the Companies Act, Rules published under the Companies Act, and Notifications and Circulars issued by the Ministry of Corporate Affairs (MCA). Limited liability partnerships (LLPs) are governed by the Limited Liability Partnership Act, 2008.

Listed companies in India are also required to comply with the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the "SEBI Regulations") and the listing agreement with the stock exchange on which the company may be listed.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

India has a very strong disclosure, governance and reporting policy with many of the disclosure and governance requirements being mandatory. In the past few years, the government has started to suspend companies and disqualify directors of the companies that have not complied with the disclosure, governance and reporting requirements.

There are many additional provisions that affect governance, like the whistle-blowing policy, corporate social responsibility (CSR) and related party transactions, all of which require the maintaining of detailed records, disclosure and reporting.

The SEBI Regulations broadly require every publicly listed company to meet the following requirements.

Board Composition

- The Board of Directors shall have an optimum combination of executive and non-executive directors with at least one female director.
- No fewer than 50% of the board must comprise non-executive directors.
- The board of top 2,000 listed entities by market capitalisation shall comprise of no fewer than six directors.
- The chairperson of top 500 listed entities needs to be a non-executive director and not be related to the managing director or CEO.
- The quorum requirement of board meetings of top 2,000 listed entities is one third of its total strength or three directors, whichever is higher, including at least one independent director.
- A person should not be a director in more than seven listed entities.

Board Independence

- All listed companies in India are required to have independent directors on their boards. The quantum of independent directors depends on whether the company has a non-executive chairman or not. If the company has a non-executive chairman, then at least one third of the board must comprise independent directors. On the other hand, if the company does not have a non-executive chairman, then at least half of the board must be composed of independent directors and such independent directors are not entitled to any stock options.
- The board of the top 1,000 listed entities shall have at least one independent female director.
- The independent directors must hold at least one meeting within the financial year, without the presence of non-independent directors and members.

Mandatory Committees

- The board must constitute an Audit Committee, a Stakeholders' Relationship Committee, a Risk Management Committee, Related Party Transactions Policy and Vigil Mechanism.

Other Governance Requirements

- The board of every listed entity shall periodically review the compliance report pertaining to all applicable laws and steps taken to mitigate the non-compliances, if any.
- Top 1,000 listed entities shall undertake Directors and Officers insurance ("D and O insurance") for all independent directors of such quantum and for such risks as may be determined by its board of directors.
- SEBI has also framed regulations for the issuance of shares, foreign investment, the buy-back of securities and the prevention of insider trading.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The Companies Act, 2013 is a successor to the Companies Act, 1956, which itself was a successor to the pre-independence British-legislated Companies Act, 1913.

The 2013 Act has 29 Chapters, 470 Sections and 7 Schedules, which collectively list numerous provisions concerning independent directors, board constitution, general meetings, board meetings, board processes, related party transactions, audit committees, etc, with which every company has to comply. In addition, in the past nine years, the MCA has issued hundreds of notifications providing guidance on various provisions or requiring certain mandatory compliances, all to be filed online through an e-filing process and signed using a digital signature issued by a government authorised agency, eliminating almost all paper filings.

Since 2006, the MCA has promoted an electronic database (called MCA-21) that houses the corporate governance and disclosure information of all the companies and LLPs incorporated or formed in India. The MCA is working behind the scenes to determine how the vast data it gathers could be integrated with the databases of other government ministries and identify ways of creating a corporate governance index.

The following are some of the major mandatory requirements:

- board meetings must be held once every 120 days, with at least four meetings in a calendar year;
- every company has to hold an annual general meeting (AGM) of the shareholders within six months of the close of the financial year and no more than 15 months should elapse between two AGMs;
- the company's balance sheet and profit and loss statements have to be audited by a statutorily appointed auditor;
- auditors of companies with a certain threshold are subject to mandatory rotation/change every five years, and cannot audit more than 20 companies;
- audited financial statements along with the director's report, approved by the shareholders in the AGM, are to be filed with the Registrar of Companies (RoC);
- directors have to annually submit detailed disclosures of their and their family's interests in the company to prevent any conflicts of interest;
- every change of director has to be reported within 30 days to the RoC;
- a full-time company secretary and cost auditor shall be appointed if the company's paid-up capital or turnover is above a certain threshold;
- every special resolution (ie, one requiring more than three quarters of votes) is to be filed with the RoC; and
- every individual must mandatorily be registered in a government database and issued a director identification number (DIN) before appointment as a director.

In February 2020, the MCA launched a new integrated web form (called SPICE+) which offers a wide variety of services related to various government ministries, thereby saving time and costs to start a business in India. New companies, at the time of their registration, can, among other things:

- reserve the company's name;
- obtain a permanent account number (PAN);
- register for goods and services tax (GST);
- obtain an employee provident fund and employee state insurance registration; and
- obtain a DIN for their directors through a single integrated e-form.

Previously, each of these required separate applications, one after the other and each took a few days to a few weeks to be completed.

2.2 Environmental, Social and Governance (ESG) Considerations

The Companies Act requires companies with a certain threshold of turnover or profitability to:

- establish a CSR committee;
- develop CSR policies;
- spend 2% of profits on these policies; and
- report on these activities to the shareholders in its annual report.

Companies are encouraged to focus their CSR activities on:

- eradicating poverty, hunger and malnutrition;
- improving education;
- promoting gender equality and female empowerment; and
- environmental sustainability.

Since the outbreak of the COVID-19 pandemic, CSR funds are also permitted to be used for alleviating pandemic-related hardship.

Prior to 2019, CSR spending was voluntary. After the 2019 amendment to the 2013 Act, it has been made a mandatory obligation for companies. As per the new amendment, a company has to transfer the unspent CSR amount to a government specified fund. Non-compliance with this requirement will attract penalties for the company and defaulting officers.

In 2021, new CSR rules have specified the reporting mechanism for companies. Companies to whom CSR is applicable have to prepare an annual report on CSR in the prescribed format and attach it to its board report. Companies exceeding the specific threshold of CSR obligations have to undertake an impact assessment by an independent agency. CSR activities have to be displayed on the company's website.

Over the past decade, the government of India has formulated many regulations and offered great incentives for the promotion of ESG standards. On the one hand, there are a multitude of incentives and subsidies in the form of business opportunities encouraging companies to embrace environmentally-friendly businesses and practices. On the other, the government has enforced stricter regulations and norms to achieve its sustainability objectives.

National Voluntary Guidelines

In 2009, India's MCA published the Corporate Social Responsibility Voluntary Guidelines (the "CSR Guidelines"), recommending that all businesses formulate a CSR policy; since then, sustainability disclosures have formed an integral part of the best practices of any company that wants to develop and demonstrate its green or community-oriented credentials.

In 2011, the CSR Guidelines were superseded by the expanded and more detailed National Voluntary Guidelines (NVGs) on Social, Environmental and Economic Responsibilities of Business, containing comprehensive principles to be adopted by companies as part of their CSR activities. This introduced a structured reporting format for business, requiring certain specified disclosures and demonstrating the steps taken by companies to implement the ESG principles.

The NVGs define nine principles of responsible business conduct to be adopted by companies as part of their practices and mandates for preparing a business responsibility report by providing stakeholder information about the initia-

tives, impacts and future course of action across ethics, transparency and accountability, product life-cycle sustainability, employees' well-being, stakeholder engagement, human rights, environment, public advocacy, inclusive growth and customer value.

In 2019, the NVGs were revised and the MCA formulated the National Guidelines on Responsible Business Conduct (NGRBC). The NGRBC have been designed to assist businesses in fulfilling their regulatory compliance requirements. The NGRBC are made applicable to all businesses, irrespective of their ownership, size, sector, structure or location. These new guidelines containing precise pillars of business responsibility (called principles), accompanied by a set of requirements and actions that are essential to the operationalisation of the principles, referred to as the "core elements". The principles highlighted in the NGRBC are that:

- businesses should conduct and govern themselves with integrity in a manner that is ethical, transparent and accountable;
- businesses should provide goods and services in a manner that is sustainable and safe;
- businesses should respect and promote the wellbeing of all employees, including those in their value chains;
- businesses should respect the interests of and be responsive to all their stakeholders;
- businesses should respect and promote human rights;
- businesses should respect and make efforts to protect and restore the environment;
- businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent;
- businesses should promote inclusive growth and equitable development; and
- businesses should engage with and provide value to their consumers in a responsible manner.

Business Responsibility and Sustainability Reporting

In August 2012, SEBI issued the business responsibility report (BRR) norms that made it mandatory for the 100 largest listed companies to publish an annual business responsibility report, capturing the company's non-financial performances through economic, environmental and social factors. In 2015, this requirement was expanded to the 500 largest companies, and to the 1,000 largest listed companies in December 2019. In May 2021, SEBI introduced a new reporting format, namely the Business Responsibility and Sustainability Reporting (BRSR), which is effective from the current 2022-23 financial year. The BRSR focuses on sustainability-related factors, in addition to the existing factors.

The BRSR requires companies to disclose their compliance with the nine principles of business responsibility, which include ESG factors. For Indian companies to attract future investment, they must disclose their performance on ESG factors along with financial factors, which makes publishing BRSR essential.

The BRSR requires companies to detail the initiatives taken from an ESG perspective, in a prescribed standard template format which helps companies to publish their BRSR in a structured manner. It also helps the government in conducting a comparative analysis across multiple entities.

Companies that follow an internationally accepted reporting framework to publish their sustainability reports are not required to prepare a separate report. They have only to furnish the

same to their stakeholders along with the details of the international framework (such as Global Reporting Initiative (GRI), Sustainable Accounting Standards Board (SASB), Task Force on Climate-related Financial Disclosures (TCFD) or Integrated Reporting) under which their BRSR has been prepared along with a mapping of how the principles contained in these guidelines apply to disclosures made in their sustainability reports.

Stock Exchange Disclosure and ESG Indices

In 2018, the Bombay stock exchange published a guidance document on ESG disclosures, which served as a comprehensive set of voluntary ESG reporting recommendations, guided by global sustainability reporting frameworks. This provides 33 specific issues and metrics on which companies should focus.

The National Stock Exchange (NSE) of India has launched two ESG indices, the NIFTY100 Enhanced ESG Index and the NIFTY100 ESG Index to appeal to those parts of the investment community looking to align their investment with ESG goals. The ESG indices cover:

- a company's impact on the environment, such as its carbon intensity, recycling and waste management processes and development of renewable energy;
- social factors such as policies and the impact of a company's activity on working conditions, human rights, health and safety norms and financial inclusion; and
- governance factors measuring the effectiveness of processes and policies pertaining to corporate governance, business ethics, fraud, anti-corruption measures and public policy.

A company is rated based on three main areas: preparedness, disclosure and performance. Preparedness indicators measure the effectiveness of a company's policies, programmes and structures; disclosure indicators measure effectiveness of a company's standards and reporting process; and performance indicators capture the company's controversies and incidents and its response to them.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

A company is managed by the board of directors, who are appointed by the shareholders. The Companies Act identifies certain officers as key managerial personnel who are responsible for the day-to-day operations and governance of the company, namely:

- a managing director;
- a whole-time director (ie, any director who is a full-time employee of the company);
- a CEO;
- a CFO; and
- a company secretary (a governance professional licensed by the Institute of Company Secretaries of India).

In addition, the board of directors is authorised to appoint specific committees for specific purposes. In public companies, certain committees are mandatorily required.

3.2 Decisions Made by Particular Bodies

Generally, the board of directors is responsible for the strategic decisions and day-to-day functioning of the company. However, certain major decisions which affect the rights of shareholders are reserved by the Companies Act (shareholders in closely held companies can also agree to reserve other decisions) exclusively for share-

holders to decide, or require a super majority (namely, special resolutions, which require more than three quarters of the shareholders voting in favour).

3.3 Decision-Making Processes

In general, decisions in all matters relating to the company are taken by the board of directors of the company by a majority vote of directors present and not disqualified or barred from acting due to a personal conflict of interest in the matter to be decided in the board meeting. In addition, directors may decide urgent matters through a written “circular resolution” (ie, resolutions passed by circulation to directors) outside of board meetings.

Decisions by shareholders are taken in the form of an ordinary resolution or special resolution at the general meeting. For convening a general meeting, the company has to provide notice and other relevant information to the shareholders.

Decisions such as an alteration of the memorandum or articles of the company, a change in registered office, a reduction in share capital, a change in the objects of a public company and the winding-up of a company can only be taken by a special resolution.

4. Directors and Officers

4.1 Board Structure

Public and private companies are required to have a minimum of three and two directors, respectively, and a maximum of 15 directors. A company’s articles of association may specify a higher minimum number of directors on the board, and a company can appoint more than 15 directors by passing a special resolution. Only individuals can be appointed as directors; corporations and associations cannot be directors.

While there is no general residency requirement for directors, every company is required to appoint at least one resident director (ie, a person who has stayed in India for a total period of not less than 182 days in the previous calendar year).

Listed companies and public companies with paid-up share capital of INR1 billion or a turnover exceeding INR3 billion are required to appoint at least one female director.

The structure of the board is primarily one tier. There is no distinction between the managerial board and the supervisory board, although the Companies Act recognises a category of directors as independent directors. It prescribes that listed companies and unlisted public companies with a certain level of paid-up capital, turnover or outstanding loans should have a prescribed number of independent directors on their boards. This helps to ensure transparency in corporate governance and safeguard the autonomy of independent directors.

4.2 Roles of Board Members

Directors play a dual role – one as an agent of the company and another as a person with a fiduciary duty to the company.

Contracts entered into by a director are binding on the company only if they are within the actual authority of the director, or if the articles of association of the company or the company’s by-laws provide for the delegation of that power by a board resolution, whether or not that power has actually been delegated.

It is a legal requirement for certain classes of companies to mandatorily have the following committees:

- an Audit Committee;
- a Nomination and Remuneration Committee;
- a Stakeholders' Relationship Committee; and
- a CSR Committee.

4.3 Board Composition Requirements/ Recommendations

Firstly, directors are usually named in the articles of association of the company at the time of incorporation. If they are not, the subscribers to the organising documents are deemed to be and become the first directors. The board of directors has the power to appoint additional directors from time to time, or to appoint directors to fill any casual vacancy arising due to the death or resignation of a director, but subject to the overall number specified in the articles of the company. Additional directors appointed by the board hold office only up to the date of the next AGM, at which time the shareholders may either appoint/confirm them as regular directors or appoint new directors.

4.4 Appointment and Removal of Directors/Officers

Directors (other than first director, additional director, nominee director, alternate director and a director appointed in a casual vacancy) are always appointed by a company's shareholders in a general meeting. Generally, vacancies to the board or appointment of additional directors are permitted to be filled by the board itself, but such directors are subject to reappointment by the shareholders at the next general meeting.

The Act permits employees to be appointed as directors and, in such cases, they are typically designated as "whole-time" directors.

Directors cannot be appointed until they are first registered in a national database, issued a DIN and have given written consent for the appointment, which must be filed with the RoC. Since 1 June 2022, citizens of countries sharing a land border with India are required to obtain security clearance from the Ministry of Home Affairs, government of India before applying for a DIN. In addition, individuals who fall under this category must provide a declaration in this regard at the time of their appointment to the board of an Indian company.

Since October 2019, the MCA has required boards of directors to include the details of integrity, expertise and experience of independent directors hired during the year in their annual reports to the shareholders. Moreover, the MCA has clarified that independent directors have to pass a self-assessment test (with a 50% score in aggregate) to prove their competence, conducted by the Indian Institute of Corporate Affairs (IICA). The test will evaluate the directors based on their knowledge of the Companies Act, securities laws, basic accountancy and other subjects that are required for the individual to perform as an independent director.

A director may be removed before the expiry of their term of office by an ordinary resolution passed in a general meeting of the shareholders after a special notice has been given.

In the case of public companies, the Act requires the CEO, managing director, CFO, company secretary and whole-time director to be designated as key managerial personnel (KMP); the Act casts specific onus on the KMPs for the governance of the company.

4.5 Rules/Requirements Concerning Independence of Directors

The Companies Act prescribes that directors must not involve themselves in any situation in which they may have a direct or indirect interest that conflicts with the interests of the company. Also, directors must not achieve (or attempt to achieve) any undue gain or advantage either to themselves or to their relatives, partners or associates. If a director is found guilty of making any undue gain, they shall be liable to pay the company an amount equal to their gain.

A director is required to disclose their interest in a contract or arrangement with a body corporate in which they hold more than 2% of the shareholding, or with a firm in which they are a partner, owner or member.

Prior to appointment and at the beginning of each financial year, every director is required to disclose the list of Indian public and private companies, foreign companies, partnerships, LLPs, trusts and non-trading organisations in which they are directors, partners, members or trustees (or have any other interest). In addition, they are required to disclose a list of relatives, which includes, parents, spouse, children and siblings (including in each case step relatives). These disclosures are tabled in the first board meeting of every financial year and are intended to put the company on notice of the personal interests of the directors and the conflicts of interests that may arise due to them.

There are many privacy concerns with such information being given to the government, and many companies also question its relevance. However, most are complying, at least for now, because the government marks companies that do not comply as non-compliant and suspends certain governance activities of such companies.

In addition, the Companies Act prescribes specific detailed rules on how contracts with interested directors are to be approved, including the exclusion of the interested director from participation in such board meetings.

4.6 Legal Duties of Directors/Officers

The power of directors to manage a company can be restricted by the company's articles but, in reality, in most cases they can do anything that the company can do, generally acting in good faith and as a fiduciary of the company. The Companies Act lists the specific duties of directors as follows:

- to act in good faith in order to promote the objects of the company for the benefit of its members as a whole;
- to exercise duties with due and reasonable care, skill and diligence, in the best interests of the company, its employees and the shareholders;
- to not be involved in any situation that may cause a direct or indirect conflict of interest with the business or interests of the company; and
- to not obtain any undue gain or advantage, either for themselves or for their relatives, partners or associates.

4.7 Responsibility/Accountability of Directors

A director owes a fiduciary duty to the company and not to individual shareholders, creditors or fellow directors. Directors must act honestly, without negligence and in good faith in the bona fide interests of the company. While applying this rule, directors are expected to act for the economic advantage of the company, without disregarding the interests of the members, employees or creditors.

The major responsibilities of the board include:

- to review the annual budgets and business plans, and oversee major capital expenditures, acquisitions and divestments;
- to monitor the effectiveness of the company's governance practices;
- to monitor and manage potential conflicts of interest of management and members of the board;
- to maintain high ethical standards and take into account the interests of stakeholders; and
- to facilitate the independent directors to perform their role effectively as members of the board of directors and also as members of any committees.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Directors are jointly and severally liable for losses suffered by the company on account of omissions and commissions in breach of their duties, and are personally liable to make good the losses suffered by the company.

Directors in breach of their duties can be removed or disqualified from the company by shareholders passing a general resolution. The Companies Act prescribes significant fines for breaches of directors' duties.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Directors of a company can be held personally liable for illegal acts, fraud, wilful contribution to tortious action, negligence, conspiracy, misappropriating the company's funds and assets, breach of trust and duties, false representation, and entering into contracts ultra vires, among other things. In such cases, the company or its shareholders, along with the affected third parties, can sue the directors for such breaches, through class action lawsuits or otherwise.

To promote the ease of doing business in India, the government has introduced new amendments to the Companies Act waiving off the criminal sanctions imposed for minor, technical or procedural defaults.

The Companies Amendment Act, 2019 recategorised 16 criminal offences to civil defaults. Further, the Companies Amendment Act, 2020 decriminalised more than 46 compoundable offences where originally imprisonment was a consequence of contravention. In addition, various penalties and fines have also been reduced. For example, imprisonment has been waived for contraventions related to:

- a buy-back of shares;
- the disclosure of interest by directors, financial statements and board's reports;
- the formation of companies with charitable objects;
- the disqualification of directors; and
- the constitution of audit, stakeholder relationship, and nomination and remuneration committees.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The maximum amount of managerial remuneration by a public company to its managing director, whole-time director or manager cannot ordinarily exceed 11% of the net profits of the company in a financial year. However, in a general meeting the company may authorise the payment of remuneration exceeding 11% of the net profits of the company. Unlike public companies, there is no statutory ceiling on the

maximum amount of compensation that can be paid to the directors of private companies.

A director is permitted to receive remuneration by way of fees for attending board or committee meetings, or for any other purpose to be decided by the board. The amount of sitting fees payable to a director for attending the meetings of the board or committees can be decided by the board or the Remuneration Committee, subject to certain prescribed ceilings. The board may decide a different sitting fee payable to independent and non-independent directors other than whole-time directors. Independent directors are not entitled to any stock options.

Companies Act prescribes a penalty of INR100,000 for individuals and INR500,000 for companies in case of default in complying with the provisions related to managerial remuneration.

4.11 Disclosure of Payments to Directors/Officers

As per the Companies Act, listed companies are mandated to disclose specific details of the remuneration paid to the directors and officers of the company in their annual financial statements.

Listed companies are obligated to disclose in the board's report:

- the ratio of the remuneration paid to each director to the median remuneration of the employees of the company for the financial year;
- the percentage increase in remuneration of each director, CFO, CEO, company secretary or manager, if any, in the financial year;
- the percentage increase in the median remuneration of employees in the financial year; and
- a list of the top ten employees who draw remuneration in excess of INR1.02 million.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Shareholders are the true owners of the company and the highest governing body within the company structure. Certain types of actions by the company can be undertaken only by a shareholders' resolution, which can be passed only in a shareholders' meeting, either by the AGM or by calling an extraordinary general meeting of shareholders.

5.2 Role of Shareholders in Company Management

The Companies Act mandatorily requires shareholders' approval for the following decisions:

- a change in the name, registered office or authorised share capital;
- a modification of the memorandum of association and articles of association of the company;
- the issuance of shares on a preferential basis;
- the approval of audited accounts;
- a declaration of dividends;
- the appointment and removal of auditors; and
- the liquidation of the company.

In addition, shareholders in closely held companies may agree to or require other actions to be taken only by shareholder approval.

5.3 Shareholder Meetings

Every shareholder is entitled to participate in the general meetings of the company, and a certain specified number of shareholders may also request the board of a company to convene an extraordinary general meeting if any urgent matters need to be discussed.

A newly incorporated company is required to hold the first AGM within a period of nine months from the date of closing of the first financial year and, in all other cases, within a period of six months from the date of closing of the financial year. The Companies Act requires every company to have its financial year from 1 April to 31 March. However, if a company is consolidating its financial statement with its overseas parent, which may have a different financial year, then the Indian company is permitted to have that different financial year with the prior approval of the National Company Law Tribunal.

Every meeting requires a valid notice (in writing or electronic form) to be given to all shareholders, accompanied by a statement that sets out material facts relating to the nature of business to be transacted at such meeting.

There are two types of meetings of shareholders prescribed under the Companies Act:

- an annual general meeting, which must be held once every year within six months of the close of the financial year and no later than 15 months from the prior AGM; and
- an extraordinary general meeting, which can be called either by the board for a specific purpose or at the request of shareholders holding at least one tenth of the voting rights.

Meetings are to be presided over by the chairperson, who is elected by the members personally present in the meeting. Decisions are taken as either a "show of hands" or a vote. Every shareholder who attends, either in person or by proxy, has the same number of votes as the number of shares they hold. Like in board meetings, there is usually a minimum quorum requirement in the articles and under the provisions of the Companies Act.

A listed company is additionally required to provide the facility of remote e-voting to its shareholders, in respect of all shareholders' resolutions, and the results of each meeting are to be submitted to the relevant stock exchange within 48 hours of the conclusion of the shareholders' meeting.

Every member of a company is entitled to appoint another person or persons (whether a member or not) as their proxy to attend and vote on their behalf; however, the shareholders do not have a legal right to be accompanied by legal or other counsel.

5.4 Shareholder Claims

A shareholder is entitled to certain information, rights and considerations by virtue of an ownership stake in the business. The company must protect and facilitate the exercise of shareholders' rights, such as:

- the right to participate in decisions concerning fundamental corporate changes;
- the opportunity to ask questions of the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations;
- effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of the board of directors;

- an adequate mechanism to address the grievances of the shareholders; and
- the protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders.

The Companies Act contains provisions for shareholders' litigation and allows class action suits to be filed by shareholders if they are of the opinion that the management of the company is being conducted in a manner that is prejudicial to the interests of the company or its members.

However, derivative shareholder lawsuits are not very common and the law relating to derivative actions in India remains unclear. Under current law, a company (and by extension, therefore, the board of directors) still holds immense power and control over the shareholders. The Companies Act prescribes the minimum number of shareholders required to apply to the National Company Law Tribunal for the protection of shareholders but, in reality, there are still several hindrances that restrict shareholders from filing a lawsuit against the company's management.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Shareholders in public companies have certain additional obligations when acquiring shares or exercising voting rights. Pursuant to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the "Takeover Code"):

- no person can acquire more than 25% of the voting rights of a company without making a prior public announcement of an open offer for shares;
- an acquirer holding 25% or more, but less than the maximum permissible limit, can purchase additional shares or voting rights of up to 5% every financial year (called the "creeping route" acquisition), without having to make an open offer;
- an acquirer who holds 25% or more, but less than the maximum permissible limit, is entitled to voluntarily make a public announcement of an open offer for acquiring additional shares subject to their aggregate shareholding after completion of the open offer, not exceeding the maximum permissible non-public shareholding;
- if the acquirer together with a person "acting in concert" acquires 5% or more shares or voting rights of the target company (together with the existing shares or voting rights held by them), the acquirer is required to disclose this to the stock exchange and the target company within two business days of the receipt of intimation of the allotment of shares or the acquisition of shares or voting rights; and
- every person, together with a person acting in concert, holding shares or voting rights aggregating to 25% or more of the voting rights in a target company shall disclose their aggregate shareholding and voting rights within seven business days from the end of each financial year.

As of February 2019, the MCA mandated companies to report details of every person directly or indirectly holding or controlling 10% or more of the shares of the company. As with most Indian disclosures, this requires the controlling person to provide their father's name, their date of birth, passport number and similar personal information, which will all be stored on a public database.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

In the past few years, the MCA has made all forms of corporate governance reporting electronic, and has mandated detailed financial reporting by all companies, whether private, public or non-profit. Almost all of these filings are publicly available in the government database and can be downloaded for a very small fee.

Annually, every company must report its audited financials within six months of the closing of the financial year and include a Directors' Report and a Directors' Responsibility Statement. These reports are required to include detailed information about the company, including the number of board meetings held in the financial year, related party transactions, the performance of subsidiaries and joint ventures, and the appointment and resignation of directors and key managerial personnel during the year.

Further, the SEBI Regulations require listed companies to report their shareholding pattern, corporate governance report, statement on investor complaints, financial statements with limited review by auditors on a quarterly basis to all stock exchanges where their securities are traded.

In January 2021, the MCA made changes to the format to be used for the reporting of financial statements whereby companies have to provide following additional information:

- disclosure of shareholding of promoters;
- maturities of long-term borrowings;
- details of immovable property;
- ageing schedule of capital work in progress, intangible property and trade payables and receivables; and
- disclosure of various financial ratios such at current ratio, debt-equity ratio, return of equity ratio, net capital turnover ratio and return of investment.

As per the new accounting rules, effective from 1 April 2022, companies using accounting software for maintaining books of accounts shall ensure that the software is capable of recording an audit trail for each and every transaction, creating an edit log with each change made in the books of accounts along with the date when such changes were made, and companies shall also ensure that the audit trail cannot be disabled. Lastly, the auditor has to certify in the audit report that the company has complied with the above requirements. Since August 2022, Indian companies that maintain their accounts in an electronic form at a location outside India are required to keep a backup of those records on a daily basis on servers physically located in India.

6.2 Disclosure of Corporate Governance Arrangements

The Directors' Responsibility Statement must state that the applicable accounting standards have been followed, and that the directors have taken proper and sufficient responsibility for the maintenance of accounting records. It must also provide information on the various stakeholders regarding the performance management of the company and how diligently and ethically they are discharging their fiduciary duties and responsibilities.

In addition to above, listed companies have to attach a report on corporate governance in its annual report. This report is required to include the composition of directors, attendance of

directors in board and general meetings, the number of shares held by directors, and the skills and qualifications of the directors, etc.

6.3 Companies Registry Filings

Every company is required to prepare and keep at its registered office books of accounts and other relevant books, papers and financial statements for every financial year. Such documents should give a true and fair view of the state of affairs of the company, and must allow reasonable free access and inspection to all shareholders. In addition, it is mandatory for every company to submit their audited financial statements and annual return to the MCA through an online portal.

There are scores of other compliance and governance reports that have to be filed, which are either periodic or event-based. All event-based reporting or filing is required to be generally completed within 30, 45 or 90 days of the event.

Publicly listed companies also have to report various events to the stock exchanges within 24 to 48 hours (and sometimes even sooner), in accordance with their listing agreement or the SEBI Regulations.

Failure to comply with this requirement will result in substantial penalties for both the company and its officers who are in default. Furthermore, if non-compliance persists for more than three years, the MCA may remove the company's name from its records, and disqualify the director from serving as a director in any other company where they hold a position as a director.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Every company in India has to appoint an external independent auditor to audit its annual accounts.

The auditor of a company is required to report to the company's shareholders on the accounts examined by them and on the various financial statements that a company is statutorily required to place at every general meeting.

Listed companies, and other companies with certain thresholds of paid-up capital or outstanding loans, can appoint an individual as an auditor, who can hold office for a maximum of one term of five consecutive years, while an audit firm can hold office for not more than two consecutive terms of five years each. Such auditors or audit firms are not eligible for re-appointment to the same company as auditor for at least five years from the time of completion of their previous term. A person cannot be appointed as the statutory auditor of more than 20 companies.

Auditors may be removed from their office before the expiry of their term only by a special resolution of the shareholders, and only after being given an opportunity to explain their position. The Companies Act provides for the various eligibility requirements, qualifications and disqualifications of auditors. Only qualified chartered accountants can be auditors and, in the case of audit firms, the majority of the partners of those firms practising in India should be qualified chartered accountants.

Auditors are required to prepare the audit report in accordance with the Company Auditor's Report Order (CARO), 2016, which requires an auditor to report on various aspects of the com-

pany, such as fixed assets, inventories, loans given by the company, deposits, cost records, the utilisation of funds and the approval of managerial remuneration.

Under the Companies Act, certain prescribed categories of company (including every listed company) are required to appoint an internal auditor to conduct the internal audit of the functions and activities of the company. The Audit Committee of the board, along with the internal auditor, is responsible for formulating the scope, functioning and methodology of the internal audit.

The government has also prescribed the Cost Records and Audit Rules, 2014, which require companies in certain sectors meeting certain turnover thresholds to mandatorily appoint a cost auditor and have its cost records audited. These companies include:

- those in the telecommunications, drugs and pharmaceuticals, sugar and industrial alcohol, fertilisers and petroleum products sectors, which are required to appoint a cost auditor if their overall annual turnover within a financial year is INR500 million or more and the aggregate turnover of the individual product or service for which cost records are to be maintained is INR250 million or more; and
- those in the arms, ammunitions and explosives, iron and steel, tanks and fighting vehicles, port services, aeronautical services, textiles, electronic machinery, ores and mineral products sectors, which are required to appoint a cost auditor if their overall annual turnover within a financial year is INR1 billion or more and the aggregate turnover of the individual product or service for which cost records are to be maintained is INR350 million or more.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The board of directors must prepare a report detailing the development and implementation of a risk management policy for the company, including the identification of any risk elements that may threaten the existence of the company. Further, in the case of listed companies, the Directors' Report must contain the Directors' Responsibility Statement indicating the adequacy and effectiveness of the internal financial control mechanism adopted by the company.

The board of directors is also required to constitute the following committees in connection with the management of risk and internal controls in a public company or companies that meet certain thresholds.

- An Audit Committee has a minimum of three directors, with the independent directors forming a majority. The Audit Committee recommends the appointment, remuneration and terms of appointment of auditors of the company, reviews and monitors the auditor's independence and performance, examines the financial statement and the auditors' report, and has the authority to investigate any of these matters.
- A Nomination and Remuneration Committee has three or more non-executive directors, of which no less than one half are required to be independent directors. This Committee identifies persons who are qualified to become directors and who may be appointed to senior management positions.
- A Stakeholders' Relationship Committee is chaired by a non-executive director and such other members as may be decided by the board. This Committee considers and resolves the grievances of stakeholders of the

company where there are more than 1,000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year.
- A CSR Committee has three or more directors, of which at least one director has to be an independent director, if a company has a turnover of INR10 billion or more or a net profit of INR50 million or more or a net worth of INR500 billion or more. This Committee formulates and recommends a CSR policy to the board and monitors its implementation by the company.

In addition, every company – private or public, and irrespective of its size, capital, turnover or net profit – is required to constitute an Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013. This Committee is required to have four members (the most senior female employee as its chairperson, two other female employees or employees who understand women's issues, and one member from an external NGO involved in women's issues). This Committee is popularly referred to as the POSH (Prevention of Sexual Harassment) Committee and is required to investigate, report and recommend action on every complaint of sexual harassment it receives, and to organise periodic lectures, workshops or seminars for gender awareness within the company.

Trends and Developments

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Wakhariya & Wakhariya is a full-service international law firm, founded in 1998, which advises international companies doing business in India, USA, UK and East Africa on corporate, commercial, regulatory, compliance, governance and transactional matters. The firm specialises in providing critical, strategic and practical advice to international clients, which include Fortune 500 companies and lawyers from international law firms. The multi-dimensional practice broadly covers the following industry sectors: telecommunications and information technology, branded and generic pharmaceuticals, healthcare, oil and gas, renewable and sustainable energy, hotels and hospitality, textiles, civil aviation, professional services, food and beverages, metals and minerals, education and non-profit.

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Transparent, Collaborative and Sustainable: The Way Forward for ESG Reporting

The post-pandemic era has seen a surge in global environmental, social and governance (ESG) investing, as investors have come to view COVID-19 as the first "sustainability" crisis of the century, one that has renewed attention towards climate change, prompting decision-makers to prioritise investments that align with a more sustainable approach. According to a 2022 investor survey report conducted by EY, 99% of international investors consider a company's ESG performance when making their investment decisions and 78% of international investors want companies to focus on tackling ESG issues that are pertinent to their operations, even if it means lower profits in the short run.

Prompted by a worldwide pool of ESG-oriented capital worth trillions of dollars, Indian businesses are swiftly integrating ESG considerations into their comprehensive business approach. They recognise that their responsibilities go beyond merely generating financial returns and encompass the creation of a positive social and environmental impact. By adopting ESG principles, companies can accelerate their growth, improve their public perception and potentially access capital at reduced costs.

India has emerged as a responsible contender with the potential to take significant action towards addressing climate change and achieving the United Nations' Sustainable Development Goals (SDGs) through various domestic regulatory initiatives. Companies in high-emitting sectors like industry and energy are subject to strict scrutiny, with the Securities and Exchange Board of India (SEBI) mandating ESG disclosures for the top 1,000 listed companies under the Business Responsibility and Sustainability Reporting (BRSR) initiative for financial year 2022-23. This reporting framework for sustainability aligns with the nine principles of the National Guidelines for Responsible Business Conduct (NGRBC) also introduced by SEBI. To attract global capital, Indian companies that fulfil specific net profit or turnover criteria must allocate a minimum of 2% of their net profits to corporate social responsibility (CSR) activities and disclose their ESG profiles.

Post pandemic scenario

In the wake of COVID-19, India's banking and non-banking sectors have shifted their focus to sustainable development, with the Reserve Bank of India (RBI) joining the Network for Greening the Financial System (NGFS) and prioritising stress testing, constructing strategies, enhancing capacity, and establishing govern-

ance structures for managing risks related to climate change. The State Bank of India has also implemented ESG-compliant lending policies for companies, while forward-looking organisations are reporting their ESG performances using globally-recognised frameworks such as the Global Reporting Initiative (GRI) and Task Force on Climate-related Financial Disclosures (TCFD).

Although the Indian corporate ecosystem is still in the early stages of optimising its transition strategy, financing requirements and ESG profiles, many large global investors have adopted well-defined ESG policies in their investment monitoring processes. Such investors capitalise on opportunities to promote ecologically impactful investing and environmental sustainability while performing exclusionary screening for socially sensitive companies and avoiding investment in entities with poor ESG parameters. Unlisted companies are also willingly disclosing their ESG practices to attract investments.

Adapting quickly: the need for improved data measurement and reporting

There is currently no standard framework for measuring ESG metrics, which can lead to inconsistent reporting and difficulty in comparing companies' ESG performance. This is particularly true in emerging markets like India, where ESG reporting is still in its introductory stage. A new comprehensive system or a common framework for ESG reporting is the need of the hour to measure ESG rating from a standard baseline, promote consistencies in reporting, increase awareness and understanding of ESG reporting, improve data availability, address regulatory guidance and reporting complexity, and promote stakeholder engagement.

While addressing ESG reporting issues, companies should prioritise the following two areas.

To align with investors on long-term value, companies must develop a deeper understanding of the sustainability expectations of investors and how corporate reporting can address their ESG priorities while meeting their disclosure needs. This involves focusing on communicating progress on material sustainability issues and opportunities to facilitate productive discussions between companies and shareholders. Such discussions can cover topics such as how the company is driving long-term value, adopting emerging reporting standards, and ensuring third-party assurance of disclosures.

Secondly, to enhance stakeholder confidence in disclosures, companies should clearly define the involvement of finance leaders in ESG reporting and establish a closer connection between sustainability and the finance function. This includes identifying the technologies, operating model and talent required to deliver on this mandate.

Key developments

A 2022 survey conducted by the RBI on climate risk and sustainable finance exposed that medium to small Indian banks are not prepared to adopt ESG norms into their existing lending models for reasons such as ambiguity surrounding the application of these rules to lenders and the lack of technology and systems to track their implementation. The RBI, while acknowledging climate change as a source of financial risk, would likely use these findings to frame guidelines and boost green finance.

In February 2023, SEBI released a consultation paper asking for comments on new ESG disclosures and ratings. Should these frameworks be implemented, large companies in India may be required to provide assurance on their ESG reporting and supply chain-level ESG disclosures, and ESG investment funds will encounter

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more stringent portfolio and stewardship criteria to enhance transparency and mitigate the risk of greenwashing.

To satisfy the need for ESG disclosure assurance, SEBI has introduced the "BRSR Core" in their consultation paper, comprising of specific key performance indicators (KPIs) for diverse E, S and G factors that require assurance. The top 250 companies will have mandatory assurance beginning next year, followed by the top 500 companies the following year, and the top 1,000 after that. For the supply chain, the regulator is proposing ESG disclosures according to the BRSR Core for the top 250 companies on a comply-or-explain basis from 2024, with assurance beginning the following year.

Regarding ESG investing, SEBI's consultation paper presents several recommendations to increase disclosure for ESG funds and improve transparency, with a particular emphasis on mitigating the risks of mis-selling and greenwashing.

The consultation paper proposes certain measures for ESG ratings providers, including an India-specific list of ESG parameters and mandating the providers to provide a "Core ESG Rating" based on information that has undergone auditing or assurance.

The future of corporate sustainability

Although ESG reporting expectations are changing rapidly, the general direction towards specific frameworks, transparency and greater participation from various committees and departments within companies is apparent. Companies may need to adapt quickly to advance their climate data measurement and reporting and to drive decision-making regarding the allocation of resources. Overall, ESG is gaining traction in the Indian corporate sector as companies recognise that incorporating sustainability principles into their operations can lead to long-term financial performance and create value for all stakeholders.

Board Diversity

Diversity on corporate boards has become increasingly significant in recent years, drawing greater scrutiny and attention. One aspect of this issue is the underrepresentation of women on corporate boards, particularly in countries like India where gender inequality remains a pervasive issue. Despite comprising almost 50% of the population, women are significantly underrepresented in leadership positions, which has led to calls for greater board diversity and efforts to ensure that women are better represented in corporate decision-making.

In India, promoting board diversity could be a key factor in improving business performance. Diversified boards achieve a range of benefits, such as improved decision-making, fostered creativity and innovation, a better understanding of diverse customer needs, enhanced reputation and increased profitability. By embracing diversity on their boards, companies in India can unlock a wealth of knowledge, perspectives and experiences that can help them thrive in an ever-evolving market, while also contributing to a more inclusive and equitable society.

In recent years, there has been a growing demand for board diversity in India, with policy makers, investors, business leaders and governing bodies all recognising the importance of diverse perspectives in corporate decision-making. The government and regulators in India have undertaken the following initiatives to diversify the Indian corporate boards.

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Appointment of female directors under the Companies Act, 2013

The Companies Act, 2013 (the "2013 Act" or the "Act") introduced a revolutionary provision aimed at promoting gender equality and increasing female representation in corporate decision-making in India. The second proviso of Section 149(1) of the Act requires certain companies to have at least one female director on their board. This requirement applies to both listed companies and public companies with a share capital of INR1 billion or a turnover of INR3 billion in the previous financial year.

Failure to comply with the provision mandating the appointment of female directors under the 2013 Act may result in a default under the Act and may attract penalties for both the companies and the defaulting directors and officers.

The SEBI Regulations

The requirement for companies to have female director on their board is not only reflected in the 2013 Act but also in the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the "SEBI Regulations"). The SEBI Regulations are applicable to all listed entities in India and stipulate that companies must have an optimal combination of executive and non-executive directors on their board, including at least one female director. For the top 1,000 listed entities, the SEBI Regulations go further and mandate the appointment of at least one independent female director. These additional mandates demonstrate the Indian regulatory authorities' commitment to promoting gender diversity and inclusion in the country's corporate sector and ensuring that companies uphold their legal obligations to promote gender equality.

Business responsibility and sustainability reporting

As outlined above, SEBI has recently introduced a new reporting framework – BRSR – which requires the top 1,000 listed entities in India to disclose certain information related to ESG issues, including diversity in the workforce. In particular, companies are expected to provide various disclosures related to female workforce.

India has made significant strides in promoting gender diversity on corporate boards through aforesaid regulatory mandates. As a result, women now hold approximately 18% of board seats in India, marking a significant increase from previous years. Additionally, 95% of NIFTY 500 companies have complied with the requirement to appoint at least one female director on their boards, highlighting the growing recognition of the importance of diverse perspectives in corporate decision-making. Despite these initiatives, there is still a long way to go to achieve true diversity on corporate boards in India. Women are still vastly underrepresented on boards, and there is a lack of diversity in terms of ethnicity, age and expertise. Companies need to take a more proactive approach to promote diversity and inclusion on their boards, and although the initiatives by SEBI are a step in the right direction, policymakers need to continue to create a regulatory environment that supports these efforts.

Physical Verification of Office

In a move to combat fraudulent activities such as registering shell companies, use of fake addresses and falsified documents and maintaining inappropriate records, the Ministry of Corporate Affairs in India (MCA) has recently introduced a new amendment to the Companies (Incorporation) Rules, 2014. The amendment, known as the Companies (Incorporation) Third Amend-

ment Rules, 2022, includes the addition of Rule 25B, which mandates physical verification of registered office addresses by the Registrar of Companies (RoC). This amendment is intended to ensure that the government and other stakeholders of companies maintain accurate and up-to-date records, thus enhancing transparency and accountability in the corporate sector.

According to Rule 25B, the RoC is empowered to conduct the physical verification of the registered office of the companies in the presence of two independent witnesses from the local area where the registered office is located. The RoC can also take the assistance of the local police, if necessary, to facilitate the verification process.

Existing law

Having a physical registered office address is mandatory for every company in India, the location of the physical address is required to be reported to RoC at the time of incorporation and in case of any change through an e-form on the MCA portal. The power to conduct physical verification was first granted to the RoC in 2018 through an ordinance and was subsequently included in the 2013 Act in 2019 through an amendment. This power enables the RoC to conduct physical verification where there is a reasonable cause to believe that the company is not carrying on any business or operations. While the Act has not provided the procedure for conducting physical verification, this new rule outlines the appropriate method for carrying out physical verifications.

Procedure for conducting physical verification

For carrying out physical verification, the RoC is required to visit the registered office address of the company and conduct physical verification in the presence of two independent witnesses of the locality. The RoC may also seek for the help of police, if required. The RoC may cross-verify the authenticity of the documents reported by the companies on the MCA portal and also take photographs of the premises for the same. Upon completion of the physical verification, a comprehensive report containing various details must be prepared.

Consequences

If the RoC determines that the registered office of the company is unfit to receive/acknowledge communication, a notice shall be sent to the company and its directors informing them of the intention to strike off the company from the Register of Companies. The company and its directors will be given a 30-day period to provide their representations in response to the notice.

Decriminalisation of Offences

The 2013 Act plays a vital role in regulating the operations of corporate entities in India. It aims to ensure accountability to stakeholders, promote transparency in corporate affairs and establish effective corporate governance norms. To achieve these objectives, the Act imposes stringent penalties, fines, and even imprisonment in some cases, for companies and their officers in case of defaults and offences. This helps to enforce compliance and promote ethical business practices, ensuring that companies act responsibly and in the best interests of their stakeholders.

Offences under the Act are classified into two categories: compoundable and non-compoundable offences. Compoundable offences refer to those offences that are punishable with a fine, imprisonment or both, and can be settled through payment of a fee or by reaching a compromise with the compounding authorities. Non-compoundable offences, on the other hand, are

more severe and cannot be settled through payment of a fee or by reaching a compromise. These offences are punishable with both a fine and imprisonment or with imprisonment alone, depending on the gravity of the offence committed.

Over the past few decades, Indian corporate legislation has undergone significant change and one such reform is the decriminalisation of offences under the Act. This move is part of a broader effort by the Indian government to promote the ease of doing business in the country and create a more conducive environment for corporate growth and development. Another reason for the decriminalisation of offences under the Act is to reclassify procedural, technical and minor non-compliances as civil liabilities instead of criminal offences, which helps to ensure that such violations do not burden the criminal justice system unnecessarily.

To date, the government of India has decriminalised more than 46 compoundable offences where originally imprisonment was a consequence of contravention. In addition, various penalties and fines have also been reduced.

Impact of decriminalisation

The impact of decriminalisation of offences under the Act has been largely positive. It has reduced the burden of compliance on companies and improved the ease of doing business in India. By categorising offences and allowing for in-house adjudication, minor procedural and technical defaults can be resolved without resorting to prosecution in special courts.

The decriminalisation of offences under the Act is a complex and contentious issue. While proponents argue that it will reduce the burden on the criminal justice system and promote a more business-friendly environment, opponents contend that it will weaken the regulatory framework and reduce the deterrence against corporate malfeasance.

However, it is essential to ensure that companies remain accountable for their actions and that effective measures are in place to prevent corporate wrongdoing. This can include strengthening civil penalties, improving corporate governance practices, and promoting a culture of ethical conduct and transparency in the business sector.

IRAQ

Law and Practice

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Contents

1. Introductory p.278

1.1 Forms of Corporate/Business Organisations p.278
1.2 Sources of Corporate Governance Requirements p.280
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.280

2. Corporate Governance Context p.280

2.1 Hot Topics in Corporate Governance p.280
2.2 Environmental, Social and Governance (ESG) Considerations p.280

3. Management of the Company p.280

3.1 Bodies or Functions Involved in Governance and Management p.280
3.2 Decisions Made by Particular Bodies p.281
3.3 Decision-Making Processes p.282

4. Directors and Officers p.282

4.1 Board Structure p.282
4.2 Roles of Board Members p.282
4.3 Board Composition Requirements/Recommendations p.283
4.4 Appointment and Removal of Directors/Officers p.283
4.5 Rules/Requirements Concerning Independence of Directors p.283
4.6 Legal Duties of Directors/Officers p.283
4.7 Responsibility/Accountability of Directors p.283
4.8 Consequences and Enforcement of Breach of Directors' Duties p.283
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.284
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.284
4.11 Disclosure of Payments to Directors/Officers p.284

5. Shareholders p.284

5.1 Relationship Between Companies and Shareholders p.284
5.2 Role of Shareholders in Company Management p.285
5.3 Shareholder Meetings p.285
5.4 Shareholder Claims p.286
5.5 Disclosure by Shareholders in Publicly Traded Companies p.286

6. Corporate Reporting and Other Disclosures p.286
6.1 Financial Reporting p.286
6.2 Disclosure of Corporate Governance Arrangements p.286
6.3 Companies Registry Filings p.286

7. Audit, Risk and Internal Controls p.287
7.1 Appointment of External Auditors p.287
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.287

AMERELLER is a leading international law firm focused on the Middle East. It has more than 60 lawyers working in fully integrated offices in Basra, Baghdad, Berlin, Cairo, Dubai, Erbil, Munich, Ras Al Khaimah and Tripoli. The offices are legally separate entities, as required by applicable law, but managed and operated as a single law firm. Its Baghdad office was established in 2003 and is a full-service office, advising local and international corporate clients, government authorities as well as NGOs in all areas of commercial and corporate law, including general corporate governance issues, director duties and obligations, and corporate housekeeping. The offices in Baghdad and Erbil are each staffed with teams of seven locally admitted lawyers. The firm has advised major international companies and organisations on their entry strategy to Iraq, and continues to provide legal and strategic advice on major investments including infrastructure projects, project financing, direct investments, real estate, M&A, general commercial transactions and day-to-day legal matters.

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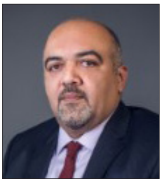

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Non-public companies in Iraq are established in accordance with the Companies Law No (21) of 1997, as amended by Law No (17) of 2019 ("Companies Law"). The Companies Law recognises two types of companies:

- private companies, in which public sector participation, if any, is limited to 25% of share capital; and
- mixed companies, in which private persons and public entities jointly establish an entity with at least 25% public sector participation.

Private companies may take the form of a limited liability company (LLC), joint-stock company (JSC), general partnership, individual enterprise or simple company. Mixed companies may only take the form of LLCs or JSCs.

The entities most commonly registered by persons conducting business in Iraq are limited liability companies and branches of foreign companies.

The Companies Law now requires LLCs and JSCs to hold at least 51% Iraqi shareholding capital (by Iraqi individuals or corporations). It should be noted that the Companies Law as amended does not apply to the Kurdistan Region of Iraq (KRI), as to date it has not been passed by the Kurdish Parliament. As such, 100% foreign participation is permissible in the KRI.

The Iraqi Constitution provides the Kurdish Parliament with legislative powers, with the exception of certain matters that are reserved to the federal government. As far as the Kurdish legislature has not made use of the legislative competencies conferred on it, Iraqi federal law applies if it has been either adopted by the Kurdish legislature or enacted prior to 1992.

On the other hand, the Kurdistan Regional Government has its own ministries and authorities that mirror those of the federal government; however, they operate independently of the federal authorities. This results in the need to register an entity in parallel in the KRI and in Baghdad.

Unless otherwise expressly indicated, references to any law, instruction or regulation is a reference to such a statute as applied in Federal Iraq.

Limited Liability Company

An LLC may be established by a maximum of 25 shareholders. There is no minimum requirement. The shareholders may be legal entities or individuals, or a combination of both.

The general assembly of shareholders appoint and determine the powers of the managing director, who may be a foreign national.

The minimum capital for an LLC is IQD1 million. Any public subscription of shares in an LLC is prohibited.

Joint-Stock Company

A mixed or private JSC is founded by at least five shareholders, and their liability is limited to the amount payable on their shares.

The general assembly of shareholders elect the board of members which governs the JSC. The board of a private JSC is composed of a minimum of five and a maximum of nine members. The board of members then elects the chairman and deputy chairman from among its members. The liability of the board of directors is the same as that of the managing director of an LLC.

The minimum share capital of a JSC is IQD2 million. Unlike an LLC, part of the shares of a JSC must be offered to the public for subscription. The public subscription must be completed before a certificate of establishment can be issued.

Insurance and financial investment companies are required to register as JSCs.

Other possible entities under the Companies Law include the following.

- General partnership – a general partnership is an association of two or more persons who are jointly and severally liable for partnership debts. The minimum capital requirement is IQD50,000.
- Individual enterprise – an individual enterprise consists of one natural person who owns the single share and is personally liable for the enterprise's debts to the full extent of his personal assets.
- Simple company – a simple company is established by a minimum of two and maximum of five partners. The partners may also contribute to capital through services. The establishment process is, as the name suggests, extremely simple.
- Holding company – the holding company may be in the form of a JSC or LLC, and has control over one or more JSCs or LLCs. The holding company was introduced as a permissible type of company under the newly amended Companies Law.

Branch of a Foreign Company

A common registered entity is the branch of a foreign company. It should be noted that the commercial activity of the branch is limited to the registered activity of the foreign company. The foreign company would also be liable for any liabilities of the branch. The registration requirements for branches in Iraq are stipulated in Regulations No (2) of 2017 on Foreign Companies' Branches.

For the registration of a branch in Federal Iraq, the foreign company must have been established at least two years earlier. Any managerial changes must be approved through a shareholders' resolution by the parent company.

1.2 Sources of Corporate Governance Requirements

The main source of law related to corporate governance requirements in Iraq is the Companies Law. No code or regulation has to date been enacted specifically to regulate corporate governance matters.

The Companies Law sets out most of the corporate governance rules, determining managerial powers and responsibilities of the different bodies within the company.

The articles of association may also set out rules and requirements, though this is not particularly mentioned in the law. However, the document must at a minimum include the following:

- name and form of the company;
- the company's objects and type of business;
- address of head office in Iraq;
- name, nationality and profession of founder(s);
- share capital, amount of cash and in-kind contributions, a description of any contributions in kind, and names of the contributors; and
- number of elected members on the board of directors (in a JSC).

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Joint-stock companies are the only type of entity in Iraq whose shares may be publicly traded. It is required for a part of the shares to be offered for public subscription.

The chairman or deputy chairman may not also be the managing director of the JSC.

The following committees are to be established comprising members selected from the board of directors:

- audit committee to recommend external, independent auditors; and
- compensation committee to determine the remuneration of board members and the managing director.

Committee members may not be officers, employees or holders of 10% or more of shares in the company.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

There are no other key corporate governance rules and requirements to be drawn out in Iraq.

2.2 Environmental, Social and Governance (ESG) Considerations

There are no laws or regulations for companies regarding environmental, social and governance (ESG) issues. These provisions may be provided for in the company's internal policies or articles of association based on standard international practices in this area.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The general assembly of shareholders consists of all members of the company and is considered the highest authority of the company, according to the Companies Law.

The general assembly of an LLC appoints and determines the authorities of the managing direc-

tor and deputy managing director. The deputy managing director may carry out the managing director's responsibilities in the latter's absence. A managing director's functions involve carrying out the day-to-day business operations of the LLC.

Private JSCs are governed by a board of directors consisting of a minimum of five and a maximum of nine members elected by the general assembly.

Being a member of the board of directors is subject to the following eligibility requirements:

- they must be legally qualified and not banned from managing a company under law or legal decision; and
- they must own no fewer than 1,000 shares – any number below this must be increased to meet the minimum within 30 days of membership.

The board must elect the chairman and deputy chairman from among its members. The managing director is not required to be a board member. However, the managing director may not also be the chairman, and cannot be the managing director of any other joint-stock company.

The powers of the board of directors are determined by the Companies Law and mentioned in **3.2 Decisions Made by Particular Bodies**.

3.2 Decisions Made by Particular Bodies

Shareholders

As the governing body of the LLC, the general assembly of shareholders may deal with any matter that is in the company's interest. The shareholders appoint, remove and determine wages and powers of the managing director and must also approve the LLC's budget, final accounts and annual plan.

Managing Director

Under the Companies Law, the responsibilities of the managing director in an LLC are the same as that of the board of directors of the joint-stock company, subject to the decisions of the general assembly.

The managing director must carry out the tasks within the powers assigned by the general assembly (or board of directors in the JSC).

Board of Directors

In a JSC, the board of directors must meet at least once every two months at the request of the chairman or any one of its members. The board is responsible for the necessary administrative, financial, planning, organisational and technical duties of the company's business, except those which fall under the powers of the general assembly. In particular, the board of directors has the following powers.

- Appointment of the managing director and determining his remunerations and authorities.
- Dismissal of the managing director.
- Implementation of the general assembly's decisions and follow-up thereof.
- Evaluating an annual plan for the company's activities as prepared by the managing director.
- Preparing final accounts of the previous year, to be reported to the general assembly along with the results of the annual plan.
- Following up on implementation of the annual plan with periodic reports to the auditor.
- Preparing statistical studies to further develop the company's business.

- Making decisions related to loans, mortgages and securities.
- Establishing an audit committee within its board to recommend external, independent auditors. The audit committee is responsible for meeting the auditors and ensuring the accuracy of their work.
- Establishing a compensation committee from its board to recommend the compensations for the board and managing director. These committee members must be impartial and may not be employees or own 10% or more of the company's shares.

The chairman must sign any decision made by the board of directors and follow up on the implementation of such decisions.

3.3 Decision-Making Processes

The Shareholders (General Assembly)

The general assembly of shareholders makes decisions through meetings, which are required to be held twice a year, or once a year in the case of a joint-stock company. The details of the meeting process are found in **5.3 Shareholder Meetings**.

The Board of Directors

The board of directors must meet seven days after the formation of a company and shall elect the chairman and deputy chairman for a one-year term that is renewable.

The board of directors is required to meet at least once every two months at the invitation of the chairman or any of its other members. The meeting should be held at the company's head office or as determined by the chairman if the head office is not an option at that time.

Board decisions are reached through an absolute majority of the votes. In the case of a tie, the chairman's vote prevails.

4. Directors and Officers

4.1 Board Structure

The board of directors is composed of between five and nine members elected by the general assembly. The membership lasts three years and is renewable. The board of directors appoints a chairman and deputy chairman.

In a mixed JSC, the board of directors consists of seven members, two of whom represent the public sector and five of whom are elected by the general assembly. The composition would be three and four members respectively if the public sector's share capital exceeds 50%.

4.2 Roles of Board Members

Board Members

The board members appoint and dismiss the managing directors, carry out the general assembly decisions, prepare final accounts, and handle the administrative, financial, planning, organisational and technical duties of the company, as stated in the Companies Law.

Chairman

The chairman is required to follow up on the implementation of the decisions made by the board of directors. The chairman's vote determines the result of the board decisions whenever there is a tie.

Deputy Chairman

The deputy chairman, also appointed by the board of directors, shall replace the chairman in his absence. The deputy chairman may not become the managing director.

4.3 Board Composition Requirements/Recommendations

There must be between five and nine members of the board of directors in a private JSC. Each board member must own at least 1,000 shares in the company. The board members may be freely determined by the shareholders, as long as they are legally qualified under the applicable laws.

4.4 Appointment and Removal of Directors/Officers

LLC

The managing director and deputy managing director of an LLC are appointed by the general assembly and may only be removed by the general assembly.

The LLC must also have one auditor and one legal advisor, who must be Iraqi nationals. These officers are also appointed and dismissed by the general assembly.

JSC

The general assembly may elect or dismiss a chairman or board member through a secret ballot held during its meeting. The chairman or deputy may also be considered as having resigned if they fail to attend three consecutive meetings or successive meetings for over six months and without a legitimate reason.

The board of directors appoints a managing director and has the power to remove him through a decision. The decision must cite the reasons for removing the managing director and should be signed by the chairman. The same steps apply for the appointment and removal of a deputy managing director.

4.5 Rules/Requirements Concerning Independence of Directors

The Companies Law states that the chairman or board members cannot have any direct or indirect interest in any business or transaction undertaken by the company, except where the general assembly grants approval after being made aware of the nature and extent of the interests. The chairman or board member will be directly liable for any damage that may arise in violation of that rule.

Voting on a matter in which the chairman or board member has direct or indirect interests is also prohibited unless a majority of the members grant permission after the nature and extent of the interests are disclosed.

4.6 Legal Duties of Directors/Officers

The Companies Law provides that the chairman and members of the board of directors shall do their best to serve the company's interests and run the company in a sound and legal manner. They are liable to the general assembly in carrying out these duties.

They must also disclose any direct or indirect interests they have with regard to any transactions and dealings with the company.

4.7 Responsibility/Accountability of Directors

The board of directors are responsible before the general assembly in carrying out their duties. They are required to serve the interests of the company as they would their own personal interests.

4.8 Consequences and Enforcement of Breach of Directors' Duties

An inspection may be requested by a shareholder of more than 10% of share capital, the manag-

ing director of a company, or a member of the board of directors in the case of a JSC, if there are reasonable grounds to believe that there is a violation of law, shareholders' resolution or the company's articles of association.

The inspectors will be determined by the Registrar of Companies ("Registrar"), who would then inform the relevant authorities so that action may be taken in the case that there is a breach of duties by a director or manager. The Registrar would thereby also guide the company based on the findings of the report.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Directors or officers shall be held liable if the duties mentioned in **4.6 Legal Duties of Directors/Officers** are proven to be violated.

The liability of LLC shareholders towards third parties is limited to the nominal value of their shareholding. However, Iraqi courts have yet to develop a consistent doctrine concerning the liability of shareholders and/or managers towards third parties.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

All payments to current or previous board members or managing directors must be included in a detailed report on the final accounts to be submitted to the shareholders.

The shareholders determine the remuneration of the managing director of an LLC.

In a JSC, the general assembly of shareholders fixes the remuneration of the chairman, deputy chairman and other members of the board of directors, which must be in proportion to the latter's scope of work and fulfilment of the company's plans and profits. The board of directors determines the remuneration of the managing director.

Although the consequence is not specified in the law for non-compliance with the approval requirements, inspections may be carried out by the Registrar, who must inform the responsible authorities for any questionable findings in their report in order for the appropriate action to be taken. This could lead to suspension of the company's file at the Registrar and possible fines.

4.11 Disclosure of Payments to Directors/Officers

No public disclosures with regard to remuneration, fees or benefits to directors or officers are required to be made.

As mentioned previously, the final accounts report disclosed to the shareholders must include the payments received by board members or the managing director in cash or in kind.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The Companies Law governs the relationship between the company and its shareholders.

Shareholders may not use their powers and voting rights for their own personal gain and make decisions which harm or put the company at a disadvantage. Furthermore, they may not withdraw capital or transfer assets if prohibited or if insolvency is imminent.

Shareholders of over 10% of the shares of a company may propose items to be included in

the agenda of the general assembly meeting, which must then be passed by the majority of shareholders present there.

The general assembly of shareholders has the following powers in the company:

- fixing remuneration of chairman and board members;
- discussing and approving the founder(s)' report regarding establishment procedures;
- electing and dismissing representatives of shareholders within the board of directors;
- making decisions on reports from the board of directors or managing director, as well as the auditor;
- discussing and approving final accounts;
- discussing and approving the proposed annual plan and budget (not applicable to JSCs);
- appointing and fixing remuneration of the auditor (not applicable to JSCs);
- making decisions on proposals regarding loans, mortgages and securities (for LLCs);
- approving the percentage of profits to distribute among members; and
- approving employment rules in the case of a mixed joint-stock company.

5.2 Role of Shareholders in Company Management

According to the Companies Law, the general assembly of shareholders is the governing body of the company. It is the body which elects and dismisses representatives of shareholders in the board of directors.

The general assembly of shareholders also makes decisions on the reports from the managing director of the company or board of directors of a JSC, as well as the auditor's reports. It is also authorised to appoint and determine the wages of an auditor, and approve the company's final accounts, proposed annual plan and budget, except in the case of a JSC. Other matters include decisions on borrowing. In the JSC, the shareholders determine the wages of the board of directors, including the chairman and deputy chairman.

5.3 Shareholder Meetings

Iraqi law does not distinguish between ordinary and extraordinary shareholders' meetings.

The general assembly is required to hold two meetings a year, or once a year if it is a joint-stock company, by invitation of the founder(s) of the company (for the constituent meeting held within 30 days of the issuance of the company's certificate of establishment), chairman of the joint-stock company or managing director in other companies, or at the request of members of the company who own at least 10% of the paid-up capital. The meeting may also be called upon by the Registrar or the auditor.

General assembly resolutions are passed through a simple majority of votes. Votes may be made in person or by proxy. A proxy may be issued to another shareholder or a third party, and must be deposited with the company three days prior to the meeting. Resolutions may not be passed unless a majority of the members are present.

In an LLC, the general assembly may determine appointment, wages and managerial authority, as well as approve budgets and annual plans. In the JSC, the general assembly elects and determines the wages of the board of directors.

Decisions by the general assembly are to be kept in a special register and signed by the chairman.

The company administration should inform members of their invitation to the meeting or send it to their postal addresses. In a JSC, the invitation to a meeting must be issued in the Registrar's bulletin, two daily newspapers and the Baghdad Stock Exchange.

5.4 Shareholder Claims

Shareholders who hold at least 10% of the share capital may request inspection of the company if there are reasonable grounds to believe that the company has violated a provision of the Companies Law, the company's articles of association, or a resolution passed by the general assembly.

Shareholders who hold at least 5% of the shares may object to a resolution of the general assembly by petition to the Registrar within seven days of the resolution being passed.

5.5 Disclosure by Shareholders in Publicly Traded Companies

The Registrar must be provided with all data in relation to the subscription process, the names of subscribers and number of shares, and amounts paid against the value of shares.

There are no specific obligations in relation to the ultimate beneficial owner of publicly traded companies. The owner of record is the legal owner as far as the authorities are concerned.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

The managing director of a company is required to prepare the final accounts within the first six months of each year, write a detailed report on them, and submit them all to the general assembly. In a JSC, the board of directors is responsible for this. The board must also submit periodic reports to the auditor and an annual report to the general assembly regarding the results of the implementation of the annual plan.

The final accounts would also be audited by external auditors appointed by the general assembly. The auditors will provide a report to the company that addresses their findings and the extent of the accounts' compliance with the law and the company's articles of association.

Copies of the final accounts and the related reports must be submitted to the Registrar.

6.2 Disclosure of Corporate Governance Arrangements

There are no particular corporate governance arrangements required to be disclosed in these reports.

6.3 Companies Registry Filings

The general assembly meeting notes and decisions should be recorded in the minutes of the meeting and sent to the Registrar within four days of being implemented. Copies of the final accounts, annual plan and related reports must also be sent to the Registrar.

General assembly meetings regarding the final accounts must be notified to the Registrar, and the following must be sent:

- the annual list;
- the final accounts of the previous year and the auditor's report; and
- the managing director's or board of directors' report on the annual plan of the previous year.

The Registrar is entitled to obtain any document from the company for the purpose of carrying out its responsibilities under law.

None of the filings made with or sent to the Registrar are made publicly available.

The company may be subject to inspection by the Registrar for any violation of the aforementioned. Any questionable findings will be reported to the responsible authorities in order for the appropriate action to be taken and will lead to suspension of the company's file and payment of fines. If the Registrar is prevented from seeing the company's records or documents, the company official responsible for this action shall be, according to the Companies Law, subject to imprisonment of up to six months or a fine of up to IQD12 million.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

External auditors are appointed by the general assembly and are required to evaluate a company's final accounts based on the law and the company's articles of association, and should apply international accounting standards.

In a JSC, external auditors are selected by the audit committee established by the board of directors. The external auditors meet with the audit committee and apply international accounting standards in their work. They may be subject to questions regarding the accuracy and correctness of their reports.

In a mixed company, the accounts are required to be audited by the Financial Control Bureau.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The board of directors of a JSC is required to establish an audit committee within the board that will recommend external, independent auditors. These members may not be officers or employees of the company, or hold 10% or more of its shares.

The board of directors of a JSC, or managing director in the case of other companies, must also prepare a report in relation to the final accounts that includes details on the company's activities, such as any transaction in which major shareholders, board members or the directors have a direct or indirect interest.

The chairman of a JSC, or managing director in the case of other companies, must sign the company's final accounts and shall be liable for the correctness of the statements.

Trends and Developments

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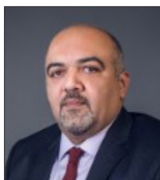
AMERELLER is a leading international law firm focused on the Middle East. It has more than 60 lawyers working in fully integrated offices in Basra, Baghdad, Berlin, Cairo, Dubai, Erbil, Munich, Ras Al Khaimah and Tripoli. The offices are legally separate entities, as required by applicable law, but managed and operated as a single law firm. Its Baghdad office was established in 2003 and is a full-service office, advising local and international corporate clients, government authorities as well as NGOs in all areas of commercial and corporate law, including general corporate governance issues, director duties and obligations, and corporate housekeeping. The offices in Baghdad and Erbil are each staffed with teams of seven locally admitted lawyers. The firm has advised major international companies and organisations on their entry strategy to Iraq, and continues to provide legal and strategic advice on major investments including infrastructure projects, project financing, direct investments, real estate, M&A, general commercial transactions and day-to-day legal matters.

Authors



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1. Commercial Agency in Iraq

Iraq has seen a growth in the automotive market since 2021, with the industry providing an important source of revenue in the private sector market in the country. Foreign investment in the automotive industry is as strong as ever, and big and small players alike are investing in the region as vehicle sales continue to surge.

Though the commercial agency law has never been strictly applied in practice, the government has started taking gradual steps in applying it, notably in the automotive market. However, the government has not yet requested any distributor to register as a commercial agent upon import of the vehicles, though there have been cases where distributors or dealers trying to make a deal with the government have been requested to provide proof of registration in accordance with the commercial agency law.

Iraq's new commercial agency law, No. 79 of 2017, introduced many changes, notably the following:

- prohibition of importation unless it is through an authorised agent; and
- protection from termination for registered agents.

The previous commercial agency law, passed in 2000, was never strictly enforced. And though the more recent law has not been implemented in practice, especially with regard to the import restriction, the authorities are increasingly applying it to certain cases. The increasing implementation by the authorities is likely to affect foreign investment in Iraqi import businesses. Though the scope and practical implementations remain unclear, some of the possible ramifications could include changes to business structures such as shareholding.

As the Iraqi automotive market continues to be one of the largest in the Middle East, foreign companies that are looking to expand in Iraq or are already in the market will need to consider the possible registration or restructuring requirements brought about by the possible enforcement of the provisions of the commercial agency law.

2. Legal Background

2.1. Previous Commercial Agency Law No. 51 of 2000

Iraq passed its first commercial agency law, Law No. 51 of 2000, and created a framework for the registration of Iraqi businesses as commercial agents of imported goods and services. This law was never strictly enforced. For instance, although exclusivity was not required by law, there were instances where the Ministry of Trade prohibited registration of a new agency on the grounds that there was already an existing registered agent. In practice, any business lawfully operating in Iraq was able to import into Iraq.

The Iraqi Civil Code contains certain provisions regarding commercial agencies which are applied in addition to the specific provisions of the commercial agency law (Articles 927-949).

2.2. New Commercial Agency Law No. 79 of 2017

A new commercial agency law was approved in 2017 by the Iraqi Parliament and published in the Official Gazette on 13 November 2017. The new commercial agency law was published as Law No. 79 of 2017.

Although this new law was effective from its date of publication in the Official Gazette, businesses experienced little to no change and the practice remained the same during the years following the passing of the law.

2.3. Applicability to Kurdistan Region

Federal laws that were passed after 1992 are enforced in the Kurdistan Region of Iraq ("KRI") only after they have been ratified by the Kurdistan Parliament.

The commercial agency law of 2017 has not to date been passed by the Kurdistan Parliament, although there has been talk of amending the current law. Kurdistan continues to apply the previous legal framework, which is in theory the commercial agency law of 2000, but in practice the Civil and Commercial Codes.

3. Appointment of Agents and Distributors

Though the commercial agency law of 2017 explicitly requires foreign suppliers to appoint commercial agents or distributors when exporting to Iraq, in reality agents are rarely registered in either Federal Iraq or the KRI.

The new commercial agency law empowers the State Company for Fairs (under the Ministry of Trade) and the Customs Authorities (under the Ministry of Finance) to prohibit the import of goods for trading purposes unless such import is through a commercial agent. Though this has not been applied in practice, authorities are increasingly demanding the registration of commercial agents and distributors.

Unlike the previous law, the 2017 commercial agency law explicitly applies to distributors as well as commercial agents. This is based on the definition of "Commercial Agency" in Article 1 of the law:

"Commercial Agency: a contract whereby a natural or juristic person is appointed to sell *or distribute goods* products or provide services in Iraq in the capacity of an agent *or a distributor, or franchisee* acting on the behalf of a principal outside Iraq against a profit or commission, and who assumes after-sale services, maintenance works and the supply of spare parts for products and goods marketed by that agent." (emphasis added).

4. Commercial Agency Registration in Iraq and Kurdistan

4.1. Commercial Agent Eligibility

The laws currently applicable in Iraq and the KRI are largely the same except for some important changes as provided by the new commercial agency law. The below highlights the legal requirements and procedures present in both laws as well as where those laws differ.

In order to be granted a licence to become a commercial agent in Iraq or the KRI, the applicant must fulfil the following requirements:

- be an Iraqi citizen and reside in Iraq (where a company is going to act as a commercial representative, it must have 100% Iraqi ownership);
- be at least 25 years of age;
- have no criminal record;
- have a registered commercial office in Iraq;
- be a member of Iraqi/Kurdish Chambers of Commerce; and
- not be a public sector employee.

The old law, still technically applicable in the KRI, allows the registering of a maximum number of three agencies. However, since this is not enforced in practice, it does not act as a practical block on the commercial activity of an Iraqi business. The new commercial agency law of 2017 does not provide any such limitation.

4.2. Licence Registration and Procedure

The process of application for a licence is explained in Article 5 of both laws.

The applicant must submit an application to the Registrar of Companies (the "Registrar") along with documents which establish compliance with the eligibility requirements stipulated above. The decision by the Registrar will be issued within ten days starting from the date of submission at the Registrar. For the KRI, this would be 30 working days.

A rejection decision by the Registrar may be challenged before the Minister of Trade within 30 days from the day after the date of receipt of the rejection. The subsequent decision of the Minister of Trade is final in the KRI but may be appealed before the Administrative Court in Federal Iraq.

The licence will include a serial number, and the name and a photograph of the commercial agent. In the case of a company being the agent, the photograph will be of the company's authorised director.

4.3. Licence Renewal

4.3.1. Licence Renewal in Federal Iraq

By law, the commercial agency licence will need to be renewed within the first 60 days of each year.

The licence will be revoked if it is not renewed within the aforementioned period, or in any of the following cases:

- if the registration was based on any incorrect data or document;
- if either of the parties to the agency contract requests revocation, without prejudice to the interests of either party;
- if the foreign company has been blacklisted by Iraq;
- 90 days after the Registrar notifies the agent of the expiry of the contract; or
- if a new licence is revoked and not re-obtained within 180 days from the date of such revocation.

4.3.2. Licence Renewal in the KRI

The licence will need to be renewed every two years within 60 days of expiry, according to law. Each day of delay after this period will be subject to a fine unless the delay exceeds another 60 days, in which case the licence will be revoked.

The Registrar will revoke a licence if its requirements are no longer fulfilled, or if the agency contract has not been submitted to the Registrar within 90 days of the licence being issued. The Minister of Trade may be called upon to review the decision. Unlike in other countries of the Middle East, amicable termination and de-registration of a former agency is not a prerequisite for the registration of a new agency agreement.

4.4. Exclusivity

The commercial agency laws and the Iraqi Civil Code are silent on commission and exclusivity. Accordingly, it is up to the parties to agree on these issues.

It is advisable that all agency or distribution agreements be non-exclusive, or exclusive only if stated sales targets are achieved. Where a foreign supplier has a range of products, consideration should be given to limiting the scope of the agreement to specific products for a trial period.

4.5. Termination

4.5.1. Termination and Non-Renewal Restrictions in Federal Iraq

The commercial agency law of 2017 protects commercial agents from termination or non-renewal in the event that the principal does not have “a reason that justifies” such termination or non-renewal. No such material reasons are stated or clarified, and it therefore remains unclear what reasons could qualify for this standard. The law also does not determine whether termination without such a material reason results in a claim of compensation from the terminated commercial agent or in an invalid termination.

Furthermore, said provision does not provide a method of calculating damages in the event of unlawful termination, nor does it clarify whether it is possible to terminate even if compensation is paid.

Iraqi companies that register may benefit from this statutory protection, including companies that were previously outside the scope of commercial agency registration, such as those under distributor, dealer and franchise agreements.

4.5.2. Termination in the KRI

Article 946 of the Iraqi Civil Code provides that an agency agreement terminates when one of the parties dies, when the work which is the subject of the agency agreement is completed, or when the period of the agency agreement has expired.

Apart from the above legal reasons for the termination of the contract, the question of termination is left to the parties and should be regulated by contract. The commercial agency law applicable in the KRI does not include any provision on termination.

Whenever possible, contracts should fix sales targets to enable termination on the basis of failure to perform. Contracts should also be for a fixed period, or subject to termination without cause at the end of a fixed notice period.

4.6. Governing Law and Dispute Resolution

The previous commercial agency law of 2000 (still applicable to the KRI) did not contemplate a mechanism for dispute resolution. As such, this should be agreed between the parties.

Article 20 of the 2017 commercial agency law recognises international arbitration as a valid form of dispute resolution and non-Iraqi law as a potential governing law of the commercial agency agreement. Article 20 provides the following:

"The Principal shall not terminate the Commercial Agency contract or not renew it unless there is a reason that justifies the termination or non-renewal of it. The Commercial Agency contract may be terminated by mutual agreement between the two parties or by an agreement made between them that determines the arbitration procedures, its location and the applicable law."

The Article seems to contemplate the possibility that the parties to an agency agreement may agree on a foreign law and arbitration as a dispute resolution mechanism. It is also, however, poorly drafted. The Registrar takes the view, according to its model commercial agency contract, that the agent must include the provision that the agency contract is governed by the commercial agency law and Iraqi law, and that foreign law and arbitration are only permitted in relation to disputes. This interpretation is very strange since the purpose of a governing law and dispute resolution clause in a contract is to determine the law and jurisdiction in the event of a dispute, since such choice will be of no relevance if there is no dispute.

4.7. Compensation

Article 947(3) of the Iraqi Civil Code grants agents the right to claim compensation if they suffer damage as a result of termination at an "inopportune moment" and "without just cause". This provision, together with the general principle of good faith, sometimes serves courts as a basis for compensation awarded to agents and distributors on termination.

Although Iraqi law does not provide for any compensation payable to the agent, if the principal refuses to renew a fixed-term contract on its expiry, the exclusion of such compensation should be expressly stipulated in the agency contract.

ITALY

Law and Practice

Contributed by:
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NUNZIANTE MAGRONE

Contents

1. Introductory p.298
1.1 Forms of Corporate/Business Organisations p.298
1.2 Sources of Corporate Governance Requirements p.298
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.298

2. Corporate Governance Context p.298
2.1 Hot Topics in Corporate Governance p.298
2.2 Environmental, Social and Governance (ESG) Considerations p.299

3. Management of the Company p.299
3.1 Bodies or Functions Involved in Governance and Management p.299
3.2 Decisions Made by Particular Bodies p.300
3.3 Decision-Making Processes p.300

4. Directors and Officers p.300
4.1 Board Structure p.300
4.2 Roles of Board Members p.301
4.3 Board Composition Requirements/Recommendations p.301
4.4 Appointment and Removal of Directors/Officers p.302
4.5 Rules/Requirements Concerning Independence of Directors p.302
4.6 Legal Duties of Directors/Officers p.302
4.7 Responsibility/Accountability of Directors p.303
4.8 Consequences and Enforcement of Breach of Directors' Duties p.303
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.303
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.303
4.11 Disclosure of Payments to Directors/Officers p.305

5. Shareholders p.305
5.1 Relationship Between Companies and Shareholders p.305
5.2 Role of Shareholders in Company Management p.305
5.3 Shareholder Meetings p.305
5.4 Shareholder Claims p.306
5.5 Disclosure by Shareholders in Publicly Traded Companies p.307

6. Corporate Reporting and Other Disclosures p.308
6.1 Financial Reporting p.308
6.2 Disclosure of Corporate Governance Arrangements p.308
6.3 Companies Registry Filings p.308

7. Audit, Risk and Internal Controls p.309
7.1 Appointment of External Auditors p.309
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.309

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Under Italian law, business organisations can take the form of personal partnerships and corporations. The difference between these two types of business organisation is that corporations enjoy limited liability to the extent of the corporate capital, while participants in a partnership can be held personally liable for the activity carried out by the organisation. Furthermore, partnerships have a more simplified organisational structure.

The main forms of corporation under Italian law are joint stock corporations (*Società per azioni*-SpAs) and limited liability companies (*Società a responsabilità limita* – Srls).

In Spas, where the corporate capital is split into shares, the main corporate bodies are:

- the shareholders' meeting;
- the governing body (usually a board of directors); and
- the board of statutory auditors.

In Srls, where the corporate capital is made up of quotas, the main corporate bodies are:

- the quotaholders' meeting;
- the governing body (normally a sole director or a board of directors); and
- the board of statutory auditors (only in certain cases when required by law).

1.2 Sources of Corporate Governance Requirements

The main source of legislation regulating corporate governance is the Italian Civil Code (ICC). The Consolidated Act on Finance enacted by Legislative Decree No 58/1998, as last amended by Legislative Decree No 23/2019 (TUF), is also a primary source for listed companies. Listed companies may choose to comply (under the "comply or explain" principle) with the provisions of the Corporate Governance Code issued by the Corporate Governance Committee of the Italian stock exchange (the "Governance Code").

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

In addition to the ICC, the TUF provides for other mandatory requirements applicable to publicly listed companies. It provides for, inter alia, additional integrity and independence requirements that must be fulfilled by the individuals performing management and control roles in companies with publicly traded shares.

The Governance Code (*Codice di Autodisciplina*), issued by the Italian stock exchange, lays down further rules on the corporate governance of listed companies. Even though these rules are not binding, such companies must keep the market and their shareholders informed of their governance structure and degree of compliance with the same Governance Code.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The main hot topics in corporate governance within the Italian jurisdiction are the following.

- Sustainability and corporate social responsibility: attention is growing towards the environmental, social and economic sustainability of companies. Corporate governance must take these issues into consideration, for example through the definition of corporate

social responsibility policies, ethical codes and sustainability programmes.
- The gap between manager and employee remuneration: more attention is being paid to the gap between manager and employee remuneration. It appears necessary to guarantee correct remuneration for managers, also taking into consideration the financial sustainability of the company and the balance with the employees' remuneration and their rights.
- The role of shareholders and the participation of minorities in the strategic decisions of the company: corporate governance should be aimed at transparency and shareholder participation in the company's strategic decisions; furthermore, it should ensure adequate representation of minorities on the board of directors and in the company's decision-making processes.
- Digitisation and innovation: corporate governance must take these aspects into account, for example through the definition of data management policies, cybersecurity programmes and innovative business models.
- Crisis management: crisis management is an ever-green topic in corporate governance. Corporate governance must ensure proper crisis management, for example through the definition of contingency plans, risk management policies and internal control mechanisms.

2.2 Environmental, Social and Governance (ESG) Considerations

Legislative Decree No 254/2016, which implemented Directive 2014/95/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, provides that large companies (ie, companies that have had, during the financial year, more than 500 employees and have exceeded at least one of the following two dimensional limits: (i) total balance sheet of EUR20 million, (ii) total net revenues of EUR40 million) must present an individual declaration on non-financial information such as environmental, anti-corruption issues, human rights and board diversity.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The governance and management of the company is the responsibility of the management body.

In SpAs, the most common model of corporate governance is the traditional model (*modello tradizionale*), which establishes that the company is managed either by a sole director (*amministratore unico*), or a board of directors composed of two or more directors (*consiglio di amministrazione*).

Alternatively, the SpA may adopt:

- the two-tier or dualistic model (*modello dualistico*), according to which the company is managed by a management board (*consiglio di gestione*) which is appointed by the supervisory board (*consiglio di sorveglianza*), while the supervisory board is appointed by the shareholders; or
- the one-tier or monistic model (*modello monistico*), according to which the company is managed by a board of directors (*consiglio di amministrazione*) which is appointed by the shareholders meeting – the board of directors elects the controlling body (*comitato per il controllo sulla gestione*) from among its members.

For listed companies, the Governance Code establishes the rule that the company must provide prior information on the reasons why and manner(s) in which it intends to adopt a non-traditional model.

In Srls, the management body might be either a sole director, two or more directors, with joint or separate powers, or a board of directors composed of two or more directors.

3.2 Decisions Made by Particular Bodies

As a general rule and unless the by-laws provide otherwise, the management body has the power to manage the company and to carry out any act of ordinary and extraordinary management of the company, except for those matters reserved to the shareholders/quotaholders by the law or the by-laws, such as:

- approval of the annual financial statements and distribution of dividends within 120 days (or, in the case of postponement for justified reasons, 180 days) after the end of the fiscal year;
- appointment and remuneration of the members of the management body;
- appointment of statutory auditors and external auditors;
- responsibility of directors and statutory auditors;
- amendments to the by-laws;
- reduction of the corporate capital for loss; and
- appointment and revocation of liquidators.

In exceptional cases in which the management body is unable to perform its function, the decisions can be taken by the supervisory board.

3.3 Decision-Making Processes

The directors have joint and several power to manage the company and to carry out any act of ordinary and/or extraordinary administration; the decision process is not subject to specific formalities, but the majority rule is often used in case of disagreement on some decisions.

4. Directors and Officers

4.1 Board Structure

According to Article 2380-bis, paragraph 4, of the ICC, if the by-laws make no provision for the number of directors, but indicate only the maximum and minimum number, the number is determined by the shareholders’ meeting.

Either a sole director or a number of directors may be appointed in unlisted SpAs, but a board of directors must be appointed in listed companies.

The board of directors selects the chairperson from among its members, unless they are appointed by the meeting.

According to Article 2386 of the ICC, if in the course of the fiscal year a vacancy for one or more directors occurs, the others provide for their replacement by resolution approved by the board of statutory auditors, provided that the majority is always constituted by directors appointed by the meeting. The directors so appointed remain in office until the next meeting.

If vacancies of a majority of the directors appointed by the meeting occur, those who remain in office shall call a meeting to provide for filling the vacancies.

4.2 Roles of Board Members

In SpAs, under Article 2380-bis of the ICC, the directors are exclusively entitled to manage the company and they shall act as necessary to pursue the corporate purpose.

If the by-laws or the shareholders' meeting so allows, the board of directors may delegate its functions to an executive committee composed of some of its members.

In Srls, under Article 2475 of the ICC, when the management is entrusted to various persons, those persons represent the board of directors, but the by-laws may provide that the management is entrusted to them on a joint or several basis.

4.3 Board Composition Requirements/ Recommendations

The number of members of the board of directors is normally selected according to the requirements of the company concerned. In Italy, small and medium-sized companies normally have a board of directors composed of three or five members; in listed companies the average is 11 members. Companies in the financial sector have a larger number of directors.

Persons disabled from their rights, bankrupts and those who have been convicted with a sentence entailing legal sanction, even temporary, from public office or are unable to exercise managerial functions, cannot be appointed directors or management board members and, if appointed, shall forfeit their office. These are known as causes of ineligibility.

Special laws provide for numerous causes of incompatibility with the office of the director: eg, civil servants, holders of government positions and members of parliament cannot sit on a board of directors. Lawyers can sit but they cannot be assigned executive or managing powers. The causes of incompatibility, separate from the causes of ineligibility cited above, mean only that the person concerned must choose between the positions; thus, the resolution appointing them is not null and void.

In companies adopting one-tier systems, at least one third of the members of the board must hold the requirements of independence, which are:

- not having been deprived of their rights, bankrupted or convicted with a sentence entailing interdiction, even temporary, from public office or being unable to exercise managerial functions;
- not being a spouse or related to the directors of the company, the company, the relatives and those who are related by blood or marriage within the fourth degree to the directors of companies controlled by it, of companies that control it and of companies under common control; and
- not being related to the company or to companies controlled by it or to companies that control it or companies under common control by an employment relationship or by a regular consultancy contract or by other economic relationship that may prejudice the independence, as well as, if provided by the by-laws, requirements provided for in codes of conduct drafted by trade associations or by companies managing regulated markets.

For listed companies, the members of the board of directors must be appointed on the basis of their professional profiles, independence, knowledge and skills.

The Governance Code provides that the board shall be made up of executive and non-execu-

tive directors, as well as that an adequate number of non-executive directors (in any case, not less than two) shall be independent, in the sense that they do not maintain, nor have they recently maintained, directly or indirectly, any business relationships with the listed company, or persons linked to it, of such a significance as to influence their autonomous judgement.

Furthermore, it is not possible for a director to simultaneously hold more than five directorships in listed or non-listed companies.

For listed companies, the by-laws must always provide for mechanisms appointing the board of directors that assure a balance between men and women (the "pink share"). The gender less represented must obtain at least one third of the elected positions. The same criterion is also valid for the oversight committee in the two-tier system.

4.4 Appointment and Removal of Directors/Officers

In SpAs, adopting the traditional system or the one-tier system, as well as in Srls, the shareholders' meeting shall appoint and remove directors, using the majority principle. However, in Srls, management is usually entrusted to the quotaholders, unless otherwise provided in the company's by-laws.

4.5 Rules/Requirements Concerning Independence of Directors

The by-laws may set specific requirements for the independence of the directors. In the case of listed companies, statutory requirements are provided for the independence of directors.

As a general rule, the directors are liable for damages arising from their breach of conflict-of-interest rules. In such cases, statutory auditors, external auditors and abstaining and absent directors can challenge the resolutions adopted by the board with a vote of directors in conflict, to the extent that the vote in conflict was essential to reach the needed quorum, and the company suffered damage as a result of the decision.

In the case of SpAs, pursuant to Article 2391 of the ICC, the directors have the duty to disclose any interest they may have, personally or on behalf of third parties, in a specific transaction, indicating the nature, terms, origin and relevance thereof to the board of directors and to the board of statutory auditors and abstaining from taking any action in conflict (or, in case of a sole director, referring the decision to the board of statutory auditors). If such action is taken, the board of directors must expressly state the reason and the benefit to the company of the transaction.

Directors of listed companies who fail to disclose conflict of interests may incur criminal liability in accordance with Article 2629-bis of the ICC.

In the case of Srls, a court can be asked to declare contracts entered into by a director void to the extent that: the director acted in their own interest or in the interest of a third party; and the third party with which the director contracted was aware of the conflict.

4.6 Legal Duties of Directors/Officers

Under Article 2392 of the ICC, the directors must fulfil the duties imposed upon them by law and by the by-laws with the diligence required by the nature of the appointment and by their specific competencies. In fact, directors' specific competencies can be evaluated when determining their duties on a case-by-case basis.

4.7 Responsibility/Accountability of Directors

The management of the company is the exclusive responsibility of the directors and their primary duty and responsibility is achieving the corporate purpose. They are jointly liable to the company for damages caused by non-compliance with such duties, except for functions vested solely in the executive committee or in one or more directors. In all cases, the directors are jointly liable if, being aware of detrimental acts, they did not do what they could have done to prevent their occurrence or to reduce their harmful consequences. Liability for acts or omissions of directors does not apply to a director who, being without fault, has had their dissent recorded without delay in the relevant corporate books and has immediately given written notice to the chairperson of the board of statutory auditors.

Moreover, directors are liable towards company creditors for non-observance of their duties concerning the preservation of the company's assets.

4.8 Consequences and Enforcement of Breach of Directors' Duties

The company, the shareholders/quotaholders and third parties can enforce a breach of directors' duties and obligations, and claim damages arising out of such breaches.

In SpAs, an action for liability of the directors can be brought pursuant to a resolution of the shareholders' meeting and may be started within five years of termination of their office. A company action may also be taken by shareholders representing at least one fifth of the capital or the percentage indicated in the by-laws, which in any event cannot be higher than one third and, in companies having recourse to the risk capital market, may be brought by shareholders representing one twentieth of the capital. An action for liability against directors may also be brought by creditors when the company's assets prove insufficient to satisfy of their claims. Finally, individual shareholders and third parties are entitled to compensation for damages if they are directly damaged as a result of malice, fraud or negligence of the directors. In this case, the action may be brought within five years of the act that damaged the shareholder or the third party. In companies adopting the two-tier system, an action for liability against directors may be brought by the shareholders, as explained above, or by the oversight committee.

In Srls, an action for liability against directors may be brought by any quotaholder. Further, any quotaholder or third party who has been directly damaged by wilful or negligent acts of the directors is entitled to compensation for damages.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Directors may also operate so that the company incurs criminal and administrative liability according to Legislative Decree No 231/2003 (eg, false company communications, fraudulent bankruptcy, bribery, death or personal injury in lack of adoption of measures to protect safety at workplace, environmental pollution).

In addition, directors may also be considered personally criminally liable for the same crimes.

4.10 Approvals and Restrictions Concerning Payments to Directors/ Officers

Under Article 2389 of the ICC, directors are entitled to receive a remuneration for their activities. The directors' fee is established under the by-laws and if it is not provided therein, it may be established at the time of their appointment by

the shareholders' meeting (in the one-tier and traditional administration system under Article 2364, paragraph 1, No 3 and Article 2389 of the ICC, respectively) or by the supervisory board (in the two-tier system unless otherwise indicated in the by-laws).

Should the compensation not have been established (and there is no evidence that the directors have waived it), the directors may ask the court to set an appropriate amount.

Generally speaking, the remuneration is composed of:

- a fixed amount;
- a variable amount relating to the achievement of specific goals;
- special treatments when the termination occurs; and
- benefits like the personal use of certain company assets or an insurance policy for civil liability.

Remuneration may also be represented in whole or in part by profit sharing or by the attribution of the rights to subscribe shares of the future issue at a predetermined price.

The remuneration of directors vested with special appointments (for example, chairperson or managing directors) in compliance with the by-laws is decided by the board of directors, after having heard the board of statutory auditors.

As regards listed companies, the remuneration of directors and key management personnel shall be established in a sufficient amount to attract, retain and motivate people with the professional skills necessary to successfully manage the listed company, as well as that shall be defined in such a way as to align their interests with pursuing the priority objective of the creation of value for the shareholders in a medium to long-term timeframe.

Referred to directors with managerial powers or performing functions related to business management, as well as with regard to key management personnel, a significant part of the remuneration shall be linked to achieving specific performance objectives, possibly including non-economic objectives, identified in advance and determined in line with the guidelines contained in the general policy. The remuneration of non-executive directors shall be proportional to the commitment required from each of them, also taking into account their possible participation in one or more committees.

Listed companies must submit a document (*Piano di Remunerazione*) containing the directors' remuneration policies for the approval of the shareholders' meeting, and must establish a qualified majority for decisions on the remuneration of directors and executives.

Should the directors' remuneration document not be approved, the company may decide to resubmit it to the shareholders' meeting, after making the changes requested by it. Alternatively, the company may decide to continue applying the previous remuneration plan, if any, or adopt a temporary remuneration plan.

In any event, the non-approval of the directors' compensation plan can create tension within the company. Furthermore, non-approval can have negative consequences on the company's reputation and on investors' confidence in it.

4.11 Disclosure of Payments to Directors/Officers

There are no specific obligations to make public disclosures in relation to the remuneration, fees or benefits payable to directors and officers.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

There are two main sources from which a relationship between the shareholders and the company arise: the law and the by-laws.

Within the limits set out in the ICC, the shareholders, when they enter into the deed of incorporation of a company, are allowed to regulate several important aspects of their relationship with the company in the by-laws.

The by-laws, which can be amended only by way of resolution of the extraordinary shareholders'/quotaholders' meeting before a public notary, also establish the rules applicable to the relationship of the shareholders to each other and cover issues such as the transfer of shares/quotas, granting specific rights to certain shareholders/quotaholders, and the withdrawal and exclusion from the company.

5.2 Role of Shareholders in Company Management

According to Article 2380-bis of the ICC, board activity is characterised by autonomy and exclusivity. The shareholders cannot, therefore, interfere with the management of the business or take formal steps to require the board to pursue a particular course of action; they can only remove the directors at a shareholders' meeting or choose not to re-elect them when their tenure expires.

5.3 Shareholder Meetings

In the case of SpAs, shareholders' meetings are duly assembled with the presence of as many shareholders as represent at least half of the company's share capital, excluding shares without voting rights. The ordinary meeting passes resolutions by an absolute majority of the attendees unless a higher majority is required by the by-laws.

Extraordinary meetings pass resolutions with the vote in favour of as many shareholders as represent more than half the share capital of the company unless a higher majority is required by the by-laws.

Extraordinary meetings of companies that have recourse to the risk capital market are duly assembled when as many shareholders as represent at least half of the capital or a higher percentage provided for in the by-laws are present and such a meeting passes resolutions with a vote in favour of at least two thirds of the share capital present at the meeting. If the shareholders present do not represent the proportion of capital required for a quorum, the meeting must be called again. At the second meeting, the ordinary shareholders' meeting passes resolutions on the matters that should have been dealt with at the first meeting, regardless of the part of capital represented by shareholders in attendance, while an extraordinary meeting is duly assembled with the presence of shareholders representing more than one third of the share capital and passes resolutions with a vote in favour of at least two thirds of the share capital present at the meeting.

To participate in the meeting, if the shares are in registered form, the company shall record in the shareholders' book those shareholders who have attended the meeting or who have depos-

ited their shares. In any event, the by-laws may allow for attendance at the meeting through telecommunications or the expression of a vote by correspondence.

Under Article 2351 of the ICC, each share gives the right to vote. Other than as provided in special laws, the by-laws may provide for the creation of shares without voting rights, with voting rights limited to specific matters or with voting rights subordinated to the occurrence of certain conditions not merely dependent on the exercise of individual rights. The value of such shares cannot be higher in aggregate than one half of the capital.

Shares carrying multiple voting rights can be issued, but each multiple voting share can have up to a maximum of three voting rights.

In the case of Srls, the by-laws may provide that quotaholders adopt decisions through written consultation or on the basis of consent expressed in writing. The documents must be signed by the quotaholders and the subject matter of the resolution, as well as the consent to it, must be made clear.

Otherwise, the quotaholders' meeting must be called, in the manner established in the by-laws, when required by the directors or by quotaholders representing at least one third of the capital.

The quotaholders' meeting must also be called in the event of decisions regarding amendments to the by-laws, decisions to enter into transactions that cause a substantial change in the corporate purpose or a significant change in the rights of the quotaholders, and decisions regarding the reduction of capital for losses.

Generally, in the case of Srls, decisions are validly adopted when the number of quotaholders present represents at least half the capital and the decisions are passed by an absolute majority of the attendees. However, decisions regarding amendments to the by-laws or decisions to enter into transactions that cause a substantial change in the corporate purpose or a considerable change in the rights of the quotaholders are adopted if quotaholders representing at least half of the capital vote in favour.

Further, if provided by the by-laws, quotaholders may attend the meeting by telephone or videoconference.

5.4 Shareholder Claims

In SpAs, an action for liability of the directors can be brought pursuant to a resolution of the shareholders' meeting and may be started within five years of the termination of a director's office. A company action may also be exercised by shareholders representing at least one fifth of the capital or the percentage indicated in the by-laws, which in any event cannot be greater than one third and, in companies having recourse to the risk capital market, may be brought by shareholders representing one twentieth of the capital.

Individual shareholders and third parties are entitled to compensation for damages if they are directly damaged as a result of malice, fraud or negligence of the directors. In this case, the action may be brought within five years of the act that damaged the shareholder or the third party.

In companies adopting the two-tier system, an action for liability against directors may be brought by the shareholders, as explained above, or by the oversight committee.

In Srls, an action for liability against directors may be brought by each quotaholder.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Specific obligations of disclosure are provided for by law in publicly traded companies in relation to shares and other financial instruments.

Shares

Under Article 120 of the TUF, parties with a shareholding in an issuer of listed shares, having Italy as their home member state, in an amount greater than 3% (5% if the issuer is an SME) must notify the company and the National Commission for Companies and the Stock Exchange (CONSOB).

Under Article 117 of CONSOB Regulation No 11971/1999, parties who hold the share capital of a listed company must notify the investee company and CONSOB when:

- the threshold of 3% is exceeded, if the company is not an SME;
- the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50%, 66.6% and 90% are reached or exceeded; and
- the investment falls below the thresholds indicated under letters (a) and (b) above.

Financial Instruments

Under Article 119 of CONSOB Regulation No 11971/1999, parties who, directly or through nominees, trustees or subsidiary companies, hold an investment in financial instruments, must notify the investee company and CONSOB when:

- the thresholds of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 66.6% are reached or exceeded; and
- the investment in financial instruments is reduced under the thresholds set forth by letter (a) above.

Under Article 122-bis of CONSOB Regulation No 11971/1999, anyone who holds financial instruments to which the appointment of a member of the board of directors or of the board of statutory auditors is reserved, shall inform the issuer and CONSOB if either:

- it is able to elect on its own a member of the board of directors or of the board of statutory auditors, or it ceases to be able to do so; or
- it exceeds, with respect to the aggregate amount of financial instruments issued in the same category, the thresholds of 10%, 25%, 50% and 75%, or falls below such thresholds.

Legislative Decree No 231/2007 provided for the obligation for listed companies to identify the ultimate beneficial owners of shares with voting rights, which exceed the abovementioned thresholds.

The identity of the ultimate beneficial owners can be ascertained by listed companies by:

- the acquisition of information directly from the owners of the investments;
- the use of registers and databases: companies can use public registers and databases, such as the Companies Register or the Register of Beneficial Owners (*Registro dei Titolari Effettivi*), to verify the identity of the ultimate beneficial owners;
- the acquisition of information from financial intermediaries: companies can request financial intermediaries who manage shareholdings to provide the information necessary to identify the ultimate beneficial owners; and

- the analysis of accounting documents or the evaluation of cash flows.

In any event, listed companies must adopt suitable measures to guarantee the effective identification of the ultimate beneficial owners of the shareholdings, in order to prevent the risk of possible speculative transactions and to fight the risk of money laundering and terrorist financing.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Within 30 days of approval by the shareholders'/quotaholders' meeting, companies shall file the annual financial statements (along with the reports of the directors, the auditors and the external auditor) in the Registry of Companies (*Registro delle imprese*) kept by the territorial Chamber of Commerce.

Under Article 154-ter of the TUF, in addition to the annual financial statements, publicly listed companies shall make available to the public (at the company's headquarters, on the website and by the other means established by CONSOB) a six-month financial report containing a simplified half-year statement, interim management report and, where applicable, six-month statements from the statutory auditor or external auditor.

6.2 Disclosure of Corporate Governance Arrangements

Italian listed companies are required to publish a "Report on corporate governance and ownership structure" every year. This annual publication includes data on ownership and control structure, corporate boards, annual general meetings and related party transactions. Listed companies must also keep their website updated in order to comply with the shareholders' right to information. In particular, such companies must publish on their website a notice regarding the calling of any shareholders' meetings, a report of the relevant agenda and of the relevant records and minutes.

6.3 Companies Registry Filings

The information publicly available on a company from the Registry of Companies includes:

- the company's name, corporate capital, registered office, tax code and VAT numbers;
- the directors, shareholders (including share options) and statutory auditors;
- bonds issued (if any);
- any transfers of going concerns, mergers or demergers;
- enrolment in specific registers; and
- already approved financial statements (along with the reports of the directors, the auditors and the external auditor).

In addition to the above, it is possible to obtain from the Registry of Companies a certificate of good standing of the target, as well as copies of the by-laws, deed of incorporation, minutes of shareholders' and board of directors' meetings approving the financial statements, and any special powers of attorney granted.

As regards listed companies, in addition to the information registered with the Registry of Companies, CONSOB also makes other information publicly available, for example:

- if the company's by-laws allow the increase of voting rights;
- if the company has issued multiple voting shares (*azioni a volto multiplo*);

- the investments in financial instruments and aggregate investments;
- the extracts of shareholders' agreements;
- if the company has carried out operations on its own securities;
- communications by the holding companies; and
- other information.

The main consequences of failing to file financial statements are the following.

- Administrative fines: companies that do not file their financial statements risk incurring administrative fines, which can be very high.
- Liability of the directors: the directors of the companies can be held liable for failure to submit financial statements, and therefore can be subject to fines and be ordered to compensate for the damages caused to the company and/or its creditors.

Therefore, companies that do not file their financial statements could lose their right to certain tax breaks.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The SpAs must appoint statutory auditors and an independent auditor (either a registered accountant or an external auditing firm) when the company is required to draft consolidated financial statements or is a listed company, a bank, an insurance company or a public interest entity (PIE). Otherwise, the company has the faculty to entrust the auditing of the company's accounts to the statutory auditors.

As regards Srls, under Article 2477 of the ICC, a controlling body or an external auditor must be appointed if the company:

- is obliged to draft consolidated financial statements;
- holds the control of another company which is subject to the accounting audit; or
- has exceeded at least one of the following limits for two consecutive financial years:
  - (a) total assets of EUR4 million;
  - (b) revenues from sales and services of EUR4 million;
  - (c) average number of 20 employees during the financial year.

The duty to appoint a controlling/auditing body ceases if none of these conditions is exceeded for three consecutive financial years.

Therefore, if the above conditions are met, the Srls will generally have the possibility to choose between an external auditing firm and the appointment of a controlling body (whose members need, however, to be enrolled at the Registry of Auditors) entrusted also with the auditing of the company's accounts.

The obligation to appoint an external auditor can be included in the by-laws of the company.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The directors have the exclusive responsibility for the management of the company. According to Article 2086 of the ICC, this entails the creation of an organisational, administrative and accounting structure that is appropriate to the nature and size of the business. In companies adopting the one-tier system, a controlling body must be established within the board of direc-

tors. Unless otherwise provided in the by-laws, the board of directors shall determine the number and the appointment of the members of the committee. However, the members of the committee cannot be fewer than three in companies that have recourse to the risk capital market. The committee is formed by directors having the requirements of good repute, professional experience and independence provided for in the by-laws, who are not members of the executive committee and to whom powers or specific appointments are not delegated, and who in any event do not perform functions pertaining to the management of the company or of the companies that control it or are controlled by it. At least one member of the committee must be selected from subjects registered in the Register of Accounting Auditors.

JAMAICA

Law and Practice

Contributed by:
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Contents

1. Introductory p.314
1.1 Forms of Corporate/Business Organisations p.314
1.2 Sources of Corporate Governance Requirements p.314
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.314

2. Corporate Governance Context p.315
2.1 Hot Topics in Corporate Governance p.315
2.2 Environmental, Social and Governance (ESG) Considerations p.315

3. Management of the Company p.315
3.1 Bodies or Functions Involved in Governance and Management p.315
3.2 Decisions Made by Particular Bodies p.315
3.3 Decision-Making Processes p.316

4. Directors and Officers p.317
4.1 Board Structure p.317
4.2 Roles of Board Members p.317
4.3 Board Composition Requirements/Recommendations p.317
4.4 Appointment and Removal of Directors/Officers p.318
4.5 Rules/Requirements Concerning Independence of Directors p.318
4.6 Legal Duties of Directors/Officers p.319
4.7 Responsibility/Accountability of Directors p.320
4.8 Consequences and Enforcement of Breach of Directors' Duties p.320
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.320
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.321
4.11 Disclosure of Payments to Directors/Officers p.321

5. Shareholders p.321
5.1 Relationship Between Companies and Shareholders p.321
5.2 Role of Shareholders in Company Management p.322
5.3 Shareholder Meetings p.322
5.4 Shareholder Claims p.324
5.5 Disclosure by Shareholders in Publicly Traded Companies p.324

6. Corporate Reporting and Other Disclosures p.324
6.1 Financial Reporting p.324
6.2 Disclosure of Corporate Governance Arrangements p.325
6.3 Companies Registry Filings p.325

7. Audit, Risk and Internal Controls p.326
7.1 Appointment of External Auditors p.326
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.326

Henlin Gibson Henlin provides advice and assists clients with incorporations, including public and private companies. The firm advises management, boards of directors and special committees in connection with a broad array of corporate governance and related matters. The firm also advises on board and committee composition, including board diversity, leadership structures, as well as board functions and duties, codes of ethics and other governance-related materials designed to comply with legal and regulatory requirements and best practices. The firm has a specialisation in commercial matters, including corporate and shareholder litigation issues.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

The principal forms of business organisations in Jamaica are:

- sole traders or sole proprietors;
- partnerships – general or limited, joint ventures;
- private companies limited by shares;
- public companies limited by shares;
- companies limited by guarantee with or without a share capital;
- companies having unlimited liability; and
- branches of overseas corporations.

1.2 Sources of Corporate Governance Requirements

The principal source of corporate governance requirements for companies in Jamaica are:

- the Companies Act, 2004 (as amended);
- the PSOJ Corporate Governance Code, 2021;
- the Jamaica Stock Exchange Rules;
- the Jamaica Stock Exchange Corporate Governance Index Manual, 2020;
- the Corporate Governance Framework for Public Bodies; and
- the OECD Guidelines on Corporate Governance.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

The corporate governance requirements that exist for companies with shares that are publicly traded relate to compliance with the principles in the Jamaica Stock Exchange Rules and Rulebooks, Corporate Governance Index Framework and the PSOJ Corporate Governance Code which takes into account whether the company has regulations or policies that cover the following.

- Shareholder rights – the rights of shareholders including access to information, participation in shareholder meetings, approval of board remuneration, shareholder views or management of the control structure of the company.
- Fair and equitable treatment of shareholders – promotes the equitable treatment of shareholders, taking into account the allocation of voting rights and effective mechanisms for minority shareholder participation including the ability to influence board composition, insider trading or disclosure of related-party transactions and adequate notices of shareholder meetings.
- Stakeholders and corporate governance – stakeholder participation including the attention given to employee welfare, employee membership on boards, whistle-blowing policies, environmental issues and employee share option schemes or opportunities.
- Disclosure and transparency – the form of ownership and structure of the company in a manner that promotes openness, trust and transparency including the form of owner structure as well as the role and importance of the audit function, and the extent to which the policies are disclosed in the annual reports or on company websites.
- The board of directors – the responsibilities of the board including its oversight of policies relating to governance, disclosure and ethics, meeting frequency, the composition of the board as between independent and non-independent directors, the existence of board committees and the independent evaluation of board performance.
- Compliance with Jamaica Stock Exchange requirements – the Jamaica Stock Exchange's

regulations including whether they conform to acceptable industry standards such as the IFRS, disclosure of the top ten shareholders, connected parties of directors, shareholders and senior management, communications and timely disclosures, updated website with the company's mission vision and financial performance.

All the requirements listed above are desirable and, in the case of the JSE rules, mandatory.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Directors or other officers of the company are generally responsible for ensuring that all filings and maintenance of registers are carried out in accordance with the relevant provisions of the Companies Act. The Companies Act requires the filing of compliance documents with the Registrar of Companies (the "Registrar"), such as notice of change of director(s), secretary or the annual returns. A penalty may be imposed on any director who knowingly and wilfully allows these notices to not be filed or these actions to not be taken on the company's behalf.

2.2 Environmental, Social and Governance (ESG) Considerations

Reporting on ESG is considered in the context of the role of stakeholders in corporate governance. It takes into account whether there are board-approved policies as to how environmental issues are to be addressed or handled. Companies are evaluated on the existence of the policies as well as their availability for inspection such as in the annual reports, on the website or any other publicly accessible source.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies or functions involved in the governance and management of a company are:

- the board of directors;
- board committees;
- the company secretary;
- shareholders in general meetings; and
- senior management and the chief executive officer (CEO) or managing directors.

Board committees support the board in carrying into effect the policy making, governance and strategic objectives. There are different types of board committees such as audit and remuneration, corporate governance, risk management and corporate social responsibility committees.

3.2 Decisions Made by Particular Bodies

The Board of Directors

The board of directors is responsible for the company's business, stewardship and strategic direction. Board power is kept in check by shareholders in a general meeting. They make decisions in relation to:

- nomination of board members;
- appointment of board members to fill casual vacancies;
- appointment and removal of the company secretary;
- addressing conflicts of interest;
- auditor-related issues other than their appointment;
- treasury, risk management, capital and internal controls;
- dividend policy and payments;
- communications and disclosure;

- accounting and management control policies and practices including the signing of cheques, promissory notes and other negotiable instruments;
- appointment and termination of directors and senior management;
- acquisition and disposal of major assets;
- budget, strategy, mission and vision; and
- major contracts and investments.

The following resolutions are subject to the approval of the board:

- determining and amending the operational and financial strategic objectives of the company;
- determining and amending key performance indicators in support of the strategic objectives (including, for example, any financial ratios); and
- any other matters that Jamaican laws or regulations or the company's articles of incorporation require the board to approve.

Other Decision-Makers

The board committees support the boards within the scope of their terms of reference.

The company secretary does not make decisions. The company secretary is the administrative office of the company. The secretary ensures compliance of the company with its governing legislation and regulations, for example, preparation of returns and filings with the Registrar of Companies and maintenance of company registers.

Shareholders are the ultimate decision-makers in companies. They exercise their powers in general meetings. The following powers are reserved to them:

- the appointment, removal and remuneration of auditors;
- the appointment, removal and remuneration of directors; and
- the amendment of articles.

3.3 Decision-Making Processes

In the decision-making process:

- the board of directors makes decisions at meetings by resolutions or consensus – resolutions may also be made as written resolutions, if permitted by the articles;
- board committees make decisions by consensus and in accordance with their terms of reference;
- the company secretary makes only such decisions as are authorised by the board or terms of appointment;
- shareholders make decisions by resolutions in extraordinary general meetings and annual general meetings by resolutions or consensus – resolutions may also be made as written resolutions, if permitted by the articles; and
- senior management, CEOs and managing directors make decisions to carry into effect the policy and strategic directions of the board and within its authorised limits.

Meetings

All meetings must be convened on proper notice and must be quorate. Directors or shareholders entitled to attend and vote at meetings may waive procedural irregularities in the giving of notice. Absence of quorum cannot be waived.

Extraordinary general meetings or special meetings may be called by the directors at any time or at the request of the shareholders to conduct any business which needs to be conducted in between annual general meetings.

The directors and shareholders meetings are presided over by a chairman.

Questions, Votes and Resolutions

Questions arising at meetings are determined by a majority of votes except where in relation to the special resolution in Section 138(2) of the Companies Act, which provides that a majority vote is three fourths of all the members present and entitled to vote in person or by proxy.

In cases of an equality of votes, the chairman may, depending on the chairman, have either a second or casting vote.

Article 64 of Table A of the Companies Act provides that at any general meeting a resolution put to the vote of the meeting must be decided on a show of hands unless a poll is demanded by:

- the chairman;
- at least three members present in person or by proxy;
- any member(s) present in person or by proxy and representing not less than one tenth of the total voting rights of all the members having the right to vote at the meeting; or
- a member(s) holding shares of the company being shares on which an aggregate sum has been paid up equal to not less than one tenth of the total sum paid up on all the shares.

4. Directors and Officers

4.1 Board Structure

The structure of the board of directors is as follows:

- chairman;
- vice-chairman;
- independent directors; and
- non-independent directors.

4.2 Roles of Board Members

The chairman presides over board meetings and ensures their orderly conduct, sets the agenda for meetings and leads the discussions, appoints all committee chairs and recommends committee members. The chairman usually maintains strong communication with the chief executive officer and maintains corporate integrity.

The CEO functions as the senior executive officer responsible for ensuring that decisions of the board are implemented and that the organisation functions effectively and efficiently.

Non-executive directors help develop and approve proposals on strategy. They are mostly involved in policymaking decisions, and provide independent oversight and constructive challenge to the executive directors.

It is not uncommon for the board of directors to only have a chairman because of the small nature of a company.

4.3 Board Composition Requirements/Recommendations

The requirements and recommendations are as follows. Each board member should:

- be independent of each other;
- be able to assess the company's overall policy and strategy;
- have adequate knowledge of the environment in which the company operates and its associated risks; and
- have subject matter expertise to enable the performance of their role as a board member.

Regarding the board as a whole:

- the composition of the board should match the intended board composition as to diversity in gender and expertise;
- at minimum, the board should be comprised of members with expertise in governance, general finance, business, accounting, law, human resources and management; and
- be transparent as to the number of directors who should be independent.

4.4 Appointment and Removal of Directors/Officers

Appointments may be made by directors to fill casual vacancies and by the shareholders in a general meeting. In either case, they are appointed by ordinary resolution.

There is, subject to the provisions of the Companies Act and the articles of incorporation, a requirement for the staggered retirement of directors except at the first annual general meeting where all the directors must retire. In all subsequent years, one third of the directors must retire, if there are multiples of three. If there are no multiples of three the number nearest to one third shall suffice. Each year, it is the longest-serving directors who shall be required to retire. If two directors were appointed simultaneously, the director to retire is chosen by lot.

Directors may also be removed pursuant to Section 179 of the Companies Act prior to the expiration of their term of office. Directors can also be removed in accordance with the articles, where they:

- cease to be a director by virtue of Section 177 of the Companies Act;
- become bankrupt or make arrangements or compositions with their creditors generally;
- become prohibited from being a director by reason of any order made under Sections 180 and 182 of the Act;
- become of unsound mind;
- resign by notice in writing to the company; or
- have been absent for more than six months without permission of the directors from meetings of the directors held during that period.

Section 177 deals with the duty of directors who are entitled to be directors by virtue of a share qualification. Section 180 sets out the procedure by which directors may be removed by the court. Section 182 sets out the considerations by the court for the disqualification of the directors which includes persistent breaches of the Act.

4.5 Rules/Requirements Concerning Independence of Directors

The Companies (Amendment) Act, 2017 incorporates the common law duty of directors "to avoid circumstances which, whether directly or indirectly, constitute a conflict of interest or may result in a conflict of interest with the interests of the company".

The duty is not infringed by mere interest or relationship. The Act provides that this duty is not infringed if the circumstances cannot reasonably be regarded as likely to give rise to a conflict of interest or if the matter giving rise to the circumstances has been approved by the director. Therefore, a director has a duty to disclose the nature of their interest at a meeting of the directors where they are directly or indirectly interested in a matter which may constitute a conflict of interest or may result in a conflict of interest with the interests of the company. The necessary quorum must be met at the meeting without including the director in question.

Additionally, pursuant to Section 193(1), directors or officers must disclose their interests in a contract or proposed contract. They must disclose the nature and extent of their interest in writing to the company or request to have this information entered in the minutes of the meetings of the directors.

Disclosure

The disclosure by a director must be made at the meeting at which a proposed contract is first considered or at the first meeting after they become interested in a contract or proposed contract. A person who has interests in a contract and thereafter becomes a director must disclose his interest at the first meeting of the directors. The same is true for an officer of the company.

A record of this contract must be kept at the registered office of the company. The contract is subject to the approval of the board of directors of the company, and subject to the provisions of the First Schedule. It is important to note that the director concerned must not be present during any deliberations of the board in connection with that approval.

Voting

Additionally, Article 90(2) of Table A of the Companies Act provides that a director must not vote in respect of any contract or arrangement in which they are interested, and if they must do so their vote must not be counted, nor must they be counted in the quorum present at the meeting.

The PSOJ Corporate Governance Code, 2021 recommends that the board identifies in its disclosures each board member that it considers to be independent. The board should determine whether a director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement. It also recommends that the board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- has been an employee of the company or group within the last three years;
- has or has had, within the last three years, a material business relationship with the company, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company;
- has received or receives additional remuneration from the company apart from a director's compensation, and participates in the company's share option or a performance-related pay 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; or
- represents a significant shareholder.

Former CEOs

A former CEO will not qualify as an independent director unless there has been a period of at least three years between the date on which they ceased employment with the company as CEO and the date of their appointment to the board.

4.6 Legal Duties of Directors/Officers

The principal legal duties of directors and officers of a company are contained in the Companies Act. The Act stipulates that every director

and officer of the company in exercising their powers and discharging their duties must:

- act honestly and in good faith with a view to the best interest of the company; and
- exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances, including, but not limited to, the general knowledge, skill and experience of the director or officer.

Directors have a duty to avoid circumstances which directly or indirectly constitute a conflict of interest.

4.7 Responsibility/Accountability of Directors

Directors owe their duties to the company alone.

However, in determining what the best interests of a company are, a director or officer may have regard to the interests of the company's shareholders and employees and the community in which the company operates.

4.8 Consequences and Enforcement of Breach of Directors' Duties

A director may be removed or required to pay damages in the event that there is a breach of duty.

If a director's breach causes harm to the company, the following persons may enforce the action on behalf of the company:

- a member or former member of a company or affiliated company;
- a debenture holder or former debenture holder of a company or an affiliated company; or
- a director or former director or officer of a company or an affiliated company.

These are complainants pursuant to Section 212(3) of the Companies Act.

A complainant may apply to the court for leave to bring a derivative action in the name of the company and on behalf of the company for the purpose of prosecuting, defending or discontinuing an action on behalf of the company.

The result of this is that the court may make an order as it deems fit, including:

- authorising the complainant, the Registrar or any other person to control the conduct of the action;
- giving directions for the conduct of the action;
- directing that any amount adjudged payable by a defendant in the action be paid, in whole or in part, directly to former and present shareholders or debenture holders of the company or its subsidiary, instead of to the company or its subsidiary; or
- requiring the company or its subsidiary to pay reasonable legal fees incurred by the complainant in connection with the action.

The harm caused to the company will be remediated including restoring any loss sustained by the company.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Section 213A of the Companies Act makes provision for action to be taken against the directors or officers of the company where it is alleged by a complainant that:

- an act or omission of the company or any of its affiliates effected a result;
- the business or affairs of the company or any of its affiliates are or have been carried on or conducted; or

- the powers of the directors of the company or any of its affiliates are or have been exercised in a manner that unfairly disregards, or is unfairly prejudicial or oppressive to, any shareholder or debenture holder, creditor, director or officer of the company.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Shareholder or member approvals are required in connection with the remuneration, fees or benefits payable to directors. Article 82 of Table A of the Companies Act, 2004 provides that the remuneration of the directors must, from time to time, be determined by the company in general meeting. The remuneration is deemed to accrue from day to day. The directors may also be paid all travelling, hotel and other expenses properly incurred by them in attending and returning from meetings of the directors or any committee of the directors or general meetings of the company, or in connection with the business of the company.

The directors have the power to determine the remuneration of the company secretary and the managing director.

4.11 Disclosure of Payments to Directors/Officers

Guided by the Jamaica Stock Exchange Rules and the PSOJ Corporate Governance Code, companies are required to state in their annual report the components of director remuneration including whether a director received or receives additional remuneration from the company apart from director's fees, or participates in its share option scheme or any performance-related pay or profit sharing scheme or guarantees on termination.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Shareholder Rights

Shareholders do not participate in the day-to-day management of the company. They own while the directors manage. However, they exercise ultimate control in general meetings. In the period between meetings, however, they have certain rights. These include:

- the right to access financial records;
- the right to access and inspect the financial records; and
- the right to inspect a company's books and records.

Section 157 of the Companies Act provides that:

- the auditors must make a report to the members on the accounts examined by them, and on every balance sheet, every profit and loss account and all group accounts laid before the company in general meeting during their tenure of office, and the report must contain statements as to the matters mentioned in the Seventh and Eighth Schedules; and
- the auditors' report must be read before the company in general meeting and must be open to inspection by any member.

Under the Companies Act, shareholders have the right to sue directors and officers of the company for breach of their duties or for acting in a manner that is inimical to or disregards their interests.

Voting Rights and Shareholder Powers

Shareholders also have voting rights. This means that they are able to participate in corporate decision-making, including the right to appoint

directors, make proposals and vote for structural changes such as acquisitions or liquidation.

The articles of incorporation usually reserve certain powers to the shareholders to be exercised in general meeting. Shareholders have the right to attend general meetings of the company where the directors present the company's annual report and comment on its performance over the year. At the annual general meeting and extraordinary general meetings, shareholders may, among other things, elect new directors, discuss directors' remuneration, and ask questions regarding the company's future.

Shareholders can also require directors to convene extraordinary general meetings if they are the holders of one tenth of the paid-up capital of the company.

Shareholders also have the right to transfer ownership. They have the option of quickly liquidating shares into cash by selling their shares.

5.2 Role of Shareholders in Company Management

See **5.1 Relationship Between Companies and Shareholders**.

5.3 Shareholder Meetings

Shareholder meetings are required. Section 126 of the Companies Act provides that every company must in each year hold a general meeting as its annual general meeting in addition to any other meetings in that year, and must specify the meeting as such in the notices calling it; and not more than 15 months must elapse between the date of one annual general meeting of a company and that of the next.

The Statutory Meeting and Statutory Report

Section 127 of the Companies Act prescribes that every company limited by shares and every company limited by guarantee and having a share capital must, between one month to three months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which must be called "the statutory meeting". The directors must, at least seven days before the day on which the meeting is held, forward a report (referred to as "the statutory report") to every member of the company.

The statutory report must be certified by not less than two directors of the company or where there are less than two directors, by the sole director, and must state:

- the total number of shares allotted, distinguishing shares allotted as fully or partly paid up other than in cash, and stating in the case of shares partly paid up the extent to which they are so paid up, and in either case, the consideration for which they have been allotted;
- the total amount of cash received by the company in respect of all the shares allotted;
- an abstract of the receipts of the company and of the payments made thereout, up to a date within seven days of the date of the report, exhibiting under distinctive headings the receipts of the company from shares and debentures and other sources, the payments made thereout, and particulars concerning the balance remaining in hand, and an account or estimate of the preliminary expenses of the company;
- the names, addresses and descriptions of the directors, auditors, if any, managers, if any, and secretary of the company; and

- the particulars of any contract, the modification of which is to be submitted to the meeting for its approval, together with the particulars of the modification or proposed modification.

The directors must deliver to the Registrar a certified copy of the statutory report for registration after the sending of the report to the members of the company. Also, the directors must make a list showing the names, descriptions and addresses of the members of the company, and the number of shares held by them respectively, to be produced at the commencement of the meeting and to remain open and accessible to any member of the company during the continuance of the meeting. Section 127 does not apply to private companies.

Voting at Meetings and Giving Notice

The Act stipulates that the directors of a company, notwithstanding anything in its articles, must, on the requisition of members of the company holding not less than one tenth of the paid-up capital of the company, at the date of the deposit, which carries the right of voting at general meetings of the company – or, in the case of a company not having a share capital, members of the company representing not less than one tenth of the total voting rights of all the members having at that date a right to vote at general meetings of the company – proceed duly to convene an extraordinary general meeting of the company.

The requisition must state the objects of the meeting and must be signed by the requisitionists and deposited at the registered office of the company. If the directors do not within 21 days from the date of the deposit of the requisition proceed duly to convene a meeting, the requisitionists, or any of them representing more than half of the total voting rights of all of them, may themselves convene a meeting, but any meeting so convened must not be held after the expiry of three months from that date. Also, a meeting convened by the requisitionists must be convened in the same manner, as nearly as possible, as that in which meetings are to be convened by directors. Additionally, in the case of a meeting at which a resolution is to be proposed as a special resolution, notice of the meeting must be given in order for the meeting to be duly convened.

The Companies Act describes the notice that must be given for any shareholder meeting. In the case of the annual general meeting, this is 21 days' notice in writing and in the case of a meeting other than an annual general meeting or a meeting for the passing of a special resolution, 14 days' notice in writing, in the case of a company other than an unlimited company; and seven days' notice in writing in the case of an unlimited company.

A meeting of a company called by a shorter notice period indicated may be deemed to have been duly called if it is so agreed in the case of a meeting called as the annual general meeting, by all the members entitled to attend and vote at the meeting; and in the case of any other meeting, by a majority in number of the members having a right to attend and vote at the meeting, being a majority together holding not less than 95% in value of the shares giving a right to attend and vote at the meeting, or, in the case of a company not having a share capital, together representing not less than 95% of the total voting rights at that meeting of all the members.

Section 129 of the Companies Act requires 21 days' notice for calling an annual general meeting and 14 days' notice in writing in the case of

a meeting other than an annual general meeting or for the passing of a special resolution.

Section 130 requires that notice of the meeting must be served on every member of the company.

The court may make orders for the calling or conduct of meetings where it is impractical to do so in any manner in which meetings of the company may be called.

5.4 Shareholder Claims

See **4.6 Legal Duties of Directors/Officers** and **4.9 Other Bases for Claims/Enforcement Against Directors/Officers**.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Shareholder disclosures are not required except where those shareholders are directors or senior management. See **6. Corporate Reporting and Other Disclosures**.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Section 145 of the Companies Act states that companies are obligated to provide shareholders with an annual report card on the financial position of the company. They must place before the annual general meeting a profit and loss account or an income and expenditure account, a balance sheet with a directors' report attached, and an auditor's report.

In accordance with Jamaica Stock Exchange (JSE) Rule 407, public companies are required to submit to the JSE two hard copies and one electronic copy of their quarterly financial statements at intervals not exceeding three months and within 45 days of the end of the period to which the statements relate. Directors, senior management, their connected person shareholdings and the shareholdings of those persons holding ten of the largest block of shares must be included in the financial report.

The quarterly financial statements must be approved by the board of directors and signed by two or more directors of the company, and should state whether or not they are audited or unaudited. Companies with quarterly filings that are 45 days overdue shall have the trading in their shares suspended until the reports are submitted to the stock exchange.

A company that is unable to comply with the JSE quarterly reporting requirement in a timely manner must notify the JSE where it can be foreseen that there is the probability of a delay, and the circumstances and probable extent of the delay. Simultaneously, the company should place an advertisement in the print media advising shareholders of the delay.

Listed companies have the option of submitting their quarterly results as follows:

- fourth-quarter financials be submitted in 45 days (unaudited) and 90 days (audited); or
- audited financial results submitted in 60 days.

Listed companies are required to indicate to the stock exchange and the market which of the two options would be chosen at the beginning of the third quarter each year. However, if there is no change in the option previously chosen, no communication is required.

6.2 Disclosure of Corporate Governance Arrangements

Rule 414 of the Jamaica Stock Exchange Rules requires listed companies to adopt and disclose corporate governance guidelines.

The PSOJ recommends that the companies listed on the JSE describe, in their annual report and accounts, their corporate governance from two perspectives: the first dealing generally with their adherence to the Corporate Governance Code's main principles, and the second dealing specifically with the explanations for non-compliance with any of the Code's provisions. These descriptions together should provide shareholders with a clear and comprehensive picture of a company's governance arrangements in relation to the Code as a criterion of good practice.

6.3 Companies Registry Filings

Every company must deliver to the Registrar successive annual returns which are made up no later than the anniversary date of the incorporation of the company or the anniversary of the last return that was delivered. Each return must be delivered to the Registrar within 28 days after the date on which it is made up.

Every company having a share capital must also deliver to the Registrar a return containing a list of all persons who are members of the company and of all persons who have ceased to be members since the date of the last return or, in the case of the first return, of the incorporation of the company. In respect of the beneficial ownership of a company, or an intended company, a beneficial ownership return must be filed:

- when forming a company;
- upon the delivery of a return of allotments, in respect of each allottee named therein;
- by a company and delivered to the Registrar annually within 28 days after the date on which it is made up; and
- within 14 days after any change of beneficial ownership information that occurs before the next annual filing of the return is due.

A beneficial ownership return must include the following information:

- the date on which it is made up;
- the name of the company, address of the registered office and, in the case of an overseas company, its principal place of business;
- an accurate, adequate and up-to-date list of all persons who, on the date of the return, are members and beneficial owners of the company, and of all persons who have ceased to be members and beneficial owners since the date of the last return or, in the case of the first return, of the incorporation of the company;
- the name, date of birth and nationality, address, occupation, taxpayer registration number or other tax identification number or the number, place of issue and expiry date of the valid passport or driver's licence of the beneficial owner;
- in the case of a past member or beneficial owner, the last valid passport or driver's licence held prior to the cessation of membership or ownership of the company, as the case may be;
- in respect of each member who is not an individual, the member's name, date of establishment, nationality, address and taxpayer registration number, or other tax identification number; and
- in the case of a company having shares, the number of shares held by each of the existing members and beneficial owners at the date of the return, specifying the shares transferred

since the date of the last return or, in the case of the first return, of the incorporation of the company by persons who have ceased to be members or beneficial owners, respectively, and the dates of registration of transfers.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The company must appoint an external auditor. The Act stipulates that none of the following persons can qualify for appointment as auditor of a company. These are:

- an officer or servant of the company;
- a person who is a partner of or in the employment of an officer or servant of the company; or
- a body corporate.

Section 154(1) of the Companies Act, 2004 provides that at each annual general meeting, a company must appoint an auditor to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting. The first auditor of a company may be appointed by the directors at any time before the first annual general meeting. An auditor so appointed holds office until the conclusion of that meeting. It is to be noted that the company in general meeting may appoint an auditor if the directors fail to do so.

The auditor of a company has a right to receive notice of every meeting of the shareholders and to attend and be heard at the meeting on matters relating to his duties as auditor. The auditor must make a report to the members on the accounts examined by them, and on every balance sheet, every profit and loss account and all group accounts laid before the company in general meeting during their tenure of office.

The auditor of a company must always have a right of access to the books and accounts and vouchers of the company, and is entitled to request any information and explanation from the officers of the company as is necessary for the performance of his duties.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Guided by the Jamaica Stock Exchange Rules and principles in the PSOJ Corporate Governance Code, the board of directors must ensure the implementation of robust risk management and internal control systems. This includes disclosure in the annual report in a separate segment – Management Discussion and Analysis (MD&A). The MD&A should cover:

- liquidity and capital resources;
- effect of any transactions involving related parties;
- results of operations;
- risk management; and
- present and future prospects of the company.

The MD&A should entail in detail the method by which they have assessed the prospects of the company, over what period they have done so and why they consider that period appropriate. The directors should declare whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of assessment. Also, the board of directors must monitor the company's risk management and internal control system and carry out a review of their effectiveness annually.

JAPAN

Law and Practice

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Contents

1. Introductory p.331
1.1 Forms of Corporate/Business Organisations p.331
1.2 Sources of Corporate Governance Requirements p.331
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.332

2. Corporate Governance Context p.333
2.1 Hot Topics in Corporate Governance p.333
2.2 Environmental, Social and Governance (ESG) Considerations p.334

3. Management of the Company p.335
3.1 Bodies or Functions Involved in Governance and Management p.335
3.2 Decisions Made by Particular Bodies p.336
3.3 Decision-Making Processes p.336

4. Directors and Officers p.336
4.1 Board Structure p.336
4.2 Roles of Board Members p.336
4.3 Board Composition Requirements/Recommendations p.337
4.4 Appointment and Removal of Directors/Officers p.337
4.5 Rules/Requirements Concerning Independence of Directors p.338
4.6 Legal Duties of Directors/Officers p.339
4.7 Responsibility/Accountability of Directors p.339
4.8 Consequences and Enforcement of Breach of Directors' Duties p.339
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.340
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.341
4.11 Disclosure of Payments to Directors/Officers p.342

5. Shareholders p.342
5.1 Relationship Between Companies and Shareholders p.342
5.2 Role of Shareholders in Company Management p.343
5.3 Shareholder Meetings p.343
5.4 Shareholder Claims p.345
5.5 Disclosure by Shareholders in Publicly Traded Companies p.345

6. Corporate Reporting and Other Disclosures p.346
6.1 Financial Reporting p.346
6.2 Disclosure of Corporate Governance Arrangements p.347
6.3 Companies Registry Filings p.347

7. Audit, Risk and Internal Controls p.348
7.1 Appointment of External Auditors p.348
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.348

Nagashima Ohno & Tsunematsu has an established reputation as a leading Japanese law firm in the area of corporate governance. With a team of approximately 85 partners, having various backgrounds ranging from corporate/M&A and capital markets to litigation and investigations, the firm regularly advises on corporate governance matters. It provides practical and strategic advice related to corporate governance based on relevant laws, regulations and guidelines as well as current practices. The key areas of the firm's practice in the corporate governance sector include conduct of shareholder meetings; proxy statements, securities reports and other disclosure materials; investor relationships; dealing with shareholder activists; management composition and governance structure; management compensation; internal control systems; risk and crisis management; and fiduciary duties, the business judgment rule and directors' liability. The firm primarily advises listed companies in the corporate governance context, but from time to time advises institutional investors as well.

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NAGASHIMA OHNO & TSUNEMATSU

1. Introductory

1.1 Forms of Corporate/Business Organisations

The following are the principal forms of corporate/business organisations in Japan. Explanations found in **1.2 Sources of Corporate Governance Requirements** and later sections focus on the joint stock company unless otherwise indicated.

Joint Stock Company (Kabushiki Kaisha or KK)

A joint stock company is the most commonly used form of corporate/business organisation in Japan. All Japanese listed companies are joint stock companies. This form is commonly used for closely held companies as well. All shareholders of a joint stock company enjoy limited liability up to their respective contribution amounts. This form is not a pass-through entity for Japanese tax purposes.

Limited Liability Company (Godo Kaisha or GK)

The form of a limited liability company is used only for closely held companies. Because the governance structure and rights of equity holders (including the allocation of profit distributions among equity holders) can be determined in a flexible manner by the articles of organisation, this form is suitable for joint ventures and wholly owned subsidiaries. All equity holders of a limited liability company enjoy limited liability up to their respective contribution amounts. This form is not a pass-through entity for Japanese tax purposes.

General Partnership Company (Gomei Kaisha) and Limited Partnership Company (Goshi Kaisha)

The form of a general partnership company and that of a limited partnership company are used only for closely held companies, but are not commonly used. General partners in these companies have unlimited liability; limited partners enjoy limited liability. These forms are not pass-through entities for Japanese tax purposes.

Limited Liability Company Established under the Commercial Code (Prior to Enactment of Companies Act in 2006) (Yugen Kaisha or YK)

This “legacy” form of a limited liability company is still used for closely held companies and is treated as a joint stock company under the Companies Act. All equity holders of this type of entity enjoy limited liability up to their respective contribution amounts. This form is not a pass-through entity for Japanese tax purposes.

Limited Liability Partnership (LLP)

The form of a limited liability partnership is used for joint ventures. The number of limited liability partnerships has been increasing but, despite its pass-through nature for Japanese tax purposes, has not become very popular because of some practical inconveniences arising from its lack of legal personality.

1.2 Sources of Corporate Governance Requirements

There are various sources of corporate governance requirements for companies in Japan. The following are the principal sources.

Companies Act (Act No 86 of 2005, as Amended)

The Companies Act, together with its subordinate regulations, provides the basic corporate governance requirements for companies, wheth-

er listed or not. The latest major amendment was made in December 2019.

Financial Instruments and Exchange Act (Act No 25 of 1948, as Amended) (FIEA)

The FIEA, together with its subordinate regulations, requires listed companies and certain other publicly held companies to make disclosures related to corporate governance in various filings.

Securities Listing Regulations Published by the Tokyo Stock Exchange (the "TSE Regulations")

The TSE Regulations require companies listed on the Tokyo stock exchange, among other things, to file corporate governance reports and to appoint "independent officers" and file independent officer notices. The Tokyo stock exchange, which used to have five segments (TSE-1, TSE-2, JASDAQ Standard, JASDAQ Growth and Mothers), was entirely reorganised into three new segments (Prime, Standard and Growth) effective from 4 April 2022. Companies listed at the Prime Market must meet enhanced corporate governance requirements. Companies listed at the Prime Market, the Standard Market and the Growth Market respectively account for approximately 48%, 38% and 14% among approximately 3,800 companies listed at the Tokyo stock exchange as of April 2023.

Corporate Governance Code

The Corporate Governance Code is a part of the TSE Regulations. The Tokyo stock exchange requires listed companies to "comply or explain" with respect to the principles included in the Corporate Governance Code and to disclose some corporate governance matters in their corporate governance reports. The latest amendment to the Corporate Governance Code took effect in June 2021.

Stewardship Code

The Stewardship Code published by the Council of Experts on the Stewardship Code, established by the Financial Services Agency, is another source of important corporate governance requirements, although it is not directly applicable to listed companies but to institutional investors. The Stewardship Code of 2020 is the most recent version. Many major institutional investors have published their own proxy voting policies in response to the Stewardship Code, will vote at shareholder meetings in accordance with their own policies, and will have engagement discussions with the management of listed companies to encourage mid to long-term growth.

Guidelines and Study Reports

Japanese governmental agencies or study groups organised by them from time to time publish various guidelines or study group reports with respect to corporate governance issues, which include the Corporate Governance System Guidelines, the Fair M&A Guidelines and the Outside Directors' Guidelines, each published by the Ministry of Economy, Trade and Industry.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Listed companies are subject to various corporate governance requirements, including the following.

Governance Structures

Having a board of directors is mandatory. Listed companies must choose one of the three governance structures:

- company with a board of statutory auditors;
- company with an audit and supervisory committee; or

- company with nominating and other committees.

Companies with a board of statutory auditors, companies with an audit and supervisory committee, and companies with nominating and other committees respectively account for approximately 60%, 38% and 2% among approximately 3,800 companies listed at the Tokyo stock exchange as of April 2023.

Outside/Independent Members

All the listed companies are required to have outside director(s) under the Companies Act.

The TSE Regulations require listed companies to appoint one or more directors or statutory auditors who meet the "independent officer" criteria determined by the Tokyo stock exchange and to file independent officer notices. The TSE Regulations further require listed companies to make efforts to secure at least one independent outside director as a board member.

The Corporate Governance Code provides that one third or more of the directors should be independent outside directors in the Prime Market (or two or more directors must be independent outside directors in the other markets). If a listed company has a controlling shareholder:

- a majority of the directors should be outside directors who are independent from the controlling shareholder in the Prime Market (or one third or more of the directors should be outside directors who are independent from the controlling shareholder in the other markets); or
- it should have such a special committee consisting of independent persons including independent outside director(s) as is expected to discuss and review important transactions and actions which may involve conflict of interest between the controlling shareholder and the minority shareholders.

Shareholder Proposal Right

Shareholders who hold 1% or more of the total voting rights or 300 or more of the votes for six months or longer may make a proposal of agenda (including appointment and dismissal of directors) by notifying the company at least eight weeks (or a shorter period if so provided in the articles of incorporation) prior to a shareholder meeting, and requesting the company include not more than ten proposals in the company's proxy statements at the company's cost and expense.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

As of the end of March 2023, approximately a half of the companies listed at the Tokyo stock exchange have PBR (Price Book-value Ratio) below 1.0 and ROE (Return On Equity) below 8%. In March 2023, in order to revitalise the capital markets, the Tokyo stock exchange issued to the companies listed at its Prime and Standard Markets a notification which encourages the management of each company to (i) properly identify its cost of capital and capital efficiency, (ii) evaluate those statuses and its stock price and market capitalization, and (iii) disclose policies and specific initiatives for improvement as necessary. This will prompt many Japanese listed companies to take strategic initiatives such as M&A's, aggressive capital investments and readjustment of debt equity ratio.

The Tokyo stock exchange was reorganised into three new segments (Prime, Standard and Growth) effective from 4 April 2022, but as of the

end of December 2022, over 500 companies still did not meet the applicable segment criteria and were granted a moratorium on delisting. In January 2023, the Tokyo stock exchange determined that the moratorium will end during the period from March 2025 to February 2026 depending on the end of fiscal year. Relevant companies will be required to improve their market liquidity, market cap, trading volume, etc to satisfy the segment criteria before that.

In April 2023, the Japanese government announced that the ratio of female directors, statutory auditors and officers in the companies listed at the Prime Market of the Tokyo stock exchange should be increased from approximately 10% (as of July 2022) to approximately 30%. Details will be discussed from now on.

Recent increase of shareholder activism and hostile takeovers in Japan reveals that some updates and reforms be necessary in the regulations regarding the bulk shareholding reports and the takeover bids in the FIEA. In March 2023, the Financial Services Agency started reviewing and discussing possible updates and reforms.

2.2 Environmental, Social and Governance (ESG) Considerations

The Corporate Governance Code suggests that a listed company:

- take appropriate measures to address sustainability issues including social and environmental matters;
- develop a basic policy for the company's sustainability initiatives from the perspective of increasing corporate value over the mid to long- term; and
- appropriately disclose its initiatives regarding sustainability in its management strategies and provide information on investments in human capital and intellectual properties.

In particular, a listed company on the Prime Market is encouraged to collect the necessary data to analyse the impact of the risks and earning opportunities related to climate change on its business activities and profits and to enhance the disclosure based on the TCFD recommendation or an equivalent framework.

Under the FIEA, publicly traded companies (in this context, listed companies and other companies that are required to file annual securities reports *yukashoken-hokokusho* under the FIEA) are required to disclose their notion and efforts on sustainability in annual securities reports. This disclosure requirement, which was introduced in 2023, spans the following four categories: (i) governance, (ii) strategy, (iii) risk management, and (iv) indexes and goals. Among these categories, publicly traded companies are required to disclose "governance" and "risk management". On the other hand, they are expected to consider whether "strategy" and "indexes and goals" should also be disclosed based on materiality of the disclosure, although it is generally recommended. In addition, there are several reports or guidance to be referred to for the purposes of enhancing disclosure of non-financial information including ESG elements, such as TCFD Guidance 3.0 and the recommended disclosure examples issued by the Financial Services Agency.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

Shareholder Meeting/Directors/Board of Directors

All joint stock companies are required to have a shareholder meeting and directors. If a company has a board of directors, it must appoint three or more directors. A listed company is required to have a board of directors. A company may have one of the following bodies:

- a statutory auditor *kansayaku* and, as the case may be, a board of statutory auditors *kansayakkai*;
- an audit and supervisory committee *kansa-tou-iinkai*; and
- nominating and other committees *shimei-iinkai-tou*.

If a company has any of a board of statutory auditors, an audit and supervisory committee or nominating and other committees, it must also have a board of directors. A listed company that is a large-size company *daigaisha*, ie, a company that has recorded on its audited and approved balance sheet for its most recent fiscal year either JPY500 million or more in stated capital, or JPY20 billion or more in liabilities, is required to have one of these bodies.

Statutory Auditors

The main role of a statutory auditor is to audit the execution of the duties of the directors. A listed company with statutory auditors is required to have a board of statutory auditors.

Audit and Supervisory Committee

An audit and supervisory committee consists of three or more audit and supervisory members *kansatou-iin*, who are also directors of the company elected as such by its shareholder meeting. A majority of the audit and supervisory members must be outside directors. The main role of the audit and supervisory committee is to audit and supervise the execution of the duties of the directors.

Nominating and Other Committees

Nominating and other committees means a set of a nominating committee *shimei-iinkai*, an audit committee *kansa-iinkai* and a compensation committee *hoshu-iinkai*. Each committee consists of three or more directors, and a majority of each committee's members must be outside directors. The main roles of a nominating committee, an audit committee and a compensation committee are, respectively, to determine the candidates for directors, to audit and supervise the execution of the duties of the management, and to determine the compensation of each management member.

In a company with nominating and other committees, an executive officer *shikkoyaku* is supposed to have the broader authority to decide the execution of the company's operation as compared to other types of companies. A representative executive officer *daihyo-shikkoyaku* appointed from among the executive officers by a board of directors represents the company.

Accounting Auditor

In addition, a large-size company must have an accounting auditor *kaikei kansanin* who is expected to audit the accuracy of the company's financial statements. An accounting auditor must be appointed from among external accounting firms or licensed accountants. A company with an audit and supervisory committee or nominating and other committees is also required to have an accounting auditor.

3.2 Decisions Made by Particular Bodies

The roles of a shareholder meeting and directors may differ depending on whether or not a company has a board of directors. In the case of a company without a board of directors, a shareholder meeting may adopt any action on behalf of the company, and a director has the broad authority to decide and execute the company's operation.

If a company has a board of directors, the authority of a shareholder meeting is more limited. In this case, the shareholder meeting may adopt only such matters as provided under the Companies Act or the articles of incorporation. A board of directors typically delegates to the representative director and other executive directors the authority to decide the execution of the company's operation except for the matters specifically prescribed under the Companies Act.

Monitoring Model Approach

However, in the case of a company with nominating and other committees, a board of directors may delegate to the executive officer the broader authority to decide the execution of the company's operation, and the matters that the board of directors is required to decide are fairly limited as compared to other types of companies. In this sense, the corporate governance of a company with nominating and other committees is designed as a monitoring model. Likewise, a company with an audit and supervisory committee may take a similar approach if:

- a majority of its directors consist of outside directors; or
- it is so provided in the articles of incorporation.

3.3 Decision-Making Processes

At the board level, unless otherwise provided in the articles of incorporation, a decision by a board of directors is made by a majority of the directors present at a board meeting, as long as a majority of the directors who are entitled to participate in the vote are present. Directors who have a special interest in the resolution may not participate in the vote. A board meeting may be held through a videoconference or conference call system.

If so provided in the articles of incorporation, a board resolution may be made without holding a physical meeting if all directors who are entitled to participate in the vote agree in writing (whether physically or electronically) to a proposal submitted by a director. That being said, circulation of board minutes to the board members together with their signatures on the minutes is not deemed to be a board resolution.

4. Directors and Officers

4.1 Board Structure

A board of directors consists of three or more directors and is required to appoint one or more representative directors. In the case of a joint stock company with an audit and supervisory committee or nominating and other committees, a majority of each committee's members must be outside directors.

In the case of a company with nominating and other committees, members of each committee may serve as members of other committees.

4.2 Roles of Board Members

The board members are, in general, divided into the following categories:

- representative directors;
- other executive directors; and
- outside directors.

Representative Directors

The role of the representative director is to execute the company's operation and represent the company. The authority of the representative director extends to all actions (whether judicial or non-judicial) in connection with the company's operation. The representative director may also decide the company's operation to the extent permitted by law as long as the board of directors authorises them to do so.

Other Executive Directors

Other executive directors may not represent the company without a delegation from the representative director but may decide and execute the company's operation, as is the case with a representative director subject to the same condition. However, in the case of a company with nominating and other committees, directors (other than executive officers) are not generally allowed to decide and execute the company's operation because such functions are carried out by an executive officer.

Outside Directors

Outside directors are expected to supervise the management of the company from an independent point of view.

4.3 Board Composition Requirements/Recommendations

A company with an audit and supervisory committee or nominating and other committees must have two or more outside directors. There are several requirements or recommendations for listed companies.

- First, a listed company with a board of statutory auditors is obligated to have one or more outside directors under the Companies Act.
- Second, the Corporate Governance Code recommends that:
  - (a) listed companies on the Prime Market ensure that one third or more of their directors are independent outside directors; and
  - (b) other listed companies appoint at least two independent outside directors.
- Third, the TSE Regulations require listed companies to make efforts to secure at least one independent outside director as a board member.

In addition, the Corporate Governance Code recommends that a board of directors of a listed company be composed in a manner to achieve diversity, including in terms of gender, international experience, work experience and age.

4.4 Appointment and Removal of Directors/Officers

Appointing Directors

Directors are appointed by a resolution of a shareholder meeting. Unless otherwise provided in the articles of incorporation, this resolution must be made by a majority of the votes of the shareholders present at the meeting if a quorum is satisfied (ie, by the presence of shareholders representing a majority of those who are entitled to exercise their voting rights). The company may lower the quorum for the appointment of directors down to a third pursuant to the articles of incorporation.

A cumulative voting system is also available although this is not common in Japan. In the case of a company with an audit and supervisory committee, directors who are audit and supervisory members must be appointed separately

from the other directors of the company. Other management members, including an executive officer in a company with nominating and other committees, are appointed by the board of directors.

In addition, the Corporate Governance Code recommends that a listed company, unless it has nominating and other committees or its independent outside directors constitute a majority of its board of directors, seek the involvement of, and advice from, an independent nominating committee regarding the appointment of its directors or other management members. In particular, a listed company on the Prime Market is encouraged to ensure that a majority of such nominating committee's members are independent outside directors and disclose, among other things, the view on the independence regarding the composition of the nominating committee and its authority and roles.

Dismissing Directors and Other Members of Management

Directors may be dismissed at any time by a majority of the vote at a shareholder meeting, except audit and supervisory members, whose dismissal requires two thirds of the votes at a shareholder meeting. However, a dismissed director is entitled to seek damages arising out of the dismissal except in cases where justifiable grounds exist. Typically, a dismissed director may claim the compensation they would have received during their remaining term.

In addition, if a director engages in any misconduct or commits a material violation of law or the articles of incorporation in connection with the execution of their duties as a director, and a proposal to dismiss the director is rejected at the shareholder meeting, then a shareholder holding, for the preceding six months or longer, not less than 3% of the voting rights of all shareholders may file a lawsuit to dismiss the director.

Other management members, including an executive officer in a company with nominating and other committees, may be dismissed by a board of directors. A dismissed executive officer may seek damages, as in the case of a dismissed director.

Statutory Auditors

Statutory auditors are appointed by a majority of the votes at a shareholder meeting. However, dismissal of statutory auditors requires two thirds of the votes at a shareholder meeting. As in the case of directors, a dismissed statutory auditor is entitled to seek damages arising out of the dismissal, except in cases where justifiable grounds exist.

4.5 Rules/Requirements Concerning Independence of Directors

An outside director is a director who does not, in principle, execute the company's operations, has no relationship with its affiliate companies or their management, etc. A more detailed definition of an outside director is provided in the Companies Act. A company having an audit and supervisory committee, or nominating and other committees, must have two or more outside directors.

Also, a listed company with a board of statutory auditors is obligated to have an outside director under the Companies Act.

Furthermore, the TSA Regulations and the Corporate Governance Code have certain requirements or recommendations in relation to "independent" outside directors. An independent outside director is an outside director who satisfies the "independent officer" criteria as estab-

lished by the Tokyo stock exchange. According to these criteria, an outside director who is an executive director or officer of one of the company's main business partners, or an expert who receives a substantial amount of fees or compensation from the company, is not qualified to be an "independent" outside director. In this sense, the "independent officer" criteria are more stringent than the "outside director" criteria under the Companies Act. Under the Corporate Governance Code, if a listed company on the Prime Market does not appoint such a number of independent outside directors as to constitute one third or more of its directors (or if a listed company on other markets does not appoint two or more independent outside directors), it must publicly explain the reason why. Under the Corporate Governance Code, it is also recommended that a person who has experience managing other companies be included among such independent outside directors.

The Corporate Governance Code also suggests that a listed company with a controlling shareholder appoint such number of independent outside directors who are independent of the controlling shareholder as to constitute at least one third of its directors (in respect of a company listed on the Prime Market, a majority) unless the listed company establishes a special committee composed of independent persons, including independent outside directors, to deliberate and review material transactions or matters that involve a conflict of interest between the controlling shareholder and the minority shareholders.

4.6 Legal Duties of Directors/Officers

Directors owe a fiduciary duty to the company. The Companies Act specifically provides that directors of a company must perform their duties to the company in a loyal manner, with this duty of loyalty being construed as part of a fiduciary duty. As part of their fiduciary duty, directors are required to establish an internal control system of the company. Furthermore, directors have a duty to supervise other directors' execution of the company's operation.

In connection with the decision on a company's operation, the business judgement rule applies, whereby directors are given broad discretion in making business decisions and are not to be held liable for those decisions unless the business decision or the process thereof is construed as significantly unreasonable.

If a director intends to carry out any transaction:

- with the company;
- that competes with the business of the company; or
- that results in a conflict of interest between the director and the company,

then the director is required to disclose the material facts relating to the transaction to the board of directors and obtain its approval.

4.7 Responsibility/Accountability of Directors

In general, directors owe their duties to the company. However, if a director breaches its fiduciary duty or any other duties, it may be held liable not only to the company but also to any third party that has suffered damage arising from the breach.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Injunctive Relief

If a director engages, or is likely to engage, in an act in violation of law or the articles of incorporation (such acts include breach of a fiduciary duty) and this act is likely to cause substantial damage

to the company, a shareholder holding shares in the company for six consecutive months or longer (or a shorter period if so provided in the articles of incorporation) may seek injunctive relief. In the case of a closely held company, the restriction on the shareholding period does not apply. In the case of a company with statutory auditors, an audit and supervisory committee or nominating and other committees, injunctive relief is granted only if the company is likely to suffer irreparable damage because statutory auditors or the relevant committee members are expected to audit and supervise the directors.

Compensation for Breaches/Third-Party Claims

If a director or a statutory auditor breaches their duties, the company may seek compensation for the damage caused by the breach. In addition, a shareholder may also file a shareholder derivative action on behalf of the company if the shareholder requests that the company file a lawsuit against a breaching director or statutory auditor but the company does not do so within 60 days of such a request. Moreover, if a third party suffers damage arising from the performance of the duties by a director or a statutory auditor who had knowledge that their conduct was inappropriate or was grossly negligent, then the third party may seek recovery of the damage from the director or statutory auditor.

Even if a director or a statutory auditor fails to perform their duties, their liability to a company arising from such failure may be discharged or limited through:

- the consent of all shareholders;
- a resolution of a shareholder meeting; or
- a resolution of a board of directors (or, in the case of a company without a board of directors, consent of a majority of two or more directors) pursuant to the articles of incorporation.

In addition, a director who is neither a representative director nor an executive director or a statutory auditor may enter into an agreement with a company to limit his or her liability, if so permitted by the articles of incorporation.

Indemnification Agreement/D&O Insurance

A director may enter into a corporate indemnification agreement with a company, pursuant to which in certain circumstances the company indemnifies the director for the costs (including attorneys' fees) and damage that the director has incurred in connection with the performance of their duties. D&O insurance is widely available in Japan. The Companies Act makes clear that in order to enter into a corporate indemnification agreement or D&O insurance, a company needs to obtain an approval of its board of directors or, in case of a company without a board of directors, a shareholder meeting.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

In relation to corporate governance, a third party is able to make claims against directors, statutory auditors and other officers for damage incurred in connection with misrepresentations in a company's financial statements, business reports or any other documents unless the directors, statutory auditors or other officers can prove that they have exercised due care. Directors, statutory auditors and other officers of a listed company are also liable for misrepresentations in the public disclosure documents of the company, such as annual securities reports *yukashoken-hokokusho*, under the FIEA.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Compensation to Directors

Compensation to directors must be approved by a shareholder meeting unless it is provided in the articles of incorporation. In usual circumstances, a shareholder meeting approves the maximum aggregate amount of compensation of all directors and delegates to the board of directors the authority to decide the compensation to be paid to each director within the approved maximum aggregate amount. In such a case, the board of directors of a listed company with a board of statutory auditors that is a large-size company or a company with an audit and supervisory committee must approve the policy as to how to determine the specific amount of compensation of each director and disclose this policy in the annual business report. The authority to decide the compensation of each director based upon this policy is often delegated to a representative director or an independent compensation committee. If the total amount of the compensation of all directors exceeds the maximum aggregate amount of compensation approved by a shareholder meeting, the compensation in excess of the maximum aggregate amount is invalid. In such case, it is considered that the amount of the compensation of each director would be reduced based on a ratio of the total amount of the compensation of all directors to the maximum aggregate amount approved by a shareholder meeting and a company has a right to request each director to return the excessive amount regardless of its negligence. In addition, the directors involved in such illegal payment are jointly and severally liable to the company for the amount in excess of the maximum aggregate amount approved by a shareholder meeting.

If a company issues its stock or stock options to its directors as compensation, it also needs to obtain the approval of a shareholder meeting on the maximum number of such stock or stock options to be issued and other prescribed details. In the case of a company with an audit and supervisory committee, the compensation of audit and supervisory members must be determined separately from other directors, and the allocation of compensation among audit and supervisory members is determined based upon their discussion unless a shareholder meeting resolves otherwise or the articles of incorporation provide differently.

In the case of a company with nominating and other committees, a compensation committee determines the compensation of each director and executive officer.

Principles Under the Corporate Governance Code

The Corporate Governance Code recommends that a listed company, unless it has nominating and other committees or its independent outside directors constitute a majority of its board of directors, seek involvement of and advice from an independent compensation committee regarding the compensation of its directors. In particular, a listed company on the Prime Market is encouraged to ensure that a majority of such compensation committee's members consists of independent outside directors and disclose, among other things, the view on the independence regarding the composition of the compensation committee and its authority and roles.

The Corporate Governance Code also considers that listed companies should reflect mid to long-term business results and potential risks in determining the compensation of the management and recommends that the proportion

of management compensation linked to mid to long-term results and the balance of cash and stock paid as compensation, respectively, be set appropriately.

Compensation to Statutory Auditors

Compensation to statutory auditors must also be approved by a shareholder meeting unless it is provided in the articles of incorporation. If a company has two or more statutory auditors, compensation of each statutory auditor may be determined based on their discussions, within the maximum aggregate amount of compensation approved by a shareholder meeting or provided by the articles of incorporation.

4.11 Disclosure of Payments to Directors/Officers

A listed company must disclose the compensation of its directors, statutory auditors and other officers in its business report. Such disclosure is required with respect to the total amount of the compensation on a position-by-position basis along with the number of persons appointed to each position, if and to the extent that the amount of the compensation of each individual is not disclosed. In the case that a company has outside directors/statutory auditors, the total amount of the compensation paid to them and the number of such outside directors/statutory auditors must also be disclosed.

Further, a listed company is required to disclose its basic policy, if any, on the determination of the compensation of its each director, statutory auditor and other officer. Unless the specific amount of compensation for each director is stated in the articles of incorporation or approved at a shareholder meeting (which is a rare case in practice), the policy as to how to determine the specific amount of compensation of each director also needs to be disclosed. If the compensation is linked to performance, the KPIs used for the calculation of the amount of such compensation, the reasons for choosing such KPIs or other prescribed details must also be disclosed.

Furthermore, a listed company is required to disclose the compensation of individual directors, statutory auditors and other officers in its annual securities report under the FIEA if the amount of such individual compensation is JPY100 million or more.

In the case of a closely held company, while there is no such disclosure requirement, it may have to make available the total amount of compensation paid to its directors, statutory auditors and other officers in its financial statements.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Shareholders, through their ownership of shares, have equity interests in a joint stock company. The basic and primary rights of shareholders are:

- the right to receive dividends;
- the voting right at shareholder meetings; and
- the right to receive residual assets upon the liquidation of the company.

Shares are issued only upon the full payment of the issuance price by a shareholder; accordingly, there exists no obligation of shareholders to make an additional investment/payment in their capacity as shareholders. Additionally, unlike in some other jurisdictions, it is generally construed that a controlling shareholder does not owe any fiduciary duty in relation to the operation of the company.

Accordingly, in principle, the risk assumed by shareholders is limited to the equity amount invested in the company. However, in limited circumstances, a doctrine to pierce the corporate veil exists pursuant to court precedent where the benefit of the corporate form is abused or the existence of the corporate form becomes a mere facade.

5.2 Role of Shareholders in Company Management

Shareholders are not directly involved in the management of a company.

Rather, shareholders, in their capacity as members of a shareholder meeting, vote on agenda items presented at the shareholder meeting and make resolutions on such proposed matters. In the case of a company with a board of directors, the shareholder meeting only has the power to make resolutions on the matters stipulated by law or stipulated in the articles of incorporation. Accordingly, it is not expected that a shareholder meeting will make resolutions regarding the day-to-day management of the company.

Once a resolution is passed by a shareholder meeting, the directors of the company owe a duty to act in accordance with such a resolution.

In the case that a director or a company is to take certain actions that are likely to adversely affect shareholders or the company, under limited circumstances satisfying the criteria stipulated in the Companies Act, a shareholder may demand that the company or director refrain from taking such actions. Additionally, a shareholder may bring a claim against the company or directors as explained in **5.4 Shareholder Claims**.

For the purpose of monitoring the company's management, when satisfying the requirements provided under the Companies Act:

- a shareholder holding 3% or more of the voting rights may request the court to appoint an inspector for the company's business;
- a shareholder holding 3% or more of the voting rights may request the disclosure of the accounting books and related documents of the company; and
- a shareholder may request, with the court's permission, the disclosure of the minutes of meetings of the board of directors.

5.3 Shareholder Meetings

Types of Shareholder Meetings

A company is required to have an annual shareholder meeting once every fiscal year. At an annual shareholder meeting, the financial statements/business reports are approved or reported and annual dividends may be declared. The appointment of directors or statutory auditors may also take place.

The articles of incorporation usually set forth that the shareholders as of the end of the relevant fiscal year will have voting rights at the annual shareholder meeting, and this annual shareholder meeting is required to be held within three months after the end of the relevant fiscal year.

An extraordinary shareholder meeting may be convened from time to time. For a company whose shares may be transferred without restriction (including listed companies), the company must set a record date by giving public notice in order to identify the shareholders who may exercise their voting rights at the relevant shareholder meeting.

Some listed companies are holding a virtual or semi-virtual shareholder meeting by using web conference systems. An amendment to the relevant laws was passed in 2021 that enables a company to have a "full" virtual shareholder meeting (ie, a shareholder meeting without a concept of the "venue" of the meeting).

Convocation Procedure

The convocation of a shareholder meeting by the company is required to be made by a resolution of the board of directors and, in general, a convocation notice is required to be sent out to the shareholders at least two weeks prior to the scheduled date of the shareholder meeting.

In the case of a listed company, the required content of the proxy statements for a shareholder meeting is stipulated in the relevant regulations. Until last year, a listed company was required to prepare such proxy statements in printed form and send such documents together with a convocation notice. From this year 2023, pursuant to the latest amendment to the Companies Act, which was enforced on 1 September 2022, a listed company is required to provide the proxy statements via electronic means at least three weeks prior to the scheduled date of the shareholder meeting. In exchange, it is not legally required to send the proxy statements in printed form unless requested so by a shareholder. However, at least for this year 2023, it is said that many listed companies are voluntarily sending the proxy statements in printed form as well just in the same manner as last year.

In the case of a closely held company with a limited number of shareholders, if all the shareholders agree to have a shareholder meeting with a shortened notice period, a shareholder meeting may be validly held in accordance with such agreement. Additionally, if all the shareholders approve the proposed agenda unanimously in writing (or by email), then the resolution of a shareholder meeting will be deemed to have been made without having an actual physical meeting.

Apart from the convocation of a shareholder meeting by the company, a shareholder holding 3% or more of the voting rights may, with the court's permission, convene a shareholder meeting.

Proposal by a Shareholder

When the company convenes a shareholder meeting, within the scope of an agenda item proposed by the company, a shareholder may make a counter proposal during the meeting. For example, if the company proposes one individual as a director candidate, a shareholder may make a counter proposal to make another individual a director candidate during the meeting.

Further, a shareholder holding 1% or more of the voting rights (or holding 300 or more voting rights) may request the company add a certain agenda item for an upcoming shareholder meeting by making the request eight weeks prior to the scheduled date of the shareholder meeting.

Resolution Requirement

The voting/quorum requirements for a shareholder meeting resolution differ depending on the agenda item to be resolved.

A supermajority vote, requiring two thirds or more of the affirmative votes among the shareholders present at the meeting, is required for some important matters such as amendments of the articles of incorporation, approval of mergers, dissolution of the company and others. The quorum requirement, which is the attendance of shareholders holding more than half of all the

voting rights, may be relaxed by the articles of incorporation.

A simple majority vote, requiring more than half of the affirmative votes among the shareholders present at the meeting, applies to general matters such as the approval of financial statements, distribution of dividends, appointments of directors or statutory auditors, and others. The quorum requirement is the attendance of shareholders holding more than half of all the voting rights, which may be relaxed by the articles of incorporation.

There are some other resolution requirements for certain exceptional matters.

Disclosure of Result of Resolution

In the case of a listed company, the voting results for each agenda item (ie, the number of affirmative votes, negative votes and abstentions) are required to be disclosed to the public.

5.4 Shareholder Claims

A shareholder has the right to request the company institute a suit against a director by itself seeking indemnification of the company by the director (or statutory auditors or an accounting auditor). If the company does not bring such a suit by itself within 60 days of the demand being made by the shareholder, the shareholder may, on behalf of the company, bring a suit (a derivative suit) against the director (or statutory auditors or an accounting auditor). In limited circumstances satisfying the requirements under the Companies Act, a shareholder may also bring a derivative suit against the directors (or statutory auditors or an accounting auditor) of a wholly owned subsidiary.

A shareholder may also file an action with the court to nullify certain corporate actions taken by the company, such as the issuance of new shares, merger, company split and resolution of a shareholder meeting, if there exist grounds for such nullification.

5.5 Disclosure by Shareholders in Publicly Traded Companies

For publicly traded companies, a large shareholding report system exists. A shareholder holding more than 5% of the outstanding shares, as calculated pursuant to the relevant regulations, is required to file a large shareholding report within five business days of it satisfying such requirements. Thereafter, as long as the shareholder satisfies the requirements, the shareholder is required to file updated reports when material changes occur with respect to the information contained in the report, including the case of an increase or decrease of 1% or more in the shareholding ratio. In this regard, some beneficial owners satisfying the criteria stipulated in the FIEA are deemed to hold the relevant shares, but such regulation is not able to capture the ultimate beneficial owners. Possible amendment to such regulation is now under discussion at the Financial Council set by the Financial Services Agency.

In the case of institutional investors, some exceptions exist to relax the reporting timing and reduce the reporting contents.

The Council of Experts on the Stewardship Code, established by the Japanese Financial Services Agency, published "Japan's Stewardship Code". This Code is not a law or a legally binding regulation, but many institutional investors have accepted it and make disclosure in accordance with it. Under the Code, institutional investors should have a clear policy on voting and publicly disclose the same. Additionally, under the Code, institutional investors are expected to disclose

voting records, including reasons for their voting decisions, for each investee company on an individual agenda item basis.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

The Companies Act provides for annual financial reporting requirements for all joint stock companies. Following the end of each fiscal year, a joint stock company is required to prepare:

- financial statements (consisting of a balance sheet, profit and loss statement, statement of changes in shareholders' equity, and notes to financial statements);
- a business report; and
- supplementary statements to each of the foregoing.

When finalised, the financial statements and business report will ultimately be submitted to the company's annual shareholders meeting for either approval or report to the shareholders.

Depending on the governance structure of the relevant joint stock company, the procedural requirements for finalising such documents will vary. In the case of a company with a board of directors, which is the most typical structure, its financial statements, business report and supplementary statements must be reviewed by the company's statutory auditor or a board of statutory auditors (as applicable), and the financial statements and their supplementary statements must be reviewed and audited by the company's accounting auditor *kaikei kansanin* (if applicable). The board of directors will then approve such documents, which will be approved by the shareholders, or reported to the shareholders (in the case where the company's accounting auditor has issued an unqualified opinion as to the company's financial statements and other conditions are met), at annual shareholder meetings.

Requirements Under the FIEA

Publicly traded companies (in this context, listed companies and other companies that are required to file annual securities reports under the FIEA) are required to prepare consolidated financial statements as well. In addition, under the FIEA, a publicly traded company is required to submit an annual securities report, which must contain audited financial statements (consolidated and non-consolidated) and be filed within three months of the fiscal year end. A publicly traded company is also required to submit a quarterly report (if listed on a Japanese stock exchange) or a semi-annual report, both of which contain summary financial information and must be filed within 45 days of the relevant quarterly end. Financial information contained in quarterly reports is required to undergo quarterly review by the accounting auditor. Please note, however, that there are ongoing discussions regarding abolishment of the quarterly reporting obligations under the FIEA.

Requirements Under the Stock Exchange

With a view to providing more timely financial information to public shareholders, the TSE Regulations also require that Japanese listed companies publish annual and quarterly summaries of consolidated financial results *kessan tanshin*. Financial information contained in such summaries is not required to have been audited or reviewed by the accounting auditor. The Tokyo stock exchange requests that such summaries be made public within 30 days of the quarterly end, and no later than 45 days thereafter.

6.2 Disclosure of Corporate Governance Arrangements

Corporate governance arrangements are generally required to be disclosed in business reports. Matters to be disclosed include a summary of the company's corporate governance system, internal audit and statutory audit system, outside directors and statutory auditors and their relationships with the company, measures to prevent conflict of interest transactions, and cross shareholding, details regarding compensation, corporate indemnification and D&O insurance. Publicly traded companies (in this context, listed companies and other companies that are required to file annual securities reports under the FIEA) also need to disclose certain information regarding corporate governance which includes, among other things, a summary of the corporate governance system, officers, internal and statutory audit activities, officers' compensation and the shares held by a company. The scope of such disclosure obligation under the FIEA was recently expanded.

In addition, the TSE Regulations require that each listed company submit a corporate governance report based on the Corporate Governance Code. In the corporate governance report, each listed company must explain, among other matters:

- its basic policy on matters included in the Corporate Governance Code established by the Tokyo stock exchange;
- the reasons for non-compliance with any of the principles of the Corporate Governance Code (if applicable);
- any disclosures required under the Corporate Governance Code;
- the composition of shareholders (eg, foreign shareholders, top ten largest shareholders, controlling shareholders, if any);
- the measures for protection of minority shareholders in relation to transactions with controlling shareholders; and
- the company's corporate governance system, including appointment of outside directors.

Under the Corporate Governance Code, companies that are listed on the Prime Market are required to provide English-language versions of key disclosure documents.

6.3 Companies Registry Filings

A joint stock company is required to file certain matters in a commercial registry, which is administered by the legal affairs bureau, upon incorporation and whenever any change to such matters arises. Matters required to be so registered include:

- corporate name, business purposes, amount of paid-in capital, the class and number of shares;
- the type and number of stock acquisition rights *shinkabu yoyakuken*;
- directors, statutory auditors, accounting auditor, branch manager *shihainin* and other statutory organs;
- branches;
- merger, demerger and other statutory reorganisations; and
- dissolution and liquidation.

Matters registered in the commercial registry are publicly available, while the filings made to the legal affairs bureau are not.

A failure to file a required commercial registry may result in a civil penalty not exceeding JPY1 million.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The following categories of joint stock companies must appoint an accounting auditor *kaikei kansanin*:

- a large-size company *daigaisha*, ie, a joint stock company that has recorded on its most recent fiscal year either JPY500 million or more in stated capital, or JPY20 billion or more in liabilities;
- a company with an audit and supervisory committee; and
- a company with nominating and other committees.

An accounting auditor must be appointed from among external auditing firms or licensed accountants. For publicly traded companies, the accounting auditor usually provides audit certification on the financial statements filed under the FIEA.

In order to ensure independence of an accounting auditor, the Companies Act bars interested firms or persons with ties to the company from serving as an accounting auditor. Also, with the aim of shielding an accounting auditor from undue influence from the management, the board of statutory auditors (or their equivalent), rather than the board of directors, has the right to approve the appointment, removal and compensation of the accounting auditor.

With respect to an accounting audit for a listed company, statutory registration system is in place where the Japanese Institute of Certified Public Accountants assesses the appropriateness of an external auditing firm, etc, that engages in an accounting audit.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The Companies Act requires any large-size company *daigaisha*, any company with an audit and supervisory committee and any company with nominating and other committees to determine and establish its internal control system to ensure that the company and its corporate group operate in a compliant and appropriate manner. In the case of a company with a board of directors, the board must decide the basic framework of the internal control system to be established. The establishment and implementation of an appropriate internal control system are generally considered to form part of the duties of due care of directors.

A joint stock company is required to outline the decisions made by the board of directors with respect to its internal control system and the implementation of the internal control system in its annual business report. The internal control system is audited by statutory auditors and the board of statutory auditors. Under the TSE Regulations, each listed company must describe its basic policy and implementation status of the internal control system in a corporate governance report as well.

Trends and Developments

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Anderson Mori & Tomotsune

Anderson Mori & Tomotsune Anderson Mori & Tomotsune (AMT) is one of the largest full-service law firms in Japan with more than 500 lawyers. AMT is headquartered in Tokyo with branch offices in Osaka and Nagoya, and overseas offices in Beijing, Shanghai, Singapore, Ho Chi Minh City and Bangkok. AMT has also established associated firms in Jakarta, Hong Kong and London. The combined resources and network of AMT provides an extraordinarily powerful value proposition and has enabled the firm to advise on some of the largest and most complex cross-sector transactions. AMT regularly advises listed companies and investors from the standpoint of corporate governance. Recently the firm has also advised listed companies on shareholder proposals, including the countermeasures available against proposals from activist funds or disputing shareholders, and subsequent proxy fights.

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JAPAN TRENDS AND DEVELOPMENTS

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Introduction

In recent years, activist shareholders have been increasingly active in Japan. During the annual general shareholders' meeting season in June 2022, shareholders made 330 proposals against 97 companies (in the previous year, there were 187 proposals against 65 companies). The number of companies that had to deal with shareholder proposals was at an all-time high, with a particularly large increase in shareholder proposals from institutional investors, including activists. Since these shareholder proposals cover a wide range of topics, including, among others, those related to corporate governance such as appointment and dismissal of directors, those seeking shareholder return, and those seeking ESG-related responses, and different types of activists (such as whether they are long-term investors or event-driven investors), responding to these shareholder proposals is not a straightforward process. Japanese listed companies are being challenged on how to respond to such proposals and how to improve their corporate value over the medium to long term through constructive dialogues.

On the other hand, the number of tender offer transactions announced in 2022 was only 59 (on a reported basis, excluding tender offers purported to buy back shares), showing a decline for the first time in four years. In addition, there was no hostile tender offer transaction in 2022 for the first time in six years, down from five in the previous year. However, there was still movement of hostile acquisitions, mainly by activist investors, including behind-the-scenes movements. There are many types of hostile acquisitions in Japan. Acquisitions by corporations are often conducted with the bona fide aim of managing the target company. Acquisitions by mainstream western-style activists who aim to reorganise their business portfolios often lead to higher corporate value of the target company. These hostile acquisitions can be considered "good" acquisitions from the viewpoint of increasing corporate value. On the other hand, in recent years a concerning acquisition tactic known as the "stock speculator wolf pack" has emerged in Japan. This tactic involves attempting to seize control of the management of the target company by gaining 30-40% of the voting rights by buying up in the market and requesting convocation of an extraordinary general meeting of shareholders. Those who initiate such acquisitions aim to make the target company a "shell company" for the purpose of stealing profits after the acquisition. This situation requires attention. It has been pointed out that in many cases of "stock speculator wolf pack" – since the leaders of such wolf pack have a low sense of compliance awareness and have internal control issues – they often fail to submit large shareholding reports in a timely manner or makes false statements in their process of purchasing on the market.

Based on these trends, the Ministry of Economy, Trade and Industry (METI) launched the Fair Acquisition Study Group (chaired by Hideki Kanda, Professor, Graduate School of Law, Gakushuin University; the "Study Group") in November 2022 to promote discussions for the improvement of predictability and best practices of the concerned parties of the acquisition and capital market parties to facilitate desirable acquisitions that enhance corporate value in a fair M&A market.

In this article we would like to review recent trends in activist shareholders and examples of hostile takeovers, and to present the current state of discussions in the Study Group.

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Trends in Shareholder Proposals by Activists

As mentioned above, although shareholder proposals by activists in Japan are on an increasing trend, such shareholder proposals rarely pass in practice. In the recent years, however, there have been two cases which drew attention from the perspective of corporate governance, where proposals by activist investors to appoint or dismiss executives were passed. In both cases, the activist requested the target company to convene an extraordinary general meeting of shareholders instead of making a shareholder proposal at an ordinary general meeting of shareholders. The two cases are outlined below.

One of those cases involves Oasis Management Incorporated ("Oasis"), a Hong Kong investor famous for its activist movements against Japanese companies. Oasis requested Fujitec to hold an extraordinary general meeting of shareholders and made its shareholder proposal. Oasis called for the removal of all then-current outside directors and proposed appointment of six directors nominated by Oasis. As a result, four Oasis candidates were elected at an extraordinary general meeting of shareholders held on 24 February 2023, while three then-current directors were dismissed. Oasis launched its campaign against Fujitec much earlier than the extraordinary general meeting request. They claimed that they were particularly concerned about Fujitec's inappropriate related-party transactions between Fujitec and a company controlled by the chairperson of Fujitec and their relatives. As a result of these campaigns, Fujitec withdrew the proposal to nominate the chairperson as a candidate for the director of Fujitec at the annual general meeting of shareholders held on 23 June 2022. However, after the general meeting, it was announced that the chairperson would be appointed as chairperson of the board (although not a director). In response, Oasis continued its campaign, which led to the request for holding an extraordinary general meeting of shareholders.

The other case involves 3D Investment ("3D"), a Singaporean investor also known for its activist movements against Japanese companies. 3D requested Fujisoft to hold an extraordinary general meeting of shareholders and made its shareholder proposal. 3D proposed appointing four director nominees of its choice at the extraordinary general meeting. At the extraordinary general meeting held on 4 December 2022, two directors nominated by 3D were successfully elected. Similar to the Oasis and Fujitec case, the conflict between 3D and Fujisoft had been ongoing prior to the meeting in which 3D highlighted concerns regarding Fujisoft's capital efficiency and business efficiency, primarily attributing them to excessive real estate investments. At Fujisoft's annual general meeting of shareholders held in March 2022, 3D proposed the appointment of two director candidates, but the proposal was rejected while receiving just under 40% of the votes (a majority vote is required to appoint or dismiss a director at a shareholders' meeting under Japanese laws). Consequently, the above-mentioned extraordinary general meeting was convened following further share acquisitions and submission of the proposal.

In Japanese companies, which traditionally have a strong shareholder base composed of (among others) clients and banks that are favourably inclined towards the company, claims made by activist investors have not always been highly appealing to shareholders. Against this background, the above two cases attracted attention as the activists' proposals concerning the appointment and dismissal of executives, which form the cornerstone of corporate governance,

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have passed (even though not all appointments and dismissals were passed). The circumstances surrounding these cases can be attributed to the presence of corporate governance issues, as in the case of Fujitec. However, it is also worth noting that a series of governance reforms, including the establishment of the Japan Corporate Governance Code and the Stewardship Code by the Financial Services Agency (FSA) and the Tokyo Stock Exchange, have brought about major changes in the shareholder structure of Japanese companies, as well as changes in investor awareness, making it easier for activists' claims to be heard if they are found to be legitimate. Furthermore, listed companies have also experienced a shift in mindset. In some cases, the company did not simply oppose the activist proposal, but also engaged in dialogues with the activist, leading to the withdrawal of the proposal when the company and the activist reached a mutually agreeable solution, such as the company accepting a portion of the proposal.

Hostile Takeover Trends

As mentioned above, although the number of hostile tender offer transactions that actually commenced in 2022 recorded zero, it does not mean that there was no movement of such transactions.

For example, Yamauchi No. 10 Family Office ("Yamauchi"), a fund established by the founding family of Nintendo Co, which is one of Japan's leading game companies, announced on 18 May 2022 that it planned to launch a tender offer against Toyo Kensetsu. According to Yamauchi's announcement, the tender offer has not yet been implemented because Toyo Kensetsu's management has not agreed to discuss Yamauchi's acquisition proposal. This acquisition proposal remains effective, and on 17 April 2023 Yamauchi further announced that it had made a shareholder proposal regarding the election of directors at the Toyo Kensetsu's annual general shareholders' meeting.

Operating companies also made attempt to conduct hostile acquisitions in 2022 which eventually turned out to be not hostile. On 30 August 2022, Oisix Ra Daichi Inc ("Oisix") launched a tender offer against SHiDAX CORPORATION ("Shidax"). The tender offer started as an agreement between Oisix and the founder of Shidax, but due to Shidax's management's opposition to such transaction, the tender offer was then launched as a hostile takeover. During the tender offer period, a third party, COLOWIDE Co, Ltd ("Colowide") made an acquisition proposal to Shidax, which was withdrawn later on. Ultimately, Shidax changed its position regarding this tender offer from opposing to being neutral and the tender offer commenced upon ceasing to be a hostile acquisition.

In recent years, hostile takeovers, which had long been considered taboo in Japan, have become an option for those seeking to acquire attractive target companies and thus remain to be actively pursued. Nevertheless, there have been questionable cases of acquisitions that lack good faith, such as takeover employing the "stock speculator pack" tactic described at the beginning of this article. There have been calls for the establishment of rules governing hostile takeovers and takeover defence measures, giving rise to the discussions led by the METI as outlined in the following Section and discussion led by the FSA to reform the relevant rules of large shareholding reports and, possibly, tender offers.

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Discussion in the Study Group on Fair Takeover

The Study Group, established in November 2022, has been examining ways to improve the predictability of takeovers of the parties involved and related parties in the capital market and to present best practices, with the aim of facilitating desirable takeovers through the sound exercise of market functions in a fair M&A market. The Study Group is also analysing the behaviour of parties involved in takeovers from the perspective of further developing M&A practices in Japan, taking into consideration the legal systems and practices in other countries as well as opinions provided by domestic and foreign parties. The Study Group aims to revise the "Guidelines Regarding Takeover Defense for the Purpose of Protection and Enhancement of Corporate Value and Shareholders' Common Interests" published by the METI and the Ministry of Justice in 2005 (the "Current Guidelines").

The first session of the Study Group was held on 18 November 2022, and following sessions continue to be held on a monthly basis. A public consultation period of about one month was also set up to solicit opinions from the public. At the sixth study group session held on 28 March 2023, draft guidelines based on the results of the previous discussions and public consultation were presented. Further discussions will continue to be held based on the content of the draft guidelines, and ultimately be formally published (as of the date of this article, the final version of the guidelines has not yet been published; the new guidelines shall hereinafter be referred to as the "New Guidelines").

New Guidelines

An outline of the draft New Guidelines is as follows:

The New Guidelines primarily focus on the act of an acquirer gaining management control by acquiring shares of a listed company. The New Guidelines cover unsolicited offers and bids where an acquisition proposal is made without any request or offer from the target company's management and the relationship of trust between the potential buyer and the target company has not yet been established.

The three principles that should be respected in acquisitions that aim to gain control of listed companies are:

Corporate value and ordinary shareholders' interests

The desirability of an acquisition should be assessed on Proposal A: whether it enhances corporate value and secures benefits that should be enjoyed by ordinary shareholders; or Proposal B: whether it secures or improves corporate value and, in turn, shareholders' common interests.

It should be noted that whether to adopt Proposal A or B in the New Guidelines is still under discussion.

Shareholders' intentions

Matters involving management control of the company should be decided based on the reasonable intentions of shareholders.

Transparency

Information necessary for shareholders' judgement should be properly made available by the acquirer and the target company, who shall ensure transparency of the acquisition through compliance with laws and regulations relating to the acquisition.

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Code of Conduct for Directors and Board of Directors in Relation to Acquisition Proposals

Generally, in an acquisition which seeks to gain control over management of a company, directors and the board of directors of the target company (including, if applicable, the special committee established by the target company) should determine whether the acquisition proposal will increase the company's corporate value. Furthermore, they should make reasonable efforts to ensure that the acquisition is conducted under terms and conditions which benefit ordinary shareholders.

Below are some basic examples of how directors and the board of directors should act in various situations after receiving an acquisition proposal seeking management control.

- Upon receiving a proposal containing a specific acquisition offer, it should be submitted to the board of directors for deliberation.
- The board of directors should examine the proposal while considering whether the proposed acquisition is a "bona fide acquisition proposal" (an acquisition proposal that is concrete, legitimate and feasible).
- The board of directors should take a substantial role in the analysis and evaluation of the acquisition proposal. It shall also maintain a supervisory role to ensure the fairness of the review process to address conflict of interest risks.
- To foster mutual trust it is also reasonable to consider securing appropriate negotiation time and opportunities through provisions in a confidentiality agreement so that the acquirer will not publicly disclose the acquisition proposal, commence a tender offer, or purchase additional shares without agreement with the company (a standstill clause).
- When deciding whether or not to agree to implementation of due diligence, it is necessary to consider the specific details of the proposal identified during examinations and negotiation with the acquirer, the acquirer's business environment, track record, and other factors. In cases where there are competing proposals, consideration should also be given to fair treatment towards such other proposers.

In particular, in a company whose board of directors is not primarily composed of outside directors (meaning the outside directors do not constitute the majority), it is beneficial to establish a special committee that is independent from the parties to the acquisition (meaning the acquirer and the management of the target company) and to respect the judgement of such committee in order to complement the independence of the board of directors and ensure the fairness of transactions.

Increasing the Transparency of Acquisitions

Disclosure and provision of information by the acquirer

At each step, the acquirer shall comply with the large shareholding report rules and the tender offer rules to enhance transparency and provide shareholders with sufficient information and time to make appropriate decisions (informed judgement).

Disclosure by the target company

Enhancing the disclosure of information by the target company should enable informed judgement by ordinary shareholders.

In addition, the ex-post disclosure of information on how the target company reviewed the acquisition proposal and how it led to the acquisition can enhance the transparency of the process of

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forming the terms and conditions of the transaction.

Prevention of actions that may distort shareholders' decision-making

The acquirer should not, among others: (i) conduct a structurally coercive acquisition tactic, such as a coercive two-step acquisition; (ii) disclose inaccurate information or provide misleading information to shareholders; or (iii) pursue a takeover while concealing the intention to do so.

Policies and Countermeasures for Responding to Acquisitions

The ideal approach, before employing countermeasures to acquisitions, is for the parties involved in an acquisition to conduct appropriate actions to seriously consider and negotiate, have both the target company and the acquirer provide necessary information, ensure transparency and fairness, and then let the shareholders decide whether or not to accept the proposed acquisition.

The following points should be considered in relation to the countermeasures to acquisitions.

- The implementation of countermeasures should, in principle, be based on the reasonable intention of the shareholders as it involves a change of control over the company.
- The countermeasures should be carried out in a necessary and appropriate manner, taking into consideration the principle of the equality among shareholders, protection of property rights, and the prevention of abuse of management power for self-preservation.
- The introduction and disclosure of countermeasure policies during normal times (such as before receiving a hostile offer) are desirable as they will improve the foreseeability for the acquirer. However, before considering the introduction of such policies, companies should make reasonable efforts to enhance the intrinsic value of the company in day-to-day operations and work towards ensuring that it is reflected in the market capitalisation.

While the Current Guidelines focus on how companies should act upon enacting countermeasures to acquisitions, the New Guidelines currently under discussion within the Study Group focus on facilitating serious considerations and negotiations between the acquirer and the target company, as well as comprehensive information disclosure to ensure transparency. By facilitating such actions, the New Guidelines expect that shareholders will be able to take informed judgements regarding the acquisition proposal.

The New Guidelines, once officially published, will significantly influence M&A practices in Japan. Traditionally, unsolicited acquisition offer or bid tends to be unsuccessful in the Japanese market as the Japanese society tends to be reluctant to support hostile transactions. Nevertheless, the publication of the New Guidelines will encourage Japanese companies to take such offer or bid more seriously, assess the effect of such offer or bid from a corporate value perspective, and engage in in-depth discussions and negotiations with the acquirer, which may, as a result, lead to an increase of unsolicited acquisition offer or bid against Japanese companies.

It should be noted, however, that the New Guidelines aim to facilitate only "good" acquisitions which enhance corporate value of a company. Hence, the New Guidelines provide certain guidance on the countermeasures to acquisition proposals that are not bona fide or "not good" (such as acquisitions for short-term profit or acquisitions employing the "stock speculator wolf pack" tactic). In any event, the Japanese

market and policy makers are engaging in major discussions on how to deal with hostile or unsolicited acquisition offer or bid on listed companies, and close attention should be paid to such discussions.

KUWAIT

Law and Practice

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Contents

1. Introductory p.362
1.1 Forms of Corporate/Business Organisations p.362
1.2 Sources of Corporate Governance Requirements p.362
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.363

2. Corporate Governance Context p.364
2.1 Hot Topics in Corporate Governance p.364
2.2 Environmental, Social and Governance (ESG) Considerations p.364

3. Management of the Company p.365
3.1 Bodies or Functions Involved in Governance and Management p.365
3.2 Decisions Made by Particular Bodies p.366
3.3 Decision-Making Processes p.367

4. Directors and Officers p.368
4.1 Board Structure p.368
4.2 Roles of Board Members p.369
4.3 Board Composition Requirements/Recommendations p.369
4.4 Appointment and Removal of Directors/Officers p.369
4.5 Rules/Requirements Concerning Independence of Directors p.370
4.6 Legal Duties of Directors/Officers p.370
4.7 Responsibility/Accountability of Directors p.370
4.8 Consequences and Enforcement of Breach of Directors' Duties p.370
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.371
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.371
4.11 Disclosure of Payments to Directors/Officers p.372

5. Shareholders p.373
5.1 Relationship Between Companies and Shareholders p.373
5.2 Role of Shareholders in Company Management p.373
5.3 Shareholder Meetings p.373
5.4 Shareholder Claims p.374
5.5 Disclosure by Shareholders in Publicly Traded Companies p.375

6. Corporate Reporting and Other Disclosures p.376
6.1 Financial Reporting p.376
6.2 Disclosure of Corporate Governance Arrangements p.376
6.3 Companies Registry Filings p.376

7. Audit, Risk and Internal Controls p.376
7.1 Appointment of External Auditors p.376
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.377

Meysan Partners is a modern, progressive law firm that seeks to set itself apart by offering high-quality, innovative legal advice delivered by a team of highly experienced multilingual lawyers. This is underpinned by more than 100 years of combined legal experience in the Middle East shared by its partners who, in recent years, have advised clients across a range of industry sectors on some of the most noteworthy and complex transactions and disputes in the region. The firm has around 100 employees in total, including 60 highly experienced lawyers. Meysan has a presence in five countries: Kuwait, UAE, KSA, Egypt and Lebanon. Its client list includes regional blue-chip companies and family groups, multinational corporations, international financial institutions, sovereign governments and their agencies, domestic corporations and financial institutions, as well as high net worth individuals.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Business undertakings may be established in Kuwait under several forms as per the Kuwait Companies Law No 1 of 2016 ("Companies Law"), which offers a flexible and dynamic environment for international businesses to expand in the Middle East and throughout the Gulf Cooperation Council (GCC). Kuwait does not impose corporate income tax on companies wholly owned by Kuwaiti nationals or other GCC countries nationals. Foreign non-GCC corporates that have a shareholding in a Kuwaiti company (which shareholding cannot exceed 49% of the share capital of the company) will be subject to taxation at 15% on their net profit.

Forms of Companies

Under Kuwaiti laws, corporate entities may be incorporated under any of the following forms:

- General Partnership Company.
- Limited Partnership Company;
- Partnership Limited by Shares;
- Joint Venture Company;
- Shareholding Company, closed or public;
- Limited Liability Company; and
- Single Person Company.

Furthermore, a business in Kuwait may be carried out through an agency relationship between a foreign principal and a Kuwait-based agent, distributor or commercial representative.

Business Practice

A business in Kuwait may be practised as a conventional business or as a Sharia-compliant business as may be determined in the constitutional documents of the company. The distinction between conventional and Sharia-compliant businesses is relevant to all types of companies and to financial institutions that are regulated by the Kuwait Capital Markets Authority (CMA) or by the Central Bank of Kuwait (CBK) that can operate either as a conventional or Sharia-compliant business, each subject to a different legal framework.

A business in Kuwait may also be practised by Professional Companies, where licensed professionals such as lawyers, engineers, auditors and other practitioners can form their partnerships under the law.

A business may also be practised through a profit or non-profit-seeking entity.

1.2 Sources of Corporate Governance Requirements

The principles of corporate governance are set out in the Companies Law and its Executive Bylaws No 287 of 2016, as amended, and in the CMA's regulation concerning listed entities or entities regulated by the CMA. In fact, the CMA, by Resolution No 72 of 2015 on the issuance of the Executive Bylaws of Law No 7 of 2010 and its amendments regarding the establishment of the CMA and regulating securities activities ("CMA Regulations"), introduced an entire Module 15 dedicated to corporate governance framework and requirements.

Corporate governance requirements are also found in other modules of the CMA Regulations, such as Module 10 which regulates the disclosure and transparency obligations of companies, avoiding conflict of interest and insider trading, and Module 11 which authorises the issuance of green, social, and sustainable bonds and sukuks and sets out the compulsory reporting obligations to the bondholders and sukukholders.

Corporate governance standards for Kuwaiti banks remain significantly regulated by the instructions issued by the CBK on 20 June 2012 and updated on 10 October 2019. These instructions are largely in line with global standards set by the CBK's international peers.

In relation to Islamic banks in Kuwait operating in accordance with Sharia principles, Law No 30 of 2003 was issued to add a dedicated section for Islamic banks (Section Ten) to Chapter Three of Law No 32 of 1968 on "Currency, the Central Bank of Kuwait and the Organisation of Banking Business". Article 93 of the added section mandates the establishment of a Sharia Supervisory Board in Islamic banks. This board's role is to assist these banks in the implementation of sound corporate governance practices in conformity with Sharia principles and objectives.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Listed Corporate Governance Requirements

Corporate governance requirements for companies with publicly traded shares are covered under Module 15 of the CMA Regulations. The main corporate governance rules concern the following:

- Construction of a balanced board.
- Establishment of appropriate roles and responsibilities.
- Recruitment of highly qualified candidates for members of board of directors and executive management.
- Safeguarding of the integrity of financial reporting.
- Application of sound systems of risk management and internal audit.
- Promotion of code of conduct and ethical standards.
- Ensuring timely and high-quality disclosure and transparency.
- Preservation of the rights of the shareholders.
- Recognition of the roles of the stakeholders.
- Encouragement and enhancement of performance.
- Focus on the importance of corporate social responsibility.

The principle of "comply or explain" forms the foundation for the corporate governance rules in Module 15 of the CMA Regulations. However, it is the CMA's responsibility to compel all listed and regulated entities to comply fully with the corporate governance rules without exception unless a particular rule does not apply in a relevant context.

Banks' Corporate Governance Requirements

The nine basic pillars pertaining to banks' corporate governance as per the CBK instructions consist of the following:

- Role and responsibilities of the board of directors and the issues related to the board members.
- Corporate values, conflict of interests and group structure.
- Executive management.
- Risk management and internal controls.
- Remuneration policies and systems.
- Disclosure and transparency.
- Complex corporate structures.
- Protection of shareholders' rights.
- Protection of stakeholders' rights.

The corporate governance rules set out in the corporate governance regulations for banks are mandatory for all banks registered in Kuwait.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

In 2023, ESG (Environmental, Social, and Governance) has become an increasingly hot topic in corporate governance in Kuwait. The country's recognition of the importance of sustainable practices has led to a surge in discussions surrounding ESG factors and their integration into corporate decision-making processes. In line with this, green, sustainable and social bonds and sukuks have gained significant traction as financial instruments that support environmentally friendly and socially responsible projects. As further detailed in **2.2 Environmental, Social and Governance (ESG) Considerations**, these bonds and sukuks offer a unique opportunity for CMA-licensed companies in Kuwait to raise capital dedicated to initiatives addressing climate change, renewable energy, and social welfare. The growing interest in these instruments reflects a desire to align financial investments with sustainability goals while generating attractive returns for investors. By integrating ESG principles into its corporate governance framework, Kuwait aims to allure conscientious investors, foster long-term value creation, and contribute to the global sustainability objectives. Consequently, companies in Kuwait are recognizing the imperative of embracing ESG practices.

UBO reporting is another topic that recently gained great importance in the corporate governance framework in Kuwait, following the issuance by the MOCI of a UBO resolution, as further detailed in **5.5 Disclosure by Shareholders in Publicly Traded Companies**. The resolution is intended to enhance transparency in the corporate sphere following the best global corporate governance practices. The UBO resolution entails the identification and disclosure of individuals who exert ultimate control over a company, even through intricate ownership structures. This crucial step fosters transparency and combats illicit activities, including money laundering and terrorism financing. Kuwait's commitment to implementing UBO regulations aligns with global endeavours to combat financial crimes and promote corporate transparency.

2.2 Environmental, Social and Governance (ESG) Considerations

The Rise of ESG Investing

Environmental, social and governance are three disciplines that have their own set of standards, practices and approaches and which jointly indicate an organisation's dedication to achieving greater goods in light of today's global challenges. Without a doubt, it has become important for governments and regulators all over the world to establish ESG regulatory frameworks and introduce ESG-related disclosures in their regulations.

On 30 January 2017, the government of Kuwait mobilised a new National Development Plan known as the "New Kuwait", which aims to promote sustainable development across seven pillars with the expectation of attracting new investors through transforming Kuwait into a financial, cultural and trade hub regionally and internationally by 2035 (the Kuwait Vision 2035). The seven pillars are aligned with the United Nations Sustainable Development Goals (SDGs). At the end of 2017, Boursa Kuwait developed an ESG reporting guide for sustainability disclosure intended for all issuers listed on Boursa Kuwait in line with the Kuwait Vision 2035.

The guide is intended to encourage market participants to understand corporate sustainability, the various ESG areas and the importance of ESG reporting. While the disclosures contained

in the guide are not compulsory, large corporates in Kuwait are voluntarily committing to sustainable business practices.

Non-compulsory Disclosure Basis

Disclosure of ESG issues under the current Kuwaiti legal framework is not compulsory. However, disclosure and transparency remain a fundamental principle of good corporate governance and to which the CMA has dedicated great importance in the CMA Regulations, specifically under Module 15 on corporate governance. This module sets forth corporate social obligations on listed companies and licensed companies, including corporate social responsibility-related disclosures. The board of directors of listed and licensed companies shall put in place a mechanism to disclose goals of social responsibility assumed by the company for its employees. Moreover, work plans of social responsibilities provided by the company shall be disclosed in accordance with the periodical reports related to the company's activities.

Additionally, Module 11 on dealing in securities introduced the rules for listed companies aiming at enhancing and encouraging companies to issue green, social and sustainable bonds and sukuks in accordance with the related instructions and guidance principles of the International Capital Market Association or the Climate Bonds Initiative standards or any other related international standards. The revenues of such green, social and sustainable bonds shall be used for financing or re-financing green and social projects.

Module 11 also provides compulsory sustainability disclosures by the issuers of green, social or sustainable bonds or sukuk, as the issuers of such bonds or sukuks must provide the bondholders' association and sukukholders' association, as the case may be, with the following reports that shall be publicly made available on the issuer's website:

- A framework document of the Green, Social, Sustainable Sukuk shall be submitted and prepared according with the related instructions and guidance principles issued by the International Capital Market Association (ICMA), or in accordance with the Climate Bonds Initiative standards or any other related international standards.
- A report must be prepared by an independent environmental and social specialist to study the framework document submitted for the Green, Social, Sustainable Sukuk that shall be issued to analyse how its proceeds or revenues shall be used and managed and to evaluate whether the project shall be deemed fit to be qualified or recognised as a green or social project.

Ongoing Initiatives

Whereas it is established that no compulsory requirements exist for companies in relation to reporting on ESG matters under Kuwaiti laws, the CMA and Boursa Kuwait are certainly set to significantly improve their ESG score with the continuous initiatives deployed by the CMA and Boursa Kuwait to develop the ESG-specific directions and disclosures of ESG metrics and reporting, and the publication of annual corporate governance reports.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

Depending on the legal form or type of the company, the company's governance structure shall consist of the following:

- Board of directors that is elected by the shareholders convened in an ordinary general assembly.
- Committees of the board of directors that are formed by the members of the board of directors, and which shall be entitled to review and set policies on certain selected matters.
- Executive management that comprises the chief executive officer and executives selected and appointed by the board of directors on the recommendation of the remuneration and nomination committee of the company.
- Assembly of shareholders who convene in ordinary and extra-ordinary assemblies to resolve upon reserved matters.
- Supervisory board that may be formed to assess the compliance of a company with its conduct standards and with Sharia requirements for Islamic companies.

3.2 Decisions Made by Particular Bodies

The board of directors or manager(s) can generally exercise all acts required for running the company in accordance with the objectives of the company while monitoring the performance of the executive management of the company. The board and the management shall have overall responsibility for the business entity, including the approval and implementation of the business' strategic objectives and goals, corporate governance rules and values. The board may also provide an oversight of the company's executive management while assuming full responsibility for the financial soundness of the business, fulfilment of all law requirements and protecting the legitimate rights and interests of shareholders, employees, staff and stakeholders of the company.

The board may also appoint a chief executive officer who enjoys the required and adequate technical competencies, and the other executive managers such as the chief financial officer, an internal auditor, risk general manager and head of compliance department, while ensuring that each appointed individual shall possess all required qualifications and compatible experience.

However, the board of directors and the management are subject to restrictions on their powers in respect of exercising certain acts. The acts of lending, borrowing, mortgaging, giving guarantees and sale of real estate assets are subject to shareholders' approval convened in an ordinary general assembly. Other matters relating to settlement, arbitration, donation and granting are subject to shareholders' ordinary assembly approval. The CMA Regulations have also developed a requirement that any disposal of assets of the company with a transaction value equal to or more than 50% of the total asset value of the company shall be submitted to the shareholders' approval convened in an ordinary general assembly.

Certain matters are strictly reserved to the shareholders' assembly of the company. The ordinary general assembly at its annual meeting shall be able to resolve on any matters falling under its competencies and in particular the following:

- The board of directors' report on the company's activities and its financial position for the last financial year.
- The auditor's report regarding the financial statements of the company.
- Report on any violations noted by supervisory authorities and in respect of which the company has been penalised.
- The financial statements of the company.
- Proposal of the board of directors on the distribution of profits.

- Discharge of the members of the board of directors.
- Election and removal of members of the board of directors and determination of their remunerations.
- Appointment of the company's auditor and determination of his remuneration or authorisation of the board of directors to determine the remuneration.
- Appointment of the Sharia Supervisory Board for companies that operate in accordance with the provisions of Sharia and hearing the report of such board.
- Report on the transactions that have been or will be carried out with related parties and identification of the relevant parties.

The extraordinary general meeting shall be competent to discuss the following matters:

- Amendment of the company contract.
- Sale of the whole project for which the company has been established or a disposition in any other way.
- The company's dissolution, merger, transformation, or division.
- Increase or decrease of the company's capital.

3.3 Decision-Making Processes

The formal process for making decisions vastly depends on the company's legal form or type. Generally, decisions are carried out during a partners' meeting or a shareholders' meeting initiated by a notice to attend a meeting. The meetings shall be convened on the basis of an invitation by the company's manager or by the company's chairman.

Quorum and Majority for Board of Directors' Meeting

Subject to the company contract stipulating a higher quorum or number of members, the meeting of the board of directors shall only be valid if attended by half of the members, provided that the number of those present shall not be less than three members. Participation via modern communication methods is permissible. Resolutions may be passed by way of circulation, subject to the approval of all members of the board of directors. The board of directors shall meet at least six times a year, unless the company contract mandates a greater number of meetings.

Quorum and Majority for Ordinary General Meeting

The invitation to attend the shareholders' meeting shall include the agenda, time and venue of the meeting and shall be extended twice through announcement or by any methods of modern announcement. The second announcement shall be made after a period of not less than seven days from the date of publication of the first announcement and at least seven days before the meeting for non-listed companies. As for listed entities, based on CMA Resolution No 139 of 2022 and related CMA Circular No 11 of 2022, annual general meetings of the listed company must be convened at least 15 business days from the date of the meeting and the shareholders having the right to attend the meeting are those who are registered in the shareholders' register of the listed company, held by the Clearing Agency, at least 10 business days prior to the meeting. The Ministry of Commerce and Industry (MOCI) must be notified in writing of the agenda, time and venue of the meeting and approve the agenda for the meeting before the invitation is published.

The ordinary general meeting shall not be valid unless attended by shareholders representing more than half of the company's issued share capital. If this quorum is not ascertained, an invitation to a second meeting shall be extended and the second meeting shall be valid if attended by any number of attending shareholders. Resolutions shall be passed by a majority of more than half of the attending shareholders' shares in the company's share capital.

Quorum and Majority for Extraordinary General Meeting

The extraordinary general meeting shall meet at the invitation of the board of directors, or upon a reasoned request of shareholders representing 15% of the company's issued capital or a request of the MOCI. The board of directors must call for the extraordinary general meeting to meet within 30 days from the date of submission of the request.

If the board of directors does not call the extraordinary general meeting during the period specified in the preceding paragraph, the MOCI shall call the meeting within a period of 15 days from the expiration of the date of the period mentioned herein. As for listed entities, based on CMA Resolution No 139 of 2022 and related CMA Circular No 11 of 2022 mentioned above, extraordinary general meetings of the listed company must be convened at least 15 business days from the date of the meeting and the shareholders having the right to attend the meeting are those who are registered in the shareholders' register of the listed company, held by the Clearing Agency, at least 10 business days prior to the meeting. The Ministry of Commerce and Industry (MOCI) must be notified in writing of the agenda, time and venue of the meeting and approve the agenda for the meeting before the invitation is published.

The extraordinary general meeting shall not be valid unless attended by shareholders representing three-quarters of the company's issued share capital. If this quorum is not ascertained, an invitation to a second meeting shall be extended and the second meeting shall be valid if attended by shareholders representing more than half of the issued share capital. Resolutions shall be passed by a majority of more than half of the company's issued share capital.

4. Directors and Officers

4.1 Board Structure

Board Composition

The board of directors for listed companies shall have at least five members. Banks are required to have at least 11 members on the board. The board of directors shall elect by secret ballot a chairman and a deputy chairman of the board of directors. The chairman shall represent the company in its relations with any third parties and before the judiciary, in addition to assuming other functions set out in the company contract. The chairman's signature shall be deemed the signature of the board of directors regarding the dealings of the company towards any third party. The chairman shall execute the resolutions of the board of directors and shall be bound by its recommendations. The deputy chairman shall take the place of the chairman in the absence of the latter or if the chairman is hindered in exercising his powers and functions.

Management

The company shall have one chief executive officer or more to be appointed by the board of directors from among or outside its members. The chief executive officer shall be assigned the task of managing the company. The board of directors shall determine the chief executive

officer's remuneration and his/her powers to sign on behalf of the company. The positions of chairman of the board of directors and chief executive officer shall not be combined.

Independent Members

The supervisory authorities may require that companies subject to their supervision shall include in the boards of directors one or more qualified and experienced independent members, to be elected by the ordinary general meeting. Their remuneration shall be determined on the basis of the principles of corporate governance. The number of independent members shall not exceed half the number of members of the board of directors. Independent members of the board of directors are not required to be shareholders in the company. Listed companies are required to have 20% of the board composition as independent members. Banks are required to have at least four independent members.

4.2 Roles of Board Members

The board of directors may distribute tasks among its members in accordance with the nature of the company's operations. The board of directors may delegate to one of its members or to committees formed from among its members or third parties one or more functions or the responsibility to oversee a certain aspect of the company's activities or the task to exercise some of the powers or authorities vested in the board of directors. The responsibilities of the board of directors must be clearly specified in the company contract.

A chairman of the board of directors must ensure that board discussions of all major matters are conducted effectively and timely and represent the company before third parties in accordance with the company contract. The chairman will encourage all members of the board of directors to full and effective contribution to board affairs management to ensure the board is acting for the company's interests and shall procure practical communication with shareholders and refer their opinions to the board. Also, a chairman shall encourage constructive relations and effectual participation of the board of directors and executive management with executive members, non-executive members and independent members and shall create constructive criticism concerning issues of different points of view among members of the board of directors.

4.3 Board Composition Requirements/ Recommendations

The board shall be composed of sufficient members so that it can form the required number of committees derived from it, subject to governance rules requirements. The board of directors of the companies listed in Boursa Kuwait and licensed shareholding companies regulated by the CMA are recommended to form specialised independent committees such as the audit committee, risk management committee, nominations committee and remuneration committee. Upon board composition, a variety of experiences and specialised skills must be considered to enhance the efficiency of undertaking resolutions.

4.4 Appointment and Removal of Directors/Officers

A shareholder, be it a natural or legal person, may appoint its representatives to the board of directors of the company in equal proportion to its shareholding. The number of appointed members of the board of directors shall be deducted from the aggregate number of members of the board of directors to be elected.

The appointed members of the board of directors shall have the same rights and duties as the

elected members. The ordinary general meeting of the company may, by resolution, remove any one or more members of the board of directors or dissolve the board of directors and elect a new board of directors.

4.5 Rules/Requirements Concerning Independence of Directors

Conflict of interest mitigation rules laid down by the Companies Law and the CMA Regulations include, inter alia, the following:

- The majority of board members must be non-executive members.
- The board must include independent members who must have qualifications, experience and technical skills that are consistent with the company's activity. An independent member must not (i) hold 5% or more of the company's shares; (ii) have a first-degree relation with any board member or executive management member in the company or any other company of the same group or the relevant main parties; (iii) be a board member in any company of the same group; (iv) be an employee in the company or any company in the same group or of any of the stakeholders; and (v) be an employee for corporate entities who own controlling shares in the company.

It is also important to note that the chairman and the members of the board of directors may not participate in the board of directors of two competing companies, or in any activity that would compete with the company, or trade for their own account or the account of third parties in a field that is traded in by the company. In the event of violation of these rules and, if not approved by the ordinary general meeting, the company shall be entitled to claim compensation or to consider the activities exercised by the member for his own account to have been exercised to the account of the company. Furthermore, no person who has appointed a representative to the board of directors, the chairman or any member of the board of directors, any member of the executive management nor their respective spouses or relatives of the second degree, may have any direct or indirect interest in the contracts and acts concluded with the company or to the account of the company, except with prior authorisation of the ordinary general meeting.

4.6 Legal Duties of Directors/Officers

Please refer to **3.2 Decisions Made by Particular Bodies** and **4.2 Roles of Board Members**.

4.7 Responsibility/Accountability of Directors

In accordance with Module 15 of the CMA Regulations, the board of directors of the company shall be held accountable towards the shareholders of the company.

When discharging their duties, directors are required to take into account the interest of the company, other board members, the shareholders, and other stakeholders and the entire company group.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Breach of Managing Duties and Responsibilities

The members of the board of directors are responsible towards the company, its shareholders and any third party for any acts of fraud or misuse of power, for any violations of the law and the company contract and any management errors.

In the event that the breach of the directors' duties is related to managing duties and respon-

sibilities, the shareholders of the company shall enforce such breach by way of a general meeting (during which the members of the board of directors may not participate in the voting) discharging the directors of their responsibility for their management or in decisions that pertain to a special benefit for them or their spouses or relatives of the first degree or relating to any dispute between them and the company.

The shareholders of the company may be further entitled to vote to remove directors from the board before their terms expire.

The liability of the board of directors mentioned above shall either be personal, pertaining to an individual member, or joint among all members of the board of directors. In the latter case, the members shall be jointly liable for compensation, unless a certain group of them has raised an objection against the resolution that has led to such liability and such objection was recorded in the minutes of the general meeting of the company.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Liability Claim Against the Members of the Board of Directors

The company shall be entitled to file a liability lawsuit against members of the board of directors, because of any errors resulting in any damages to the company. If the company is in the process of liquidation, the liquidator shall be responsible to file the lawsuit.

Any shareholder shall be entitled to personally file a liability claim on behalf of the company, in case the company fails to file such a claim. In this case, the company shall be made party to the claim in order to obtain a judgment of compensation in its favour. Furthermore, a shareholder may file a personal claim for compensation, if the error has caused him/her damages. Any stipulation in the company contract to the contrary shall be null and void.

Limitation of Claims Against Members of the Board of Directors

The liability claim shall lapse five years as of the date of the general meeting passing the resolution of discharging the board of directors of its responsibility or establishing an error. However, if the act attributed to the members of the board of directors constitutes a criminal offence, the lawsuit shall not lapse unless the criminal lawsuit lapses.

Claim of Invalidity and Challenge of Resolutions of the Extraordinary General Meeting

Each shareholder may file a claim on the invalidity of any resolution of the board of directors, ordinary general meeting or extraordinary general meeting that is in violation of the law or the company contract or if aimed at destabilising the interests of the company.

Such invalidity claims shall be time-barred two months from the date of the resolution of the general meeting or the date on which the shareholder gained knowledge of the resolution of the board of directors.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The company contract shall set out the manner of determining the remunerations of the chairman and the members of the board of directors. The aggregate of such remunerations may not exceed 10% of the net profits after any depreciation and reserves and distributing profit dividends of at least 5% of the company's capital to

shareholders or any greater percentage, as may be stipulated by the company contract.

However, an annual remuneration of KWD6,000 may be distributed to the chairman and each member of the board of directors as of the date of incorporation of the company until it realises sufficient profits that allow the company to pay the remunerations.

Should the remunerations distributed to the members of board of directors fail to comply with the company contract or are distributed against the company's annual general meeting report which includes the amounts, benefits and advantages received by the company's board members, the chairman and the members of the board of directors shall be held responsible towards the company, its shareholders and any third party for such violations.

A lawsuit for liability against members of the board of directors may be filed, as further detailed in **4.9 Other Bases for Claims/Enforcement Against Directors/Officers**.

As per Module 15 of the CMA Regulations, the company shall set an apparent remuneration policy including determination of the chairman and members of the board of directors' remunerations. Independent members of a board of directors may be excluded from the referred maximum remuneration rate pursuant to the resolution of the ordinary general assembly.

Any substantial deviations from the remunerations policy for the chairman and the members of the board of directors must be approved in advance by the board of directors of the company. In the event the company does not abide by such obligation, the company must disclose to the CMA in its corporate governance report its non-compliance with the remunerations policy rule, along with the reasons and justifications for non-compliance. Any failure to comply with the remuneration policy or the required approvals for the distribution or deviation from the remuneration policy may subject the company to one of the penalties stipulated under the CMA Regulations, which include the following:

- cautioning the company to discontinue committing the violation;
- issuing a warning;
- suspending its activities for a period not exceeding one year;
- final suspension from practising its activities;
- suspending the licence for a period not exceeding six months;
- revocation of the licence;
- imposing restrictions on the activity or activities of the company;
- dismissal of a member of the board of directors or of a manager of one of the licensed companies or listed companies who failed to perform his/her duties as provided in the CMA Regulations; and
- imposing financial penalties that are defined according to the severity of the violation not exceeding KWD50,000.

4.11 Disclosure of Payments to Directors/Officers

In accordance with the provisions of Module 15, an annual governance report must be prepared that includes the total remunerations given to members of the board of directors to be submitted to the CMA.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The relationship between a company and its shareholders is rooted in a similar form of mutualism. The rules and requirements governing the relationship between the company and its shareholders is based on cooperation, transparency and direct communication between the management members of the company and its shareholders.

While the boards of directors are responsible for the governance of their companies, the shareholders' role in the governance of the company is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

5.2 Role of Shareholders in Company Management

Shareholders may mainly participate in the management of the company by way of electing its board of directors or executive management, as their role mainly resides in the enforcement of the resolutions made by the general meeting of the company. Moreover, shareholders must refrain from committing any acts that are detrimental to the company's financial or moral interests and compensating any damages resulting from such acts, and to follow the rules and procedures established in respect of the trading in shares.

Under Module 15 of the CMA Regulations, the roles of the shareholders of listed and CMA-licensed companies in the management of the company may be manifested through the following:

- Listing the ownership value of their shared investment in the company records.
- Disposing of shares, including registration and transfer of ownership.
- Receiving the decided share in dividends.
- Receiving a share in company assets in case of liquidation.
- Having access to data and information of the company activity and operational and investment strategy regularly and easily.
- Participating in meetings of the shareholders' general assembly and voting on the resolutions thereof.
- Electing members of the board of directors.
- Controlling performance of the company, in general, and the board of directors, in particular.
- Approving any sale and purchase transactions or disposal in any way of the company's assets, if the value of such transaction is equal to 50% or more of the total value of the company's assets.

5.3 Shareholder Meetings

Shareholders shall hold annual meetings convened at the invitation of the board of directors within three months following the end of the financial year, at the place and time to be specified in the company contract.

The board of directors can invite the general meeting whenever necessary. It shall invite the general meeting at the reasoned request of shareholders holding at least 10% of the capital in the company or upon the request of the auditor, within 15 days as of the date of such request. The body requesting the meeting shall prepare the agenda of the meeting.

Under Module 15 of the CMA Regulations, the shareholders' general assembly shall be held upon the invitation of the board of directors with-

in the set dates in the time and place set out in the company contract and the invitation for the general assembly. The items of the shareholders' agenda shall include the company's governance report and the audit committee report, in addition to allowing the shareholders to review all data set out in the disclosure record of the board of directors and executive management members of the company. The shareholders shall exercise their right of voting in the shareholders' general assembly equally, as they shall vote as principal or by proxy upon being provided with all the standards that govern the voting process and rights.

5.4 Shareholder Claims

A resolution validly taken in a duly convened ordinary or extraordinary general meeting, having met the invitation, majority and quorum requirements set by the law, is in principle binding upon all the shareholders of the company, including the dissenting shareholders who did not vote in favour of the decision and those who did not attend the meeting. Shareholders may, however, challenge a general meeting's resolution before the Kuwaiti competent courts if any of the following conditions are met:

- The resolution is taken in violation of the law or the company contract or with the intention of harming the interests of the company. The same applies for BOD resolutions. The legal proceeding for the nullification of the resolution must be commenced by a shareholder of the company, who may also claim damages. Any legal action to nullify a board or general meeting resolution must be commenced within two months as of the date of the general meeting's resolution or, regarding actions against a board resolution, the date on which the shareholder becomes aware of the board resolution.
- The resolution prejudices the rights of minority shareholders. The legal action must be brought by shareholders holding at least 15% of the issued share capital of the company and who have not agreed to such resolution, meaning those shareholders who have not signed the resolution or who have signed and expressed their reservation on the resolution. The lawsuit challenging such resolutions must be commenced within two months as of the date of the ordinary or extraordinary general meeting's resolution. The court may uphold, modify or repeal the resolution or postpone its execution until an appropriate settlement for the purchase of the shares of the dissenting shareholders is reached, provided that such shares shall not be purchased from the company's capital.

The Rights of the Stakeholders and Shareholders of Listed Companies

Under Module 15 of the CMA Regulations, the shareholders of the company shall hold the company's members of the board of directors accountable and file tort cases if they fail to meet roles entrusted thereto and to present to the general assembly meeting any breaches monitored by the regulatory bodies of the company and any penalties issued due to such breaches and which led to (financial/non-financial) penalties against the company.

The company shall further develop policies that include rules and measures to ensure protection and acknowledgment of the rights of stakeholders and allow them to have access to compensations, in case of any breach of the rights in respect of dealing with the members of the board of directors.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Pursuant to Module 10 of the CMA Regulations, listed companies shall disclose, on a yearly basis, any major shareholders whose ownership reaches 5% or more of the company capital in each of the following cases:

- When a shareholder of the company owns 5% or more of the company's capital.
- Any change to percentage of ownership of any shareholder whose ownership reaches 5% or more of the company's capital.
- Decline in the ownership of any shareholder below 5% of the company's capital.

A person, its subsidiary companies and the companies over which it has effective control shall be deemed as a group acting as an "interested person" if its collective ownership of shares reaches 5% or more of a listed company's capital. The interested person shall be liable to disclose such collective ownership, its details and any change occurring to it that exceeds 0.5% of the listed company's capital, even if the change is made by one of its subsidiary companies or companies in which it has effective control on owning 5% or more in the same listed company.

In addition, pursuant to MOCI Resolution No 4 of 2023 regarding the procedures of determining the identity of the UBO (the "UBO Resolution"), which became effective from 1 April 2023, Kuwaiti companies must adopt the necessary measures and procedures to obtain and keep appropriate, accurate and updated information on the UBO. The requirement does not, however, apply to CMA-licensed companies as these companies are bound anyhow by the disclosures set out in the CMA Regulations.

The UBO Resolution outlines that individuals who have a direct or indirect ownership stake of 25% or greater in a Kuwaiti company (non-licensed by the CMA), hold voting shares that amount to 25% or more of the company's voting shares, or are capable of exerting control over the company in any way, are considered UBOs.

As such, it is mandated that Kuwaiti companies subject to the provisions of the UBO Resolution prepare and maintain a register of their UBOs, containing information relating to the UBO and other information related to its affiliation with the company and, if relevant, the date on which their association with the company ended from a corporate perspective. Such register must be submitted to the MOCI within: (i) 60 days of the effective date of UBO Resolution; or (ii) upon establishment and registration of the company at the commercial registry department at the MOCI (the "Registrar"); or (iii) upon renewal of the commercial license of the company; or (iv) upon occurrence of any changes to the corporate documents of the company; or (v) whenever may be requested by the Registrar.

It is also worth noting that Kuwaiti companies (non-licensed by the CMA) must also create registers for their partners or shareholders and board of directors' nominees which shall contain specific information related to those persons. Moreover, the company must update the information contained in the aforementioned registers on a regular basis, and any changes made must be notified to the MOCI within 15 days of the date of such change.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

The company's financial year shall be no less than 12 months.

The board of directors shall prepare an annual report for the financial year that has ended. Additionally, listed companies shall have their financial reports reviewed quarterly and submitted to the CMA within 45 days from the end of the quarter and annual audited financial statements within three months from the end of the financial year.

6.2 Disclosure of Corporate Governance Arrangements

Listed companies shall submit a quarterly report to the CMA to include all the transactions in the company's shares for the period concerned in the report, and which shall be accompanied by a statement of the balance of treasury shares (a company's shares that the issuing company repurchases or buys back or otherwise makes use of), duly ratified by the Clearing Agency. Meanwhile, an Islamic bank shall publish the fatwa (Sharia legal opinion) and resolutions passed by the Sharia Supervisory Board through printing booklets or bulletins including those fatwa and resolutions and making them available to those who desire to read them.

6.3 Companies Registry Filings

Kuwaiti companies are required to submit their annual audited financial statements within three months from the end of the financial year to the MOCI, which administers the companies registry in Kuwait. Also, any and all amendments to the company contract and the update in the company's information, including the licence and the update to the shareholders list and board of directors and authorised signatories, are regularly updated with the companies registry.

If a company fails to make such mandatory filings and/or make the required updates to the company's information with the Registrar, an official notice is issued by the MOCI to the defaulting company, requiring it to submit all requested information while highlighting any legal or practical breaches or incomplete disclosures. The company must adhere to the specified deadline, failing which it shall be subject to a fine of not less than KWD5,000 and not exceeding KWD50,000. Additionally, any person who refrains from providing information, documents and clarifications requested by the MOCI relating to the company's books and documents may be imprisoned for a term not exceeding one year and a fine of not less than KWD5,000 and not exceeding KWD10,000, or either of these two penalties.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Companies are required to appoint external auditors, by resolution of the annual ordinary general assembly, for the review and auditing of its financial statements, based on a proposal by the board of directors of the company. The company's internal audit committee shall provide the board of directors with its recommendations concerning the appointment, re-appointment or replacement of the external auditors, and identifying their remunerations, in addition to reviewing the external auditors' appointment letters and ensuring their independence. The internal audit committee shall also follow up on the work of the external auditors and review the external auditors' observations concerning the company's financial statements, and follow up on its status.

The annual ordinary general assembly shall appoint the company's external auditor according to the board of directors' proposals, provided the following is taken into consideration:

- The nomination of the external auditor should be based on the audit committee recommendation submitted to the board of directors.
- The auditor should be listed in the CMA's external auditors register, ie, fulfilling all the required provisions stated in the CMA's resolution concerning the mechanism of listing external auditors.
- To ensure the independence of the external auditor from the company and its board of directors and ensure no services other than services related to the audit functions are provided to the company, which may affect the auditors' neutrality or independence.
- The auditor should be permitted to discuss his opinions with the audit committee, prior to the submission of the annual financials to the board of directors for taking a decision in this regard.
- The external auditor shall be granted permission to attend the meetings of the general assembly, and to present his/her report to the shareholders, clearly stating any encountered obstacles or interferences during the audit process. The external auditor should also inform the CMA of any material violations or obstacles, and their details.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Risk Committee

The board of directors of a company shall form a risk management committee, in which the number of members shall not be less than three. The head of such committee shall be a non-executive member of the board of directors. The chairman of the board of directors shall not be a member in such committee. The board of directors shall specify the term of membership in the committee and the working system thereof.

Audit Committee

Existence of an audit committee shall be considered a main feature indicating application of good governance. As such, the committee shall incorporate the culture of liability inside the company through ensuring the soundness and integrity of financial reporting of the company, in addition to sufficiency and effectiveness of the conditions of internal audit systems applied in the company. Accordingly, the board of directors shall form an audit committee consistent with the nature of the company's activity and having full independence, in addition to the necessity of provision of human personnel of specialised experience at the committee, in order to perform their duties.

The main features of the audit committee are as follows:

- The board of directors shall form an audit committee, in which the number of members shall not be less than three, provided that at least one of members shall be independent. The board chairman or executive members of a board of directors shall not be members in such committee.
- The committee shall include at least a member of educational qualification and/or practical experience in the accounting and financial fields and such committee shall be entitled to outsource external expertise, based on the approval by the board of directors.
- The board of directors shall specify the membership term of the committee members and mechanisms of its operation.

Trends and Developments

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Meysan Partners

Meysan Partners is a modern, progressive law firm that seeks to set itself apart by offering high-quality, innovative legal advice delivered by a team of highly experienced multilingual lawyers. It has a team of over 130 highly dedicated and committed professionals, including 14 partners and 65 extensively experienced lawyers and paralegals. Meysan is currently present in five countries and six offices, Kuwait, UAE (Abu Dhabi and Dubai), KSA, Lebanon and Egypt. Meysan Partners adopts a boutique approach to its practice, limiting the number and type of matters it undertakes, to ensure the highest-quality offering for its clients. It strives to maintain a ratio of associates to partners significantly below that of other firms in the region, and generally focuses on matters that require the focus and experience of its partners, particularly in relation to cross-border regional transactions and high-stakes commercial litigation.

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Introduction

Corporate governance plays a paramount role in shaping the success and sustainability of businesses globally. Within the rapidly growing economy of Kuwait, organisations are increasingly recognising the significance of effective governance practices. As the year 2023 unfolds, Kuwait's corporate landscape is undergoing a significant transformation, driven by emerging trends and developments that are reshaping the country's approach to corporate governance. This article delves into the key factors propelling these changes, with a specific focus on the revolutionary resolution pertaining to disclosures to be made in respect of the actual ultimate beneficial owners of corporate entities in Kuwait and its profound impact on corporate governance in Kuwait, together with (i) the corporate governance regime applying to robo-advisers and their algorithms and technologies as introduced by the Capital Market Authority (CMA) under the new Module 19 "Fintech" added to the Executive Regulations of the Capital Markets Law No 7 of 2010 (Capital Markets Law); and (ii) the updated guidelines issued by the CMA for the companies listed on Boursa Kuwait on preparing the non-binding sustainability reports.

Increased Attention to Applying Corporate Governance Practices

Companies in Kuwait are increasingly focusing on applying proper corporate governance practices. These trends signal the importance of establishing laws that facilitate effective and ethical corporate governance. The trends observed in Kuwait are as follows:

- Increased Transparency: This includes providing more detailed information on their financials, operations, and management.
- Improved Board Oversight: This includes increasing the number of independent directors, strengthening the role of the audit committee and improving the board's ability to monitor management.
- Enhanced Risk Management: This includes implementing more robust internal controls, developing comprehensive risk management policies and increasing the use of technology to monitor and manage risk.
- Improved Corporate Governance Practices: This includes implementing better corporate governance codes, strengthening the role of shareholders and increasing the focus on corporate social responsibility.

UBO Resolution

Effective corporate governance serves as a cornerstone for organisations, ensuring transparency, accountability, and ethical conduct in their operations. In Kuwait, there has been a growing recognition of the need to establish strong governance frameworks that align with international standards. As a result, both public and private entities are actively working towards enhancing their governance practices to meet the evolving demands of stakeholders.

In response to the evolving global landscape and the imperative of combating money laundering and enhancing transparency, the Ministry of Commerce and Industry (MOCI) in Kuwait issued, on 4 January 2023, Resolution No 4 of 2023 regarding the procedures of determining the identity of the ultimate beneficial owner (UBO), as amended, which entered into effect on 1 April 2023 (UBO Resolution). The UBO Resolution specifically addresses the procedures for determining the identity of actual ultimate beneficial owners of corporate entities in Kuwait and has a far-reaching influence on corporate governance practices in the country. This resolution mandates that the companies disclose the individuals who ultimately own or control the

relevant Kuwaiti entities, aligning Kuwait with international standards and reinforcing its commitment to combat illicit activities while bolstering corporate governance and preserving the integrity of its financial system.

UBO Resolution: A Catalyst for Transparency

The implementation of the UBO Resolution has far-reaching implications for corporate governance in Kuwait. It requires companies to conduct thorough due diligence and maintain accurate records of their beneficial owners. This information will be shared with relevant authorities, enabling them to monitor and regulate corporate activities more effectively. By identifying UBOs, Kuwait aims to eliminate illicit activities, strengthen corporate governance, and protect the integrity of its financial system. The UBO Resolution acts as a catalyst for increased transparency and accountability in Kuwaiti businesses, creating an environment conducive to sustainable growth, fostering investor confidence, and strengthening corporate governance practices. Accordingly, by disclosing UBO information, businesses can demonstrate transparency in their ownership structures, thus enhancing stakeholder trust and confidence. The disclosure requirements foster greater accountability among corporate entities, ensuring that decision-making processes and financial transactions are carried out in a responsible and ethical manner.

Moreover, the UBO Resolution aligns Kuwait with international standards and regulatory frameworks provided under the Capital Markets Law and the Companies Law No 1 of 2016. The resolution creates a framework for the country to effectively combat money laundering and other financial crimes. Businesses operating in Kuwait must ensure compliance with the UBO disclosure requirements to avoid penalties and reputational risks.

Kuwaiti governmental authorities play a crucial role in facilitating the successful implementation of the UBO Resolution. They are responsible for enforcing compliance, establishing robust monitoring mechanisms, and conducting investigations to ensure the integrity of the disclosure process. These agencies must navigate challenges such as resource allocation, data management, and the coordination of efforts across various sectors. Effective collaboration between government agencies and businesses is vital for the smooth implementation of the UBO Resolution and the overall strengthening of corporate governance practices in Kuwait.

Application of the UBO Resolution

The relevant Kuwaiti corporate entities must comply with the relevant UBO disclosures pursuant to the UBO Resolution by the end of May 2023 in accordance with the process and mechanism to be set out by the MOCI. Although this deadline passed, the MOCI is yet to set out such mechanism and process. The lack of guidance by the MOCI creates unnecessary pressure on the corporate entities in Kuwait that are willing to comply with the UBO Resolution by exposing all such entities to potential penalties disregarding their cooperative spirit and willingness to comply.

Further, nominee arrangements are widely adopted by foreign investors in Kuwait which may be seen as a structure orchestrated to circumvent the restriction set out under Article 23 of the Commercial Code No 68 of 1989 (Commercial Code). Such article requires at least 51% of any business to be held by Kuwaiti nationals, subject to certain exceptions under the Commercial Code and other exceptions granted by the Kuwait Direct Investments Promotion Authority.

Given that the UBO Resolution has been recently enacted and its application has not yet been tested, it is unclear whether the relevant foreign investors adopting nominee structures would be deemed in breach of the Commercial Code upon making such disclosures pursuant to the UBO Resolution. Thus, the MOCI executive resolutions and court judgments that will be issued while applying the UBO Resolution will form an integral part of the wide understanding of such a requirement on the nominee arrangements.

Expected Challenges Relating to the UBO Resolution

The UBO Resolution presents a host of challenges for businesses. For businesses operating in Kuwait, the implementation of UBO disclosure requirements requires a thorough assessment of their ownership structures and diligent efforts to ensure compliance. The process of identifying and disclosing UBOs may pose challenges, particularly for complex corporate structures or cases where ownership is held through intricate arrangements. Additionally, businesses must navigate the potential risks of reputational damage and penalties for non-compliance. However, the UBO Resolution also presents an opportunity for businesses to demonstrate transparency, foster stakeholder trust, and bolster accountability. The relevant challenges may include, inter alia, the following:

- Data Collection and Verification: Collecting accurate and comprehensive UBO information can be challenging, particularly for complex ownership structures or cases involving offshore entities. Verification processes may require collaboration with external entities and extensive due diligence efforts.
- Regulatory Compliance: Businesses need to navigate the regulatory framework of the UBO Resolution and ensure they meet the UBO disclosure requirements, including understanding the reporting mechanisms and disclosure timings.
- Privacy and Data Protection: Balancing the need for transparency with privacy and data protection concerns can be challenging. Safeguarding sensitive UBO information is crucial to maintain trust and compliance with data protection regulations.

In summary, the UBO Resolution in Kuwait aims to enhance transparency, combat financial crimes, and bolster corporate governance practices. Businesses operating in Kuwait must adhere to the UBO disclosure requirements, facing challenges related to data collection, verification and compliance. However, the implementation of the resolution paves the way for a more transparent and accountable business environment in Kuwait.

Robo-Advisers Corporate Governance Rules

While designing the legal framework for the fintech industry in Kuwait, the CMA did not disregard the importance of corporate governance rules. Thus, under Module 19 “Fintech” of the Executive Regulations of the Capital Markets Law, the CMA imposed the relevant corporate governance rules relating to the algorithm and technology of the robo-advisers regulated under such module.

Algorithms are the basis of the financial and automated advisory tools that are designed and developed in the technical service programs. The algorithms use a variety of financial modeling techniques and assumptions to translate data inputs into suggested actions at each step of the financial advisory identification chain. As such, the entire process must be subject to a comprehensive framework of governance and controls.

This framework will enable the board of directors and senior management of the robo-adviser service provider to supervise and control the design, performance, use and safety of algorithms in a tight manner, providing that the roles and responsibilities of all employees responsible for overseeing the design, performance and integrity of algorithms must be clearly defined. The board of directors and senior management of the robo-adviser service provider shall be liable for the application of such governance rules in case they have delegated the daily operational activities or governance duties to other employees.

The obligations imposed on the robo-adviser service providers in this respect include, inter alia, the following:

- establishing controls to detect any error or bias actions in the algorithms ensuring that the results produced by the relevant model are interpretable, trackable and repeatable;
- ensuring that appropriate processes are in place to manage any changes to the algorithms including security arrangements to monitor and prevent unauthorised access to the algorithms;
- revising and updating the algorithms whenever there are any factors that may affect its suitability (eg, market changes and change in law);
- ensuring the availability of adequate human resources with sufficient competence and experience to develop the methodology of the algorithms and regularly revise the same; and
- notifying the relevant client in the event of any modification or suspension of the algorithms.

Robo-adviser service providers shall establish governance and supervision mechanisms appropriate for the technology and applications used in maintaining the personal data of the relevant customers of such robo-adviser service providers, providing that such service providers must ensure the relevant systems and controls are appropriate in light of the volume, nature and complexity of their businesses and this particularly applies to the systems and controls relating to, inter alia, the following:

- data transfer and storage;
- risk management and assessment including cybersecurity;
- execution and monitoring the transactions of the robo-adviser service provider;
- technical operations of the robo-adviser services; and
- receiving assistance from external parties.

Robo-adviser service providers shall ensure that their security policies are updated and must include, inter alia, the following:

- description of the information technology relating to the operations supporting the technology and applications of the relevant robo-adviser service provider;
- the applicable security procedures and mechanisms defining the scope of supervision of the robo-adviser service provider and the nature of such supervision;
- policies relating to the monitoring of the relevant applications, confidentiality of communications and identification of any penetrations/hacking and the antivirus systems;
- security policies and mechanisms for buildings and data centres of robo-adviser service providers (eg, excess policies and environmental security); and
- permitted communications with external parties (eg, technology partners, services providers, employees working remotely, providing

that the reasons for such communications must be clarified).

Further, robo-adviser service providers shall:

- establish sufficient internal regulations to protect their customers from inappropriate consultation and manage the operational risks and other risks resulting therefrom;
- establish regulations for protecting the privacy of the data of the customer by way of applying the international data privacy regulations; and
- through their board of directors and senior management, establish working policies and procedures securing a sound environment and culture for risk management in addition to abiding by the relevant rules and regulations.

Sustainability Reports Guidelines

By way of background, companies listed on Boursa Kuwait may issue (and not under an obligation) an annual report on sustainability to be published on the website of the relevant company indicating the impact of the activities of the relevant company on environment, society and economy, together with the opportunities and risks relating thereto and the methods used by the relevant company to manage such opportunities and risks (the "Sustainability Reports"), provided that the CMA should be notified of the same and such report to be published on the website of Boursa Kuwait.

On 22 May 2023, the CMA published updated guidelines, prepared by Boursa Kuwait, for the relevant companies preparing the Sustainability Reports.

The guidelines propose a set of preliminary indicators of institutional sustainability in line with the State of Kuwait's ambitions in the field of sustainable development as set out in Kuwait Vision 2035 "New Kuwait," the national development plan of Kuwait, and the goal to achieve carbon neutrality by 2060. Furthermore, the guidelines follow the recommendations of the Sustainable Stock Exchanges Initiative and the World Federation of Exchanges and are directed to all companies listed on Boursa Kuwait, providing that all applicable terms therein are not mandatory and without prejudice to any other mandatory rules set out in applicable laws and regulations. While preparing such guidelines, Boursa Kuwait was aware that applying best practices in respect of ESG will vary depending on the business and sector of each relevant company.

The proposed indicators recommended by the guidelines are as follows:

- Environmental: greenhouse gas emissions, emissions intensity, use of energy, energy intensity, energy mix, water usage, environmental operations, climate risk mitigation and environmental oversight (ie, does the board of directors/management team oversee and/or manage climate-related risks and/or other matters on sustainability?).
- Social: gender pay ration, employee turnover, gender diversity, temporary worker ration, non-discrimination, injury rate, global health and safety, child and forced labour, human rights and nationalisation.
- Governance: board of directors' membership diversity, board of directors' independence, incentivised pay, collective bargaining, supplier code of conduct, ethics and anti-corruption, data privacy, sustainability reporting, disclosure practices and external assurance.

By considering the various impacts on the environment, broader society, and corporate governance, businesses and UBOs can choose to take more directed, intentional steps to foster a sustainable future for Kuwait. The guidelines support stakeholders in playing their part in achieving the Kuwait Vision 2035.

Conclusion

Corporate governance in Kuwait has seen an increased demand for accountability and open practices. The UBO Resolution facilitates a transformative era in Kuwait by ensuring that all UBOs are disclosed to relevant authorities. Stakeholders can expect a more transparent business environment and explicit repercussions for financial crimes that go against these guidelines. While businesses operating in Kuwait must adhere to the UBO Resolution, this might clear the way for introducing anti-fronting regulations in Kuwait. Further, such businesses may also face challenges related to data collection, verification and compliance. The state of Kuwait recognizes the significant role of robo-advisers in the fintech industry by setting up specific governance regulations for the algorithms and technologies used by the relevant robo-adviser service providers. The sustainability guidelines published by the CMA suggest indicators for businesses to step closer to a more sustainable future in a developing corporate governance environment. These developments in corporate governance set Kuwait on the road to achieving a more integrated and integrous business environment. To support such trends, further actions, such as the introduction of anti-fronting regulations, must be considered by the regulators towards an equitable and transparent environment for all stakeholders.

MEXICO

Trends and Developments

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Mijares, Angoitia, Cortés y Fuentes, S.C. started out as a financial, securities and M&A legal boutique, and is now a multidisciplinary firm providing integral legal services. It has developed important work relations with numerous law firms across Asia, Europe, Latin America and the US, enabling it to efficiently assist clients. The firm is profoundly engaged in quality and responsiveness, and has established itself as one of the most prominent Mexican law firms. It provides comprehensive international advice through its strategic alliances with Affinitas and Taxand.

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MIJARES ANGOITIA CORTES Y FUENTES

Compliance Trends and Developments in Mexico

Emphasising ESG concerns in the corporate sector has proven to be beneficial in maintaining healthier and more resilient companies. With changing environments due to health, political and economic instability, climate change, shifts in social dynamics, consumer habits, etc, it has become increasingly evident that companies cannot be driven solely by an economic purpose. Hence, there is a growing demand from investors to ensure that businesses place ESG factors at the core of their strategies.

ESG has proven to add value to business models by:

- attracting investors with a sustainable focus;
- maximising a company's performance by correlating impact metrics with business metrics;
- increasing brand value by implementing sustainable practices that generate greater credibility and loyalty;
- enhancing organisational resilience by adopting sustainability standards that address environmental changes;
- improving performance by institutionalising processes and initiatives towards a global purpose;
- providing real-time, operationally supported information to customers, employees and social investors; and
- driving and promoting new social, economic and environmental policies that demonstrate the advancement of a more deeply rooted culture of corporate social responsibility.

The role of the board of directors in ESG

The COVID-19 pandemic severely challenged the crisis management plans of many companies in the world, and Mexico was no exception. It was the first time that risks that had previously been considered independent came together, including health, safety, supply chain disruption, stock price decline, decrease in sales, decrease in savings and decisions by authorities on how to handle the pandemic (lockdown).

The pandemic magnified the strengths and weaknesses of boards of directors and their operating methods. Those who entered the crisis with robust corporate governance were better equipped, as the pandemic proved to be an acid test for:

- cohesion and solidarity;
- boards' trust in the ability of their executives to address the crisis;

- the self-control and maturity of boards and their executives;
- the effectiveness of crisis management tools and processes;
- the ability to seize opportunities (ie, taking advantage of competitors facing difficulties);
- the strength of succession plans (if any); and
- the commitment and motivation of employees, among many others.

In a post-pandemic world, it is crucial to fully understand and incorporate into the DNA of boards the importance of having a robust corporate governance that:

- recognises and protects the rights of shareholders and stakeholders;
- ensures the accurate and timely disclosure of significant organisational matters;
- promotes equal treatment and safeguards the interests of all shareholders; and
- generates economic and social value for the organisation.

The board of directors should be seen as the agent to direct and control the shareholders, being the primary force that pressures the company's operational executives to seize opportunities and fulfil their obligations to shareholders, employees, customers and the communities in which they operate, safeguarding the future of the organisation. To fulfil this role, the board must be independent of the company's management. The ideal board should not have the CEO/director of the company as a member, as this would compromise independence and hinder its ability to provide critical input.

On the other hand, the board of directors, consistent with its fiduciary duties, must take ESG factors into account, implementing and monitoring systems to identify and address material risks, to preserve and protect the value of the company in the long term. It is imperative that companies monitor and address these ESG risks, as they can damage and alter strategies, business positioning, operations and relationships that are essential to guarantee its long-term sustainability.

A wide range of private and public companies in Mexico are already signatories to the United Nations Global Compact and have adhered to its ten principles to protect human rights, maintain ethical labour practices, preserve the environment and combat corruption. For such purposes, there is a tendency in public companies to create specific committees (sustainability, inclusion or diversity committees) to continue strengthening the company's strategies regarding ESG matters, among other objectives, to contribute to increasing customer satisfaction, operational continuity and reductions in costs.

In conclusion, in Mexico there is a lack of metrics to establish what constitutes successful corporate governance, considering that one of the main challenges is the separation of ownership and control, whereby someone other than the owner makes the decisions.

The Taxonomy

Presented on 16 March 2023 by the Ministry of Finance and Public Credit, Mexico's Sustainable Taxonomy (the Taxonomy) is a globally unique tool facilitating a comprehensive approach to sustainability. It provides a classification tool to determine which economic sectors and activities can be considered sustainable. The Taxonomy establishes three objectives:

- mitigation of climate change;
- gender equality; and

- access to adequate basic services related to sustainable cities.

The Taxonomy is directed at six economic sectors:

- agriculture, livestock breeding, forestry and logging;
- the generation, transmission, distribution and commercialisation of electric power and the supply of water to the final consumer;
- construction;
- manufacturing industries;
- transportation; and
- waste management and remediation services.

To align the 124 activities assessed in such economic sectors, the following criteria must be met:

- eligible activities must be included in the Taxonomy;
- such activities must be classified under various metrics and thresholds;
- Non-Significant Harm (NSH) criteria must be met; and
- activities must maintain minimum safeguards.

The use of the Taxonomy will require ethical behaviour among companies that intend to communicate to their stakeholders that their economic activity is sustainable, according to criteria of legitimacy and based on science; therefore, it seeks to reduce the risks of greenwashing and "social washing". Although the Taxonomy has no direct regulatory objectives, which means it does not require compliance with environmental regulation and legislation protecting human rights, it will provide certainty and transparency to financial markets and investments in sustainable activities. The Taxonomy also establishes cross-guidelines to identify activities to ensure compliance with gender equality.

ESG compliance in Mexico shall be implemented to ensure that companies, organisations and entities use the Taxonomy ethically and in accordance with the applicable laws, regulations, standards and practices. This is a relevant issue for Compliance Officers, who must identify the inherent risk scenarios that greenwashing and social washing will generate for the company, as well as adjust the control environment to ensure the application of the NSH principle and promote the transparency that allows the financial sector and different stakeholder groups of organisations to have confidence in the classification and sustainability rating of business activities.

Amendment to the Securities Market Law

A working team comprised of authorities and participants in the Mexican stock market is working on amending the Securities Market Law. Within this project, a new section is being considered that would grant the Ministry of Finance the authority to establish general provisions regarding sustainable and equitable development, with the prior opinion of the Securities and Banking Commission and the Mexican Central Bank. These provisions are expected to apply to securities issuers, brokerage firms, stock exchanges, rating agencies and other participants in the Mexican market.

Mexican pension funds

In terms of ESG regulations, the National Commission of the Retirement Savings System (CONSAR) currently has a regulation on ESG investments. The ten Retirement Fund Administrators (AFORES) have been incorporating these aspects into their strategies since April 2022, and must include an analysis of issuers' adher-

ence to ESG standards in their assessment of characteristics and risks inherent to the investments they make.

On 27 September 2022, CONSAR published a regulation establishing that the AFORES are already obliged to have a continuous ESG training programme in place for personnel.

In addition, the Mexican AFORES worked with the AMAFORE(the Mexican Association of AFORES) in 2022 to standardise an ESG questionnaire for public companies, which is expected to be disclosed and implemented by mid-2023.

Sustainability Reporting Standards

During the first quarter of 2023, the Mexican Council for Financial Reporting Standards (CINIF) publicly announced its annual work plan. In addition to its objectives of continuous improvement of existing financial regulations, it presented its plans regarding publications and collaborations with other counterpart organisations worldwide, including its plan for the development of Sustainability Reporting Standards (SRS).

The SRS are important as they are the benchmark for sustainability reporting for private companies in Mexico, and likely for other Latin American countries as well. Furthermore, they will serve as a pathway for transitioning from voluntary reporting (the current state) to mandatory reporting, and will greatly contribute to the overall development and adoption of an "ESG culture" in Mexico.

Publicly traded companies (with listed securities on the Mexican Stock Exchange or the Institutional Stock Exchange) will adopt the "IFRS S," which are the sustainability standards developed by the London-based International Sustainability Standards Board (ISSB). These standards are expected to become the most widely used regulatory framework worldwide for reporting ESG. Private companies (not listed on stock exchanges) will adopt network and information systems (NIS), which will be developed and implemented in two phases according to the plan.

In the first phase, starting in 2023, two documents will be developed:

- General Standards for Sustainability Information Disclosure (NIS 1); and
- Disclosure of Basic Sustainability Indicators (NIS 2), which will require companies to report minimum (quantitative) indicators for all dimensions of sustainability.

Both standards are expected to come into effect in 2025.

In the second phase, starting in 2024, new NIS will be developed to gradually complement the existing set, potentially aligning with thematic standards issued by the ISSB.

Financial information and sustainability are complementary spheres, with an interesting intersection that deserves ongoing study and analysis. Financial statements alone are not sufficient to assess the comprehensive value of a company and its ability to be sustainable over time.

Chief sustainability officer (CSO)

ESG has brought new roles within companies and their organisational structures. The emerging role of the CSO is a clear example of the recent trend in corporate organisational design that responds to the need to assign duties of co-ordinating the organisation's sustainability efforts to a dedicated professional. Tracking

sustainability performance and reporting and ensuring compliance with ESG frameworks and standards are day-to-day tasks that should be carried out within the control and supervision ethics environment of the organisation.

The interaction of the ethics compliance officer and the CSO on a day-to-day basis is seen as a rapidly emerging compliance best practice in Latin America, and Mexico is no exception. The new relationship of the ESG function implies its role as the first line of defence against greenwashing and social washing. Ethical compliance work will remain the second line of defence to prevent ESG conflicts and litigation that can arise from social concerns, operational incidents and the perception of unethical, misleading or deceptive ESG information dissemination by the organisation. The above has led to a deeper understanding of the role of compliance as a basic tool for ESG oversight, being the cornerstone for any company to supervise compliance with the applicable regulatory framework and the ESG commitments assumed with the company's stakeholders (lenders, investors, clients and authorities).

Therefore, to make ESG information more useful to the different stakeholders of a company, a solid financial complement is required. For example, for each ESG risk that a company identifies, it is necessary to identify potential impacts on the financial position, operating results, supply chain and cash flows. Eventually, these disclosures will enable companies to access capital more easily and remain relevant in the market.

MONTENEGRO

Law and Practice

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Contents

1. Introductory p.395
1.1 Forms of Corporate/Business Organisations p.395
1.2 Sources of Corporate Governance Requirements p.395
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.395

2. Corporate Governance Context p.396
2.1 Hot Topics in Corporate Governance p.396
2.2 Environmental, Social and Governance (ESG) Considerations p.396

3. Management of the Company p.396
3.1 Bodies or Functions Involved in Governance and Management p.396
3.2 Decisions Made by Particular Bodies p.397
3.3 Decision-Making Processes p.400

4. Directors and Officers p.402
4.1 Board Structure p.402
4.2 Roles of Board Members p.402
4.3 Board Composition Requirements/Recommendations p.403
4.4 Appointment and Removal of Directors/Officers p.403
4.5 Rules/Requirements Concerning Independence of Directors p.403
4.6 Legal Duties of Directors/Officers p.403
4.7 Responsibility/Accountability of Directors p.403
4.8 Consequences and Enforcement of Breach of Directors' Duties p.403
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.404
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.404
4.11 Disclosure of Payments to Directors/Officers p.404

5. Shareholders p.404
5.1 Relationship Between Companies and Shareholders p.404
5.2 Role of Shareholders in Company Management p.405
5.3 Shareholder Meetings p.405
5.4 Shareholder Claims p.405
5.5 Disclosure by Shareholders in Publicly Traded Companies p.406

6. Corporate Reporting and Other Disclosures p.406
6.1 Financial Reporting p.406
6.2 Disclosure of Corporate Governance Arrangements p.406
6.3 Companies Registry Filings p.407

7. Audit, Risk and Internal Controls p.408
7.1 Appointment of External Auditors p.408
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.408

Radonjic Associates is a leading Montenegrin full-service law firm, providing integrated legal advice on complex transactions to its clients. As a premier business law firm whose practice covers a broad spectrum of transactional and regulatory matters, Radonjic Associates enjoys an international reputation and is the preferred local partner for many international law firms, international financial institutions and embassies. The firm's client base is a diverse range of large international corporations, leading energy and construction companies in Europe and the wealthiest individuals investing in Montenegro. Radonjic Associates has a particularly strong focus in the corporate and commercial, energy, banking and finance, foreign direct investment, real estate and construction sectors.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

The principal and the most frequently used legal forms of corporate organisations under Montenegrin Law on Business Organisations are capital companies and, in particular, the joint stock company and the limited liability company.

The joint stock company *akcionarsko društvo* may be established by one or more individuals and/or legal entities in the capacity of shareholders whose share capital is determined and divided into shares. The minimum founding capital of a joint stock company amounts to EUR25,000.

On the other hand, the limited liability company *društvo sa ograničenom odgovornošću* may be established by one or more individuals, as well as by legal entities in the capacity of members, and it is mostly used for small and medium-sized businesses. The founding capital of limited liability company is divided into stakes and the minimum founding capital amounts to EUR1.

Besides the previously mentioned capital companies, Montenegrin Law on Business Organisations also recognises companies such as partnership and limited partnership, as well as additional forms of commercial activity performers including entrepreneurship and as part of a foreign company.

1.2 Sources of Corporate Governance Requirements

The Montenegrin Law on Business Organisations, LBO (Official Gazette of Montenegro, Nos 65/2020 and 146/2021) is the principal source of law regulating the corporate governance requirements and regulates all forms of business organisations existing in Montenegro.

Furthermore, Montenegrin Law on Capital Markets, LCM (Official Gazette of Montenegro, No 1/2018) provides regulation of the capital market.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

The principal sources of corporate governance requirements for companies with publicly traded shares are LBO and LCM, according to which any capital company may, if it deems necessary, adopt a Corporate Governance Code. Adoption of a Corporate Governance Code is not obligatory under Montenegrin law and it is a matter of the company's choice. The Montenegro Stock Exchange *Montenegroberza* is the only Montenegrin stock exchange.

The governance requirements for a public joint stock company are practically the same as for a private joint stock company, with a few exceptions. Namely, for a joint stock company with publicly traded shares LBO provides some additional mandatory governance requirements in respect to minimum number of members of the board of directors and independent members of the board of directors, as well as a minimum number of members of the supervisory board and number of independent members of the supervisory board, as specified in more detail in **4.1 Board Structure**.

As to the governance requirements for public limited liability companies, the governance requirements provided by the law for a joint stock company shall apply accordingly to public limited liability companies. In addition, the LBO provides the same governance bodies and structure for both a public joint stock company and a public limited liability company.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

In addition to the above-mentioned rules and requirements, there are no particular key or topical corporate governance rules and requirements to be drawn out in the Montenegrin jurisdiction.

The Russian sanctions regime had the impact on internal decisions of the banks where the banks often deny opening the bank accounts for Montenegrin legal entities founded by Russian citizens or Russian legal entities.

There are no developments in green/sustainability reporting.

2.2 Environmental, Social and Governance (ESG) Considerations

The issue of sustainable development is regulated by Montenegrin Environmental Law, EL (Official Gazette of Montenegro, No 52/2016, 73/2019 and 73/2019, which does not provide legal requirements in relation to mandatory reporting of ESG issues. However, the EL provides obligation for the companies to (at the request of the Environment Protection Agency of Montenegro) submit data and information for the purposes of maintenance of the unified Environmental Information System.

Moreover, there are some general rules and requirements for companies provided in order to ensure the sustainable use of natural resources as a basic condition for sustainable development. The general obligations of legal entities in respect to sustainable development consist in the protection of the environment through:

- sustainable use of natural resources, goods and energy;
- introduction of more energy-efficient technologies and use of renewable natural resources;
- the use of products, processes and technologies that pose less threat to the environment;
- taking measures to prevent and eliminate the consequences of endangerment and damage to the environment; and
- control of activities and operation of installations that may pose a risk or cause danger to the environment and human health.

In addition, EL provides obligation in relation to the rational use of natural resources, cost-accounting based on environmental protection within investment and production costs, application of regulations and taking environmental protection measures in accordance with the law and other applicable regulations.

In addition to the above, various forms of ESG reporting are provided exclusively for companies dealing with environmental and industrial activities.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

In accordance with Montenegrin LBO, the governance and management of a joint stock company may be organised as unicameral or bicameral.

The bodies of a joint stock company in unicameral governance are:

- general meeting of shareholders;
- board of directors;
- chief executive officer (CEO).

On the other hand, the bodies of a joint stock company in bicameral governance are:

- general meeting of shareholders;
- supervisory board; and
- management board.

Management bodies of a joint stock company in unicameral governance are represented by the board of directors and CEO while management bodies of a joint stock company in unicameral governance are represented by the supervisory board and management board.

A joint stock company may have a company secretary appointed by the board of directors (in unicameral organisation) or the supervisory board (in bicameral organisation) and is required to appoint an independent and authorised auditor.

The essential difference between unicameral and bicameral governance is existence of a special body in the bicameral governance represented by the supervisory board whose task is to control whether the director/s implement the decisions made by the general meeting of shareholders.

The governance bodies of a limited liability company are much simpler than governance bodies of a joint stock company and are represented by the general meeting of shareholders and the CEO, while the articles of association may also determine other management bodies in accordance with the law. It is to be pointed out that a limited liability company may also introduce a more complex management structure, prescribed by provisions that regulate joint stock companies.

In addition, the public limited liability companies are obliged to have management bodies of public joint stock companies. The same applies to a limited liability company that is considered as a large legal entity in accordance with the law governing accounting, and this type of limited liability company is obliged to have management bodies as a joint stock company.

Notwithstanding the above, in the case of a one-member limited liability company, the general meeting of shareholders does not represent the mandatory body of the company.

3.2 Decisions Made by Particular Bodies

General Meeting

The general meeting of a joint stock company consists of all shareholders. Members of the board of directors and the executive director (in the case of a unicameral joint stock company), or members of the supervisory and management board (in the case of a bicameral joint stock company), as a rule attend the general meeting of the joint stock company.

The general meeting makes decisions in respect to:

- adoption of the company's articles of association;
- changes and amendments to the company's articles of association;
- electing members of the board of directors – ie, the members of the supervisory board – and appointing the auditor;
- dismissal of members of the board of directors – ie, members of the supervisory board – and auditors;
- appointment and dismissal of the liquidator;
- the remuneration policy, as well as the amount of remuneration of the members of the board of directors – ie, the members of

the supervisory and management boards, at each regular annual session;
- adoption of the annual financial statements and the report on the company's operations;
- disposal of the company's assets (purchase, sale, lease, exchange, acquisition or other disposal) whose value exceeds 20% of the book value of the company's assets (high-value assets), unless the articles of association determine a lower share;
- the distribution of profits;
- increases or decreases of the share capital of the company determined by the articles of association and replacement of shares of one class with shares of another;
- voluntary liquidation of the company, restructuring or submission of proposals for initiating bankruptcy proceedings;
- approval of the assessment of non-monetary deposits;
- issues within the competence of the board of directors or supervisory board related to the company's operations;
- approval of the conclusion of an agreement on the purchase of property from the founder or majority shareholder of the company, when the payment exceeds one-tenth of the share capital of the company determined by the articles of association and when the agreement should be concluded within two years of registration;
- the issue of bonds – ie, convertible bonds or other convertible securities;
- limiting or revoking the priority right of shareholders to subscribe for shares or acquire convertible bonds, with the consent of a two-thirds majority vote of the shareholders to whom the decision applies;
- independent or joint establishment of another company or a decision authorising the management bodies in the company to make a decision on independent or joint establishment of one, more or an indefinite number of companies;
- adoption of procedural rules; and
- all other decisions in accordance with the company's articles of association.

Board of Directors

The board of directors has at least three members. Notwithstanding, the board of directors of a public joint stock company shall have at least five members. The number of members of the board of directors is determined by the company's articles of association and must be odd. The members of the board of directors shall be elected for a period determined by the articles of association, which may not exceed four years. The board of directors must have at least one-third independent members, and the board of directors of a public joint stock company must have at least two-fifths independent members.

The board of directors makes decisions in respect to:

- management of the company;
- the internal organisation of the company and act on systematisation;
- appointment of the CEO and secretary of the company, as needed;
- determination of the business strategy in accordance with the guidelines of the general meeting;
- determination of the company's accounting policies and risk-management policies;
- appointment of persons in charge of conducting internal audit in the company, at the proposal of the audit board, if formed in the company;
- convening sessions of the general meeting and determination of the proposed agenda with proposed decisions;

- determination of the amounts of dividends which, in accordance with this law, the articles of association and the decision of the general meeting, belong to certain classes of shareholders, as well as the manner and procedure of their payment;
- execution of the decisions of the general meeting;
- proposing the remuneration policy to the members of the management body;
- giving and revoking the power of attorney;
- adopting quarterly reports of the CEO on the company's operations; and
- other tasks in accordance with this law and the articles of association.

The CEO

The CEO is appointed by the board of directors of the company and may not be a member of the board of directors, except in the case of a one-member company.

The CEO has an executive role and its authorisations are the following:

- representation of the company;
- conclusion of agreements on behalf of the company;
- organisation and management of the affairs of the company;
- managing the company's assets;
- execution of the decisions of the board of directors;
- deciding on the disposal of the company's financial resources;
- deciding on the rights and obligations of employees in connection with work;
- submission of quarterly reports on the current operations of the company and other reports;
- performing other tasks determined by law and the company's articles of association.

The CEO shall perform the duties of the secretary of the company, if the secretary of the company has not been appointed.

Supervisory Board

The supervisory board has at least three members. Notwithstanding, the supervisory board of a public joint stock company shall have at least five members. The number of members of the supervisory board is determined by the articles of association and must be odd.

The supervisory board makes decisions in respect to:

- determination of the business strategy of the company and monitoring its implementation;
- appointment of the members and the president of the board of directors, as well as the secretary of the company, if such exists in the company;
- adopting the reports of the board of directors on the operations of the company, determining the financial reports of the company and the assembly for adoption;
- giving and revoking the power of attorney;
- appointment of the company's internal auditor;
- convening sessions of the assembly and determination of the proposed agenda;
- the acquisition of own shares, in accordance with this law;
- proposal to the general meeting of a policy of remuneration to governing bodies;
- election of the president of the supervisory board;
- submission of reports to the general meeting; and
- performance of other tasks in accordance with the LBO and the articles of association.

Management Board

The management board has at least three members. The number of members of the management board is determined by the articles of association and must be odd. Members of the board of directors are appointed by the supervisory board, in accordance with the company's articles of association. The members of the management board shall be appointed for a period determined by the articles of association, which may not be longer than four years.

The management board has an executive role and its authorisations are the following:

- management of the affairs of the company;
- determination of the internal organisation of the company, with the consent of the supervisory board;
- supervision of the keeping of the company's business books and the preparation of the company's financial statements;
- proposition of the agenda for the sessions of the company's assembly to the supervisory board;
- calculation of the amount of dividends, determining the day, procedure and manner of their payment, in accordance with the decisions of the general meeting;
- execution of the decisions of the assembly and the decisions of the supervisory board;
- submission to the supervisory board of quarterly reports on the current operations of the company; and
- performance of other tasks and making decisions in accordance with this law, the statute, decisions of the assembly and the supervisory board.

The general decision-making powers of the general meeting in a limited liability company consist of making decisions in respect to:

- amendments to the founding act and articles of association;
- increasing and decreasing the share capital of the company, as well as on each issue of securities;
- distribution of profits and the manner of covering losses, including determination of the day of acquiring the right to share in the profit and the day of payment of the share of profit in the members of the company;
- initiating liquidation proceedings, restructuring, as well as on submitting proposals for initiating bankruptcy proceedings by the company;
- the acquisition of own shares;
- the request for resignation of a member of the company;
- the exclusion of a member of the company due to non-payment – ie, failure to enter the registered deposit;
- initiation of a dispute for expulsion of a member of the company;
- initiation of the procedure and granting a power of attorney to represent the company in a dispute with the procurator, as well as in a dispute with the CEO;
- initiation of proceedings and granting a power of attorney to represent the company in a dispute against a member of the company; and
- changes in the form of organisation of the company.

3.3 Decision-Making Processes

Pursuant to LBO, the sessions of the general meeting of shareholders may be ordinary or extraordinary. A joint stock company is obliged to hold an ordinary assembly at least once a year. The first annual session of the general meeting of shareholders must be held within 18 months of the founding general meeting of the company, and after that the general meeting is convened once a year. The ordinary annual

general meeting of shareholders is held within six months from the end of each business year, except for the first year since the establishment of the company.

The notice on convening the general meeting of shareholders shall be submitted no later than 30 days before the day of holding the general meeting. The general meeting of shareholders may not make decisions on issues that are not on the agenda, unless all shareholders with voting rights attend the general meeting and unanimously accept the change in the agenda. In the event of a change or extension of the agenda, shareholders shall be notified of changes to the agenda in the manner in which they are notified of the holding of the general meeting of shareholders and no later than ten days before the day of the general meeting session.

The presence of shareholders or their representatives at the general meeting of shareholders shall be proven by signing the list of attendees, which shall also show the number of votes held by each shareholder.

The general meeting of shareholders is chaired by the CEO – ie, the president of the management board – unless otherwise decided by the majority of present or represented shareholders. The secretary of the company is the secretary of the general meeting of shareholders. In the absence of the secretary of the company, the president of the general meeting appoints another person as the secretary of the session of the general meeting.

The quorum of the general meeting of shareholders consists of shareholders who own more than half of the total number of shares with voting rights, and who are present, are represented by representatives or have voted by ballot.

After voting on each individual decision, the president of the session shall inform the general meeting of the votes "for" or "against" of the present shareholders with voting rights, as well as of the voting of shareholders who did so in writing. The company is obliged to publish the exact results of voting on individual decisions on its website within 15 days from the day of holding the general meeting. The general meeting shall make a decision by a majority vote of the shareholders present or represented or who voted by ballot, except in cases when a second majority is required to make a decision.

An "extraordinary assembly" is convened if:

- shareholders who hold at least 5% of the voting rights submit a written request for holding the general meeting;
- the board of directors – ie, members of the supervisory board or shareholders – propose:
  - (a) a change of the activity of the company;
  - (b) a change of the share capital of the company;
  - (c) a change of the auditor before the expiration of the term for which the auditor was elected; or
  - (d) a change of a member of the board of directors – ie, a member of the supervisory board – before the expiration of their mandate;
- there are large losses of the company or the allowance of the company to buy its own shares is needed;
- reorganisation, merger, voluntary liquidation or submission of a proposal for initiating bankruptcy proceedings of the company is approved;
- this is required by the resigned auditor;
- there is termination of membership in a member of the board of directors or supervisory board; or

- the board of directors – ie, the supervisory board – considers that a certain issue should be considered at the extraordinary general meeting of shareholders.

The joint stock company shall, within three days from the day of the end of the general meeting of shareholders, publish on its website the adopted decisions and voting results on all items on the agenda.

The session of the board of directors may be scheduled by the president of the board of directors in person or at the request of a member of the board of directors. If the president of the board of directors does not convene a session of the board of directors upon such request, within 30 days from the day of submitting the request, the session of the board of directors may be convened by any member. A member of the board of directors who convenes a session shall state in the request the reasons for convening the session and propose the agenda.

The session of the board of directors may be held if more than half of the members are present, and decisions shall be made if at least half of the present members of the board of directors vote for them. The members of the board of directors have the same right to vote, and in the case of an equal number of votes, the vote of the president of the Board of Directors is decisive.

According to LBO, the rules prescribed for the decision-making process of the board of directors shall apply accordingly to the decision-making process of the supervisory board and the management board.

When it comes to the sessions of the general meeting in the limited liability company, they may be held by using a conference call or other audio and visual communication equipment, in such a way that all persons participating in the work of the session can communicate with each other at the same time. A member of the company may vote by letter as well, unless otherwise determined by the founding act, the articles of association or procedural rules of the general meeting.

Decisions of the general meeting may be made without a session as well, if signed by all members of the company with voting rights.

4. Directors and Officers

4.1 Board Structure

The board of directors has at least three members. Notwithstanding, the board of directors of a public joint stock company shall have at least five members. The number of members of the board of directors is determined by the company's articles of association and must be odd. The members of the board of directors shall be elected for a period determined by the articles of association, which may not exceed four years. The board of directors must have at least one-third independent members, and the board of directors of a public joint stock company must have at least two-fifths independent members.

4.2 Roles of Board Members

The members of boards of directors have all the same role, with exception of the president of the boards of directors who is elected from among the members of the board of directors.

The additional roles of the president of the boards of directors are: (i) conclusion of the employment agreement with the CEO and the secretary of the company; and (ii) convening and chairing sessions of the board of directors, proposal of

the agenda and responsibility for keeping the minutes from the sessions of the board. The particular role of the president of the boards of directors in respect to decision-making process is provided in **3.3 Decision-Making Processes**.

4.3 Board Composition Requirements/Recommendations

Please see **4.1 Board Structure** in which a board of directors' composition requirements are described.

4.4 Appointment and Removal of Directors/Officers

The general meeting of shareholders is competent for appointment and dismissal of members of the board of directors as well as members of a supervisory board.

The board of directors is competent for appointment and dismissal of the CEO and secretary of the company.

4.5 Rules/Requirements Concerning Independence of Directors

The LBO prescribes that the board of directors must have at least one-third independent members, and the board of directors of a public joint stock company must have at least two-fifths independent members.

An independent member of the board of directors is considered to be a person who is not a relative in the direct line, a relative in the collateral line, concluding with the second degree of kinship, marital and extramarital spouse of other members of the company's management body – ie, shareholders who have a significant or majority share in the share capital – and a person who in the period of at least two years before the election as a member of the board of directors has not:

- been the majority owner, owner with significant share in the share capital, member of the management body, except the body to which they are elected, procurator, person employed in the company within whose body they are elected or in another company related to that company; or
- received or claimed from the company body in whose bodies they are elected, or from companies related to that company, a fee whose total value exceeds 10% of the annual income of that person.

In the event of a board member failing to comply with any of requirements stated above, the mandate of that member in the board of directors shall stop.

4.6 Legal Duties of Directors/Officers

The CEO, members of the board of directors, members of the management board and members of the supervisory board have special legal duties towards the company, such as:

- duty of care;
- declaration of personal interest;
- avoidance of conflict of interest;
- protection of business secrets; and
- respect for the prohibition of competition.

4.7 Responsibility/Accountability of Directors

The special legal duties are owed by directors to the company (ie, shareholders of the company).

4.8 Consequences and Enforcement of Breach of Directors' Duties

In cases of breach of special legal duties to the company by persons who have the obligation to respect them, the company has the possibility of filing a lawsuit and accordingly seeking compensation and, in the determinate cases, transfer

of benefits realised by that person to the company (ie, related person as a consequence of breach of duty and exclusion of the person from the company, if that person is a member of the company).

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

The members of the board of directors shall be liable for the damage caused to the company. Notwithstanding, the members of the board of directors are not responsible for the damage to the company that occurs as a result of the implementation of the decisions of the general meeting of the company.

If the damage occurs as a result of a decision of the board of directors, the members of the board of directors who voted for that decision shall be liable for the damage.

The same rules apply for members of the management board and supervisory board.

Furthermore, the members of the management body of the merging company are responsible for the damage they cause to the company (ie, to the shareholders of the company in the merger process).

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The general meeting of the shareholders is authorised to make decisions on the remuneration policy, as well as on the amount of remuneration for the members of the board of directors – ie, the CEO, members of the supervisory board and the management board.

If the remuneration policy is not adopted at the general meeting of the shareholders, a revised proposal is submitted at the next meeting, where the company can continue to pay renumeration:

- in accordance with the previously approved renumeration policy; or
- in accordance with existing practice, if there is not renumeration policy adopted in the previous period.

The LBO provides that the members of the board of directors and management board may exercise the right to remuneration for work through a share in the company's profit as well.

As to the CEO, the LBO and applicable by-laws prescribes the obligation for the company to conclude the employment agreement with the CEO and, in that respect, the CEO is remunerated through the monthly salary.

There are no specific restrictions on remuneration on fees or benefits payable to directors and officers.

4.11 Disclosure of Payments to Directors/Officers

The LBO provides legal requirements for public joint stock companies in respect to the remunerations of the officers and in particular that it must be disclosed in the annual financial reports.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

As a general rule of limited liability, shareholders of a joint stock company and members of a limited liability company shall not be liable for the obligations of the company.

However, shareholders of the joint stock company and members of a limited liability company shall be liable if they abuse the rule of limited liability, in which case their joint, solidary and unlimited liability for the company obligations may be determined by the competent court.

The LBO provides types of such abuse that exists when shareholders (ie, members):

- use the company to achieve a goal that is forbidden to them;
- use the company or its property to the detriment of the company's creditors;
- manage or dispose of the company's property contrary to the law; or
- reduce the company's assets in order to gain benefits for themselves or third parties, even though they knew or had to know that the company will not be able to settle its obligations.

In case of use of the company or its property to the detriment of the company's creditors, the creditor of the company is entitled to file a lawsuit to the competent court within six months of knowledge of the abuse (subjective deadline) and no later than three years from the date of the abuse.

5.2 Role of Shareholders in Company Management

The shareholders of the joint stock company and members of limited liability company constitute the general meeting. In that respect they have involvement in the management of a company by exercising their powers in the work of the general meeting, as explained in **3.2 Decisions Made by Particular Bodies.**

Moreover, shareholders holding at least 5% of the share capital may hire an expert to examine the company's operations or accounting.

The general rule prescribed by LBO provides that the general meeting consists of shareholders in the joint stock company (ie, members in the limited liability company). However, the shareholder and member have the right to authorise another person to vote as their representative at the general meeting or to perform other legal actions.

5.3 Shareholder Meetings

Meetings of shareholders are provided by the LBO in the form of sessions. For the rules on holding and conducting such sessions, please see **3.3 Decision-Making Processes.**

5.4 Shareholder Claims

The shareholders are entitled to submit legal actions against the directors:

- to seek indemnification or transfer of benefit gained as a result of particular kinds of breach of legal duties or for exclusion of company member, depending on the type of violated legal duty;
- for compensation of the damage caused to shareholders by the violation of special duties towards the company that represents individual direct action, and the particularity consists in the fact that compensation belongs to the shareholder if the shareholder succeeds with the claim; and
- for compensation of the damage caused to shareholders by the violation of special duties towards the company that represents derivative action, and the particularity consists in the fact that the compensation belongs to the company if the shareholder succeeds with the claim.

5.5 Disclosure by Shareholders in Publicly Traded Companies

The LCM regulates the obligation of shareholders in publicly traded companies on notification of the issuer of its voting rights when a shareholder:

- reaches, exceeds or falls below the threshold of 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75% as a result of the acquisition or disposal of the issuer's shares; or
- reaches, exceeds, or falls below the threshold referred to above, as a result of a change in the number of voting shares into which the issuer's share capital is divided, or changes in the number of voting rights from those shares.

According to the Montenegrin Law on Prevention of Money Laundering and Financing of Terrorism. publicly traded companies do not have to report their UBOs when they are listed on the regulated market that is subject to the disclosure requirements.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

The general meeting of shareholders is competent for adoption of regular annual financial reports and statements. The audit of the company's financial reports is performed upon the expiration of the accounting year and before the general meeting session is convened. Copies of the financial reports, including the auditor's reports, must be available for the shareholders' inspection at the company's registered office during regular business hours, at least 30 days prior to holding the general meeting of shareholders, and at the general meeting of shareholders as well.

The annual financial reports and consolidated reports of both joint stock company and limited liability company shall be submitted no later than 31 December of the business year, as well as on the day of the registration of status changes and on the day of issuing a decision on the voluntary liquidation of a legal entity.

The financial and management reports in written and electronic form shall be submitted to the competent tax authority no later than 31 March of the current year for the previous year, while the consolidated financial reports and consolidated management reports shall be submitted no later than 30 September of the current year for the previous year.

Furthermore, the joint stock company is obliged to submit financial reports to the Central Registry of Commercial Entities in Montenegro (CRPS) for the purpose of its registration.

6.2 Disclosure of Corporate Governance Arrangements

The disclosure of the corporate governance arrangements exists in the form of a report on the operations of the company, the integral parts of which are the relations of the company with the parent company and companies in which its parent company has the status of parent or subsidiary.

The report on the operations shall list all legal transactions and transactions that the company had with its parent company and companies in which its parent company has the status of parent or subsidiary, with a statement of the board of directors or supervisory board including information if the company suffered damage

from those transactions, as well as whether the company was compensated for any damage it may have received from such legal transactions.

6.3 Companies Registry Filings

The joint stock company is obliged to submit to CRPS, within seven days from the day of the change, documentation and data on the changes related to:

- the articles of association and the special act, or the founding act if the changes relate to the founding act;
- appointment, dismissal and other changes in data on members of the board of directors and CEO (ie, members of the supervisory board and management board);
- appointment, dismissal and information on the auditor, audit committee and secretary of the company, if any; and
- appointment, dismissal and other changes in the data on persons authorised to represent the company with the scope of authorisation to represent (individually or collectively).

In the event of initiating liquidation or bankruptcy proceedings the joint stock company is obliged to submit to CRPS:

- the decision on initiating of proceedings in case of liquidation or bankruptcy proceedings;
- the decision on the appointment of the liquidator (ie, the bankruptcy trustee), their identity, qualifications and authorisations, except those determined by the company's articles of association or the law; and
- the decision on the termination of the liquidation procedure (ie, the bankruptcy procedure), with the obligatory indication of all legal consequences of deleting the company from the register.

All the data mentioned above in relation to the joint stock company is publicly available and shall be published in the Official Gazette of Montenegro, stating the documentation on the basis of which the registration at the CRPS was performed.

A limited liability company is obliged to submit documentation and data on the changes in the company related to:

- articles of association;
- name and seat of the company;
- address for receiving official mail;
- email address;
- persons elected as members of the governing body and their appointments and dismissals;
- persons who, collectively or individually, have the authority to represent the company in relations with third parties and their appointments and dismissals;
- liquidation of the company;
- annulment of the establishment of the company by the competent court;
- appointment of liquidator; and
- shares and the amount of share capital, if the increase in share capital does not require a change in the statute.

All the data mentioned above in relation to the limited liability company is publicly available and shall be published on the website of the company, if it exists.

In case the documentation is not completed or the data from the application incomplete, CRPS will reject the incorporation of the company or implementing the change.

Furthermore, failing to make the filings is considered as misdemeanour.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The Montenegrin Audit Law (Official Gazette of Montenegro, No 1/2017) provides types of legal entities for which an audit is mandatory. Such legal entities, inter alia, are:

- entities of public interest (legal entities that issue securities and other financial instruments traded on the organised market, banks and other financial institutions and insurance companies);
- medium-sized legal entities;
- parent legal entities, which together with dependent legal entities meet the conditions for classification in the group of medium-sized legal entities;
- parent legal entities, which together with dependent legal entities meet the conditions for classification in a group of large legal entities; and
- investment companies, fund and fund-management companies.

The audit of the company's financial report is performed after the end of the financial year, before the regular general meeting, in accordance with the law. The audit shall be audited by an independent auditor who meets the requirements established by the law. The auditor is appointed by the general meeting of shareholders, for a period determined by the articles of association, which cannot be longer than one year.

The auditor has the right to inspect all business books of the company at the time agreed and has the right to request from members of the board of directors (ie, members of the supervisory and management board), CEO and other employees of the company, explanations and information necessary to compile the audit report.

The auditor has the right to attend the assembly and provide explanations and answers to questions asked regarding the assessments and opinions given in the audit report. An excerpt from the audit report shall be read at the annual general meeting (AGM) and shall be available for inspection to all shareholders at that AGM.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Requirements prescribed by LBO in relation to directors in respect to management of risk and internal controls in the company are provided in **4.6 Legal Duties of Directors/Officers**, **4.8 Consequences and Enforcement of Breach of Directors' Duties** and **4.9 Other Bases for Claims/Enforcement Against Directors/Officers**.

Trends and Developments

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Radonjic Associatesis a leading Montenegrin full-service law firm in Podgorica with 13 specialist fee earners of which ten are attorneys. Radonjic Associates provides its clients with integrated legal advice on complex transactions. As a premier business law firm whose practice covers a broad spectrum of transactional and regulatory matters, Radonjic Associates enjoys an international reputation and is the preferred local partner for many international law firms, international financial institutions and embassies. The firm's client base is a diverse range of large international corporations, leading energy and construction companies in Europe and the wealthiest individuals investing in Montenegro. Radonjic Associates has a particularly strong focus in the corporate and commercial, energy, banking and finance, foreign direct investment, real estate and construction sectors.

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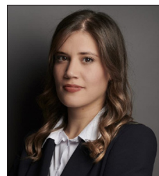

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Introduction to Current Goals and Amendments

The current Law on Business Organisations ("the law") was adopted in 2020 and contains more current improvements upon the Law on Business Organisations of 2002. However, in order to respond to the challenge of harmonising the national legislative framework with the existing regulations of the European Union, preconditions were required to be created for a more integrative approach to the national market and its easier connection with the foreign market environment in July 2022, and the Ministry of Economic Development and Tourism of Montenegro formed the working group for the preparation of amendments to the current law, whose most important goal was to harmonise the law with the directives of the European Union, namely with:

- Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009, which treats single-member capital companies;
- Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007, which defines the rights of shareholders in joint stock companies which operate through the stock exchange environment;
- Directive 2017/1132/EU of the European Parliament and of the Council, on certain aspects of company rights from 14 May 2017, with emphasis on the procedure of cross-border mergers (with amendments from Directive 2019/1151 and 2019/2121);
- Directive 2017/828/EU of the European Parliament and of the Council and advice on long-term shareholders' co-operation;
- Directive 2005/56/EC of the European Parliament and of the Council, on cross-border merging of Limited Liability Companies (with amendments from Directive 2009/109/EC, 2012/17/EU and 2014/59/EU).

Compliance is maintained with regulations and recommendations of European commissions.

Additionally, due to numerous shortcomings of the current law, emphasis was placed on their removal, supplementing insufficiently regulated issues, as well as harmonising all parts of the law.

Therefore, on 9 May 2023, the Draft of the Amendments to the law was published and contains 620 Articles, while the current law contains 333 Articles. In this regard, it is clear that there are numerous novelties, improvements and refinements.

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Novelties in Legislation and Current Practice

In general, the main novelties in relation to the current law are as follows:

- Defining the concept of the "member of the company". The term "member" is mentioned in the current law, although it is not precisely defined, and there was confusion as to what the legislator meant by that term. The new draft precisely defines the concept of a member of the company, which includes:
  - (a) in a partnership – partners;
  - (b) in a limited partnership – general partners and limited partners;
  - (c) in a limited liability company – members;
  - (d) in a joint stock company – shareholders.
- The goal of the company as a long-term increase of its own value and sustainable business in order to protect the interests of the members as well as the interests of other persons operating in the interest of the company.
- Effects of registration on third parties. The goal is completeness and accuracy of information in order to protect the trust of third parties, so that those persons in legal transactions can rely on registered data and cannot bear harmful legal consequences resulting from incorrectly registered data. In addition, it is considered that third parties are familiar with the registered data from the date of publication on the website of the competent authority for registration, in accordance with the Law on Registration (we will discuss this in more detail in the second part of the text). In order to protect unscrupulous third parties, there is an opportunity for them to prove within 15 days that it was impossible for them to get acquainted with the data during that period, while the company can prove that third parties were aware, or should have been aware, of the companies' documents and data about the company even before their registration in accordance with the Law on Registration. Finally, third parties have the right to rely on the company's documents and information about the company that were created but not recorded in the register.
- Annulment of establishment of a company. The competent court can determine the nullity of the establishment of a company in civil proceedings if:
  - (a) the Founding Act and Articles of Association (AoA) of the company do not have the form prescribed by the law;
  - (b) the activity of the company that is stated in the Founding act and/or AoA is contrary to compulsory regulations or public order;
  - (c) the Founding Act or the AoA do not contain provisions on the business name of the company, the roles of the members, the amount of the basic capital or the predominant activity of the company;
  - (d) the requirements regarding the minimum founding capital have not been met; or
  - (e) all the founders, at the time of the conclusion of the Founding Act, were legal/business incompetent.
- Any person who has a legal interest can file a lawsuit in order to determine the nullity of the establishment of the company within six months from the date of establishment of the company. Thereafter, the court submits to the competent registry the verdict establishing the nullity of the establishment of the company within 15 days from the date of effectiveness of the verdict, for the purpose of registration and initiation of the court's liquidation procedure. This verdict has no effect on the company's legal affairs with conscientious third parties.
- Agreement of company members, ie, an internal act concluded between two or more

members of a company, which regulates issues of importance for their mutual relations in connection with the company. The current law does not have a rule that applies to those agreements, but the new article in the proposed amendments defines that the members' agreement produces its effect exclusively between the members of the company who concluded it.
- Abuse of the status of a legal entity, ie, every limited partner, member of a limited liability company and shareholder who misuses the rule on limited liability is jointly and severally liable for the company's obligations. "Abuse" in this context is defined as any kind of cheating, ie, disrespecting the legal personality of the company by the above-mentioned person or a person related to him, on the basis of which – whether through commingling of funds, their reduction, irregularities in management, operations contrary to the goals of the company, neglect of identity, damage to creditors and/or other actions – creates a general impression of their identification with the company. In case of abuse, the creditor of the company can file a lawsuit against the above-mentioned person within six months from the day of discovering about the abuse,and no later than within three years from the date of the abuse.
- Instead of the term "name" of the company, the term "business name" will be used, and the name will be only one part of the business name. The name will be a distinctive part of the business name by which the companies will be distinguished. The business name must be in the Montenegrin language, Latin or Cyrillic script.
- A business name in a foreign language can only be used together with a business name or an abbreviated business name in the Montenegrin language, and the company is obliged to display its business name or abbreviated business name visibly on every business premises.
- Limitation of the authorisations of the representative – the representative of the company represents the company within the limits of his authorisations registered, and if he exceeds them, he is responsible for the damage caused by the excess. Registration does not assume that the third party knew about the limitations of authorisations, so the limitations of authorisations cannot be asserted against third parties if they were not aware of the limitations.
- Signing – every representative and procurator of a company is obliged to indicate his position in the company with his signature when signing documents on behalf of the company.
- Reporting a legal action of a personal interest (in accordance with the 2017 Shareholders' Rights Directive) which requires an approval. In the case of joint-stock companies, if the value of the subject matter of the legal transaction, ie, the legal transaction amounts to at least 10% of the book value of the total assets of the company shown in the last annual balance sheet, the board of directors – ie, the supervisory board – will make an assessment as to whether the legal transaction is fair and reasonable from the point of view of the joint stock company and its shareholders, who have no personal interest.

Approval is not necessary in certain instances:

- When concluding a legal transaction or undertaking a legal transaction, if the value of the subject of the legal transaction amounts to no more than 5% of the book value of the total assets of the company stated in the last annual balance sheet.

- When the conclusion of a legal transaction or the undertaking of a legal action is part of the regular operations of the company and contains the usual market conditions, unless the company decides otherwise by its founding act or AoA.
- When concluding a legal transaction with another legal entity and that company, directly or indirectly, owns all shares.
- When a personal interest prevails in the sole member of the company or all members of the company.
- When registration, ie, purchase of shares or shares based on the right of pre-emption, consolidates the right of pre-emption of company members.
- In the acquisition of own shares, ie, shares by the company, if that acquisition is carried out in accordance with this law.
- Concluding an employment agreement or other appropriate agreement with the director.
- When jobs are offered to all members, ie, shareholders under equal conditions.
- *Filing a derivative lawsuit* – the novelty is that not only company members have the right to file a lawsuit, but every creditor of a single-member limited liability company and a single-member joint-stock company. A counterclaim in a derivative lawsuit is allowed only if it relates to issues on which the right to litigate depends. Modification of a derivative claim, which consists in changing the identity of the claim, increasing the existing one or emphasising another claim in addition to the existing one, is not allowed (even with the consent of the defendant) if it significantly deviates from the content of the previous claim.
- *Monetary and non-monetary contributions* – if the monetary deposit is paid in foreign currency in accordance with the law governing foreign exchange operations, the equivalent value in euros is calculated at the mid-rate of the Central Bank of Montenegro on the day the deposit is paid. Non-monetary contributions can be in things, rights, work and services, if the law does not regulate otherwise for certain forms of business companies. A proposal was also made to change the procedure for increasing non-monetary capital with regard to the need for an assessment by an authorised appraiser. In this regard, a written agreement signed by all members of the company, which contains the same elements as the authorised appraiser's report, is sufficient, except for the description of the appraisal methods. Therefore it is necessary to protect the creditor, and the right of the creditor to determine the value of the non-monetary contribution in a non-litigation procedure at the time of the introduction of the contribution if the company is not able to settle its obligations in the regular course. If the court determines that the value of the non-monetary contribution was less than the amount agreed upon, the court will order that the concerned member pay the difference and bear the costs of the procedure jointly with the company.

A Planned Draft of the Law on Registration

In addition to the novelties introduced in the draft amendments on the Law on Business Organisations, it is also proposed that a Draft of the Law on Registration business and other entities is made, since the current law does not sufficiently regulate the Institute of Registration. Namely, the current law regulates the issue of registration in the ninth part, while a large number of provisions related to registration are also mentioned in the rest of the text of the law. The registration procedure is elaborated in the rulebook on the registration procedure, detailed content and manner of keeping the Central Register of Business

Entities (CRBE). In this regard, due to imprecise regulations there was inconsistent practice when it came to registration and changes that were registered in the CRBE. The need for improving this became urgent.

The proposed draft regulates the procedure of registration of business and other entities, beneficial owners and bankruptcy estates in the CRBE, the content and manner of conducting the CRBE, publicity and the publication of data, as well as other issues of importance for the registration procedure.

This Draft of the Law on Registration clearly defines the responsibility of the competent authority of recording the identity of the data registered in the CRBE with the data from the registration application submitted to it by the applicant, while the applicant of the registration application is responsible for the credibility and accuracy of the data and documents submitted to the competent registration authority for registration in the CRPS.

Furthermore, there is a novelty in assigning the status of business and other entities registered in the CRBE (active, inactive, in bankruptcy, in liquidation, not updated, deleted), so that every interested person has information about the company's business operations.

One of the most important requirements of the EU is enabling the establishment of a company, ie, enabling submission of the application and delivery of the registration decision electronically. Article 22 of the Draft of the Law on Registration regulates the initiation of the registration procedure by submitting the registration application electronically, directly or by mail.

Finally, it is clear that the adoption of the Law on Registration and the new Law on Business Companies would significantly facilitate the company's operations in Montenegro, as well as the registration procedure.

NETHERLANDS

Law and Practice

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Contents

1. Introductory p.419
1.1 Forms of Corporate/Business Organisations p.419
1.2 Sources of Corporate Governance Requirements p.419
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.420

2. Corporate Governance Context p.421
2.1 Hot Topics in Corporate Governance p.421
2.2 Environmental, Social and Governance (ESG) Considerations p.422

3. Management of the Company p.423
3.1 Bodies or Functions Involved in Governance and Management p.423
3.2 Decisions Made by Particular Bodies p.424
3.3 Decision-Making Processes p.425

4. Directors and Officers p.426
4.1 Board Structure p.426
4.2 Roles of Board Members p.427
4.3 Board Composition Requirements/Recommendations p.427
4.4 Appointment and Removal of Directors/Officers p.429
4.5 Rules/Requirements Concerning Independence of Directors p.430
4.6 Legal Duties of Directors/Officers p.431
4.7 Responsibility/Accountability of Directors p.432
4.8 Consequences and Enforcement of Breach of Directors' Duties p.433
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.434
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.435
4.11 Disclosure of Payments to Directors/Officers p.435

5. Shareholders p.436
5.1 Relationship Between Companies and Shareholders p.436
5.2 Role of Shareholders in Company Management p.436
5.3 Shareholder Meetings p.437
5.4 Shareholder Claims p.437
5.5 Disclosure by Shareholders in Publicly Traded Companies p.438

6. Corporate Reporting and Other Disclosures p.439
6.1 Financial Reporting p.439
6.2 Disclosure of Corporate Governance Arrangements p.439
6.3 Companies Registry Filings p.440

7. Audit, Risk and Internal Controls p.441
7.1 Appointment of External Auditors p.441
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.442

Stibbe is a leading, independent, international law firm with main offices in Amsterdam, Brussels and Luxembourg, and a branch office in London. It provides the highest quality service in legal advice, transactions and litigation. The dedicated multidisciplinary teams are trusted legal advisers to clients, which range from national and multinational companies and financial institutions to government organisations and other public authorities. The firm handles transactions, disputes and projects across a wide range of sectors. Its understanding of clients' commercial objectives enables the team to provide suitable and effective advice on complex legal issues and challenges. The firm works closely together with other international top-tier firms on cross-border matters outside its home jurisdictions; its independence allows it to team up with any foreign law firm to suit clients' needs and preferences.

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Stibbe

1. Introductory

1.1 Forms of Corporate/Business Organisations

The BV and the NV

The corporate entities that are frequently used for commercial activities in the Netherlands are:

- the private company with limited liability (*besloten vennootschap met beperkte aansprakelijkheid* or BV); and
- the public company with limited liability (*naamloze vennootschap* or NV).

The BV and the NV are legal persons under Dutch law. Their equity is divided into shares that are owned by shareholders.

The BV is the most frequently used type of corporate entity in the Netherlands. In 2023, 425,705 BVs and 1,000 NVs were registered in the Netherlands. Most Dutch listed companies are NVs, but it is also possible to list a BV.

The following legal entities also have legal personality in the Netherlands:

- an association (*vereniging)*;
- a co-operative (*coöperatie*);
- a mutual insurance association (*onderlinge waarborgmaatschappij*); and
- a foundation (*stichting*).

Book 2 of the Dutch Civil Code applies to all the legal entities listed above. It does not apply to -entities without legal personality, which include:

- a general partnership (*vennootschap onder firma*);
- a limited partnership (*commanditaire vennootschap*);
- a professional partnership (*maatschap)*; and
- a sole trader (*eenmanszaak)*.

Unless otherwise stated, the answers in this chapter will focus on BVs and NVs.

1.2 Sources of Corporate Governance Requirements

General

Several acts (*wetten)* are sources of corporate governance requirements for BVs and NVs. The Netherlands is a member of the EU, which means that for a large part Dutch corporate law is based on European regulations, which have been implemented in several relevant Dutch acts.

Dutch Civil Code (Burgerlijk Wetboek)

Book 2 of the Dutch Civil Code is the primary source of corporate law in the Netherlands. Provisions regarding the following are relevant to the corporate governance of NVs and BVs:

- the various corporate bodies within a company;
- the duties, powers and liabilities of these corporate bodies;
- more specific rules on representation and directors' conflicts of interest; and
- financial reporting and disclosure.

Financial Supervision Act (FSA) (Wet op het financieel toezicht)

In addition, Chapter 5 of the FSA provides for rules on the supervision of the business conduct of Dutch listed companies. It contains rules on the disclosure of major holdings, financial reporting, the prevention of market abuse and the obligations of institutional investors. The Dutch Authority for the Financial Markets (*Autoriteit Financiële Markten* AFM) supervises compliance with these rules.

Dutch Corporate Governance Code (CG Code)

The CG Code applies to:

- all companies with registered offices in the Netherlands whose shares or depositary receipts for shares have been admitted to trading on a regulated market or a comparable system; and
- all large companies with registered offices in the Netherlands (with a balance sheet value of more than EUR500 million) whose shares or depositary receipts for shares have been admitted to trading on a multilateral trading facility or a comparable system (Dutch listed companies).

The CG Code was most recently revised in 2022, although the amendments in question have not yet been enacted; the CG Code 2022 will most likely come into force in 2023. Companies will be deemed to be compliant with the CG Code 2022 if any required changes have been implemented no later than 31 December 2023.

The purpose of the CG Code is to facilitate a sound and transparent system of checks and balances of Dutch companies that come within scope of the CG Code.

The articles of associations of a BV/NV may also provide for specific corporate governance rules within the boundaries of the Dutch Civil Code. They may require, for example, a specific quorum or majority for certain resolutions of the general meeting or of the Supervisory Board or Management Board.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

General

In addition to the applicable provisions of Book 2 of the Dutch Civil Code, which also contain various specific rules for Dutch listed companies, the following regulations apply to Dutch listed companies. The requirements of Acts are mandatory: the requirements (principles and best practice provisions) of the CG Code are based on the "comply or explain" principle.

Financial Supervision Act (FSA) (Wet op het financieel toezicht)

See **1.2 Sources of Corporate Governance Requirements.**

CG Code

The CG Code contains principles and best practice provisions regulating the relationship between the management board, the supervisory board (or the one-tier board as the case may be) and the general meeting/shareholders of Dutch companies that come within scope of the CG Code. The principles and provisions aim to define responsibilities for sustainable long-term value creation, risk control, effective management and supervision, remuneration, and the relationship with shareholders (including the general meeting of shareholders) and stakeholders.

The broad outline of the company's corporate governance is set out each year in a separate chapter of the management report or published on the company's website. Here the company explicitly states the extent to which it complies with the principles and best practice provisions stipulated in the CG Code and, where it does not comply, why and to what extent it departs from them.

Sector-specific legislation is in place for certain entities, such as financial institutions. The healthcare sector, for example, has a Healthcare Governance Code.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Sustainability Legislation Initiatives

European background

In December 2019, the European Commission introduced the European Green Deal, the purpose of which is to transform the EU into a modern, resource-efficient and competitive economy. Several legislative initiatives have since been taken to transform the EU into a more climate-neutral and green economy, including the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD).

CSRD

This Directive came into force on 6 January 2023 and must be implemented by member states by July 2024. Companies must report on sustainability, covering environmental, social and governance (ESG) issues. See **2.2 Environmental, Social and Governance (ESG) Considerations** for more information on the CSRD.

CSDDD

On 23 February 2022, the European Commission published the proposal for the CSDDD, which aims to harmonise existing EU member state laws on supply chain due diligence, obligations regarding actual and potential human rights adverse impacts and environmental adverse impacts with respect to their own operations and those of their subsidiaries and other entities in their value chain.

The European Council adopted its position on the CSDDD on 1 December 2022, proposing quite a few changes to the Commission's proposal. On 1 June 2023, the European Parliament voted on the CSDDD. The European Parliament's proposal on some points goes further than those proposed by the European Commission and the European Council. Negotiations between the European Commission, the European Parliament and the European Council on the final text of the CSDD can now begin. After the directive enters into force, member states have some time to implement the directive into national laws and regulations.

CG Code

The main theme of the CG Code 2022 is sustainable, long-term value creation. See also the following sections concerning various topics of corporate governance in relation to Dutch listed companies.

Act on Growth Quota and Target Ratios (Diversity Act)

On 1 January 2022, the Diversity Act (*Wet ingroeiquotum en streefcijfers)* entered into force. It seeks to ensure a better balance between the number of men and women on the management board, the supervisory board and the senior management of large companies (*grote vennootschappen*), and introduces a statutory diversity quota for supervisory boards of Dutch listed companies (diversity quota). In addition, large companies (*grote vennootschappen)* (whether listed or not) must set more appropriate and ambitious target ratios, draw up an action plan and report on this in the management report and to the Social and Economic Council (*Sociaal Economische Raad)* (SER) after the end of the financial year (FY) 2022.

The definition of a large company under the Diversity Act

For the purpose of the Diversity Act, a large company (*grote vennootschap)* is a company that meets at least two of the following requirements on two consecutive balance sheet dates:

- the value of the assets exceeds EUR20 million;
- the net turnover for the financial year exceeds EUR40 million; and
- the average number of employees is 250 or higher.

It is not sufficient to test the size of its own assets, net sales and employees; data from group companies that should be included in the consolidation should be included in the test. This applies even if no consolidated financial statements need to be prepared.

2.2 Environmental, Social and Governance (ESG) Considerations

Non-Financial Reporting Directive (NFRD)

Dutch large listed companies must report on policies and performance on issues such as environmental pollution. In the Netherlands, fewer than 100 companies must report non-financial information.

A company is considered "large" for the purpose of the NFRD if two of the following three criteria are fulfilled:

- a balance sheet total of more than EUR20 million;
- a net turnover of more than EUR40 million; and
- more than 500 employees.

Corporate Sustainability Reporting Directive

The CSRD revises and strengthens rules introduced by the NFRD. It will ensure that companies provide reliable, consistent and comparable sustainability information for investors and other stakeholders.

Reporting must be done in accordance with the European Sustainability Reporting Standards being developed by the European Financial Reporting Advisory Group.

The CSRD will be applicable for financial years starting on or after:

- 1 January 2024 for Dutch large listed companies (see above) that already have to report in order to conform with the NFRD;
- 1 January 2025 for large companies (*grote vennootschappen)* – see **2.1 Hot Topics in Corporate Governance** (Sustainability Legislation Initiatives); and
- 1 January 2026 for listed small and medium entities (SMEs), which will be subject to a mitigated reporting regime.

The CSRD requires an external auditor to provide assurance on sustainability reporting such assurance can initially be limited, but more reasoned assurance will be required later. The CSRD requires companies to publish their sustainability reports in a dedicated section of their management reports.

Corporate Sustainability Due Diligence Directive

Under the CSDDD, companies will need to adopt due diligence policies to identify, prevent or mitigate – and ultimately end – any adverse impact of their operations on human rights, the environment and good corporate governance (including corruption). Companies also need to have a plan

to ensure that their business strategy is compatible with limiting global warming to 1.5°C in line with the Paris Agreement.

The CSDD will apply not only to (very) large European companies (whether in certain sectors or not) but also to certain non-EU entities.

The CSDDD has not yet been adopted. The new obligations are expected to apply as of 2026/2027.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

Principal Bodies of BVs and NVs

All private companies with limited liability (BVs) and public companies with limited liability (NVs) have a management board and a general meeting. BVs and NVs may opt for a supervisory board or for non-executives in the board, resulting in the following three possible governance structures:

- only a management board is in place, with executive directors;
- both a management board and a supervisory board are in place (a two-tier structure); or
- a one-tier management board is in place, consisting of executive directors and non-executive directors (one-tier board structure).

Large Company Regime (Structuurregime)

A supervisory board (or a one-tier board consisting of executive and non-executive directors) is mandatory if a company has filed a statement with the Dutch Trade Register for two consecutive years, stating that it qualifies as a "large" company under the statutory two-tier rules (*structuurvennootschap)*. This supervisory board must consist of three or more directors (or three or more non-executive directors in the case of a one-tier board).

See **4.1 Board Structure** for more information on the one-tier board.

The main characteristics of a (*structuurvennootschap)* are:

- in principle, the general meeting and the works council (*ondernemingsraad)* can significantly influence the composition of the supervisory board;
- the supervisory board, rather than the general meeting, is authorised to appoint the directors of the management board and to remove them from office – the supervisory board lacks this authority if the so-called mitigated large company regime applies; and
- certain important resolutions of the management board require the prior approval of the supervisory board (or the majority of the non-executive directors in the case of a one-tier board).

The large company regime (*structuurregime)* is applicable to a Dutch company that has filed a registration with the Dutch Trade Register, stating that from its adopted annual accounts it appears that:

- its issued capital and reserves amount to not less than EUR16 million;
- it has set up a works council on the grounds of a statutory requirement; and
- as a rule, it employs at least 100 employees in the Netherlands.

It must also have kept this mandatory registration with the Dutch Trade Register for three consecutive years. Upon the expiration of this

three-year term, the company's articles of association must be amended to incorporate certain mandatory provisions relating to the large company regime apply.

For the second and third requirements mentioned above, the dependent companies (*afhankelijke maatschappijen*) of the potential large company are also taken into account. A company qualifies as a dependent company of another legal entity if such other entity provides at least 50% of the capital of such company.

A company that meets the criteria set out above is required to file a registration with the Dutch Trade Register within two months after the adoption or approval of the company's annual accounts by the general meeting. A repeated annual registration for consecutive years is not required.

Exemptions

The large company regime does not apply to certain companies, such as:

- companies that (virtually) exclusively operate as a holding or finance company for their group companies, provided the majority of the employees of the group are employed outside the Netherlands; and
- companies of which at least half of the share capital is held by a company that applies the large company regime.

Mitigated Large Company Regime (Beperkt Structuurregime)

Certain (*structuurvennootschappen)* are allowed to apply the mitigated large company regime (*beperkt structuurregime)* instead of the full regime. This applies, for example, to (*structuurvennootschappen)* in which at least 50% of the share capital is held by a legal entity (either by itself or by its dependent company) that employs the majority of its employees outside the Netherlands. Under the mitigated large company regime, the general meeting appoints the managing directors (as opposed to the supervisory board which is entitled to appoint the managing directors in case of the full large company regime). For more information, see **4.4 Appointment and Removal of Directors/Officers**.

Voluntary Application of the (Full or Mitigated) Large Company Regime

A company may also voluntarily apply the provisions of the full or mitigated large company regime if it (or a dependent company) has established a works council to which the provisions of the Works Council Act (*Wet op de Ondernemingsraden)* apply.

3.2 Decisions Made by Particular Bodies

The Management Board

The primary responsibility of the management board is to manage the company and its business. In the performance of its duties, the management board is collectively responsible for:

- formulating and determining the policy and strategy;
- achieving the legal entity's objects; and
- the day-to-day management of the company and its business.

The management board must carry out its duties in line with the company's objectives, which are included in the company's articles of association.

Depending on the articles of association, the management board may resolve on:

- the issuance of shares (this authority can also be granted to the management board by the general meeting);
- reservations from the profits;
- (approval of) (interim) distributions; and
- the right of initiative for certain resolutions of the general meeting, such as shares issuances, amendments to the company's articles of association, legal mergers, demergers, dissolution and conversion.

The Supervisory Board

If installed, the supervisory board supervises and advises the management board on the general course of affairs of the company and the business affiliated with it.

General Meeting – Shareholders

In principle, the general meeting may resolve on the following:

- the appointment (including remuneration and, in the case of a one-tier board, designating whether a person is appointed as an executive or non-executive director), suspension and dismissal of managing directors and supervisory directors (see **3.1 Bodies or Functions Involved in Governance and Management** regarding the deviating provisions applicable to companies subject to the full or mitigated large company regime);
- any increase (including the issuance of shares) or decrease of share capital;
- the adoption of the annual accounts;
- distributions;
- amendments to the company's articles of association, covering legal mergers, demergers, dissolution and conversion; and
- the appointment of the auditor.

The general meeting is entitled to receive information from the Management Board.

The articles of association may provide that certain management board resolutions are or can be made subject to the approval of the general meeting or supervisory board.

For the NV, the approval of the general meeting is required for resolutions of the management board concerning a major change in the identity or character of the company or business.

Listed Company

General meetings of a listed company hold an advisory vote on the remuneration report and adopt the remuneration policy for the management board and supervisory board every four years. This resolution requires a 75% majority of the votes validly cast, unless the articles of association explicitly provide otherwise.

3.3 Decision-Making Processes

Management Board

The management board has collective responsibility. If collegial governance is in place, it is possible to make a division of tasks. The responsibility for fulfilling a particular board task, as part of the board policy, always remains with the entire board.

Each managing director has one vote. The articles of association may provide that a director has more than one vote, but one director cannot have more votes than the other directors collectively.

Dutch law does not include quorum requirements (the articles of association may provide otherwise). The management board adopts resolutions by simple majority of the votes validly cast (the articles of association may provide otherwise). Meeting and decision-making rules can be included in the articles of association and elaborated on in the regulations of the manage-

ment board. The management board adopts resolutions inside a meeting; resolutions outside a meeting are allowed, depending on the articles of association.

Supervisory Board

The characteristics of the collective responsibility of the management board and the decision-making process as described above are also applicable to the supervisory board.

Shareholders Meeting

The general meeting of a BV/NV is led by a chair, who is responsible for the meeting order; often the chair of the supervisory board is the chair of the general meeting.

Every shareholder of a BV/NV has the right to attend the general meeting, speak at it and exercise voting rights, either in person or by written proxy.

A BV may have non-voting shares; shareholders with non-voting shares cannot vote but do have the right to attend the general meeting.

Management board members and supervisory board members have an advisory vote to the general meeting.

4. Directors and Officers

4.1 Board Structure

Management Board

Dutch corporate law requires BVs and NVs to have a management board.

Two-Tier Board Versus One-Tier Board

In addition to the management board, it is possible to have a supervisory board in place (two-tier system). Instead of having a management board and a supervisory board, companies are able to opt for a one-tier board with executive and non-executive directors who are directors of the management board (one-tier system).

Both directors of the supervisory board and non-executive directors must be individuals.

Dutch Companies Within Scope of the CG Code

If the supervisory board of a Dutch listed company consists of more than four directors, it should appoint the following from among its directors:

- an audit committee;
- a remuneration committee; and
- a selection and appointment (nomination) committee.

Without prejudice to the collegiate responsibility of the supervisory board, the duty of these committees is to prepare the decision-making of the supervisory board.

One-Tier Board

In a one-tier board structure, the tasks of the management board are divided among the executive directors and the non-executive directors. The executive directors are responsible for the daily management of the company. The general course of affairs of the company is the responsibility of all the board directors, both executive and non-executive. The non-executive directors always have the supervision tasks within a one-tier board.

If the (full or mitigated) large company regime applies, certain important resolutions of the management board require the prior approval of the majority of the non-executive directors.

Executive directors may not take part in the decision-making process regarding certain resolutions, such as the appointment and remuneration of the executive directors.

If the full large company regime applies, the executive directors are appointed by the non-executive directors.

4.2 Roles of Board Members

Collective Responsibility

The management board of a legal entity is charged with the management of the legal entity and its affiliated business. Specific tasks may be expressly attributed or delegated to an individual managing director or pursuant to the articles of association. The management board is collectively responsible for resolutions, even resolutions m made by individual board directors.

Taking into account the general duties mentioned above, the specific details of the management board's role depend on several factors, such as the size and nature of the legal entity's activities.

The responsibilities of the individual board directors of Dutch companies within the scope of the CG Code are often set out in charters of the management board.

Also, the supervisory board has collective responsibility.

Chairperson

Neither Book 2 of the Dutch Civil Code nor the CG Code stipulates who appoints the chairman of the management board of the supervisory board of an NV/BV. The chair of a one-tier board must be a non-executive director.

Additional Requirements for Dutch Listed Companies Following From the CG Code

A supervisory board of a Dutch listed company appoints a vice chairperson. One of the directors of the supervisory board must be a financial expert. The audit committee and the remuneration committee should not be chaired by the chairperson of the supervisory board, nor by a former managing director of the company.

4.3 Board Composition Requirements/Recommendations

General Composition

A board must have at least the following number of members.

- One member:
  - (a) a management board: being a legal person or individual; and
  - (b) a supervisory board: being an individual.
- Two members:
  - (c) one-tier board:
    - (i) one executive member; being a legal person or an individual; and
    - (ii) one non-executive member, who must be an individual.

The articles of association can limit the circle of persons eligible for appointment as supervisory director or managing director by setting requirements that directors must meet. The quality requirements set out in the articles of association may be set aside by a resolution of the general meeting with two thirds of the votes cast, representing more than one half of the issued share capital.

Dutch Companies Within Scope of the CG Code

According to the CG Code. each supervisory director and each managing director should have the specific expertise required for the ful-

filment of their duties. Each supervisory director should be capable of assessing the broad outline of the overall management. The requirement that the supervisory board has financial expertise is enshrined in law. Pursuant to the EU Statutory Audits Directive 2006/43/EC, at least one member of the audit committee must have expertise in the preparation and auditing of annual accounts. This provision has been implemented in Dutch legislation and is applicable to Dutch listed companies and other organisations of public interest (OPI) (OPIs can include non-listed banks and (certain) insurers).

Diversity

Each year, large companies (*grote vennootschappen)* must set appropriate and ambitious gender diversity targets for the management and supervisory boards and senior management.

Gender diversity – supervisory boards of Dutch companies within scope of the CG Code on Euronext

Supervisory boards of Dutch companies listed on Euronext Amsterdam (both NVs and BVs) are subject to a diversity quota of at least one-third male and one-third female directors. If the supervisory board does not meet this diversity quota, any appointment that does not balance the distribution is void, leaving the relevant vacancy open. Every listed company must take the diversity quota into account in every appointment or reappointment of a supervisory director. The same applies to non-executive directors in the case of a one-tier board.

Additional diversity requirements for Dutch companies within scope of the CG Code

The management board, the supervisory board and the executive committee (if any) should be composed in such a manner as to ensure a degree of diversity appropriate to the company with regard to expertise, experience, competencies, other personal qualities, sex or gender identity, age, nationality, and cultural or other background.

See **4.2 Roles of Board Members** regarding the composition of the committees of the supervisory board of a listed company.

Reporting requirements on diversity

On 1 July 2022, the Decree on the Contents of the Management Report was amended. Accordingly, in 2023 large companies (*grote vennootschappen)* (see **2.2 Environmental, Social and Governance (ESG) Considerations**) must report on the following in their management reports for FY 2022:

- the current male/female ratio;
- the target ratios;
- the action plan; and
- the objectives achieved.

In addition, pursuant to the Diversity Act, large companies (*grote vennootschappen)* must set more appropriate and ambitious target ratios and draw up an action plan. Every year, the progress with the obligations under the Diversity Act must be reported to the Social and Economic Council (SER), within ten months of the end of the financial year. The basic principle is that what must be reported in the management report must also be reported to the SER. Reports to the SER must be made for the first time within ten months of the end of FY 2022. To this end, the SER has developed a diversity portal. Because large companies (*grote vennootschappen)* are required to report via this portal, it is possible to monitor how these companies satisfy their obligations and how they perform relative to others.

Companies listed on Euronext Amsterdam do not have to report on the supervisory board (or on the non-executive directors on the one-tier board) in the management report, because they must already comply with the diversity quota.

Restrictions on Number of Positions of Management and Supervisory Directors

Book 2 of the Dutch Civil Code requires a maximum number of positions that each managing director or supervisory director is allowed to hold at Dutch large companies (*grote vennootschappen)* (see **2.2 Environmental, Social and Governance (ESG) Considerations**) and Dutch large foundations.

In principle, a managing director may:

- hold a maximum of two positions as a supervisory director in addition to their management board position; and
- not be the chairperson of a supervisory board or of a one-tier board.

A supervisory director may hold a total of five supervisory positions. The position as chairperson of a supervisory board or one-tier board counts twice.

Under the CG Code, the supervisory board's approval is required if a managing director of the company intends to accept a supervisory board membership elsewhere.

4.4 Appointment and Removal of Directors/Officers

Appointment of Directors

General rules for appointment of managing and supervisory directors of a BV/NV

The first appointment of supervisory directors (if applicable) and of managing directors is included in the notarial deed of incorporation of the NV/BV. After the incorporation of the NV/BV, the general meeting appoints the managing directors and supervisory directors.

The articles of association may provide that the appointment of a managing director or supervisory director by the general meeting must be based on a binding nomination. In that case, only the nominated person may be appointed as director. The binding nature of the nomination can be removed by a qualified majority resolution of the general meeting.

With respect to supervisory directors, the articles of association may provide that a maximum of one third of the supervisory directors may be appointed by third parties.

Specific rules for appointment of managing and supervisory directors of a BV

The articles of association may provide that managing directors and supervisory directors are appointed by a meeting of holders of shares of a certain class or type.

Specific rules for appointment of directors of a BV/NV subject to the large company regime (structuurregime)

The supervisory board appoints the managing directors (or the non-executive directors appoint the executive directors in the case of a one-tier board), unless the mitigated large company regime applies, in which case the general meeting appoints the managing (or executive) directors.

The general meeting appoints a supervisory director (or the non-executive directors, in the case of a one-tier board) following a special procedure, including a nomination right of the supervisory board (or non-executive directors); such

nomination takes into account the (enhanced) right of recommendation of the works council.

Removal of Directors

Removal of managing directors

Managing directors of a BV/NV may be suspended and dismissed at any time by the person/body authorised to appoint them. The articles of association of a BV may also grant the power of dismissal to another corporate body. The supervisory board may suspend managing directors at any time, unless the articles of association provide otherwise. The managing directors of a (*structuurvennootschap)* may be suspended and dismissed only by the supervisory board.

Removal of supervisory directors

Supervisory directors of a BV/NV may be suspended and removed by the person/body authorised to appoint them. The general meeting of a BV that is not authorised to appoint may nevertheless be granted the power of removal and suspension in the articles of association.

Removal of supervisory directors of a company subject to the large company regime (structuurvennootschap)

Each supervisory director may be:

- suspended by the supervisory board; and
- removed by the Enterprise Chamber of the Amsterdam Court of Appeal on account of:
  - (a) neglect of their duties;
  - (b) other serious reasons; or
  - (c) a drastic change in circumstances based on which their continuation as a director of the supervisory board cannot reasonably be required from the company.

The request may be submitted by the company, represented for this purpose by the supervisory board, and also by a representative appointed for this purpose by the general meeting or by the works council.

4.5 Rules/Requirements Concerning Independence of Directors

Independence of Supervisory Directors

Book 2 of the Dutch Civil Code contains no general provisions on the independence of the supervisory board and individual supervisory directors of a BV/NV. However, it is generally accepted that the supervisory board of a BV/NV should, in principle, be sufficiently independent in relation to the company and its stakeholders.

"Large" companies Under the Statutory Two-Tier Rules (Structuurvennootschap) – Composition of Supervisory Board

The supervisory board of a (*structuurvennootschap)* must be properly composed. Employees and union representatives cannot be supervisory directors.

Independence Requirements for Supervisory Directors of a Dutch Listed Company Following the CG Code

The following applies under the CG Code:

- all but one of the supervisory directors of Dutch listed companies must be independent, as described in the CG Code;
- less than half of the total number of supervisory directors can be "dependent" in the sense that they can own a block of shares in the company totalling at least 10%, or can be a managing director or supervisory director of a legal entity with that shareholding; and
- the chair of the supervisory board may not be a former managing director of the company and must be independent.

Potential Conflicts of Interest

A managing director or supervisory director may not participate in deliberations and decision-making if they have a direct or indirect personal interest that conflicts with the interests of the company. If a managing director or the supervisory director nevertheless participates in the deliberations or decision-making, the management board or the supervisory board resolution becomes voidable.

Any conflict of interest has an impact on internal decision-making only. This means that directors with a conflict of interest remain authorised to represent the company. There is, however, a liability risk.

Consequences of a conflict of interest of management or supervisory directors

If no management board resolution can be adopted as a result, the resolution may be adopted by the supervisory board. If there is no supervisory board, the resolution may be adopted by the general meeting, unless the articles of association provide otherwise. If all the supervisory directors have a conflict of interest, the resolution is adopted by the general meeting, unless the company's articles of association provide otherwise.

Based on case law, a supervisory director has a duty to provide full transparency about possible conflicts of interest, and to keep conflicting interests separate from the interests of the company. A similar provision applies in case of a conflict of interest of one or more supervisory directors. If all supervisory directors have a conflict of interest, the supervisory board resolution is adopted by the general meeting, unless the company's articles of association provide otherwise.

Stricter conflict of interest rules apply to Dutch companies within scope of the CG Code

The CG Code stipulates that any form of conflict of interest between the company and the managing directors or supervisory directors must be prevented, and that adequate measures should be taken to avoid conflicts of interest.

4.6 Legal Duties of Directors/Officers

The entire management board of the company is collectively responsible for the policy, strategy and day-to-day management of the company, which includes:

- the management of the company (subject to any limitations in the company's articles of association);
- keeping proper company books and records;
- preparing financial reports and publishing annual accounts in time;
- exercising management control (managing the company and its business, determining its general policy and co-ordinating its organisation, including that of the group);
- exercising financial control (managing the company's assets, controlling the flow of funds, administering the company's financial condition); and
- exercising control of the company's juridical acts (to ensure regulatory compliance and compliance with the company's articles of association, and to fulfil the duty of care towards third parties, by ensuring that the company observes the legal relationships entered into with the third parties).

In the performance of their duties, directors of all boards must be guided by the best interests of the company and the business affiliated with it. This is generally determined primarily by promoting the continued success of this business

(*bestendig succes van de onderneming)*. The Dutch Supreme Court added that, in discharging their duties, directors should also – partly based on the principle of reasonableness and fairness – exercise due care with regard to the interests of all those involved in the company and its business, and that this duty of care may require directors, in serving the company's interests, to ensure that this does not unduly or disproportionately harm the interests of those involved.

Directors should also keep in mind that the legal entity has an independent interest in ensuring that legal and statutory norms or norms arising in part from reasonableness and fairness, including procedural norms necessary for proper decision-making, have been or are properly observed. This implies taking into account the interests of all the stakeholders, including shareholders, employees, creditors and other relevant stakeholders.

In addition, companies, corporate bodies and directors have a duty to act towards each other and other corporate bodies in accordance with the principles of reasonableness and fairness.

4.7 Responsibility/Accountability of Directors

General

As mentioned in **4.6 Legal Duties of Directors/ Officers**, according to Dutch corporate law, all management and supervisory directors must act in the interest of the company and the business affiliated with it. The interest of the company is generally determined primarily by promoting the continued success of this business (*bestendig succes van de onderneming)*. The Dutch Supreme Court added that, in discharging their duties, directors should also – partly based on the principle of reasonableness and fairness – exercise due care with regard to the interests of all those involved in the company and its business.

The management board of a BV/NV is accountable both internally and externally for the fulfilment of its duties and the exercise of the powers arising from the management task. Within the company, the management board has an accountability obligation towards:

- the general meeting;
  - (a) by preparing the annual accounts for shareholders;
  - (b) by publishing a management report; and
  - (c) by providing the general meeting with all requested information, unless this would be contrary to an overriding interest of the company;
- the supervisory board that supervises the management board; and
- the works council.

Milieudefensie/Shell case

The ruling of the District Court of The Hague of 26 May 2021 is relevant in this respect. An alliance of associations and foundations, together with over 17,000 individual claimants, brought a case against Royal Dutch Shell (RDS) as the top holding company of the Shell group, alleging that RDS had an obligation to contribute to the prevention of dangerous climate change through its corporate policies for the Shell companies.

The court found that, under Dutch law, RDS owed an unwritten standard of care to Dutch residents to reduce CO_2 emissions of the Shell group's activities by net 45% by the end of 2030, relative to 2019. In doing so, the court took into account that there is widely supported international consensus that human rights protect against the consequences of dangerous climate change, and that companies must respect

human rights. The court also found that RDS' policies, intentions and ambitions were incompatible with this reduction obligation. Therefore, the court ordered RDS to comply. This is an obligation of result for the Shell group itself and a significant best-efforts obligation with regard to the Shell group's business relations and end-users.

An appeal is pending before the Court of Appeal of The Hague.

Dutch Companies Within Scope of the CG Code

According to the CG Code, the management board must pay attention to the interests of stakeholders when developing a view on sustainable long-term value creation by the company and its affiliated business, and formulate a corresponding strategy.

The CG Code describes stakeholders as groups and individuals that, directly or indirectly, influence – or are or may be influenced by – the attainment of the company's objectives: employees, shareholders and other lenders, suppliers, customers and other stakeholders.

4.8 Consequences and Enforcement of Breach of Directors' Duties

General

In general, managing directors of a BV or NV are not liable for the obligations of the company they are managing. Directors have considerable liberty to act as they deem fit, but must properly perform their duties towards the company. They are jointly and severally liable for damage suffered if the management board performs its duties improperly (*onbehoorlijke taakvervulling)*, based on the management board's collective responsibility. A distinction is made between the internal and external liability of directors: internal liability is the liability of directors towards the company, while external liability is their liability towards third parties.

Internal Liability

The company may hold the managing directors liable for damage suffered by the company on the basis of company law or tort law.

Internal liability based on company law and tort law

To establish liability in the event of the improper performance of duties (*onbehoorlijke taakvervulling)*, it must be proven that the managing director was seriously culpable (*ernstig verwijtbaar)*. If a managing director acts in breach of statutory provisions or in breach of the articles of association, they are deemed to be seriously culpable.

This gives rise to improper management, unless the contrary is proved by the managing director. In principle, if one managing director is in breach, all the managing directors are jointly and severally liable, due to their collective liability. Individual managing directors can be exonerated. Supervisory directors may also be held liable for improper supervision. In addition to liability for mismanagement, liability for damages may also be based on tort law (*onrechtmatige daad*). This concerns the liability of each director individually and not the collective liability of the board.

In an insolvency situation, the trustee may sue the directors on behalf of the company.

External Liability

Personal liability of a managing director towards third parties may arise if the managing director commits a wrongful act in their capacity as a director, or in the event of the bankruptcy of the company.

Tort law

In a situation in which the company is liable for damages based on non-fulfilment of contractual or statutory obligations or a wrongful act, a managing director may in some cases also be held personally liable for the damages. A managing director is personally liable only if they bear serious personal blame (*ernstig persoonlijk verwijt)*.

Serious personal blame on the part of a managing director generally exists if:

- the managing director knows or should have known that the company cannot fulfil the obligations under the agreement and nevertheless enters into an agreement on behalf of the company and knows and should have known that the company offers no recourse; and
- the managing director causes or allows the legal entity to fail to fulfil an obligation already entered and offers no recourse.

A managing director may be personally liable in bankruptcy.

In a bankruptcy in which any claim remains unpaid, a bankruptcy trustee may hold directors liable for manifestly improper management (*kennelijk onbehoorlijk bestuur)* that was an important cause of the bankruptcy.

Manifestly improper management is established if:

- the books and records (*administratie)* were improperly kept and the corresponding books, documents and other data carriers were not kept in such a way that the rights and obligations of the legal entity can be known at all times; or
- the company has failed to fulfil its duty to publish its annual accounts.

In these situations, it is assumed that manifestly improper management was an important cause of the bankruptcy.

If a bankruptcy trustee's claim is successful, each managing director is jointly and severally liable in relation to the bankrupt estate for the deficit in the bankruptcy, being the amount of the liabilities to the extent that these cannot be satisfied by the liquidation of the other assets.

Individual directors can be exonerated if they can demonstrate that they cannot be held liable for the manifestly improper management and that they did not fail to take measures to mitigate the consequences of the manifestly improper management.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Other Bases of Liability of Directors

Managing directors of a BV/NV may also be jointly and severally liable in the following cases:

- for the debts of the company under social security and tax laws;
- for providing misleading (interim) accounts or annual accounts or annual reports; or
- for the company acquiring shares in its own capital in certain situations.

BV

Managing directors could be liable for any due and payable company debts if the company is unable to continue paying these debts after a dividend distribution has been made, if the directors knew or reasonably should have foreseen this at the time of the distribution.

Limitation of Liability

In general, a managing director's liability may be limited in two ways.

- The general meeting discharges managing directors, waiving possible claims for damages. This concerns internal liability and is a common agenda item at the annual general meeting.
- Exoneration from joint and several liability of an individual managing director in the event of (manifestly) improper management in the case of joint and several liability of managing directors if a director can demonstrate that they cannot be held liable for the (manifestly) improper management and did not fail to take measures to mitigate the consequences of the (manifestly) improper management.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

General

BVs

The general meeting determines the individual remuneration of managing directors, unless the articles of association provide otherwise.

NVs

The articles of association of an NV may only provide that another corporate body will determine the individual remuneration, often the supervisory board. The remuneration of supervisory directors is always determined by the general meeting.

In addition, NVs must have a remuneration policy in place that must be adopted by the general meeting. The works council must be given the opportunity to take a position thereon (or give its advice in the case of a Dutch listed company); this position (or advice) shall be offered to the general meeting at the same time as the proposal to adopt the remuneration policy.

CG Code

For companies within scope of the CG Code, the following applies on a “comply or explain” basis;

- the remuneration policy for the management board, prepared by the supervisory board’s remuneration committee, should also focus on sustainable long-term value creation for the company and its affiliated business;
- severance pay is limited to one year’s salary and will not be awarded if the managing director resigns or in the event of seriously culpable or negligent behaviour by the director; and
- supervisory directors must not be awarded remuneration in the form of shares and/or rights to shares.

4.11 Disclosure of Payments to Directors/Officers

Disclosure in Relation to Remuneration

Companies that are not listed

These companies must publish the following in the notes to the annual accounts.

- The amount of the remuneration, including pension charges and other benefits, for:
  - (a) the managing directors and former managing directors; and
  - (b) separately, the joint supervisory and former supervisory directors (this provision does not apply to micro and small companies).
- The amount of loans, advances and guarantees granted for the benefit of individual directors and supervisory directors.

Companies that are listed

Dutch listed companies must publish a remuneration report, which must:

- be clear and understandable;

- summarise all the remuneration awarded or due to individual directors in the previous financial year;
- be submitted to the annual general meeting for an advisory vote;
- be made public on the company's website after the general meeting and must be accessible for ten years; and
- be checked by the external auditor as to whether all the required information is included in the report.

The company explains in the remuneration report how the previous vote of the general meeting has been considered.

CG Code

For companies within scope of the CG Code, in addition to the statutory requirements, the requirements of the CG Code apply on a "comply or explain" basis.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The management board manages the company; see **3.2 Decisions Made by Particular Bodies** and **4.6 Legal Duties of Directors/Officers.**

Shareholders provide the equity and, in principle, are liable only up to the amount of their investment in the company. They do not participate in most corporate decisions, and may establish contractual arrangements between shareholders and the company, such as relationships agreements.

See **3.2 Decisions Made by Particular Bodies** regarding the adoption of resolutions by the general meeting.

5.2 Role of Shareholders in Company Management

General

In general, shareholders are not involved in the management of the company.

The articles of association may stipulate that the management board must act in accordance with the instructions of a corporate body of the company (eg, the general meeting). The management board should assess whether the instruction is in the interest of the company and its affiliated business.

Dutch Listed Companies

It is apparent from case law that the following applies to Dutch listed companies with respect to the role of the general meeting and the policy and strategy of the company.

- The rule of law is that the management board, under the supervision of the supervisory board, is responsible for determining the policy and strategy of the company and its business.
- The management board is accountable to the general meeting in respect of its policy and strategy.
- The management board is not obliged to involve the general meeting in its decision-making in advance, nor to consult the general meeting; this is different if statutory provisions or provisions in the articles of association provide otherwise.
- The general meeting may express its opinions in this regard by exercising its powers prescribed by law or in the articles of association of association. Shareholders cannot force the company to include voting items, regardless of whether this is a binding or advisory vote, on the agenda in respect of matters that fall

within the powers of the management board, such as determining the policy and strategy.

5.3 Shareholder Meetings

General

Both BVs and NVs must have one general meeting a year. The annual general meeting of an NV must be held within six months after the end of the company's financial year. The articles of association may provide for a shorter period. The annual general meeting of a BV must be held once a year, unless all shareholders are also directors of the BV; the signing of the annual accounts by all directors is also considered adoption of the annual accounts (the articles of association may provide otherwise).

Extraordinary Meeting

In addition to the annual general meeting, extraordinary meetings may also be convened for matters that come up between the annual meetings and need to be addressed in a general meeting.

Convening of a General Meeting

Both the management board and the supervisory board may convene a general meeting of an NV/BV and BV (*bijeenroeping)*. The articles of association may also grant this power to other parties.

Shareholders whose shareholding exceeds a certain threshold may request the board and supervisory board to convene a general meeting. If this request is denied, they can enforce in court that the general meeting be convened.

The general meeting is held at a place stated in the articles (for a BV this can also be outside of the Netherlands) or in the municipality where the company has its place of business. A general meeting of an NV can also be held elsewhere if the entire share capital is represented or if, in the case of a BV, all persons with meeting rights agree to it.

Procedure at a General Meeting

Resolutions of the general meeting are adopted by absolute majority (*volstrekte meerderheid)* – ie, more than 50% of the votes validly cast. Certain resolutions are adopted by a qualified majority, as required by Dutch law, or the articles of association.

In the case of an NV, each shareholder has at least one vote. In the case of a BV, virtually every deviation is allowed and shares without voting rights may also be created.

In addition to shareholders with or without voting rights, other parties may also have meeting rights, which means they may attend and speak at the meeting.

Managing directors and supervisory directors have an advisory vote.

5.4 Shareholder Claims

The main proceedings through which shareholders can initiate legal proceedings against the company or directors are the inquiry proceedings. Shareholders can also have a board resolution nullified by the court or have it determined to be void.

Inquiry Proceedings (Enquêteprocedure)

The Enterprise Chamber of the Amsterdam Court of Appeal (Enterprise Chamber) (*Ondernemingskamer)* has exclusive jurisdiction for these proceedings, which may be initiated by shareholders owning a certain percentage of the shares.

At the written request of the shareholder, the Enterprise Chamber may appoint one or more

persons to conduct an investigation into the policy and affairs of the company. The Enterprise Chamber will only grant the request if there appear to be valid reasons to doubt a correct policy or course of action.

At any stage of the proceedings, at the request of the original applicants, the Enterprise Chamber may also order interim measures (*onmiddellijke voorziening*), for the duration of the proceedings. For example, it may temporarily appoint a managing director.

The report of the outcome of the investigation shall be filed at the registry of the Amsterdam Court of Appeal. Based on the report, the Enterprise Chamber may conclude that there has been mismanagement and order one or more of the following limitative provisions, which it considers appropriate based on the outcome of the investigation:

- suspension or annulment of a resolution of the directors, supervisory directors, general meeting or any other body of the legal entity;
- suspension or dismissal of one or more managing or supervisory directors;
- temporary appointment of one or more managing or supervisory directors;
- temporary departure from the provisions of the articles of association specified by the Enterprise Chamber;
- temporary transfer of shares for management purposes; and
- dissolution of the legal entity.

Dutch law does not recognise a derivative action.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Disclosure Obligations for Shareholders in Listed Companies

Anyone who acquires or disposes of a capital interest or the voting rights of a Dutch NV whose shares are listed on a regulated market within the EEA, or a non-Dutch listed company whose shares are listed on a Dutch regulated market, must notify the AFM without delay if the percentage of capital interest of voting rights reaches, exceeds or goes under any of the following thresholds: 3%, 5%, 10%, 15%, 20%, 25%, 30%, 40%, 50%, 60%, 75% or 95%.

This may be the case if shareholders obtain or lose ownership of shares (or related financial instruments) and/or votes, or due to an increase or decrease in the issued share capital of the listed company.

The same applies to anyone holding a gross short position in the company that reaches, exceeds or falls below any of the aforementioned thresholds.

The AFM publishes the notifications in its online registers.

In addition, the EU Short Selling Regulation contains disclosure obligations in respect of net short positions in EEA issuers.

Disclosure Obligations Applicable to Directors of Listed Companies

Managing directors and supervisory directors of Dutch NVs whose shares are listed on a regulated market in the Netherlands also need to notify the AFM of their shares and voting rights, and of any changes in these shares and voting rights concerning (rights to acquire) shares in the

issuing institution of which they are director and in affiliated issuing institutions.

Additional reporting obligations may apply under the EU Market Abuse Regulation.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Annual Reporting Obligations for BVs and NVs

The financial report consists of three parts:

- the management board report;
- the annual accounts; and
- other information – eg, the report of the external auditor.

The management boards of both BVs and NVs must publish their annual accounts and file them with the Dutch Trade Register no later than eight days after adoption by the general meeting. If the annual accounts have not been adopted within two months after the end of the period set for their preparation, the management must publish the annual accounts with a statement that the annual accounts were not adopted.

In any event, annual accounts shall be filed within ultimately 12 months after the end of the financial year, regardless of whether or not they are adopted by the general meeting, together with other parts of the financial report. See **6.3 Companies Registry Filings** regarding filing requirements.

Dutch Listed Companies

Dutch listed companies must prepare and publish the financial report within four months after the end of the financial year, and the half-yearly financial reports within three months after the end of the first six months of the financial year, both with the AFM.

6.2 Disclosure of Corporate Governance Arrangements

General

Corporate governance arrangements need to be disclosed in the management report. The management board describes the main risks and uncertainties to which the BV or the NV is exposed. The management report of large companies must also contain an analysis of both financial and non-financial performance indicators, including environmental and employment-related issues.

Dutch Listed Companies

Dutch listed companies must include additional information in the management report, including the following:

- the key features of the internal risk management and control systems in relation to the financial reporting process of the company and its consolidation group;
- the composition and performance of the management board, the supervisory board and their committees; and
- the diversity policy regarding the composition of the management board and the supervisory board.

Additional information in line with the CG Code

The CG Code provides that the company must explicitly state in a separate chapter of the management report (or a publication on the company's website) the extent to which it complies with the principles and best practice provisions of the CG Code and, where it does not comply,

why and to what extent it deviates from these principles or best practice provisions.

According to the CG Code, the management board report must include a report on sustainable long-term value creation by providing information on the effects of the actions of the company and its affiliated business on people and the environment, a report on risk management, and explanatory notes on the culture within the company, the contribution of the culture and the values to the sustainable long-term value creation, and the effectiveness and compliance with the code of conduct.

Supervisory Board Report

The supervisory board report is mandatory only for Dutch listed companies and, according to the CG Code, it must include:

- the role of the supervisory board, such as its involvement in the establishment of the strategy and the way in which it monitors its implementation;
- the independence of the supervisory board and of its directors and chair; and
- the way the evaluation of the supervisory board, its committees and the individual directors has been carried out.

6.3 Companies Registry Filings

Annual Accounts

Non-listed companies

The management boards of both non-listed BVs and NVs must publish their management reports and file them with the Dutch Trade Register, after which they will become publicly available.

The management board must prepare the annual accounts and make them available for inspection by shareholders at the company's offices within five months after the end of the financial year. The general meeting can extend this deadline by five months in exceptional circumstances.

The general meeting has two months to adopt the annual accounts after the period for preparing the annual accounts has expired. Within two months after that period has expired, the general meeting must adopt the annual accounts, during a general meeting.

Please see **6.1 Financial Reporting** regarding the relevant filing deadlines and **5.3 Shareholder Meetings** regarding the timing of holding general meetings.

Dutch listed companies and large legal companies have to disclose complete financial statements. There are exemptions for medium, small and micro legal entities.

Dutch listed companies

Dutch listed companies whose securities are admitted to trading on a regulated market in the European Union must make the annual accounts publicly available and simultaneously file them with the AFM within four months after the end of the financial year.

The general meeting has two months to adopt the annual accounts, which also need to be filed with the Dutch Trade Register within eight days after they are adopted.

Please note that if the annual account has not been adopted within two months from the end of the period prescribed for preparation in accordance with the statutory requirements, the management board must immediately make the prepared annual account public.

Semi-annual accounts only mandatory for Dutch listed companies

Dutch listed companies whose securities are admitted to trading on a regulated market in the European Union must publish and file semi-annual financial reports with the AFM, simultaneously, within three months after the end of the first six months of the financial year. This is in accordance with the FSA.

The AFM can impose an order subject to penalty for non-compliance and an administrative fine when these accounts are not filed in time.

Sanctions

Not filing the annual accounts on time is an economic crime, as stated in the Dutch Economic Offences Act. The penalty for this can range between paying a fine and prosecution. Not filing the annual accounts on time can also be proof of mismanagement, which could lead to the management board being personally liable for debt when a company is declared bankrupt on the basis of manifestly improper management (*kennelijk onbehoorlijk bestuur)*.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Dutch corporate law requires an audit of the financial statements for all large and medium-sized companies.

The external auditor must examine whether the annual accounts provide the requisite legal disclosures and provide a true and fair view, whether other parts of the financial report comply with the statutory requirements, and whether the management report conflicts with the annual accounts or contains any other material misstatements.

The external auditor reports on their audit to the management board and the supervisory board, and records the result of the audit in an independent auditor's report.

Appointment of the External Auditor

Book 2 of the Dutch Civil Code provides the following regarding the appointment of an external auditor:

- the general meeting appoints an external auditor;
- if the general meeting fails to do so, the supervisory board is authorised to make the appointment; and
- in the absence of a supervisory board, the management board is authorised to appoint the external auditor.

If an NV/BV is a public interest entity, the appointment must be notified to the AFM.

Further rules on the selection and appointment of auditors of public interest entities (such as listed companies, banks and insurance companies) are included in Regulation (EU) 537/2014 on specific requirements regarding statutory audit of public interest entities (Audit Regulation) and in the CG Code. The audit committee plays an important role in preparing the appointment.

Public interest entities must regularly change audit firms.

An audit firm may not perform that function for more than ten consecutive years. The same firm may not carry out the statutory audit again until four years have passed. Within the relevant audit firm, the auditor responsible for the audit may not be responsible for the audit report for more than five years.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The management board is responsible for identifying and managing the risks associated with the company's strategy and activities.

The management board informs the supervisory board about the company's strategic policy, its general and financial risks, and its internal control system at least once a year, to enable the supervisory board to perform its supervisory duties.

Additional Requirements for Dutch Listed Companies Based on the CG Code

The CG Code contains several best practices to further strengthen risk management and disclosure:

- a Dutch listed company must have adequate internal risk management and control systems;
- at least once a year, the management board must audit the operation of the internal risk management and control systems, and carry out a systematic review of their design and effectiveness;
- this monitoring covers all material control measures related to strategic, operational, compliance and reporting risks; and
- in performing their duties, the auditors must take into account the effectiveness of internal risk and control systems and the integrity and quality of financial reports.

Internal Audit Function

The internal audit function is responsible for assessing the design and operation of the internal risk management and control systems. The management board is responsible for the internal audit function. The supervisory board supervises the internal audit function and maintains regular contact with the person performing this function. The internal audit function reports hierarchically to a managing director, preferably to the CEO.

In the management report, the management outlines the main risks and certainties to which the NV or BV is exposed. For a proper understanding of the results or position of the company and its group companies, the management report also includes, if necessary, an analysis of both financial and non-financial performance indicators, including environmental and employment-related issues.

NEW ZEALAND

Law and Practice

Contributed by:
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Webb Henderson

Contents

1. Introductory p.446
1.1 Forms of Corporate/Business Organisations p.446
1.2 Sources of Corporate Governance Requirements p.446
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.446

2. Corporate Governance Context p.447
2.1 Hot Topics in Corporate Governance p.447
2.2 Environmental, Social and Governance (ESG) Considerations p.447

3. Management of the Company p.448
3.1 Bodies or Functions Involved in Governance and Management p.448
3.2 Decisions Made by Particular Bodies p.448
3.3 Decision-Making Processes p.449

4. Directors and Officers p.449
4.1 Board Structure p.449
4.2 Roles of Board Members p.449
4.3 Board Composition Requirements/Recommendations p.450
4.4 Appointment and Removal of Directors/Officers p.450
4.5 Rules/Requirements Concerning Independence of Directors p.450
4.6 Legal Duties of Directors/Officers p.452
4.7 Responsibility/Accountability of Directors p.455
4.8 Consequences and Enforcement of Breach of Directors' Duties p.455
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.458
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.458
4.11 Disclosure of Payments to Directors/Officers p.458

5. Shareholders p.459
5.1 Relationship Between Companies and Shareholders p.459
5.2 Role of Shareholders in Company Management p.459
5.3 Shareholder Meetings p.460
5.4 Shareholder Claims p.461
5.5 Disclosure by Shareholders in Publicly Traded Companies p.461

6. Corporate Reporting and Other Disclosures p.461
6.1 Financial Reporting p.461
6.2 Disclosure of Corporate Governance Arrangements p.462
6.3 Companies Registry Filings p.462

7. Audit, Risk and Internal Controls p.463
7.1 Appointment of External Auditors p.463
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.463

Webb Henderson specialises in corporate and M&A projects (including corporate governance, takeovers, joint ventures, partnerships and investment projects), as well as banking and finance, competition law and regulatory advice. Across its Auckland and Sydney offices, the firm comprises 15 partners and a total of 56 lawyers. The Auckland office is headed by partners Graeme Quigley and Garth Sinclair, who are highly regarded corporate lawyers – each with more than 25 years' experience specialising in corporate governance work, M&A, strategic projects, and joint ventures. Webb Henderson regularly advises major New Zealand companies and organisations on their corporate governance frameworks and processes.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

In New Zealand, the principal forms of business organisations are:

- bodies corporate – ie, separate legal persons from their owners, including:
  - (a) companies (formed under the Companies Act 1993);
  - (b) limited partnerships (formed under the Limited Partnerships Act 2008); and
  - (c) incorporated societies (formed under the Incorporated Societies Act 2022), which may not be formed for the purpose of pecuniary gain; and
- unincorporated forms – ie:
  - (a) partnerships (formed under the Partnership Law Act 2019); and
  - (b) trusts (formed under equitable principles, common law, and the Trusts Act 2019).

Individuals may also carry on business in their own name – in which case, they are commonly referred to as "sole traders".

1.2 Sources of Corporate Governance Requirements

The primary legislation that governs companies in New Zealand is the Companies Act 1993 (the "Companies Act"). On top of the requirements of the Companies Act, additional corporate governance requirements are imposed by:

- NZX's Listing Rules (the "Listing Rules") for issuers of listed securities; and
- by industry-specific legislation (eg, for banks and insurers).

In the absence of any such additional requirements, the corporate governance arrangements applicable to a company are reasonably flexible. A company may add to, negate, or modify many (but not all) of the governance provisions of the Companies Act by adopting a constitution that sets out the rules by which the company will be governed. Nevertheless, this chapter will describe the default position under the Companies Act – unless otherwise indicated.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Companies that have financial products quoted on the NZX Main Board or Debt Market must

comply with the Listing Rules, which impose requirements in relation to corporate governance – for example, requirements concerning the composition of the board, director remuneration, continuous disclosure, financial reporting, share issues, voting rights, and approval of major transactions.

The NZX also issues a Corporate Governance Code that takes effect on a "comply-or-explain" basis, meaning that the issuer must either comply with the recommendations made in the Corporate Governance Code or explain:

- which recommendations were not followed;
- why, and in what period, those recommendations were not followed; and
- any alternative practice adopted in lieu of those recommendations (in which case, the issuer must confirm that this practice has been approved by its board).

The NZX has recently finalised amendments to the Corporate Governance Code and these will apply for financial years commencing on or after 1 April 2023. The most significant changes relate to the determination of director independence, ESG reporting and disclosure, and disclosure of director remuneration arrangements.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Recent areas of focus for corporate governance in New Zealand include ESG reporting and climate-related financial disclosures (see **2.2 Environmental, Social and Governance (ESG) Considerations**), strengthening director independence requirements, the Companies Act (Directors Duties) Amendment Bill, and recent consultations concerning the NZX capital-raising settings and major and related-party transactions (see **3.2 Decisions Made by Particular Bodies**).

Strengthening the independence criteria for independent directors of listed companies has been another focus of late. Although the recent updates to the Code include some amendments to the recommendations and commentary around director independence, an upcoming "deep-dive" review of the director independence rules is also anticipated.

The NZX is also currently reviewing its rules for capital raising, major transactions, and material transactions with related parties to ensure that the current settings provide adequate shareholder protections, as well as reflect transaction activity and international trends.

The Companies Act (Directors Duties) Amendment Bill ("the Bill") is currently before Parliament. If passed into law, in its present form (as of June 2023), the Bill would amend the Companies Act to confirm that directors may – as part of their duty to act in good faith and in the best interests of the company – consider matters other than the maximisation of profit (see **4.6 Legal Duties of Directors/Officers**). The Bill has attracted criticism on the basis that directors are already free to do this.

2.2 Environmental, Social and Governance (ESG) Considerations

The aforementioned amendments to the Corporate Governance Code – along with updates to the NZX's ESG Guidance Note - place greater emphasis on ESG factors and clarity of reporting by listed issuers on such matters. The Corporate Governance Code features a recommendation that issuers provide non-financial disclosures (including in relation to "environmental, social

sustainability and governance factors and practices") at least annually and supports the use of recognised international reporting initiatives for this purpose where appropriate to the company's scale.

In recent years, a range of regulatory inquiries in New Zealand and Australia have emphasised the importance of institutional culture in mitigating the risk of misconduct or undesirable outcomes for consumers, namely:

- the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry;
- the Australian Prudential Regulation Authority (APRA)'s Prudential Inquiry into the Commonwealth Bank of Australia; and
- the Financial Markets Authority and the Reserve Bank of New Zealand's joint review of the conduct and culture in New Zealand banks and the insurance industry.

The reports from these inquiries emphasised that boards of directors are expected to take ownership of organisational culture and set the "tone at the top", as part of their wider responsibility for risk management.

The Financial Sector (Climate-Related Disclosures and Other Matters) Amendment Act 2021 makes specified disclosures concerning climate change and emissions governance, strategy, risk management and metrics/targets mandatory for a range of financial institutions (including large listed entities) for financial years commencing from 1 January 2023 onwards.

The Listing Rules require listed issuers to report the gender balance of their directors and officers, along with a performance review of the issuer's diversity policy.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies or functions involved in the governance and management of a company are its shareholders, its board of directors, and the company's management team, if it has one. (It is common for boards of directors to appoint senior employees to management positions and delegate the necessary authority for managing the day-to-day affairs of the business to those senior employees – see **3.2 Decisions Made by Particular Bodies**.)

3.2 Decisions Made by Particular Bodies

Under the Companies Act, shareholder approval is required for certain significant matters such as adopting or altering the constitution, approving an amalgamation of the company with one or more other companies, commencing a voluntary liquidation, and "major transactions". Major transactions under the Companies Act are, in broad terms, those in which the company proposes to acquire or dispose of assets, rights or interests (or incur obligations or liabilities) – the value of which is more than half the value of the company's assets immediately prior to the transaction.

In addition, for NZX-listed entities, the Listing Rules require shareholder approval for material transactions with related parties and some categories of major transactions.

Other decisions are left to the board. The board may delegate its powers to a director, a committee of directors, an employee or any other person – although the board remains responsible for monitoring the decisions made by its delegate. There are, however, some powers that may not be delegated by the board. These are set out in

Schedule 2 of the Companies Act and include issuing new shares, authorising dividends or other distributions, and acquiring the company's own shares.

3.3 Decision-Making Processes

A shareholder resolution may be passed at a shareholders' meeting (see **5.3 Shareholder Meetings**) or by written resolution.

When shareholders exercise a power reserved to them by the Companies Act or the company's constitution, the power is exercised by ordinary resolution (ie, a simple majority of votes cast on the resolution) unless otherwise specified in the relevant provision of the Companies Act or constitution. Some matters require approval by way of a "special resolution", meaning that – if the resolution is to be passed at a meeting – a majority of at least 75% of votes cast must be obtained to pass the resolution. That threshold may be increased (but not lowered) by the company's constitution.

For a written (circular) resolution of shareholders, the resolution must be signed by not less than 75% of the shareholders entitled to vote, who must together hold not less than 75% of the votes entitled to be cast on the resolution. A copy of such a written resolution must be sent within five working days to all shareholders who did not sign it.

Decision-Making by Directors

Directors may also make decisions by way of resolutions passed at meetings or by written resolution. Schedule 3 of the Companies Act sets out the default rules for directors' meetings, including:

- requirements for notice (two business days);
- the required quorum (a majority of directors);
- means of attendance (in person or by audio or audiovisual communication); and
- voting (only a majority decision by directors present at the meeting is required, with each director having one vote – the chair does not have a casting vote).

The board must ensure that minutes of all directors' meetings are kept.

Directors may also pass a written (circular) resolution. Unless the company's constitution specifies otherwise, this must be signed or assented to by all the directors entitled to receive notice of a directors' meeting.

4. Directors and Officers

4.1 Board Structure

Under the Companies Act, companies have a single board. Boards may appoint committees to take responsibility for particular aspects of the business or the governance of the company, and the Listing Rules require listed companies to have an audit committee. The Corporate Governance Code also recommends that listed companies have a remuneration committee and a nomination committee.

4.2 Roles of Board Members

The Companies Act only provides for one class of director, meaning that all directors have the same fundamental role. However, in practice, committee memberships can mean that directors are more involved in certain aspects of the business or its governance than other areas. In addition, the company's constitution may (if desired) specify different categories of directors. Usually, the board will elect a chair. The default position under the Companies Act is that the chair does not have a casting vote.

4.3 Board Composition Requirements/ Recommendations

The Companies Act requires every company incorporated in New Zealand to have at least one director that lives in either New Zealand or an "enforcement country". If living in an enforcement country, the director must also be a director of a body corporate that is incorporated in that enforcement country under a law equivalent to the Companies Act. At present, Australia is the only approved "enforcement country".

The constitution of a company may increase the minimum number of directors.

The Listing Rules require listed companies to have at least three directors – two of whom must ordinarily reside in New Zealand and two of whom must be independent directors. The Corporate Governance Code further recommends that the majority of the board be independent directors. "Independence" in this context is assessed having regard to the factors outlined in the Corporate Governance Code. Broadly, however, "independent" for this purpose means directors who are free of any interest, position, association or relationship that could reasonably be perceived to materially influence their capacity to:

- bring an independent view;
- act in the company's best interests; and
- represent the interests of the company's financial product holders generally.

Industry-specific legislation may impose stricter obligations on the board composition of a company in that industry. By way of an example, the Reserve Bank of New Zealand's Banking Supervision Handbook for the banking sector and its governance guidelines for the insurance sector both require at least half of the company's directors to be independent directors.

4.4 Appointment and Removal of Directors/Officers

Section 153 of the Companies Act provides that, unless varied by the company's constitution, directors are appointed by ordinary resolution (a simple majority of votes) of the shareholders. In addition, the court has the power to appoint directors upon the application of a shareholder or creditor if there are no directors – or fewer directors than the quorum for a board meeting – and it is not possible or practicable to appoint directors in accordance with the company's constitution. A director may be removed by an ordinary resolution of shareholders at a meeting called for purposes that include the removal of the director (in which case, the notice of meeting must state this).

These provisions may be modified by the constitution. In an incorporated joint venture, for example, it is common for each party to be able to appoint and remove a specified number of directors – regardless of whether that shareholder is entitled to exercise more than 50% of the votes at a shareholder meeting.

4.5 Rules/Requirements Concerning Independence of Directors

Directors are restrained from acting in situations where their personal interests may conflict with the interests of the company. Section 131 of the Companies Act requires a director to act in good faith and in what the director believes to be the best interests of the company when exercising powers or performing duties – see **4.6 Legal Duties of Directors/Officers**.

Section 139 of the Companies Act further defines a director as "interested" in a transaction of the company if, in broad terms, the director:

- is a party to – or will or may derive a material financial benefit from – the transaction (or is a director, officer, trustee, parent, child, spouse, civil union partner or de facto partner of such a person);
- has a material financial interest in another party to the transaction; or
- is otherwise directly or indirectly materially interested in the transaction.

A director who is interested in a transaction with the company must disclose that interest to the board immediately after becoming aware that they are interested in the transaction – except where the transaction is in the ordinary course of the company's business and on its usual terms. Such disclosure must be entered in the interests register, including the nature and monetary value of the interest or the extent of the interest (if not quantifiable). A director may disclose an ongoing interest in a named person or company, with the effect that the director will be treated as having disclosed an interest in any future transaction with that person or company.

Failure to disclose an interest does not invalidate the transaction but does allow the company to avoid the transaction at any point during the first three months following the disclosure of the transaction to all shareholders if the company did not receive fair value (based on the knowledge of the company and the interested director at the time the transaction was entered into). Where the property has been transferred on to a third party, the company's right to avoid the transaction does not affect the title or interest of that third party if they are a purchaser for valuable consideration without knowledge of the circumstances under which the first person acquired the property.

The default position under the Companies Act is that an interested director may vote on matters relating to the transaction, be counted in the quorum, and otherwise do anything as though the director were not interested in that transaction. However, boards often adopt charters or codes of conduct that record their collective expectations as to how conflicts of interest (which may be more broadly described than the formal definition of "interested" contained in the Companies Act) will be managed. Those charters or codes of conduct commonly provide that directors with an actual or potential conflict of interest will abstain from participating in meetings and voting on matters in respect of which the conflict exists – an approach that directors of listed companies are also required to follow under the Listing Rules.

A director is also subject to restrictions on the disclosure and use of company information where that information is obtained in their capacity as a director or an employee of the company and would not otherwise be available to them. A director may, unless prohibited by the board, disclose such information to a person whose interests the director represents or a person in accordance with whose direction the director is required or is accustomed to act (see **5.2 Role of Shareholders in Company Management**). These exceptions contemplate the concept of a nominee director – ie, a director nominated by a shareholder to represent its interests on the board of the company. In the latter case, the name of the person to whom the information is disclosed must be entered in the interests register.

Alternatively, a director may disclose or make use of such information if:

- the board approves the disclosure or use;
- the disclosure or use will not, or will not be likely to, prejudice the company; and
- particulars of the disclosure or use are entered in the interests register.

When a director of a company acquires or disposes of a "relevant interest" in shares issued by that company, the director must disclose to the board the number and class of shares in which the relevant interest was acquired or disposed of, the nature of the director's relevant interest, the consideration, and the date of the transaction. That information must be entered in the interests register. A director has a relevant interest in a share if:

- the director is the beneficial owner of the share; or
- the director may exercise (or control the exercise of):
  - (a) the power to vote; or
  - (b) the power to acquire, or dispose of, the share.

In the case of a listed company, its directors and senior managers are required to also publicly disclose any acquisition or disposal of a "relevant interest" in the company's (and its related bodies corporates') quoted financial products.

A director must not trade in an unlisted company's shares or other financial products if the director possesses information material to an assessment of the financial products' value that they would not be in possession of but for their position as director or employee – unless the director pays no less or receives no more than the fair value of the financial products. Otherwise, the director is liable to the counterparty for the difference between fair value and the consideration.

As regards the quoted financial products of a listed company, the insider trading provisions of the Financial Markets Conduct Act 2013 (FMCA) apply instead. In general terms, these provisions prohibit persons (including directors) who have "inside information" from:

- trading quoted financial products;
- encouraging or advising other persons to trade or hold those financial products (or to advise or encourage a third person to do so); or
- disclosing the inside information.

In this context, "inside information" refers broadly to information that:

- is not generally available to the market (but that a reasonable person would expect to have a material effect on the price of the relevant financial products were it generally available to the market); and
- relates to particular financial products or issuers (rather than to financial products or issuers generally).

4.6 Legal Duties of Directors/Officers

The principal legal duties of directors under the Companies Act are described in the following sections. Directors also have a number of administrative obligations, including those relating to disclosure of their interests and share dealings (see **4.5 Rules/Requirements Concerning Independence of Directors**), as well as an obligation to supervise the maintenance of the company's share register and obligations to ensure relevant filings are made with the Companies Office.

Section 131 – Good Faith and Best Interests of the Company

As mentioned in **4.5 Rules/Requirements Concerning Independence of Directors**, a director is required to act in good faith and in what the director believes to be the best interests of the company when exercising their powers or duties. This test is subjective – ie, it relies on the director's belief, rather than what is objectively in the company's best interests (Madsen-Ries and Levin as Liquidators of Debut Homes Limited (in liquidation) v Cooper (2020) NZSC 100 at (113)) – although "directors will probably have a hard task persuading the court that they honestly believed that an act or omission that resulted in substantial and foreseeable detriment to the company was in the company's best interests" (at (109)). Under a subjective test, however, "the fact that an allegedly unreasonable belief was held may (...) provide evidence that the belief was not honestly held" (at (109).

Further, "a director cannot believe they are acting in the best interests of the company if they fail to consider the company's interests" (Smartpay Ltd v Kumar (2022) NZHC at (29)). If provided for in the company's constitution and (in some cases) agreed to by the other shareholders, a director may act in the best interests of a parent company or – in the case of a joint venture – their appointing shareholder, even though such actions may not be in the best interests of the company. In the absence of such a provision in its constitution, the interests of a company must be considered separately from the interests of a group of related companies (Smartpay Ltd v Kumar, at (42)).

For details of proposed amendments to Section 131, please refer to **2.1 Hot Topics in Corporate Governance**.

Section 133 – Proper Purpose

Directors must exercise their powers for a proper purpose – that is, when exercising a power conferred upon them, the director must exercise that power in line with the purpose for which it was conferred. This duty is distinct from the duty in respect of best interests, as it is possible to exercise a power for an improper purpose even if the director genuinely believed the course of action was in the best interests of the company.

Section 134 – Compliance With Companies Act and Constitution

A director may not act, or agree to the company acting, in a way that contravenes the Companies Act or the company's constitution. A contravention of another statute would not necessarily breach this duty, but may breach Section 131 (with regard to good faith and best interests of the company) and Section 133 (with regard to proper purpose).

Section 135 – Reckless Trading

A director must not agree to the business of the company being carried on – or cause or allow the business of the company to be carried on – in a manner likely to create a substantial risk of serious loss to the company's creditors. Whether or not a director believes the conduct of the business is reasonable is irrelevant. Directors are required to make a "sober assessment" of whether their future trading forecasts justify continuing to trade and whether the assumptions that underpin those forecasts are reasonable (Mason v Lewis (2006) 3 NZLR 225 at (51)); however, the benefit of hindsight should not be applied to directors' decisions. If there is not a reasonable prospect of the company regaining solvency, formal insolvency mechanisms should be invoked (see Debut Homes) – it is not enough that the director's decisions would reduce the overall deficit. Directors may not continue to

trade in a way that favours one class of creditors over another.

In the long-running Mainzeal litigation, the Court of Appeal found four former directors of Mainzeal (a construction company) to have breached Section 135 (Mainzeal Property and Construction Ltd (in liquidation) v Yan). In this case, money was extracted from Mainzeal to an overseas parent company through intermediary companies that were insolvent. A director of both Mainzeal and its parent company made representations to his fellow directors that the parent company would financially support Mainzeal when it first became insolvent in a balance sheet sense. The representation was not legally binding and the parent company did not provide the support when it was needed. The directors were found to have exposed creditors to substantial risk of serious loss by continuing to trade in reliance on the non-binding representations. However, the court did not award compensation in respect of the breach of Section 135, because the court held that the directors' conduct during the relevant period did not increase the aggregate loss suffered by Mainzeal's creditors. The Court of Appeal's decision has been appealed to the Supreme Court – see comments on Section 136.

Section 136 – Obligations

A director must not agree to the company incurring an obligation unless the director believes at the time, on reasonable grounds, that the company will be able to perform the obligation when it is required to do so. Indications that this belief is reasonable may include:

- the fact that the company is able to continue trading for a reasonable time following the incurring of the obligation;
- the fact that bank finance is still available to the company; and
- the fact that any downturn in the company's performance was unexpected or sudden.

Factors that count against the belief being reasonable include incurring long-term liabilities before the business of the company has been successfully established or incurring obligations following the loss of an important revenue stream.

In the Mainzeal case, the court held that:

- Mainzeal had used funds owed to subcontractors as working capital in order to continue to trade;
- Mainzeal entered into large construction contracts without the company's directors having reasonable grounds to believe it would be able to perform the contracts through to completion; and
- the directors breached Section 136 in agreeing to the company doing so.

In March 2022, the Supreme Court heard an appeal lodged by the Mainzeal directors, in which they argued that Section 135 and Section 136 allow directors a wide discretion to manage the company as they think best and that both sections only give rise to liability where directors act irrationally. The liquidators cross-appealed, arguing that:

- the directors would have had to reasonably believe they could return the company to solvency, not just improve its financial position; and
- the measure of damages under both Section 135 and Section 136 should be the full amount of any new debt incurred.

The latest liquidator's report records that, earlier this year, the Supreme Court heard further

submissions addressing two recent UK Supreme Court decisions (likely including BTI 2014 LLC v Sequana SA (2022) UKSC 25, which concerns similar issues). The New Zealand Supreme Court's decision is still pending.

Section 137 – Duty of Care

A director of a company, when exercising powers or performing duties as a director, must exercise the care, diligence and skill that a reasonable director would exercise in the same circumstances – taking into account (without limitation) the nature of the company, the nature of the decision, and the position of the director and the nature of the responsibilities undertaken by them.

This section does not automatically impose a higher standard of skill on directors who hold professional qualifications in a particular area. The position may, however, be different if a director is brought onto the board to add a particular skill set.

Section 138 – Use of Information and Advice

The Companies Act expressly permits directors, when exercising powers or performing duties, to rely on reports, statements, financial data, professional and expert advice, and other information provided by:

- those (including employees, professional advisers and experts) whom the director reasonably believes to be competent in the relevant area; and
- fellow directors (or directors' committees on which the director did not serve) in relation to matters within those directors' or committees' designated authority.

In each case, the director must act in good faith, have no knowledge that such reliance is unwarranted, and make proper inquiry where the need for inquiry is indicated by the circumstances.

4.7 Responsibility/Accountability of Directors

All the directors' duties described in **4.6 Legal Duties of Directors/Officers** are owed to the company, rather than to shareholders. A limited set of duties is owed directly to the shareholders, including the duty to supervise the share register and the duty of directors to disclose their interests and dealings in the company's shares.

Although directors owe none of these duties directly to creditors, Section 135 and Section 136 respectively require directors to consider whether the company's business is being carried out in a way that is likely to create a substantial risk of serious loss to creditors and whether the company will be able to perform the obligations that it proposes to incur.

If the company became insolvent and was placed into liquidation, the liquidator could then bring an action (on behalf of the company) against a director that had breached their duties to the company. Amounts received from directors as a result would be applied for the benefit of the company's creditors in the liquidation.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Shareholder Enforcement

A present or former shareholder may bring an action against a director for a breach of duty owed to them as a shareholder (Section 169), but may not directly bring an action against a director for breaches of duties owed to the company.

However, Section 165 allows a shareholder or director to apply to the court for leave to bring

proceedings in the name and on behalf of the company. This creates an avenue for shareholders to hold directors to account for breaches of their duties to the company (and may also be used for bringing proceedings against third parties). The Section may also be used to intervene in existing proceedings for the purpose of continuing, defending or discontinuing proceedings to which the company is a party.

When determining whether to grant leave to the shareholder (or director), the court must have regard to:

- the likelihood of success;
- cost;
- anticipated level of relief;
- any action already taken to obtain relief; and
- the interests of the company in the proposed proceedings.

The court should also consider whether the applicant seeking leave may have ulterior motives other than the best interests of the company (Johnson v Johnson (2020) NZHC 1563). In Vijayakumar v Vasanthan (2021) NZHC 1827, the court noted that it was helpful in this respect to consider whether an experienced liquidator would bring the claim, given that they regularly decide whether to issue proceedings against directors.

Additionally, the court may decline an application under Section 165 if a more effective alternative remedy exists under Section 174. Leave will only be granted if the court is satisfied that:

- the company does not intend to bring, diligently continue or defend, or discontinue the proceedings itself; or
- it is in the interests of the company that the proceedings should not be left to the directors or to the determination of the shareholders as a whole.

Sections 170 and 172 allow a shareholder to bring an action requiring a director or the company to take any action required to be taken by the directors or the company (respectively) under the Companies Act or the company's constitution.

In any of the above-mentioned proceedings, the court may appoint a shareholder to represent all other shareholders where the shareholders have the same or substantially the same interest (Section 173). The purpose of this provision is to avoid numerous proceedings in which the dispute in each case is essentially the same.

A present or former shareholder (or any other person on whom the constitution confers the rights of a shareholder) is also entitled to take action against the company in situations where the shareholder or person considers that the "affairs of the company" have been or are being or are likely to be conducted in a manner that is oppressive, unfairly discriminatory or unfairly prejudicial to them in that capacity or in any other capacity (Section 174). The reference to conduct of the "affairs" of a company has been interpreted broadly, encompassing any conduct that generally concerns the company. However, this does not include actions of directors or shareholders in a purely personal capacity (Van der Fluit v O'Neill (2021) NZHC 1651). Non-compliance by the company or directors with specified provisions of the Companies Act is deemed to be conduct of that kind, as is the provision of a certificate by a director without reasonable grounds for an opinion set out in that certificate. (Directors are required to certify prescribed matters in respect of decisions to, for example, issue shares or pay dividends or other distributions or

so that the company can acquire its own shares.) The court may grant a wide range of remedies in response to a successful application under this provision.

What constitutes oppressive, unfairly discriminatory and unfairly prejudicial conduct was considered by the Court of Appeal in Thomas v HW Thomas Limited (1984) 1 NZLR 686 at (694). It was said in this case that the three terms were not to be read as distinct but, rather, as overlapping terms that help to explain one another. The Court of Appeal in Latimer Holdings Limited v Sea Holdings NZ Limited (2005) 2 NZLR 328 at (138) further elaborated that "unfairness requires a visible departure from the standard of fair dealing, assessed in light of the history and structure of the company and the expectations of its members".

In Wilding v Te Mania Livestock (2017) NZHC 717, the High Court held that:

- conduct need not be unlawful to be oppressive;
- the inquiry concerns the effect of the conduct, not the intention of the parties;
- the "just and equitable" aspect means plaintiffs should not have acted wrongly; and
- remedies afforded under the section should be designed to best advantage shareholders as a whole.

A fairly calculated buyout offer made by the other parties involved may be viewed as curing unfair or prejudicial conduct (Birchfield v Birchfield Holdings Ltd (2021) NZCA 428).

Company Enforcement

The company may bring an action against one or more of its directors or former directors for breach of a duty owed by that director to the company. As the business and affairs of the company must be managed by – or under the direction or supervision of – its board, it falls to the board to decide whether such an action should be brought. If the directors do not resolve to do so (eg, if the majority of the board was complicit in the breach), a shareholder or director can apply to the court for leave to bring an action on behalf of the company in the above-mentioned manner.

Consequences

Breaches of the above-mentioned directors' duties generally attract civil liability (although a number of the administrative provisions of the Companies Act attract criminal liability). The following are two key exceptions.

- Section 138A creates an offence for serious breaches of the duty of good faith. Such a breach will occur when a director, during the course of exercising their powers, acts in bad faith towards the company, believes that the conduct is not in the best interest of the company, and knows that the conduct will cause serious loss to the company. "In short, the offending requires dishonesty" (see Spence v R (2021) NZCA 499 at (36)).
- Section 380 creates an offence for dishonestly failing to prevent a company from incurring a debt where the director knows that the company is already insolvent or will become insolvent as a result of incurring the debt.

The court may also disqualify an individual from being a director in certain circumstances, including for persistent failure to comply with relevant laws or for acting in a reckless or incompetent manner in the performance of the director's duties, or upon conviction of certain offences or crimes involving dishonesty.

In the course of a liquidation of the company, liquidators, creditors and shareholders also have limited powers to apply to the court to order a director (or a promoter, manager, administrator, liquidator or receiver) to repay or restore money or property under Section 301 if that person has:

- misapplied, retained, or become accountable for that money or property; or
- been guilty of negligence, default or breach of duty or trust in relation to the company.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

The key enforcement avenues that are generally applied in respect of corporate governance requirements in New Zealand are described in **4.8 Consequences and Enforcement of Breach of Directors' Duties**. However, there are other potentially relevant enforcement avenues, including the following.

- The Financial Markets Authority (a regulator) may apply to the court for management banning orders that prohibit individuals from engaging in certain activities with regard to the governance and management of companies.
- The Reserve Bank of New Zealand may remove directors of licensed insurers from their positions if it is not satisfied that they are fit and proper persons to hold those positions. It may also remove directors of banks if specific criteria are met.

Limitations on Liability of Directors

Section 162 of the Companies Act allows a company to effect insurance on behalf of – and to indemnify – its directors, subject to specific limits and exclusions.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The board may authorise the payment of remuneration (or compensation for loss of office) and provision of other benefits (eg, loans and guarantees) to directors. However, before doing so, the board must be satisfied that any such action is fair to the company. Any director who votes in favour must sign a certificate to this effect that also sets out the grounds for their opinion. Such grounds must be reasonable. If these requirements are not satisfied, the director receiving the payment or other benefit is liable to the company for the payment or benefit unless they prove that it was fair to the company.

For listed companies, the Listing Rules require directors' remuneration – and any increase in such remuneration – to be approved by ordinary resolution. Failure to do so is a breach of the Listing Rules and action may be taken in accordance with the enforcement policy of NZ RegCo (NZX's independently governed regulatory arm). The Corporate Governance Code also recommends that listed companies have a remuneration committee – the functions of which include recommending to shareholders (for their approval) the appropriate remuneration for directors.

4.11 Disclosure of Payments to Directors/Officers

Directors' remuneration (or any other benefit covered by Section 161) must be entered in the company's interests register, which must be made available for inspection by shareholders in the company.

For listed companies, the Corporate Governance Code also recommends that issuers have a publicly available remuneration policy in which the components of director remuneration are

clearly separated. Director remuneration should be fully disclosed to shareholders in the issuer's annual report, including a breakdown of remuneration for committee roles and for fees and benefits received for any other services provided to the issuer.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

A company has separate legal personality from its shareholders. Unless the company's constitution provides otherwise, shareholders are not liable for the company's obligations merely because they are shareholders. As such, their liability to the company is limited to amounts unpaid on their shares, liability for breaches of duty if they act as "deemed directors" of the company, recovery of unauthorised distributions, and liability provided for in the constitution (eg, for capital calls on shares).

The constitution of the company is binding as between the company and the shareholders and as between the shareholders (Section 31). It is also common for shareholders in more closely held companies to enter into shareholders' agreements that govern the conduct of shareholders and are distinct from the constitution. The key advantage of such an agreement is that it is does not have to be disclosed – whereas the constitution must be filed with the Companies Office in its electronic registry, which is freely searchable by the public.

5.2 Role of Shareholders in Company Management

Although the business and affairs of the company must be managed by – or under the direction or supervision of – the board of the company, some particularly important decisions are reserved for the shareholders of the company. These include:

- a decision to approve a "major transaction" (see **3.2 Decisions Made by Particular Bodies**) by special resolution;
- the appointment and removal of directors by ordinary resolution; and
- a decision to amalgamate the company with another company (apart from members of the same wholly owned group) or to commence a voluntary solvent liquidation, each by special resolution.

The chair at a shareholders' meeting must allow a reasonable opportunity for shareholders to question, discuss or comment on the management of the company. The shareholders are entitled to pass a resolution relating to the management of the company but, unless the constitution provides otherwise, such a resolution is not binding on the board.

In addition, the company's constitution may confer powers upon shareholders that would otherwise be exercised by the board (Section 126(2)). A shareholder that exercises, or takes part in deciding whether to exercise, that power is deemed to be a director and subject to the directors' duties contained in Sections 131 to 138 in relation to that action. Similar provisions apply where the constitution of a company requires a director or the board to exercise or refrain from exercising a power in accordance with a decision or direction by shareholders or, as mentioned in **4.5 Rules/Requirements Concerning Independence of Directors**, where a director or the board is accustomed to acting or required to act in accordance with another person's directions or instructions.

5.3 Shareholder Meetings

The board of a company is required to call an annual meeting of shareholders unless:

- there is nothing required to be done at that meeting;
- the board has resolved not to call or hold the annual meeting; and
- the company's constitution does not require such a meeting.

The board, or any other person authorised by the constitution, may call a shareholders' meeting at any time. Such a meeting must be called on the written request of shareholders holding shares carrying together not less than 5% of the voting rights.

Schedule 1 of the Companies Act sets out the default rules for proceedings at shareholders' meetings. Some of these may be modified by the company's constitution.

Written notice of a meeting must be given to each shareholder, director and auditor at least ten working days prior to the meeting. The notice must specify the time, the place and the nature of the business to be transacted at the meeting, in sufficient detail to enable a shareholder to form a reasoned judgement in relation to it. Where any special resolution is to be submitted to the meeting, the text of that resolution must be included in the notice.

Shareholders may attend in person or via audio or audiovisual communication (ie, an electronic meeting). Electronic meetings have become increasingly common following the emergence of COVID-19 and are specifically provided for in the Companies Act (Schedule 1) and the Listing Rules (Rule 2.14.3). Shareholders may also appoint a proxy to attend the meeting on their behalf or – if permitted by the constitution – cast a "postal vote", including by electronic means. The quorum requirement will be met if those attending, together with those voting by proxy or by postal vote, are entitled to exercise a majority of the votes entitled to be cast.

If the directors have elected a chair of the board, that person must chair the meeting if they are present. If the chair is not present within 15 minutes, the shareholders present may choose one of their number to chair the meeting.

For meetings held in person, the default method for voting is by a show of hands or by voice. For meetings via audio or audiovisual communication, the chair may decide how a vote is to be conducted. In each case, the number of shareholders who have voted for or against each resolution by postal vote is also counted. Any five shareholders, the chair, or shareholders who together hold 10% of the votes may require a poll to be conducted – in which case, votes must be counted according to the number of votes attached to the shares held by the relevant shareholders.

Postal votes must be received by the person authorised to receive and count them (or, if there is no such person, any director) at least 48 hours prior to the meeting.

The board must ensure that minutes are kept of all proceedings at shareholders' meetings. Minutes that are signed as correct by the chair are prima facie evidence of the proceedings.

Shareholders may raise matters for discussion or resolution at the next meeting of shareholders. The Companies Act specifies the timeframes that must be met by a shareholder who proposes to do so and how the cost of giving

notice of those matters to all shareholders will be met (ie, whether by the proposing shareholder or the company).

5.4 Shareholder Claims

See **4.8 Consequences and Enforcement of Breach of Directors' Duties**.

Dissenting shareholders also have what is commonly known as a "minority buyout right" if certain proposals are approved by shareholders and the dissenting shareholder votes against the proposal. The relevant categories of proposal are:

- an alteration of rights attached to shares in the company;
- adopting, revoking or changing the company's constitution in a way that imposes or removes a restriction on the activities of the company;
- amalgamating the company with another company; or
- entering into a major transaction.

In such a case, the dissenting shareholder may require the company to purchase their shares at fair value (as determined by binding arbitration, if the value is not agreed).

5.5 Disclosure by Shareholders in Publicly Traded Companies

Under the FMCA, a person is a "substantial product holder" of a listed issuer if the person has a "relevant interest" in 5% or more of the quoted voting products (eg, ordinary shares in a listed company) of the listed issuer. The definition of "relevant interest" for this purpose is broadly aligned with that set out in **4.5 Rules/ Requirements Concerning Independence of Directors** with regard to directors' interests in shares, although the two definitions diverge in some respects. The definition of "relevant interest" captures persons who are the ultimate beneficial owner of the share or who may exercise (or control the exercise of) the power to vote or the power to acquire or dispose of the share.

Persons are required to notify the listed issuer and the stock exchange when they become a substantial product holder, when the extent of their relevant interest changes (either up or down) by 1% or more of the total, or when they cease to be a substantial product holder.

In addition, a director or senior manager of a listed issuer who holds a relevant interest in quoted financial products of that listed issuer must disclose this to the listed issuer and the stock exchange.

Companies (whether listed or unlisted) that have 50 or more shareholders, 50 or more share parcels, and consolidated assets of NZD30 million or consolidated revenue of NZD15 million are also subject to the Takeovers Code (and, as such, are known as "Code companies"). The core requirement of the Takeovers Code is that no person may come to hold or control more than 20% of the voting rights in a Code company, or increase an existing holding or control above that proportion, except in specified ways – for example, by making a partial or full takeover offer to all shareholders or (for a holder of 50% to 90% of the voting rights) by increasing the holding by less than 5% per year.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Companies that carry out business in New Zealand are subject to varying financial report-

ing requirements that depend on their place of incorporation, ownership, size and listed or unlisted status, as follows.

- The following categories of company are required to file signed audited financial statements with the Companies Office within five months of each balance date:
  - (a) companies incorporated in New Zealand that are not subsidiaries of overseas companies and have assets greater than NZD66 million or revenue greater than NZD33 million in each of the preceding two financial years;
  - (b) overseas companies (and subsidiaries of overseas companies) that have assets greater than NZD22 million or revenue greater than NZD11 million in each of the preceding two financial years;
  - (c) companies with ten or more shareholders, unless they opt out by a 95% shareholder resolution; and
  - (d) any company where shareholders who together hold not less than 5% of the company's voting shares have given notice requiring the company to opt in to these financial reporting requirements.
- The Listing Rules require listed companies to release annual reports (within three months of each balance date), which include audited financial statements and results announcements in relation to their full-year and half-year results.
- Every issuer of a financial product that is regulated under the FMCA (ie, offerors of financial products for which a "product disclosure statement", akin to a prospectus, is required) is also required to file signed audited financial statements with the Companies Office within four months of each balance date – regardless of whether or not the issuer is listed (see **6.3 Companies Registry Filings**).

6.2 Disclosure of Corporate Governance Arrangements

If a company's shareholders resolve to adopt, alter or revoke its constitution, the board is required to notify the Companies Office within ten working days and include a copy of the constitution or amendments, which are then made publicly available. Other governing documents (eg, shareholders' agreements) do not have to be disclosed.

As regards corporate governance disclosures by listed companies, please refer to **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**. The Corporate Governance Code recommends that a listed issuer's code of ethics, board and committee charters, and certain policies (eg, concerning continuous disclosure, remuneration, diversity and financial product dealings) are made available on the issuer's website – together with any other key governance documents.

6.3 Companies Registry Filings

The following key filings are currently required to be made with the Companies Office and are publicly searchable on the Companies Office website:

- the company's constitution, registered office address, address for service of legal documents, and postal address;
- the name and addresses of the company's directors and its ten largest shareholders of each class, as well as details of any change of directors;
- details of any shares issued by the company;
- details of the company's ultimate holding company (if any); and
- the annual return of the company.

Failure to provide the above-mentioned information within the timeframes specified by the Companies Act can result in fines for directors. In the case of failure to file an annual return, the Registrar can initiate action to remove the company from the New Zealand Companies Register.

By the end of 2023, the New Zealand government intends to introduce legislation that requires details of each beneficial owner of a company or limited partnership (including their full name and basis on which they are a beneficial owner, and their own upstream beneficial ownership) to be made publicly available on the Companies Office website.

As mentioned in **6.1 Financial Reporting**, companies that have made one or more "regulated offers" under the FMCA must ensure the product disclosure statement and all other information relevant to the offer is filed on the Disclose Register, which is a publicly searchable electronic register operated by the Companies Office.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

For details of when a company's financial statements are required to be audited, please refer to **6.1 Financial Reporting**. If they are required to be audited, this must be done by a qualified auditor or audit firm, in accordance with applicable auditing and assurance standards. For that purpose, the company must appoint an auditor at its annual meeting to hold office until the close of the next annual meeting. The auditor is automatically reappointed at each subsequent annual meeting unless they resign or cease to be qualified or the company passes a resolution to replace them.

A director or employee of the company (or a partner or employee of any such person) may not be appointed or act as an auditor of the company.

The directors must ensure that the auditor has access to the accounting records of the company at all times. The auditor may require a director or employee of the company to provide such information and explanations as the auditor thinks necessary for the performance of the auditor's duties. The directors must also ensure that the auditor is allowed to attend any shareholder meeting, receives all notices and other communications to shareholders regarding the meeting, and is permitted to speak at the meeting on any part of the business of the meeting that concerns the auditor.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

As noted in **4.8 Consequences and Enforcement of Breach of Directors' Duties**, the business and affairs of the company are required to be managed by – or under the direction or supervision of – the board. Directors must exercise the care, diligence and skill that a reasonable director would exercise (see **4.6 Legal Duties of Directors/Officers**). This requires directors to keep themselves apprised of the business risks faced by the company.

The Corporate Governance Code recommends that:

- listed companies have a risk management framework (a summary of which should be included in the issuer's annual report);
- the board receives and reviews regular reports; and

- the issuer reports on the material risks – specifically, health and safety risks – facing the business and how these are being managed.

The Health and Safety at Work Act 2015 (the "HSW Act") requires a "person conducting a business or undertaking" (eg, a company) to ensure – as far as is reasonably practicable – the health and safety of all its workers while they are at work and that the health and safety of other persons is not put at risk from that work. The company and its directors can be found liable for breaches of the HSW Act, including where risks are not appropriately managed and systems are not set up to minimise risks.

For NZX-listed companies, the Listing Rules require disclosure of "material information" to the market immediately after a director or senior manager knew – or reasonably ought to have known – the information (unless an exception applies). This requires boards to have appropriate arrangements in place to ensure that any such information does in fact become known to a director or senior manager and can be released to the market as required.

NIGERIA

Law and Practice

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Contents

1. Introductory p.469
1.1 Forms of Corporate/Business Organisations p.469
1.2 Sources of Corporate Governance Requirements p.469
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.470

2. Corporate Governance Context p.471
2.1 Hot Topics in Corporate Governance p.471
2.2 Environmental, Social and Governance (ESG) Considerations p.472

3. Management of the Company p.473
3.1 Bodies or Functions Involved in Governance and Management p.473
3.2 Decisions Made by Particular Bodies p.474
3.3 Decision-Making Processes p.474

4. Directors and Officers p.475
4.1 Board Structure p.475
4.2 Roles of Board Members p.475
4.3 Board Composition Requirements/Recommendations p.475
4.4 Appointment and Removal of Directors/Officers p.476
4.5 Rules/Requirements Concerning Independence of Directors p.476
4.6 Legal Duties of Directors/Officers p.477
4.7 Responsibility/Accountability of Directors p.477
4.8 Consequences and Enforcement of Breach of Directors' Duties p.477
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.478
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.478
4.11 Disclosure of Payments to Directors/Officers p.479

5. Shareholders p.479
5.1 Relationship Between Companies and Shareholders p.479
5.2 Role of Shareholders in Company Management p.479
5.3 Shareholder Meetings p.480
5.4 Shareholder Claims p.480
5.5 Disclosure by Shareholders in Publicly Traded Companies p.480

6. Corporate Reporting and Other Disclosures p.481
6.1 Financial Reporting p.481
6.2 Disclosure of Corporate Governance Arrangements p.481
6.3 Companies Registry Filings p.482

7. Audit, Risk and Internal Controls p.482
7.1 Appointment of External Auditors p.482
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.483

Olajide Oyewole LLP is a leading business law firm in Nigeria, Africa. Established in 1965 as a corporate firm, it is a full-service law firm with over 55 years' experience of solving complex multi-sector problems, and deep expertise in multiple practice areas, particularly corporate law, mergers & acquisition, banking and finance, real estate, energy law, intellectual property, and dispute resolution. Olajide Oyewole LLP is a member of DLA Piper Africa, a Swiss Verein whose members are comprised of independent law firms in Africa working with DLA Piper, with its offices located in Lagos and Abuja, and over 60 specialised and highly qualified partners and lawyers with multi-jurisdictional qualifications and cross-disciplinary skills. Olajide Oyewole LLP's powerful value proposition leverages its immense resources and network to provide seamless cross-border advisory and transactional support to a cross-section of public and private-sector organisations and private clients.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Promoters of a business in Nigeria have a number of structures to choose from, the principals of which include the following.

Private company limited by shares – this is the most common type of company in Nigeria. It is a legal entity that is separate and distinct from its shareholders. This means that in the event the company is wound up, the extent of the shareholders' liability is limited to the remaining unpaid amounts for their shares. Private companies must issue a minimum share capital of NGN100,000, cannot have more than 50 shareholders, and cannot offer shares to the public at large.

Public company limited by shares – companies that wish to offer securities to the public can do so by way of a public company. These companies have a minimum issued share capital of NGN2 million and may be listed on the stock exchange subject to listing and reporting requirements. There is no limitation to the number of shareholders under this structure.

Less frequently used forms of business organisations include the following.

Companies limited by guarantee – this type of company is typically used to pursue charitable objects. The liability of the shareholders of these companies is limited to the amount they have undertaken to contribute to the assets of the company in the event of the company being wound up. The company has no share capital, and its income/profit cannot be paid to its shareholders.

Business name – businesses established by sole proprietors or partnerships may be carried out through a registered business name. A business name cannot sue or be sued in its name, and cannot hold assets in its name, as it has no corporate personality.

Partnerships – other corporate organisations available to partnerships include a limited liability partnership (LLP) where all partners have limited liability, and a limited partnership where one or more partners have unlimited liability and one or more partners have limited liability.

1.2 Sources of Corporate Governance Requirements

Principal Sources of Corporate Governance Requirements

The principal legislation that governs corporate governance for companies in Nigeria includes the following.

- The Companies and Allied Matters Act 2020 (Companies Act) – this is the primary legislation that regulates the formation, operation, and management of all companies in Nigeria.
- The Investment and Securities Act 2007 – this act established the Securities and Exchange Commission. It regulates the operations of capital market operators to ensure the protection of investors, fair, efficient, and transparent markets, and to reduce systemic risk.

In addition to the above, some key sector-specific governance codes and regulations include the following.

- The Nigerian Code of Corporate Governance ("the Governance Code") – the Governance Code was formulated by the Financial Reporting Council of Nigeria (FRCN) to consolidate the codes of private regulated

and public companies. The Governance Code provides a framework to ensure good corporate governance in the public and private sector. Some regulators have imposed the following additional guidelines on companies operating within their sectors:

(a) the Nigerian Communications Commission Code of Corporate Governance for Telecommunication Companies;
(b) the Guidelines on Corporate Governance for Pension Fund Operators;
(c) the National Insurance Commission Corporate Governance Guidelines for Insurance and Reinsurance Companies;
(d) the Securities and Exchange Commission Rules and Regulations ("the SEC Rules") – these rules and regulations provide participants (regulated entities) in the capital market with more precise notice of the expectations, and code of conduct required to promote fairness and equality (see **1.3 Corporate Governance Requirements for Companies with Publicly Traded Shares** for further details);
(e) the Securities and Exchange Commission Guidelines – these guidelines were issued as a replacement to the SEC Code of Corporate Governance for Public Companies 2011, and are additional guidelines to the Governance Code which all public companies are required to comply with;
(f) the Rulebook of the Nigerian Stock Exchange 2015 (the Listing Rules) – the Rulebook is a compilation of all the Rules, Regulations and Guidelines of the Nigerian Stock Exchange;
(g) the articles of association of a company are also one of the sources of corporate governance requirements in Nigeria – the articles of association specify the regulations for the company's operations and define the company's purpose.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Companies listed on the Nigerian Exchange Group (NGX) are required to comply with the legislation set out in **1.2Sources of Corporate Governance Requirements**. More particularly, the following corporate governance requirements must be considered by listed companies.

All listed companies must adopt and apply the Governance Code which covers issues relating to the board of directors, risk management, shareholder engagement, business ethics, sustainability, and transparency. However, the Code is based on "apply and explain" principles, and companies have the flexibility to demonstrate how they have tailored and applied the principles of the Code taking into consideration their size, industry, and growth phase. Non-compliance may attract penalties by the FRCN and sector regulators.

The FRCN requires companies to report on the application of the Governance Code using its reporting template. The report is to be submitted to the FRCN, any relevant sectoral regulator, and any stock exchange the company is listed on. In addition, the FRCN requires the report to be hosted on the investors' portal of the company's website for a minimum of five years.

The Securities and Exchange Commission (SEC) requires annual reporting on a company's level of compliance with the Governance Code, and in any issued prospectus. In addition, the SEC requires mandatory compliance with the SEC Corporate Governance Guidelines, which are additional recommended practices that add to transparency and accountability standards relevant to listed companies. The penalty for non-compliance is a fine of NGN500,000, and

NGN5,000 for every day that the violation persists, or any sanction the SEC may deem fit. The SEC also requires public companies to file half-yearly returns that include corporate governance issues.

Under the Rulebook of The Nigerian Stock Exchange (the Listing Rules), the eligibility criteria for admission includes an evaluation under the Stock Exchange's Corporate Governance Rating System (CGRS) and a minimum rating of 70%. All companies listed on the premium board must comply with the SEC's corporate governance requirements, and disclose in their annual report a list of the codes of corporate governance to which they are subject to, whether the company is fully compliant with the provisions of the code and, if not, provide a detailed statement of the facts of non-compliance and an explanation. Members must also undertake to adhere to any corporate governance disclosure policy requirements issued by the Stock Exchange.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Corporate Governance and Sustainable Development

The link between Corporate Governance and sustainable development continues to gain momentum, along with the growing interest in sustainability and ESG in Nigeria, as the country seeks to balance economic growth with environmental protection and social responsibility.

Business leaders are becoming increasingly aware that sustainable development practices can have a significant impact on business performance, including improved financial results, enhanced brand reputation, and increased employee and customer satisfaction. Nigerian companies that prioritise sustainable development are seeing that they can gain a competitive advantage by differentiating themselves in the market and attracting investors who prioritise sustainability.

Sustainability cannot be effectively managed or successfully integrated with a company's business strategy without a robust governance framework. While ensuring overall accountability, sustainability governance will ensure that organisations develop a sustainability strategy, set and manage ESG goals, implement the sustainability strategy, track ESG performance and manage the sustainability reporting processes. It also strengthens stakeholders' engagement.

The board and senior management play a crucial role in promoting sustainable development practices in Nigerian companies by setting the tone for the company's culture, ethics, and values, and ensuring that there is a sound sustainability governance and management framework in place. This allows the business leaders to prioritise sustainable development in decision-making, risk management, and stakeholder engagement.

ESG Reporting and Disclosure Requirements

The regulatory landscape for sustainable development in Nigeria and how it is shaping corporate governance practices is still developing. It is important to note that there are specific disclosure requirements for listed companies, as well as various regulations and rules that mandate sustainability reporting. In this context, the Global Reporting Initiative (GRI) standards are commonly recommended, and companies are also expected to report their performance against the Task Force on Climate-related Financial Disclosures (TCFD) framework and the Sustainable Development Goals (SDGs).

Nigeria is also following global trends towards mandatory sustainability disclosures: principally, the Financial Reporting Council of Nigeria's announcement that the IFRS Sustainability Disclosure Standards will be adopted in Nigeria when they are issued by the International Sustainability Standards Board's (ISSB) later this year. In addition, the Nigerian Climate Change Act has set a net-zero emissions target, and has mandated sustainability reporting for businesses with more than 50 employees. Insofar as the laws are enforced, they will have a significant impact on ESG reporting in Nigeria, and are expected to act as a catalyst for sustainability disclosures in Nigeria.

2.2 Environmental, Social and Governance (ESG) Considerations

Globally, companies are under increasing pressure from both internal and external stakeholders to demonstrate their capacity to contribute to solving environmental, social, and governance (ESG) problems in Africa, particularly as they relate to climate challenges.

The Nigerian government has taken bold steps to implement valuable climate change actions, such as the enactment of the Climate Change Act 2021. At the United Nations Climate Change Conference (COP26) the Nigerian government committed to achieving net-zero emissions by 2060. In line with this commitment, the Climate Change Act will serve as a basis for identifying the activities aimed at ensuring that the national emissions profile is consistent with the carbon budget goals, and establishing national goals, objectives, and priorities on climate adoption. The Nigerian government has also undertaken the establishment of the National Council on climate change, membership in the African Carbon Markets Initiative, and the launch of Nigeria's Energy Transition Plan 2022, with the goal of achieving carbon neutrality and net-zero emissions in terms of the country's energy consumption.

Nigerian companies have also started to take action on climate and social risk issues, such as investing in renewable energy, reducing emissions, and implementing sustainable business practices, empowerment of corporate boards with oversight of sustainability strategy and progress. Furthermore, there has been a growing trend among Nigerian businesses to adopt responsible sourcing and supply chain management practices, which help to ensure that their products are produced in an ethical and sustainable manner. Some companies have also established corporate social responsibility programmes to support local communities and address societal challenges, such as poverty and inequality.

Despite these valuable efforts, it is clear that more needs to be done to address Nigeria's growing climate and societal challenges. There is an increasing expectation among stakeholders that companies should demonstrate a clear commitment towards achieving important Environmental, Social, and Governance goals, and utilise their influence within society to make meaningful contributions. Companies that prioritise a purpose-driven approach, focusing on people, planet, and profit, are positioned for long-term success that is both sustainable and socially responsible.

Private corporations in Nigeria have the capacity to contribute towards the mitigation of climate and social challenges and possess the requisite competencies and expertise to generate value for stakeholders and communities beyond their financial performance, while improving the sustainability of their businesses.

Moreover, the increased focus on the role of sustainability creates a developing atmosphere of accountability and trust between companies and stakeholders. In this context, Nigerian companies are challenged to include robust ESG-related information in their annual sustainability or integrated report. These companies must build internal capacity to gather, analyse and authenticate ESG-related data across all the business functions, and ensure that their boards are ESG-Fluent, and that an effective sustainability governance and management framework is established. By adopting a more comprehensive and inclusive approach to ESG considerations and improving their communication and reporting practices, companies can foster greater transparency for stakeholders, create impact-withstanding strategies, while enhancing trust and loyalty from their customers and stakeholder.

Nigeria has taken the lead, by announcing its intention to adopt the International Sustainability Standards Board (ISSB) disclosure standards once it is issued in 2023. This decision is a significant move towards adopting a unified method and process on reporting on sustainability across the board. The ISSB disclosure standards demand that companies disclose sustainability-related information and report on climate-related issues that may have a direct impact on business continuity, whilst providing information on the financial records of the company in its audited accounts. The unification of the overall reporting standards will help to place more demands on the board and management of various companies, to prioritise incorporating concepts like greenhouse gas emission procedure in their annual financial statements.

Whilst we await the release and implementation of these standards, the collaborative efforts among stakeholders, including the government, civil society, the private sector, and communities, are equally crucial to ensure that the standards and policies are effective, implemented properly, and responsive to the needs of all communities. Therefore, investing in sustainable technologies and practices, building adequate skill and capacity to measure and report sustainability-related information is key. Ultimately, policy and regulation must be accompanied by collaboration and partnerships to achieve sustainable development in Nigeria.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The decision-making of a company is generally delegated to the board of directors in the company's articles of association, although there are certain decisions that are reserved for the shareholders of the company. The principal bodies and functions involved in the governance and management of a company at each level are as follows.

- *Board of directors* – the board is responsible for overseeing the affairs of the company. Directors may regulate their meetings as they deem fit and may exercise all such powers as are within the articles of association. Boards will consist of a combination of executive directors, non-executive directors and independent directors depending on the activities and size of the business.
- *Shareholders* – the shareholders are the owners of the company, and the board of directors reports to the shareholders on the affairs of the company. The articles of association and the Companies Act provide for particular decisions reserved for the shareholders which are passed by a shareholders' resolution.

- *Executive management* – the executive management team is responsible for managing the day-to-day operations of the company, and the board may delegate its powers to management to implement certain decisions and policies.

3.2 Decisions Made by Particular Bodies

Decisions made by these particular bodies are as follows.

Board of directors – the board is typically authorised to make all decisions required to manage and direct the affairs of the company, secure the company's assets, define the company's strategic goals, and ensure the company carries out its business in accordance with the memorandum and articles of association, and the relevant laws.

Shareholders – there are certain significant decisions reserved for approval by shareholders. These include amending the memorandum and articles of association of the company, appointing or removing directors, altering the corporate structure, approving the audited accounts, and voluntarily winding up the company. Decisions of shareholders are taken in the form of shareholder resolutions at general meetings or in writing.

Executive management – the executive management team is responsible for overseeing the day-to-day running and control of the affairs of the company. Management acts through delegated authorities from the board.

3.3 Decision-Making Processes

The shareholders, board of directors, and executive management make decisions in the following ways:

Shareholders – the decisions of shareholders are usually taken by way of a resolution passed at a properly convened general meeting (or in the case of private companies only, by written resolution). Most decisions are taken by ordinary resolution unless the articles of association or the Companies Act require the decision to be taken by a special resolution. A special resolution is a decision passed by at least 75% of the votes cast, and can be used to change the company name, alter any provision in the memorandum and articles of association of a company, and effect the voluntary winding up of a company. All companies other than a small company or those with a single shareholder must hold an annual general meeting in each year.

Board of directors – the decisions of the board are taken in the form of a board resolution passed at its meeting or by a written resolution signed by all directors. The voting requirements for a board meeting are set out in the company's articles of association, which may provide for a chairman's casting vote, and the resolutions are passed by a simple majority.

Executive management – the executive management acts within the authority delegated by the board of directors and is responsible for making decisions relating to the day-to-day management of the company. Accordingly, all decisions must be made within the terms of the delegation.

The Companies Act requires that the company ensure that minutes of proceedings of board, shareholder, and executive management meetings are kept.

4. Directors and Officers

4.1 Board Structure

Companies operate a single-board structure where both executive and non-executive directors sit on the same board in the discharge of their functions. Under the Companies Act, all companies are required to have at least two directors, except for companies categorised as small companies. Boards may elect a chairman to preside over their meetings, who may be granted a casting vote by the articles of association. In addition, public companies are legally required to have at least one third of the board as independent directors.

The board may constitute committees and may exercise power through the committees, or delegate responsibility for specific aspects of the governance of the company to them. Whilst there are no specific requirements on the type of committees that private unregulated companies should have, regulated entities and public companies are required to have at least an audit committee, a governance or remuneration committee, and a risk management committee under the Governance Code.

4.2 Roles of Board Members

The members of the board are collectively responsible for overseeing the affairs of a company by providing entrepreneurial and strategic leadership. The board is typically comprised of executive and non-executive directors with the following roles.

- *The chairman* – the chairman provides overall leadership to the board at its meetings and ensures that the board works together towards achieving the company's strategic objectives. The Governance Code recommends that the roles of chairman and chief executive officer are held by two separate individuals.
- *Non-executive directors (NEDs)* – NEDs provide an independent and impartial view on the running of the company's business, the governance structure, and the practice in the boardroom. NEDs are not involved in the day-to-day management of the company.
- *Independent non-executive directors (INEDs)* – INEDs must not have an interest or relationship that could reasonably be perceived to influence the director's ability to be impartial and objective in the boardroom. The Companies Act, as amended by the Business Facilitation (Miscellaneous Provisions) Act 2023, requires that one third of the board of public companies should be independent non-executive directors on the board, and the Governance Code recommends that most of the non-executive directors are independent.
- *Executive directors* – executive directors are responsible for the day-to-day management of the affairs of the company and reporting directly to the board on the overall performance of the company as relates to strategy implementation, risk management, organisational management, financial performance, amongst others. Executive directors include the managing director. The managing director/CEO is the head of the management team delegated by the board to administer the affairs of the company.

4.3 Board Composition Requirements/ Recommendations

A company may by its articles of association determine the maximum number of directors to be appointed to the board. A public company is required by law to have at least one third of its board as independent directors. Also, a person is precluded from serving as a director on more than five public companies at the same time.

The Governance Code recommends that the board be composed of individuals with an appropriate mix of knowledge, skills, experience, diversity (including experience and gender), and independence to objectively and effectively discharge its roles and responsibilities. The Code also recommends that the board be composed of a proper mix of executive and non-executive directors with the majority of the members being non-executive directors.

4.4 Appointment and Removal of Directors/Officers

The first set of directors of a company is determined in writing by the subscribers to the memorandum of association of the company or named in its articles. Directors must provide their consent to their appointment. Subsequent appointment of directors may be by a re-election at an annual general meeting or the appointment of new directors. The board of directors may also appoint new directors to fill any vacancy arising out of death, resignation, retirement, or removal of an existing director. However, such appointment is subject to the ratification of the members at the next annual general meeting, without which the director ceases to be in office.

4.5 Rules/Requirements Concerning Independence of Directors

Independence of Directors

Under the Companies Act, a director has a duty not to fetter his discretion to vote in a particular way, and to always act in the best interest of the company. Also, a public company is required to have at least one third of the total number of its directors as independent directors. The Companies Act provides that an independent director is one that:

- does not own (directly or indirectly) more than 30% of the shares of the company; or
- has not been previously employed by the company; or
- has not acted as an auditor of the company; or
- has not been paid or received from the company sums exceeding NGN20 million, or acted as a partner, director or officer of an entity that received or made a NGN20 million payment to the company.

In addition, the Governance Code recommends that most of a company's non-executive directors should be independent and provides the criteria for establishing the independent status of a non-executive director. It precludes the chairman of a board from serving as the chairman of a committee simultaneously and recommends that boards should carry out annual assessments on the independence of their directors.

Conflict of Interest

The Companies Act provides that a director has a duty to avoid conflict-of-interest situations, and to ensure that his/her personal interest does not interfere with the performance of his/her roles and responsibilities on the board. There are various circumstances where a conflict-of-interest situation may arise, which include the use of property, opportunity or confidential information while performing their role as director of the company; receiving a personal benefit or secret profit from the business; or acting as a director on the board of a competing company.

Directors have a duty to give a written notice of disclosure to the board of their interest in any transaction or proposed transaction with the company as soon as they become aware of it. The board may authorise transactions in which conflict-of-interest issues have been raised by following an established process set out in a policy document. In the absence of such approval,

the offending director is liable to account to the company for benefits derived that are contrary to the law.

4.6 Legal Duties of Directors/Officers

Directors have a fiduciary relationship with the company, and the Companies Act sets out the statutory duties they must observe. Directors must:

- discharge their duties honestly and observe good faith in any transaction in relation to the company;
- act in what they believe to be the best interest of the company to promote its objectives, while having regard to the impact of the company's operations on the environment, its employees, and its shareholders;
- exercise a degree of care, diligence, and skill which a reasonably prudent director would exercise in similar circumstances – directors must meet the minimum standard of skill and care expected of someone in their position and utilise their skills and experience;
- declare the nature and extent of any interest in proposed transactions or arrangements with the company before the secret profits are made; and
- exercise their power for the specific purpose it was given and not for any collateral purpose.

Directors must not:

- restrict their discretion to vote in any way;
- put themselves in a position where there is, or could be, a conflict between their personal interests and their duty to the company;
- make any secret profit or achieve any unnecessary benefit;
- misuse the company's information; or
- accept bribes, gifts or commissions from any person in respect of any transaction involving their company in order to induce their company to deal with such a person.

Directors are also legally required to comply with reporting and disclosure requirements including annual returns, financial statements, and other corporate information. They must also ensure the company's compliance with other legal obligations including regulations relating to data protection, health and safety, environmental matters and employment issues.

4.7 Responsibility/Accountability of Directors

Directors are appointed to direct and manage a company's business and they owe their statutory duties to the company itself. However, in making decisions in the best interest of the company, directors have a legal duty to consider the interest of its employees, the shareholders, its stakeholders and the environment in the community where the company operates.

Directors do not owe a duty to creditors directly. However, where a company is insolvent or nearing insolvency, directors may be able to avoid liability for fraudulent or wrongful trading if they can demonstrate that they took every necessary step to minimise potential loss to creditors.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Generally, only a company can enforce the breach of a director's duties or ratify an irregular act since the duties are owed to the company itself. This poses some difficulty as an individual shareholder who wishes to sue a director may not be able to obtain a board approval required to commence an action in the name of the company. The Companies Act therefore contains

provisions which allow shareholders to bring a derivative action on behalf of the company under certain circumstances.

The consequences for breach of a director's duties to the company may include payment of compensation or damages for any loss suffered on account of the breach of their duties, recovery of misapplied property, accounting for profit, restitution, rescission of a contract, being restrained by injunction or held criminally liable, where the breach amounts to a crime.

A director also risks being disqualified by the court from acting as a director or from taking part in the promotion, formation, or management of a company if the director is convicted of a criminal offence relating to the running of a company, or fraudulent or wrongful trading.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

In addition to a director's liability relating to the breach of their duties, directors who receive more money than they are entitled to as remuneration are guilty of misfeasance and accountable to the company for such money. Where a payment declared to be illegal by the Companies Act is made to a director, the amount received is deemed to have been received by them in trust for the company. In addition, if a director has breached the tax obligations of a company, the director may be held personally liable for tax penalties payable by a company.

Under various legislation including the Economic and Financial Crimes Commission Act and Money Laundering (Prohibition) Act, a director can be held criminally responsible if the director participated in the commission of the crime related to the company's activities.

The liability of directors can be limited under certain circumstances. A company cannot indemnify a director from liability arising from legal breach in respect of the company, including negligence, default, or breach of trust. However, directors can be indemnified by way of an advance against legal costs incurred by them in successfully defending legal proceedings. However, if the director is not successful, the advance must be repaid to the company.

A company may pay for directors' and officers' (D&O) insurance for its directors. This generally covers individual directors against claims made against them in their capacity as director (including defence costs). Shareholders may ratify or confirm negligent actions taken by directors, or conduct which breaches a director's duty, insofar as the breach is not illegal or fraudulent. However, this does not absolve a director from any liability to a third party.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The remuneration of directors is determined by the shareholders in a general meeting, and where remuneration is fixed by the articles of association it can only be changed by a special resolution of the shareholders. Directors cannot be paid remuneration free of income tax or varying with the standard rate of income tax under the Companies Act. The members of the audit committee of a public company are also not entitled to remuneration.

The managing director's remuneration is determined by the board of directors. The Governance Code recommends that the managing director/CEO and other executive directors should not receive sitting allowances for attending meetings of the board or its committees, and directors'

fees from the company, its holding company or subsidiary. The Governance Code also requires companies to implement a claw-back policy to recover excess or undeserved rewards, such as bonuses, incentives, share of profits, stock options, or any performance-based rewards from directors and senior executives. The Companies Act also requires that the remuneration of managers of the company be disclosed to the shareholders at general meetings.

Where the directors, officers or the company fail to comply with these approval requirements, any member of the company may seek a court injunction or declaration restraining the erring persons from proceeding with the unauthorised act. Also, where the non-compliance of the erring directors or officers leads to a personal injury against a member or members of the company, they may bring a personal action against the erring directors and the members would be entitled to damages, or a declaration or injunction to restrain the company or the erring directors.

4.11 Disclosure of Payments to Directors/Officers

Companies are required by the Companies Act to file annual returns to the Corporate Affairs Commission, accompanied by audited financial statements which are required to disclose all payments and remuneration from the company to its directors and its officers for the year. Also, the disclosure of the remuneration of officers who are senior managers of the company is required to made at the annual general meeting of the company, as part of the ordinary business transacted at an AGM.

The Governance Code also recommends that the company's remuneration policy as well as the remuneration of all the directors should be disclosed in the annual reports of the company.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

A company has a separate legal personality from its shareholders and the shareholders' liability to the company is generally limited to any amount unpaid on their shares. The relationship between the company and its shareholders is a binding contractual one governed by the articles of association of the company, whereby they agree to observe the provisions of the memorandum and articles of the company.

The shareholders are given a right of participation in the company rather than a direct interest in the assets of the company, and are entitled to dividends from the distributable profit of the company in the proportion of their shareholding. Upon winding up, the shareholders are also entitled to the surplus assets of the company after the company's creditors have been fully paid.

Sometimes, shareholders may enter into shareholder agreements with themselves and the company, outside the articles of association. A shareholder's agreement confers privacy as the articles of association are required to be filed at the Corporate Affairs Commission.

5.2 Role of Shareholders in Company Management

Unless otherwise provided in the company's articles of association, the business of the company is directed and managed by the board of directors who exercise all the powers of the company that are not legally reserved to the shareholders.

Certain powers that are exercisable only by shareholders in a general meeting include the adoption of audited accounts, the ratification of the appointment of directors and the approval of

a major asset transaction valued at 50% or more of the value of the company.

Shareholders have a right to attend general meetings and to require directors to call a general meeting to direct the board or management to take certain decisions if they hold more than one tenth of the paid-up capital of the company or total voting rights, stating the purpose of the meeting.

5.3 Shareholder Meetings

Save for small companies or companies having a single shareholder, the board is required to hold a general meeting annually in addition to any other meeting in that year. Not more than 15 months shall elapse between one annual general meeting and the next.

Written notice of the meeting must be given to each shareholder, director and auditor at least 21 days before the meeting, unless a majority shareholder holding not less than 95% in nominal value of the shares with a right to attend and vote agrees to a shorter notice. No business may be transacted at any general meeting unless notice of it has been given. Such notice must contain the place, date and time of the meeting as well as the general nature of the business to be transacted to enable the recipients to decide whether their attendance is necessary. Where any special resolution is to be submitted to the meeting, the text of that resolution must be included in the notice.

Shareholder meetings other than an annual general meeting are extraordinary general meetings, and they can be convened with 21 days' notice whenever the company sees fit.

The default method for voting on a resolution is by a show of hands and shareholders' votes for or against each resolution are counted. Alternatively, a poll may be required to be conducted by the chairman – at least three shareholders, or shareholders together holding 10% of the votes, in which case votes must be counted according to the number of votes attached to the shares held by the relevant shareholders.

Before the passage of the Companies Act 2020, all general meetings were held physically in Nigeria. Now, companies are allowed to convene shareholders' meetings electronically. Companies have also taken the opportunity to amend their articles of association to incorporate provisions on electronic meetings.

5.4 Shareholder Claims

Shareholders may institute legal proceedings in the name and on behalf of the company based on a director's action (or inaction) involving negligence, default, or breach of duty, if it is in the best interests of the company.

Proceedings may also be brought against the company or directors on the grounds that the affairs of the company are being run in an illegal, oppressive, unfairly prejudicial, or unfairly discriminatory manner, or with disregard to the interest of a shareholder or shareholders.

5.5 Disclosure by Shareholders in Publicly Traded Companies

By virtue of the Companies Act, a shareholder who possesses, either directly or through a nominee, shares in a public company that entitles the shareholder to exercise 5% of the unrestricted voting rights at any general meeting is considered a substantial shareholder and must notify the company of his or her interest within 14 days after that person becomes aware that he is a substantial shareholder.

Within 14 days of receipt of the notice or of becoming aware that a person is a substantial shareholder, the company must give notice in writing to the Corporate Affairs Commission. The duty also arises where the person ceases to be a substantial shareholder.

The Rules of the Securities and Exchange Commission require registrars to file information on beneficial owners of 5% or more of a public company's shares with the Securities and Exchange Commission, the company and a securities exchange annually. Any changes to this information are required to be filed within five days.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Under the Companies Act, companies are required to publish their financial statements, including the directors' report and auditor's report, and deliver them to the Corporate Affairs Commission annually, except where the requirement is dispensed with by law. For companies that qualify as small under the Companies Act, the directors may deliver modified financial statements instead.

The Companies Act sets out the matters the annual report should deal with. They include any significant change in the assets of the company, directors' interests, important events affecting the company, likely future developments of the business, charitable gifts, employee engagement and training.

The Listing Rules require listed companies to announce their financial statements for the full financial year immediately after the figures are available and not later than 90 days after the relevant financial period. The annual financial report must also be available to the public for at least five years. They must also announce the financial statements for each of the first three quarters of their financial year immediately after the figures are available, and not later than 30 days after the relevant financial period.

Under the SEC Rules, all listed companies must also release their earnings forecast 20 days prior to the commencement of a quarter. The chief executive officer and the chief financial officer must swear to an affidavit of correctness of the information disclosed in the annual report, accounts, and periodic financial reports released to the public.

Public companies are required by the SEC Rules to publish their quarterly financial statements in at least one newspaper and on the company's website. In addition, the Governance Code recommends a full and comprehensive disclosure of all matters that are material to investors and stakeholders as good corporate governance practice.

See **4.11 Disclosure of Payments to Directors/ Officers** for disclosure requirements relating to directors' remuneration, and **6.2 Disclosure of Corporate Governance Arrangements** for disclosure requirements on corporate governance.

6.2 Disclosure of Corporate Governance Arrangements

The FRCN requires all public companies, their holding companies (private or public) and regulated entities to comply with the Governance Code and to report annually on how they have applied its principles. Companies are required to apply all principles of the Governance Code and also explain how the principles were applied.

The FRCN's reporting template sets out the information required to be provided in the corporate governance report, which includes matters relating to the board of directors, risk management, shareholder engagement, business ethics, sustainability, and transparency. The SEC Rules also require the board of a public company to comply with the Governance Code, and to ensure that the company's annual report includes a corporate governance report that conveys clear information on the strength of the company's governance structures, policies and practices to stakeholders. The report should include information relating to the composition and responsibilities of the board and committees, the company's code of business conduct and its sustainability policies. See **1.3Corporate Governance Requirements for Companies with Publicly Traded Shares** for corporate governance disclosure requirements for listed companies.

6.3 Companies Registry Filings

A company is required to notify the Companies Affairs Commission when there are any key changes to its particulars, such as change in the registered office, shareholding and directorship. It must also file annual returns along with audited financial statements and file all special resolutions within 15 days of passing them. All documents filed at the Commission are available to the public. Apart from the penalties that may be prescribed by the Commission for failure to make the necessary filings as and when due, failure to file annual returns for a consecutive period of ten years is a ground for striking the name of a company off the companies' register at the Commission.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Every company is required to appoint an external auditor to audit the financial statements of the company. However, companies that have not carried on any business since incorporation, and small companies, are exempt from this requirement. A private company qualifies as a small company in a financial year if:

- its turnover is not more than NGN25 million;
- its net assets value is not more than half the value of the prescribed turnover;
- one of its members is an alien;
- none of its members is a government, government corporation or agency or its nominee; and
- the directors hold between themselves at least 51% of its equity share capital of the company.

Directors of a company are statutorily required to lay the audited financial statements before the shareholders at the general meeting and certify the accuracy of the financial statements. The auditors are also expected to confirm whether proper books of accounts were kept by the company and report on the correctness of the information provided in the directors' report.

The additional requirements that govern the relationship between the company and the auditor under the Governance Code include:

- mandatory rotation of external auditors after a period of ten years for regulated companies;
- the requirement to appoint persons who are qualified under the Companies Act as auditors, eg, an employee of the company may not be appointed as an external auditor – the

qualifications are generally structured to avoid conflict of interests;
- the right of an external auditor to receive notices of general meetings and attend such meetings; and
- an auditor is precluded from providing non-audit services except where any other services offered by the auditor have been approved by the board in accordance with international auditing standards.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The Governance Code requires boards of regulated companies to establish a sound framework for managing risk and ensuring an effective internal control system for their companies. It recommends setting up a risk management committee where non-executive directors constitute the majority of the committee. It also recommends the appointment of an independent reviewer to assess the effectiveness of the internal audit function at least once every three years.

The Companies Act mandates the chief executive officer and the chief financial officer of a company to certify that the company has internal controls that have been established, maintained and effected as of the date the financial statements were signed off. It is also mandatory for the statutory audit committee of a public company to constantly monitor and review the effectiveness of the company's system of accounting and internal control, and to authorise the internal auditor to conduct any necessary investigations.

All public companies are required by the SEC Rules to establish a risk management committee to assist in their oversight of the risk profile, risk management framework and risk reward strategy as determined by the board.

Trends and Developments

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Olajide Oyewole LLP (Lagos - HQ) is a leading business law firm in Nigeria, Africa. Established in 1965 as a corporate firm, it is a full-service law firm with over 55 years' experience of solving complex multi-sector problems, and deep expertise in multiple practice areas, particularly corporate law, mergers & acquisition, banking and finance, real estate, energy law, intellectual property, and dispute resolution. Olajide Oyewole LLP is a member of DLA Piper Africa, a Swiss Verein whose members are comprised of independent law firms in Africa working with DLA Piper, with its offices located in Lagos and Abuja, and over 60 specialised and highly qualified partners and lawyers with multi-jurisdictional qualifications and cross-disciplinary skills. Olajide Oyewole LLP's powerful value proposition leverages its immense resources and network to provide seamless cross-border advisory and transactional support to a cross-section of public and private-sector organisations and private clients.

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Sustainability Governance: Listed Entities in Nigeria and 2023 Regulatory Outlook

Boards have the overall responsibility for overseeing the Environmental, Social, and Governance (ESG) strategy and reporting of a company, and a company's direction and priorities can be discerned from how and where sustainability fits into the overall corporate structure. Successful integration and effective management of sustainability require committed leadership, clear direction, and strategic influence, and none of this can happen without an efficient board.

The opening principle of the Nigerian Code of Corporate Governance 2018 provides that a successful company is headed by an effective board which is responsible for providing entrepreneurial and strategic leadership as well as promoting an ethical culture and responsible corporate citizenship. As a link between stakeholders and the company, the board is to exercise oversight and control to ensure that Management acts in the best interest of the shareholders and other stakeholders while sustaining the prosperity of the company. This first principle is the essence of sustainability governance.

The Nigerian Stock Exchange (NGX) provides the rules and regulations for listed entities in Nigeria. The NGX's Sustainability Disclosure Guidelines 2018 make Boards responsible for integrating sustainable business practices in the administration, growth, and development of their organisations. The Guidelines recognize that Boards should set and clarify the corporate strategy, objectives and required outcomes from an ESG perspective. Boards are also expected to engage, enhance, and develop key resources and relationships to implement their companies' strategies to achieve sustainable business outcomes.

In addition to the regulatory requirements of the NGX, sustainability governance has become an essential aspect of business operations and is fast becoming a critical factor for investment decisions. As a result of growing investor demands, increased regulatory pressures, and a multitude of studies linking sustainable practices to long-term better and stronger corporate performance, we have seen an increased awareness of sustainability governance amongst business leaders of listed entities in Nigeria and a number of companies have started to put structures and systems in place for sustainability governance.

Sustainability Governance Practices of Leading Listed Companies in Nigeria

The first section of this article covers corporate commitment to sustainability governance practices among some of the leading Nigerian listed companies between 2021 and 2022. The companies we reviewed were chosen using judgmental sampling techniques from companies operating in the consumer goods, industrial, and manufacturing sectors because their operations have a significant environmental and social impact. The companies are classified according to a set of criteria from disclosures made in their sustainability reports to determine their level of commitment to sustainability governance practices. These predetermined criteria include sustainability measures as one of the key performance indicators for senior managers, the presence of a sustainability board committee and related sustainability governance structures, a sustainability strategy statement, board and employee sustainability training, level of sustainability expertise on the board, board committee and management, and mechanisms for monitoring ESG goals and targets. These indicators align with the NGX's position on the need for strong governance and accountability for the effective implementation of a sustainable devel-

opment strategy and embedding sustainability in any organisation. The final part of the article briefly examines the regulatory outlook for 2023 in Nigeria and how it impacts sustainability governance practices for companies in Nigeria.

The Predetermined Criteria

Selected companies were assessed based on the following criteria to show the level of their commitment to sustainability governance practices. These criteria include:

A Sustainability Strategy Statement

A sustainability strategy statement is an indicator of the board's commitment to sustainability. It is the statement from the highest governing body of the organisation which connects the strategy of the company to the company's purpose and creation of long-term value. It focuses on the areas that are material to the company and its shareholders in all ESG areas. The strategy statement creates the destination (the vision) and sets the tone on how to get to the destination (targets, policies, performance measurement, KPIs, and actions and rewards).

During our review, we observed that the companies have a sustainability strategy statement with variances in the level of detail included in the sustainability reports. A significant number of the reports that were reviewed included statements from the Chairmen of the Boards emphasising the sustainability commitments of the companies and the highlights of the companies' sustainability achievements within the period. The sustainability strategies of these companies were benchmarked against the United Nations Sustainable Development Goals, particularly in areas that have the potential for impacts on the business strategy. Sustainability permeates the companies' operations and communications to the extent that they have regular sustainability themes and established targets which are being tracked and reported.

ESG governance structure

The governance structure defines the systems through which boards provide oversight on material ESG issues. These structures could be the establishment of a dedicated board sustainability committee, sustainability infused as part of the responsibilities of the existing board, the establishment of an Executive Sustainability Committee reporting to the board through the CEO or any other senior manager, as well as the organisation of management staffing and reporting lines relating to ESG. A well-defined ESG governance structure indicates the level of seriousness and commitment of the board.

We observed significant disparity in the ESG governance structure of the companies as the publicly available information confirms the fact that there is no one-size-fits-all for ESG governance. Generally, oversight of sustainability issues is carried out by the board of these companies with management providing regular monitoring and reports to the full board as well as the existing committees. However, our analysis also indicates that oversight of ESG issues is provided by existing committees or specialised committees in a number of these companies whilst a few of the companies do not provide any information on their ESG governance structure.

Sustainability training

Sustainability is a journey, and the space is ever evolving. It is the duty of the governing body of the organisation to ensure that members of the board, senior management and employees are well trained on ESG and the sustainability issues that are material to the company, and that they are able to make informed decisions on sustainability risks and opportunities. This approach

signifies the company's commitment to embedding ESG in the operations of the company.

Some listed entities provide information on sustainability training attended by the board as well as detailed information on the sustainability training of employees including the number of employees trained and the number of training hours year on year. Most of the entities did not provide any information in this respect.

Key performance indicators

Linking sustainability performance to the remuneration of managers is one of the best indicators of a company's commitment to sustainability. A substantial number of the companies did not disclose any information that suggests that the remuneration of executive directors and/or senior managers was linked to the sustainability performance of the companies.

Mechanisms for monitoring progress

The establishment of mechanisms for monitoring the progress of the company against ESG-related targets is another best practice for sustainability governance. Some of the indicators under this heading include a board-approved sustainability policy, frequency of the board's discussion on ESG issues, management of ESG data, management reporting framework, sustainability action plans, integration of sustainability performance with appraisal structures, external assurance of ESG data, etc.

During the course of our analysis, we observed that the mechanisms that have been put in place to monitor progress against ESG-related targets differ from one company to the other. A substantial number of multinational companies simply adopt the sustainability policies of foreign parent companies and are starting to adopt or integrate sustainability management systems.

A notable number of the companies have well-defined sustainability objectives which are tracked year on year, and reports are made in respect of progress against these established targets in the annual reports. A similar number also indicates that sustainability information and data are verified by external providers, with some conducting annual materiality assessments as part of a range of processes to identify and define the material topics to be accorded priority in their business strategy and reporting. Some companies also have ESG Codes of Conduct for suppliers, vendors, and contractors as a way of integrating the best sustainability practices in their supply chain.

Sustainability expertise

Directors have a legal and fiduciary duty to understand and assess material ESG issues in making business decisions. The appointment of directors with relevant ESG expertise or experience or the employment of a member of the C-suite with ESG expertise who has direct access to the board would allow the board to minimise or eradicate potential ESG-related risks and exploit ESG opportunities in the marketplace.

Notably, some companies have appointed Heads of Sustainability in senior management, with key members of senior management possessing ESG expertise. Other companies have ESG experts on their boards or climate change experts who meet with them to share ideas on climate-related issues.

When boards decide to take sustainability seriously, it may be difficult to determine the first step to take and what resources to deploy to those initial actions. To help guide these decisions, we have defined ten actions that the board can adopt to drive sustainability governance:

- recruit ESG-competent directors and senior management;
- establish a purpose-driven culture;
- educate directors on sustainability;
- structure the board to ensure effective oversight of sustainability matters;
- engage with stakeholders on sustainability matters;
- establish a governance system that covers material ESG issues and data management;
- integrate sustainability in corporate strategy development;
- integrate ESG into co-ordinated boardroom and management deliberations;
- set goals and clear metrics for tracking sustainability initiatives; and
- include sustainability in compensation models.

Regulatory Outlook 2023

Nigeria passed the Climate Change Act 2021 (CCA) in the wake of COP26 in October/November 2021, which provides a framework for achieving low greenhouse gas (GHG) emissions and long-term economic growth. This is accomplished by enabling the development of programmes to meet long-term objectives for climate change adaptation and mitigation in accordance with national development priorities.

The establishment of the National Council on Climate Change (the Council), which has the authority to make policies and decisions regarding all climate change-related issues in Nigeria, is one of the CCA's major accomplishments. To control GHG emissions and other human-caused climate change factors, the Council will co-ordinate and determine sectoral targets and strategies.

The Council will also collaborate with the Nigerian Sovereign Green Bond and the Federal Ministries of Environment and Transportation to implement a mechanism for trading carbon emissions as part of the Council's other tasks, which also include implementing the National Climate Change Action Plan and mobilising financial resources to support climate change action. Under the CAA, businesses that employ a minimum of 50 persons are required to put in place measures to achieve the annual emission reduction targets to be specified in the National Action Plan and designate a Climate Change/Environmental Sustainability Officer responsible for annual reports.

The Financial Reporting Council of Nigeria (FRCN) announced the early adoption of the International Sustainability Standards Board's (ISSB) IFRS Sustainability Disclosure Standards in Nigeria when issued in 2023. This announcement marked a significant move in the country's progress towards supporting the development of a common language for sustainability-related disclosures. In fact, a Technical Readiness Working Group has been constituted to ensure the seamless adoption of the IFRS S1 (General Requirements for Disclosure of Sustainability-Related Financial Information) and the IFRS S2 (climate-related disclosures during the year). According to the ISSB sustainability disclosure standards, businesses must disclose sustainability-related data along with their financial statements and report on sustainability risks and opportunities that have an impact on their bottom line. They must also demonstrate a commitment to fostering long-term value creation and fostering trust in their stakeholders.

The Nigerian Federal Executive Council approved the country's Energy Transition Plan (ETP) on 2 February 2022, outlining a course for achieving its net-zero goal in 2060. By fostering economic development, providing access to

contemporary energy services, and addressing the possibility of job losses in the oil sector due to global decarbonisation, the ETP aims to bring over 100 million people out of poverty. The ETP aims to focus on technologies that maximise emission reduction across five key sectors with greater emissions, such as cooking oil, and gas, industrial, transport and power sectors. Given the lack of funding required to fund the country's energy transition, we anticipate that the Nigerian government will push for more collaborations and seek financial and technical support in 2023.

Nigeria has also signed on to the new African Carbon Markets Initiative (ACMI), joining six other countries. The ACMI plans to, among other things, generate 300 million carbon credits annually by 2030 and 1.5 billion annually by 2050, unlock six billion in revenue by 2030 and more than 120 billion by 2050, support 30 million jobs by 2030 and more than 110 million jobs by 2050, and distribute revenue in a fair and open manner to local communities. We are interested in seeing how this initiative will make it possible for climate finance to boost energy access, create jobs, save biodiversity, and advance climate action toward the Paris goals all while supporting Nigeria's economy.

Due to the technological and financial difficulties associated with financing low-carbon energy sources, we anticipate that Nigeria will increasingly rely on natural gas in the coming years. Greater expenditures in gas infrastructure projects will result from this, and we anticipate that Nigeria will make significant progress this year. For the government to gain from value-added projects and transactions, the flare gas commercialisation initiative must be implemented successfully. This recapture of flared gas for sales will not only stimulate economic growth, drive investments, and provide jobs in oil-producing communities but also reduce the environmental and health degradation of host communities through air pollution. One key introduction in this respect is the new Finance Act 2023 which introduces the imposition of tax at the rate of 50 kobo on every naira in the profits of a gas flaring company.

Although the regulatory process in Nigeria is gradual and steady, we are seeing a more aggressive push from regulators in other jurisdictions which will definitely have a serious impact on the operations of companies in Nigeria. One such regulation is the European Union (EU)'s Carbon Border Adjustment Mechanism (CBAM) which will start applying in its transitional phase on 1 October 2023. The EU's CBAM is a groundbreaking tool that will be used to set a fair price on the carbon emitted during the production of carbon-intensive goods that are imported into the EU and to encourage cleaner industrial production from the source non-EU countries. This mechanism ensures that there is a parity between the carbon price of imported goods and the carbon price of domestic production such that the EU's climate objectives are not undermined by carbon leakage.

Conclusion

The role of boards in respect of sustainability essentially involves setting the sustainability strategy of the company and ensuring that the sustainability strategy is implemented. Amid increasing stakeholder expectations, an effective Corporate Governance framework is necessary to enable the board to establish processes and controls required to deliver on the company's sustainability strategy. Due to the large number of topics comprising ESG, companies are increasingly choosing ESG governance frameworks that allocate responsibilities across their organisations, starting from the top. There

is no one-size-fits-all solution to ESG matters as each company would navigate these issues in relation to its organisational structure based on its size, reach, impact, business needs and legislative requirements.

Generally, for most listed entities in Nigeria, we observed that there is a dearth of information regarding the board's leadership roles in relation to ESG issues, although there is information on ESG targets and goals and results of each year, including major improvements on targets. In line with global best practices, there is an opportunity for listed entities in Nigeria to prioritise voluntary disclosures of their sustainability governance structures in order to explain how board and management expertise and ESG oversight are integrated with organisational strategy. It also provides stakeholders with the assurance that the company's board and management have the agility and ability to adapt to ever-evolving ESG issues.

On the regulatory front, 2023 has so far shown an increased focus on sustainability in the business environment in Nigeria, with the Nigerian government's quest to implement the Climate Change Act 2021 and the Finance Act 2023. This has received a further boost with the FRCN's adoption of the IFRS sustainability standards and the advent of international regulations with local impact such as the EU CBAM. These regulatory and legal drivers promise to propel the development of a sustainable business culture in large and listed companies in Nigeria.

NORTH MACEDONIA

Law and Practice

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Contents

1. Introductory p.495
1.1 Forms of Corporate/Business Organisations p.495
1.2 Sources of Corporate Governance Requirements p.495
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.496

2. Corporate Governance Context p.497
2.1 Hot Topics in Corporate Governance p.497
2.2 Environmental, Social and Governance (ESG) Considerations p.497

3. Management of the Company p.497
3.1 Bodies or Functions Involved in Governance and Management p.497
3.2 Decisions Made by Particular Bodies p.498
3.3 Decision-Making Processes p.498

4. Directors and Officers p.499
4.1 Board Structure p.499
4.2 Roles of Board Members p.499
4.3 Board Composition Requirements/Recommendations p.500
4.4 Appointment and Removal of Directors/Officers p.500
4.5 Rules/Requirements Concerning Independence of Directors p.501
4.6 Legal Duties of Directors/Officers p.502
4.7 Responsibility/Accountability of Directors p.502
4.8 Consequences and Enforcement of Breach of Directors' Duties p.502
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.503
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.503
4.11 Disclosure of Payments to Directors/Officers p.504

5. Shareholders p.504
5.1 Relationship Between Companies and Shareholders p.504
5.2 Role of Shareholders in Company Management p.504
5.3 Shareholder Meetings p.504
5.4 Shareholder Claims p.505
5.5 Disclosure by Shareholders in Publicly Traded Companies p.505

6. Corporate Reporting and Other Disclosures p.506
6.1 Financial Reporting p.506
6.2 Disclosure of Corporate Governance Arrangements p.506
6.3 Companies Registry Filings p.508

7. Audit, Risk and Internal Controls p.508
7.1 Appointment of External Auditors p.508
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.508

Polenak Law Firm is one of the market leaders in North Macedonia, and has continued the tradition of providing top-quality legal services since the first law office bearing the name Polenak was established in 1946. The firm has built its experience by acting as local counsel of multinational corporations, banks and international financial institutions. The number of transactions handled by Polenak makes it among the most experienced law firms in the market in banking, project finance, M&A deals, privatisation processes, competition and antitrust matters, aviation, energy, telecommunications and PPP. The knowledge and practice of the firm's litigation lawyers in criminal, civil and commercial cases is remarkable, and one of its prominent benchmarks. The affiliation with leading law firms from each jurisdiction in the region, joined together in the South East Europe Legal Group (www.seelegal.org), enables it to offer its clients coverage and superior legal services in the region.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

The governing Law on Trade Companies defines a trade company as a legal entity wherein one or more persons have invested cash, things or rights used for joint operation and who jointly share the profit or loss arising from the operation. The trade company independently and permanently performs an activity, to gain profit.

There are five legal forms of trade companies: general partnership, limited partnership, limited liability company (LLC), joint-stock company (JSC), and limited partnership with shares. Typically, trade companies are organised as an LLC and JSC.

A trade company can be incorporated only in a form and manner determined by the Law on Trade Companies. Founders are free to choose the type of trade company, unless otherwise determined by law, where mandatory form is required.

LLCs are privately held companies, like "closed corporations", with the Law on Trade Companies determining the maximum number of shareholders (up to 50), as well as granting statutory right of first refusal (pre-emptive rights) to the shareholders in the case of the sale of shares.

JSCs may also function as privately held companies, though they are subject to stricter corporate governance rules and reporting requirements than LLCs. Further, depending on certain criteria stipulated in the relevant laws, JSCs may be "reporting companies" defined as a JSC that has carried out a public offering of shares, or has a principal capital of EUR1 million and more than 50 shareholders, excluding the listed companies on the Macedonian stock exchange (the MSE). "Listed companies" are JSCs whose shares are traded on one of the trading tiers of the MSE.

1.2 Sources of Corporate Governance Requirements

Corporate governance requirements for all companies in the jurisdiction of North Macedonia are set out in the Law on Trade Companies. This is also the general law and principal source that governs the manner of the foundation of companies, requirements for their management and supervisory bodies, as well as shareholders' rights and their protection.

Listed companies also need to comply with the MSE Listing Rules and to report on compliance with the disclosure obligations under the Corporate Governance Code for Listed Companies on

the MSE. The new Corporate Governance Code was adopted in 2021 (the MSE Code).

There are few sectoral requirements applicable for commercial banks and insurance companies, which by law are mandatorily established as JSCs.

The Banking Law, adopted in 2007 and as further amended, sets the corporate governance framework for the commercial banks registered in the Republic of North Macedonia, by stipulating their mandatory management structure and authorising the National Bank of the Republic of North Macedonia (National Bank) to prescribe the best corporate governance rules in accordance with international standards. The National Bank has adopted the decision on good corporate governance rules for banks.

The same also applies for insurance companies, in accordance with the Law on Insurance Supervision, published in 2002 and as further amended, as they are under the supervision of the Insurance Supervision Agency.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Though primarily set out in the Law on Trade Companies, corporate governance provisions for listed companies go a step further in requiring greater disclosure and transparency in convening shareholders' meetings, by way of which listed companies are obliged to publish information on their websites and the MSE. This allows the shareholders flexibility in appointing proxies while at the same time considering conflict of interest matters, as well as imposing stricter criteria regarding approval of the interested parties transaction, and stipulating a mandatory requirement for an auditor opinion on fairness whenever the transaction in question exceeds 10% of the assets value in accordance with the latest audit financial reports.

The Law on Trade Companies stipulates mandatory corporate governance requirements for these companies, including the most recent in relation to the obligation to submit a corporate governance statement for application of the corporate governance code of the stock exchange on which their shares are listed, and that applies in accordance with its listing rules.

For those companies listed on the MSE, they are obliged under the criteria stipulated in the MSE Listing Rules to consider the provisions of the MSE Code.

The MSE Code follows the "comply or explain" approach. As per the MSE Code, "this approach is intended to give companies some flexibility as regards adopting the good practices set out in the Code…". The MSE understands that not all practices are suitable for all companies, thus allowing that "in such cases, companies can choose not to comply with... the MSE Code."

If a company does not comply with the MSE Code, it must:

- explain in what way the company does not comply with the MSE Code and the reasons why, with reference to the company's specific circumstances;
- describe the actions it has taken instead of complying with the MSE Code to make sure it meets the objective set out in the relevant provisions of the MSE Code; and
- if the company intends to comply with the MSE Code in the future, specify when it expects to start doing so.

Those listed companies that are required by the MSE Listing Rules to "comply or explain" regarding the MSE Code must prepare an annual statement, the contents of which are specified in the MSE Listing Rules.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

In 2023, for the first time, listed companies are obliged under the MSE Code to report on ESG matters.

2.2 Environmental, Social and Governance (ESG) Considerations

The MSE Code introduced a novelty in the Macedonian corporate landscape, by stipulating for the first time the ESG matters as a content of corporate governance, that "the supervisory and management boards shall cultivate a corporate culture that encourages a responsible attitude towards the environment and social issues; approve a strategy to promote sustainability; and ensure that their business model and risk management systems take account of the potential environmental and social impact of their activities."

Furthermore, the MSE Code stipulates, inter alia, that:

- the company shall have internal acts relating to its responsibilities for environmental and social issues and policies and procedures that enable it to identify material factors and assess the impact on the company's activities, which shall be reviewed at least annually by the supervisory and management boards, and shall be published on the company's website; and
- in the annual report, the company shall report on issues related to environmental and social issues based on the principle of transparency and in accordance with relevant legal requirements and good international practices.

With this, reporting on ESG issues receives further transparency.

On a corporate governance level, the MSE Code stipulates that the management board should explain how the recommended action, on which the supervisory board's consent is required, is consistent with the company's environmental and social policies.

Further, performance measures and incentives should take into account relevant environmental and social issues, and the company's risk management system should include processes to identify and manage risks arising from environmental and social issues.

The MSE also adopted an ESG Reporting Guide, which "in addition to general guidelines for listed companies on the subject matter, is also designed as a specific tool for listed companies that will aim to be fully compliant with the new Corporate Governance Code."

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

LLCs are managed by a manager or managers, appointed by the shareholders' meeting. If more than three managers are appointed, they may function as a management body, with the scope of authorisations and competences determined with the articles of association. The supervisory board is not a mandatory body, though the

shareholders may opt to establish it, again with the articles of association. Shareholders' rights are exercised by the shareholders on meetings or through decision-making by way of correspondence.

The management of a JSC may be either a one-tier or two-tier management system. In a one-tier management system, the board of directors consists of executive and non-executive members as the governing body, while in the two-tier management system the functions of management and control are split between the management board and the supervisory board. Shareholders exercise their rights on shareholders' assemblies.

3.2 Decisions Made by Particular Bodies

The board of directors has the broadest authority in managing the JSC within its scope of operations, and acts in all circumstances, on behalf of the JSC, except for matters falling within the authority explicitly granted to its non-executive members. The executive members have the broadest authority to perform all activities related to management, implementation of decisions of the board of directors and performance of activities in the ordinary course of business.

The board of directors entrusts the company's representation to its executive members. The board of directors cannot delegate decision-making on the following matters to its executive members, and the statute of the company may extend this list further:

- closure (termination) or transfer of an enterprise or a part thereof that participates with over 10% of the income of the company;
- reduction or expansion of the subject of operation of the company;
- substantial internal organisational changes of the company that are determined by an act of the company;
- establishing long-term co-operation with other companies essential for the company or its termination;
- establishment and termination of a trade company that participates with over one tenth of the share capital of the company; and
- establishment and termination of subsidiaries of the company.

The supervisory board in a two-tier management system supervises the management of the operations by the management board. Authorisations related to the management of the company may not be transferred to the supervisory board, unless otherwise provided by the Law on Trade Companies. The above-listed matters that cannot be transferred to the executive members of the board of directors are also matters that the management board may only decide upon following prior approval of the supervisory board.

The shareholders decide upon matters explicitly stipulated as matters under their competences – ie, there is no presumed authority of the shareholders' assembly to resolve matters. The involvement of the shareholders in the management and conducting of the company's operations, which are under the competence of the management bodies, is excluded unless otherwise determined by the Law on Trade Companies.

3.3 Decision-Making Processes

Management bodies (the board of directors, ie, the management and supervisory board) hold meetings when it is required for the performance of the activities in the scope of their competences. Any member of the management body can submit a written request to the president of the

board (stating the reasons and the purpose) to request convening a meeting of the management body. There is also the possibility of deciding upon a matter without holding a meeting.

The decision of the management bodies is adopted by majority vote. In case of a tie, the president is considered as having a casting vote. The relevant statute may stipulate a higher majority for certain matters. The Law on Trade Companies stipulates the operating quorum by requiring at least half plus one of the management bodies' members to be present, with the additional requirement for the board of directors for the non-executive members to outnumber the executive members.

4. Directors and Officers

4.1 Board Structure

The board of directors has a minimum of three and a maximum of 15 members, all elected by the shareholders' assembly. When electing the members of the board of directors, it should be specified which members are elected as its independent members. The independent members of the board of directors are elected from its non-executive members. The board of directors, from among the elected members, appoints one or more executive members.

A member of the board of directors who is elected as an independent member cannot be elected as an executive member of the board of directors. The number of executive members should be less than the number of the non-executive members of the board of directors. If the board of directors has up to four non-executive members, at least one of the non-executive members should be an independent member. If the board of directors has more than four non-executive members, at least one quarter of them should be independent members of the board of directors.

In the two-tier management system, the requirement for the number of members of the management board and the supervisory board is at least three and at most 11 members in each board. The same ratio for independent members applies for the supervisory board as in the board of directors. Here, the shareholders' assembly elects the members of the supervisory board, while the management board members are elected by the supervisory board.

Sectorial regulations, such as the Banking Law and Law on Insurance Supervision, provide further requirements for the board structure in commercial banks, ie, insurance companies.

4.2 Roles of Board Members

The board of directors, as well as members of the management board and the supervisory board, in accordance with their position determined by the Law on Trade Companies, have the same rights and obligations, regardless of how the rights and obligations are distributed among them within the board. They perform activities jointly in accordance with the authority determined by the Law on Trade Companies, and according to the matters entrusted to them in accordance with this law and the statute of the company. The statute may determine a different way of conducting and performing these activities, but only according to the authority of the members of the management body, ie, to the supervisory board determined in the Law on Trade Companies.

4.3 Board Composition Requirements/Recommendations

Composition requirements and boards structure are presented in the answer to **4.1 Board Structure**.

According to the Law on Trade Companies, a non-executive member of the board of directors, ie, a member of the supervisory board, cannot be simultaneously elected in more than five boards of directors as a non-executive member, or in more than five supervisory boards of a JSC with a head office in the Republic of North Macedonia.

An executive member of the board of directors or a member of the management board can be elected in a maximum of five other JSCs with a registered seat in the Republic of North Macedonia, as a non-executive member as well as a member of a supervisory board.

The MSE Code stipulates further recommendations on board composition requirements, applicable to listed companies, should they choose to apply.

4.4 Appointment and Removal of Directors/Officers

Appointment of the Members of the Boards

The members of the board of directors and the members of the supervisory board of the JSC are elected at the shareholders' assembly by majority votes of the voting shares, out of the operating quorum for the meeting determined with the LTC, unless a higher majority is determined by the statute in the manner and according to the conditions determined therein.

Dismissal of the Members of the Boards

The shareholders' assembly may dismiss all members of the board of directors, ie, the supervisory board, or a particular member of these bodies, even before the expiry of their term of office. The majority of the votes from the voting shares represented at the shareholders' assembly is necessary for the adoption of the decision for dismissal, unless otherwise determined by the LTC, or if a larger majority is determined in the company's statute.

Where the company has a two-tier management system, the members of the management board are elected by the supervisory board. One of the members of the management board is elected as a president of the management board, by the decision for election of the members of the management board.

The supervisory board may dismiss all members of the management board or a member of this body, at any time with or without an explanation.

Resignation of the Members of the Boards

A member of the management body or the supervisory board can submit a resignation at any time, by submitting a written notification to the body that has elected him, unless the interests of the company require otherwise. The signature of the member of the management body, ie, the supervisory board, on the resignation letter should be certified by a notary. Once filed, the resignation letter is final, and it is not subject to approval or acceptance as a precondition for its validity.

If the interests of the company so require, the management body, ie, the supervisory board, can oblige the member who has resigned to continue carrying out the office until the election of a new member in the management body, ie, the supervisory board, but for no longer than 60 days. The mandate of the resigning member terminates on the day of submitting the resignation

letter, unless another date is stated therein. On the basis of the resignation letter, an application for deletion from the trade registry maintained by the Central Registry of the Republic of North Macedonia (the “Trade Registry”) of the resigned member is submitted by the company.

For listed companies, any change in the management bodies is considered as price-sensitive information, subject to disclosure requirements to the MSE.

4.5 Rules/Requirements Concerning Independence of Directors

The Law on Trade Companies defines an independent non-executive member of the board of directors, ie, the independent member of the supervisory board, as an individual who (or whose close family member):

- in the last five years has not had any material interest or a business relation directly with the company as a business partner, as a member of the management body, as a member of a supervisory body or as a managerial person;
- in the last five years has not received or does not receive additional incomes except for the company’s salary;
- does not have a close family relationship with some of the members of the management body, the supervisory board or the company’s managerial persons; and
- is not a shareholder owning more than one tenth of the company’s shares or does not represent a shareholder owning more than one tenth of the company’s shares.

The MSE Code stipulates further criteria that should be taken into consideration in addition to those criteria specified in law when a potential candidate is considered as an independent member, as follows, where the person:

- has been a member of the supervisory board for less than 12 years;
- is not a member of the immediate family of a person who in the last five years has been CEO or a member of the company’s management board;
- is not affiliated with a company that provides consulting services to the company or its affiliated companies;
- is not a significant customer or supplier of the company or its affiliated company and is not a person affiliated with a significant customer or supplier of the company or its affiliated companies;
- is not a board member of a non-profit organisation which has received significant funding from the company or its affiliated companies; or
- in the last five years, has not been a partner or employee of an auditing company that conducted an audit of the company or its affiliated companies.

For any contract or other business activity of the company in which the company is a party and in which a member of the management body, ie, the supervisory board, has an interest, even in an indirect way, the procedure for approval of interested party transactions applies.

In such a case, the member of the management body/supervisory board that has an interest is obliged to report it immediately to the board of directors/supervisory board. Although the interested member has the right to be heard, he may not participate in the hearing or decision-making regarding the contract or other legal matter, or in the decision to grant the approval for such a transaction.

4.6 Legal Duties of Directors/Officers

The member of the management body/supervisory board shall be obliged to perform the authorisations given to him by the LTC and the statute, in the interest of the company and in the interest of all the shareholders, with due care and diligence, and cannot transfer their authority to another member of the management body/supervisory board. Even when relying on the information, opinions or reports prepared by independent legal advisers, independent authorised accountants, authorised auditors, and other persons reasonably believed to be trustworthy and competent for the matters they perform, they are not released from their obligation to act with the prudence of a meticulous and conscientious commercial entity.

"Prudence of a meticulous and conscientious commercial entity" is a legal standard aimed at determining the liability of the persons responsible for management and supervision of companies, by which the prudence of the persons performing the entrusted tasks in the companies is determined as that they should act with the prudence of a skilful and (in the company's operation) competent person (professional), wherefore they are responsible for the ordinary negligence during the performance of the entrusted activities, unless another law specifies that they are liable only for gross negligence.

4.7 Responsibility/Accountability of Directors

The members of the management bodies and the supervisory board owe their duties to the company and are obliged to perform their authorisations in the interest of all the shareholders, with due care and diligence (standard of a meticulous and conscientious commercial entity).

The MSE Code requires that the members of the management board and the supervisory board take into account the interest of the company's stakeholders.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Members of the management body who violate their obligations are jointly liable to the company for the caused damage, if they have failed to operate and act with due care and diligence. Members of the supervisory board (ie, the non-executive members of the board of directors) are jointly liable with the members of the management board (ie, the executive members of the board of directors) for the damage caused, if they did not act with due care and diligence when giving their prior consent.

However, a member of the management body who acted on the basis of a decision adopted by the shareholders' assembly even though such a member had pointed out that the decision is contrary to the provisions of the Law on Trade Companies, as well as a member who was opposed to the decision by separating their opinion in the minutes of the meeting of the management body and voting "against" the decision, shall not be held liable.

The members of the management body shall, in particular, be liable for the caused damage if, contrary to the Law on Trade Companies, they:

- return to the shareholders their contribution in the company;
- pay interest or dividends to the shareholders;
- subscribe, acquire, take as pledge or withdraw the company's shares;
- divide the assets of the company;

- make payments after the company has become insolvent or has incurred over indebtedness;
- submit false annual account and financial statements;
- misuse and use without authorisation the assets of the company; and
- in the case of conditional increase of the principal capital, issue shares contrary to the purpose or issue shares before those of the previous emission were fully paid and subscribed for.

If the members of the management body fail to remove the irregularities of the actions stated above, the shareholders are entitled to request damage compensation from the members.

If the member of the management body severely violates their responsibility to act with due care and diligence, the creditors of the company can request damage compensation provided that they have failed to settle their claims from the company.

The non-executive members of the board of directors, ie, the members of the supervisory board, are jointly liable with the executive members of the board of directors, ie, the members of the management board, for the damage caused, if they, when giving their prior consent, did not act with due care and diligence.

The right to realise the request for damage compensation becomes status-barred within a period of five years.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

No information is available on this topic.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The remuneration, fees or benefits payable to members of the management bodies are determined by decision adopted by the shareholders' assembly or by the contract regulating the relation between the company and its directors (managerial contracts with the executive directors, ie, the members of the management board).

By a shareholders' assembly decision, the monthly lump sum or the lump sum per meeting of the non-executive members of the board of directors, ie, the members of the supervisory board, is determined. These directors are also entitled to reimbursement of all other expenses (travel and other expenses), right to life insurance and other types of insurance, as well as other rights related to the performance of their activities.

The executive members of the board of directors or the members of the management board are entitled to a salary, right to life insurance and other types of insurance, reimbursement of travel and other expenses, and other rights.

The shareholders' assembly may, by a decision, also approve the executive members of the board of directors or the members of the management board to participate in the profits. Such participation, as a rule, shall consist of a share in the annual profits of the company. The approved participation in the annual profits of the company is calculated on the basis of the portion of the distributable annual profits that remain after part of the profit is used for covering the losses and for legal and statutory reserves. Any decision contrary to this is null and void.

These rights of the executive members of the board of directors or the members of the management board can be determined by the contract regulating the relations between themselves and the company, in accordance with the type and scope of the responsibilities entrusted, the employment status, and their personal contribution to the successfulness of the operation of the company.

Regarding specially entrusted matters performed for the company, additional remuneration may be acknowledged to that member and paid out of the operating costs.

4.11 Disclosure of Payments to Directors/Officers

The annual report of the company should disclose the earnings of each executive member of the board of directors and member of the management board (salary, salary allowances, bonuses, insurances and other rights), ie, the compensation of the non-executive members of the board of directors and members of the supervisory board, as well as detailed data on the earnings of management bodies in other companies (salary, salary allowances, membership compensations, bonuses, insurances and other rights) for all executive members of the board of directors, the members of the management board, the non-executive members of the board of directors, and the members of the supervisory board.

Further, provision of detailed data on employment – ie, employment with other employers (name of the employer, business activity, salary amount, salary allowances, bonuses, insurances and other rights) for the executive members of the board of directors, the members of the management board, the non-executive members of the board of directors, and the members of the supervisory board – should be mandatorily published in the annual report of the company.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The shareholders, under equal conditions, have equal status in the company. Each concluded contract or any other legal activity undertaken by a shareholder, violating the rights and interests of other shareholders, is null and void, unless all shareholders provide their consent for such a contract or legal activity.

The Law on Trade Companies stipulates the provisions regulating the relationship between the shareholders and the company. For exercising shareholders' rights granted by this law and the company's statute, each shareholder has the right to be informed regarding the operation of the company and the right to inspect the books, the acts and other documents of the company.

5.2 Role of Shareholders in Company Management

The role of shareholders in the management of the company is expressly excluded unless the law stipulates otherwise.

Shareholders are able to direct the management of a company to take, or refrain from taking, certain actions in the business, through their decision-making powers in certain circumstances, such as major transactions and interested parties' transactions.

5.3 Shareholder Meetings

The shareholders' assembly of the JSC is held on an annual basis.

The annual shareholders' assembly is convened by the management body no later than three months after the composition of the annual account, the financial statements and the annual report on the operation of the company for the previous business year, but also no later than six months after the end of the calendar year or 14 months from the last-held annual assembly.

However, when the interest of the company and the shareholders require so, the shareholders' assembly can be convened within the time period between two annual assemblies, in accordance with the rules set out in the Law on Trade Companies.

The managing body and the supervisory board, ie, the non-executive members of the board of directors, may by a majority vote of their members, on their own initiative or at the request of a shareholder, decide to convene a shareholders' meeting.

A request for convening a shareholders' meeting may be submitted by shareholders who have at least one tenth of all voting shares.

The shareholders' meeting may be convened by invitation or by announcing a public call (or both) to the shareholders, the content of which needs to be in accordance with the statutory requirements.

At least 30 days should pass from the date of the convening of the meeting before the date when the meeting is held.

5.4 Shareholder Claims

Please see the answer to **4.8 Consequences and Enforcement of Breach of Directors' Duties**.

5.5 Disclosure by Shareholders in Publicly Traded Companies

In accordance with the MSE Listing Rules, listed companies are obliged to publish a notification regarding all changes in the ownership of shareholders who have acquired 5% of the voting shares, and which contains the following information: the identity of the new owner, the number of shares and the percentage of the voting rights.

The shareholders of reporting companies are obliged to disclose the ownership of more than 5% of any type of securities issued by the JSC, by submitting a report to the Securities and Exchange Commission (SEC) and to the company within five working days from the day of the settlement of the trade transaction or the execution of the non-trade transfer of the securities.

Such a shareholder shall be obliged to submit a report to the SEC and to the JSC for each subsequent settlement, commercial transaction or performed non-trade transfer with securities issued by that JSC within five working days from the day of registration of the trade transaction and non-trade transfer of securities.

If such a shareholder sells or otherwise alienates the securities, after which he no longer owns more than 5% of any type of securities issued by the JSC, the shareholder shall submit a report on the change of ownership.

Joint-stock companies and other legal entities – issuers of securities, whose securities are not listed on the stock exchange and are not kept in the register of joint-stock companies with special reporting obligations maintained by the SEC – are obliged to publish changes in the ownership structure over 10% on the website of the MSE.

The AML Law obliges listed companies to register the required information about their beneficial owner(s) in the Register of Beneficial Owners. On the other hand, the entities to which this law applies and who are obliged to take measures and actions with regards to anti money laundering, by exemption, are not obliged to identify the UBO of the legal entities that are companies listed on an organized securities market and that are obliged to meet the requirements for publication of the data on the beneficial owners which ensures appropriate transparency of the information about the ownership in accordance with the relevant international standards.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Trade companies and a subsidiary of a foreign company prepare an annual account upon the expiry of the business year.

Each large and medium-sized commercial entity, commercial entities determined by law as performing bank activities and insurance activities, commercial entities listed on the MSE, and commercial entities whose financial reports are included in the consolidated financial reports of these commercial entities, are obliged to keep accounting in accordance with the adopted international standard for financial reporting published in the “Official Gazette of the Republic of North Macedonia”, as well as to also prepare financial reports.

Annual accounts are filed with the registry of annual accounts by the end of February, with a possibility to file by 15 March if filed electronically, for the previous business year.

As per the MSE Listing Rules, different obligations to file periodic financial reporting requirements are imposed on listed companies.

6.2 Disclosure of Corporate Governance Arrangements

In the annual report on the operations of the company for the previous business year, the management body is obliged to objectively present and explain the main factors and circumstances which had an influence on determining operations, including:

- any changes in the environment in which the company operates, and the response of the company to such changes and their impact;
- the investment policy for maintenance and support of the successfulness of the operations of the company, including the dividend policy, the sources of the company’s assets, the policy of the long-term debt in relation to the basic capital and the policy of risk management;
- major transactions and interested party transactions with data regarding the amount of the transactions conducted on the basis of the deal with the interested party, name, surname and address of the interested party (if it is a natural person), or name and head office if the interested party is a legal entity;
- the assets of the company, the value of which is not covered in the balance sheet according to the international financial notification standards;
- the tendencies of the future development of the company and its business venture;
- activities in the field of research and development; and
- information in relation to acquisition of treasury shares, depending on the relevant circumstances.

The annual report of the company shall disclose the earnings of each executive member of the board of directors and member of the management board (salary, salary allowances, bonuses, insurances and other rights) and the compensation of the non-executive members of the board of directors and members of the supervisory board.

Detailed data on the earnings of management bodies in other companies (salary, salary allowances, membership compensations, bonuses, insurances and other rights) for all executive members of the board of directors, the members of the management board, the non-executive members of the board of directors, and the members of the supervisory board, should also be disclosed.

Detailed data on employment, that is, employment with other employers (name of the employer, business activity, salary amount, salary allowances, bonuses, insurances and other rights) for the executive members of the board of directors, the members of the management board, the non-executive members of the board of directors, and the members of the supervisory board, shall be mandatorily published in the annual report of the company.

The MSE Code further stipulates disclosure requirements for listed companies to which it applies, by requiring that, in addition to the mandatory content prescribed by law and the MSE Listing Rules, the company publish on its website:

- information about shareholder rights;
- the decisions taken at the shareholders' assembly and answers to questions raised at or before the meeting (this information should be available for at least five years);
- contact details for the designated shareholder's contact person;
- the internal acts setting out the responsibilities of the supervisory and management boards;
- the board profile of the supervisory board;
- the rules of procedure for the committees of the supervisory board;
- the company's code of ethics;
- the company's whistle-blowing procedure; and
- the company's environmental and social policies.

In addition to the mandatory content prescribed by law and the MSE Listing Rules, companies should publish in the annual report:

- the number of supervisory board meetings and attendance by board members;
- the actions taken to address gender diversity on the supervisory and management boards;
- the succession plan for the supervisory board;
- the composition of the committees of the supervisory board, the number of meetings and attendance by committee members;
- details of the remuneration of individual supervisory and management board members;
- details of other board positions held by members of the management boards;
- the name of the external auditor and details of any other services they provide to the company;
- a summary of the engagement with stakeholders undertaken during the year; and
- information on environmental and social matters.

6.3 Companies Registry Filings

The following data is recorded in the Trade Registry:

- the business name and the head office of the company;
- the scope of operations of the company;
- the amount of the principal capital and the number of the issued shares;
- the total number of paid-in shares;
- the name and surname, PIN, passport number (ie, the number of the identification card) if the founder is a foreign natural person, or other document aimed at determining the identity valid in his/her country and his/her citizenship, as well as the place of residence, ie, the business name, the head office, PINE, if the founder is a legal entity;
- the name and surname of all members of the management body, ie, the supervisory body, their PIN, passport number (ie, the number of the identification card) if the founder is a foreign natural person, or other document aimed at determining the identity valid in his/her country and his/her citizenship, as well as the place of residence, ie, the business name, the head office, PINE, if the founder is a legal entity;
- the duration of the company, if it is incorporated for a definite period; and
- the authorisations for representation of the members of the management body and of other persons authorised to represent the company.

Each change of the data referred to above, except for those items related to the shareholdings and shares (fifth item) that are registered with the Central Securities Depositary and reflected in the shareholders' book of the company, is also subject to registration with the Trade Registry.

Default of the company to make these filings is sanctioned as a misdemeanour for the company and the management bodies, potentially affecting the legal effectiveness of the changes that are not registered with the Trade Registry.

Any third party can access this information, as the Trade Registry is a public registry; therefore, these filings are publicly available, for a fee.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The following trade companies are subject to a mandatory audit:

- large and medium-sized commercial entities registered as joint-stock companies;
- listed companies; and
- large and medium-sized commercial entities organised as limited liability companies.

Criteria for large and medium-sized commercial entities are provided in the law, and consider the number of employees, annual turnover, etc.

The company is obliged to have an audit opinion regarding the financial reports one month prior to holding the shareholders' meeting, ie, the assembly, at the latest.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The Law on Trade Companies stipulates that the supervisory body of the JSC shall be obliged to organise an internal audit service, as an independent organisational unit in the company. Joint-stock companies shall be obliged to appoint an internal auditor. The organisational structure, rights, responsibilities and relations

with the other organisational units of the company, as well as the responsibilities and the requirements regarding the appointment of the head of the internal audit service, shall be regulated by the supervisory body.

The MSE Code devotes a whole section to risk and control, by stating that “the supervisory and management board shall ensure that there are effective structures, policies and procedures in place to identify, report, manage and monitor the significant risks facing the company; that the company complies with legal requirements; and that the internal and external audit functions are independent and effective.” The MSE Code emphasises the importance of the risk management systems and internal audit.

PANAMA

Law and Practice

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Contents

1. Introductory p.513
1.1 Forms of Corporate/Business Organisations p.513
1.2 Sources of Corporate Governance Requirements p.514
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.514

2. Corporate Governance Context p.515
2.1 Hot Topics in Corporate Governance p.515
2.2 Environmental, Social and Governance (ESG) Considerations p.516

3. Management of the Company p.516
3.1 Bodies or Functions Involved in Governance and Management p.516
3.2 Decisions Made by Particular Bodies p.516
3.3 Decision-Making Processes p.517

4. Directors and Officers p.518
4.1 Board Structure p.518
4.2 Roles of Board Members p.518
4.3 Board Composition Requirements/Recommendations p.518
4.4 Appointment and Removal of Directors/Officers p.518
4.5 Rules/Requirements Concerning Independence of Directors p.518
4.6 Legal Duties of Directors/Officers p.519
4.7 Responsibility/Accountability of Directors p.519
4.8 Consequences and Enforcement of Breach of Directors' Duties p.521
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.521
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.521
4.11 Disclosure of Payments to Directors/Officers p.522

5. Shareholders p.522
5.1 Relationship Between Companies and Shareholders p.522
5.2 Role of Shareholders in Company Management p.523
5.3 Shareholder Meetings p.523
5.4 Shareholder Claims p.523
5.5 Disclosure by Shareholders in Publicly Traded Companies p.524

6. Corporate Reporting and Other Disclosures p.524
6.1 Financial Reporting p.524
6.2 Disclosure of Corporate Governance Arrangements p.524
6.3 Companies Registry Filings p.524

7. Audit, Risk and Internal Controls p.525
7.1 Appointment of External Auditors p.525
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.525

Arias, Fábrega & Fábrega was established in 1914 and has been at the forefront of the legal profession ever since, advising leading international financial institutions and multinational corporations, as well as some of the largest companies in Panama. The legal teams are organised in 30 practice areas and led by truly specialised lawyers, offering clients comprehensive and integrated legal services with a multidisciplinary approach. The practice covers capital markets, banking and finance, M&A, corporations, regulatory work, government contracts, trade, competition and antitrust, real estate, environmental matters, employment relations, trust and estate planning, litigation, taxation and intellectual property. The firm has a distinguished reputation for consistently providing the highest quality legal advice, and for its unparalleled expertise in structuring complex, innovative and sophisticated transactions in Panama and the Latin America region.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Corporations *sociedades anónimas* are the principal form of organisation for conducting business in Panama. Foreign investors may elect to incorporate a Panamanian entity or register a branch of a foreign entity in Panama. From a corporate standpoint, a branch of a foreign corporation must abide by the laws of its jurisdiction of incorporation. A foreign branch is deemed an extension of the foreign juridical person but does not have distinct or separate legal existence from the overseas entity.

Besides corporations, limited liability companies *sociedades de responsabilidad limitada* have recently gained popularity as vehicles for doing business in Panama, especially for US taxpayers for check-the-box purposes.

Corporations, limited liability companies and branches of foreign entities are all subject to the same obligations and responsibilities in carrying out a business activity in Panama, and any and all corporate action taken by such entities must be permitted under their own articles of incorporation.

Broadly speaking, shareholders of corporations and members of limited liability companies incorporated in Panama have the same rights, responsibilities and liabilities, with the following exceptions:

- the names of the shareholders of companies are confidential, while the names of the members of limited liability companies are public; and
- the minimum number of shareholders of a corporation is one, while the minimum number of members of a limited liability company is two.

Shareholders and members are not personally liable for the obligations of the corporation or the limited liability company, as applicable. Shareholders of corporations and members of limited liability companies are only liable for the unpaid portion, if any, of the subscription price of the shares that they owe to the corporation or limited liability company.

Similarly, directors of corporations and administrators of limited liability companies are not personally liable for the obligations of the corporation or limited liability company; however, as mentioned further in **4.6 Legal Duties of Directors/Officers**, directors and administrators have a general duty of care to the corporation or limited liability company, and may become personally liable for negligence in the discharge of these duties.

As for estate planning, the principal form of organisation in Panama is the private interest foundation *fundación de interés privado*, which is frequently used as an alternative to a trust, as it allows the founder of the foundation to maintain more direct control and direct it at its discretion. As a general rule, private interest foundations may be profit-oriented, and may engage in commercial activities in a non-habitual manner or exercise the rights deriving from the capital of business companies held as part of the foundation's assets, as long as the proceeds from such activities are used exclusively for the foundation's objective. Unlike corporations, foundations do not have shareholders or other "owners" per se; the founder of the foundation is roughly analogous to the shareholder only in the sense that it is the entity that contributes assets to the foundation (although other persons may also make contributions to the foundation).

For the purposes of this chapter, unless expressly stated otherwise, the responses shall refer to corporations that are not subject to any particular industry-specific regulation (eg, securities, banking and insurance).

1.2 Sources of Corporate Governance Requirements

Corporate governance matters for corporations are mainly regulated under Law 32 of 1927 (the Corporate Law) and the Panamanian Code of Commerce. For entities regulated by the insurance, securities or banking regulators, there are additional corporate governance requirements and recommendations under the respective industry's regulations.

For example, with respect to regulated corporations, the banking regulations require the bank and its directors, officers and controlling shareholders to be persons with good moral character who have not been convicted of money laundering, terrorism and certain other crimes, nor declared bankrupt, and who have not been responsible for the failure of a bank or banned from engaging in commercial activities.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Corporations that have registered their securities (Public Companies) with the Superintendence of Capital Markets are subject to certain non-binding corporate governance recommendations, including the following:

- designating the supervision and administration responsibilities of the board of directors;
- establishing "support committees" with specific responsibilities;
- implementing procedures to ensure access to Public Company information for shareholders, employees, clients, regulators and investors;
- developing and enforcing clear and public methods through which the minutes of meetings are elaborated;
- specifying the corporate structure of the Public Company and the business plan, along with all the risks and considerations in connection with such business plan; and

- implementing rules regarding the compensation of directors and staff of the Public Company.

In addition to these general recommendations, there are specific recommendations for the governing bodies of the Public Company. It is recommended that the majority of the board of directors shall be persons who do not participate in the daily administration of the Public Company, to reduce potential conflicts of interest. It is also recommended that one in every five directors is an independent director, and that none of the officers and directors of the Public Company demands or accepts payments or advantages for themselves at the expense of the corporation's interests, nor pursues their own interests with their decisions, nor uses their position to benefit themselves through business opportunities of the Public Company.

Regarding the aforementioned support committees, it is recommended that Public Companies have at least an audit committee and a risk management and compliance committee. For companies whose board of directors is composed of more than five members, a directors' assessment and nomination committee is also recommended.

The audit committee should be headed by the treasurer of the Public Company and comprised of members of the board of directors who do not participate in the daily administration of the Public Company. It is also recommended that at least 30% of the audit committee and the risk management and compliance committee shall be comprised of independent directors.

The majority of the corporate governance practices described in Accord 12 of 2003 are merely recommendations, and Public Companies are not obliged to comply with such practices. Nevertheless, Public Companies are obliged to disclose the implementation or lack of implementation of such corporate governance practices.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Panamanian law does not mandate significant corporate governance rules and requirements for corporations. However, it is common for shareholders to agree voluntarily to establish corporate governance rules that are set out in the constitutive document of the corporation, called the *Pacto Social* (the articles of incorporation). The board of directors may also agree to create corporate governance rules or requirements by way of *estatutos* (also known in English as by-laws).

One of the most relevant recent developments is Rule 2-2023, which was issued recently by the Superintendence of Banks and requires locally supervised banks and their shareholders to ensure that shareholders, directors, senior management and key personnel possess "recognised competency *idoneidad*, reputation, moral and economic solvency". Under Rule 2-2023, banks and shareholders are required to adopt policies to permit the identification, evaluation and monitoring of said criteria, and to "take measures" if there is a failure to meet the criteria. Although the banks have until the end of 2023 to adopt the required policies, it is unclear how those required policies should look in practice and how the banks should implement and enforce said policies. Furthermore, at the time of writing, the Rule is currently being challenged in local courts.

2.2 Environmental, Social and Governance (ESG) Considerations

There are no mandatory requirements for companies in relation to reporting on ESG issues. However, there are certain recent developments on ESG that might suggest a new trend in ESG-related initiatives, as follows.

- In 2018, the *Grupo de Trabajo de Finanzas Sostenibles* (GFTS) was formed by the relevant Panamanian government agencies (including the financial regulators) and the main private banking, financial and industry associations, for the purpose of working jointly towards positioning Panama as a centre for sustainable finance. In the same year, the Panamanian sovereign wealth fund *Fondo de Ahorro de Panamá* announced the exclusion of tobacco-related investments from its portfolio.
- Following the formation of the GFTS, the first social bond in Latin America for purposes of supporting women-led small and medium enterprises (SMEs) was issued in 2019, by Panamanian bank Banistmo. In the same year, *Corporación Interamericana para el Financiamiento de Infraestructuras* (CIFI) issued the first green bonds in Panama. The local stock exchange *Bolsa Latinoamericana de Valores* – Latinex) emphasised that such green bonds are guided by ESG principles. This trend continued in 2020, as Panasolar Generation, S.A. issued the first green bonds certified under the Climate Bonds Standards V3.0, and InterEnergy Group, which has a relevant presence in Panama, also issued its first green bonds.
- In 2019, Latinex issued formal guidance on the issuance of green, social and sustainable bonds. In 2021, it published guidance for voluntary ESG reporting and disclosure for issuers, jointly with BID-Invest.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies of corporations are the shareholders' assembly and the board of directors. The latter has the statutory power to control and direct the business of the corporation, except as otherwise agreed by the shareholders in the articles of incorporation and a few matters reserved to shareholders provided for in the Corporate Law.

In addition, the shareholders or the board of directors may issue special or general managing/administration powers of attorney in favour of agents (eg, chief executive officer, general manager), so that the regular business of the corporation may be managed by such agents.

The Corporate Law does not mandate the creation of any committees by corporations, but the board may appoint committees integrated by two or more of its members, which report to the board.

3.2 Decisions Made by Particular Bodies

Shareholders have the flexibility to determine the decision-making process in the corporation through the articles of incorporation. However, Panamanian law reserves certain powers and decisions to certain governing bodies within the corporation, as follows.

- The following decisions are specifically reserved by law for shareholders:
  - (a) any amendments to the articles of incorporation;
  - (b) the authorisation for the disposition of all or substantially all of the assets of the corporation;
  - (c) the authorisation for the dissolution or

merger of the corporation;
(d) the election of directors, except for vacancies that may be appointed by the board of directors; and
(e) the authorisation for the encumbrance of assets of the corporation to guarantee the obligations of third parties, unless otherwise provided in the articles of incorporation.

- As mentioned in **3.1 Bodies or Functions Involved in Governance and Management** and subject to the corporation's articles of incorporation, the board of directors shall have the statutory power to control and direct the business of the corporation. In addition, the board of directors may approve by-laws regulating certain corporate governance matters, unless such powers are reserved to the shareholders under the articles of incorporation.

3.3 Decision-Making Processes

Shareholders and the board of directors may make decisions through resolutions of their respective bodies. Resolutions may be adopted at meetings or by written resolutions in lieu of meetings, which may be signed in different locations on different dates.

Shareholder Meetings

Shareholder meetings can take place within the Republic of Panama or anywhere else in the world, if the articles of incorporation allow it. Shareholders owning at least 5% of the issued and outstanding voting shares have the statutory right to request that a shareholder meeting be called. The by-laws or articles of incorporation may also grant this kind of right to shareholders representing a smaller percentage than 5%.

A notice of the shareholder meeting must be given between ten and 60 days before the meeting, unless the articles of incorporation provide otherwise. The shareholders may waive notice, and may appoint proxies to vote on their behalf.

Panamanian law does not strictly specify the number or percentage of shares required to constitute a quorum of a shareholder meeting; therefore, the articles of incorporation commonly state that a simple majority is required, but it is not uncommon for higher quorum requirements to be set forth in the articles of incorporation or by-laws. Generally, shareholder decisions are adopted by holders of a majority of the issued and outstanding shares entitled to vote on the matter under consideration, but a supermajority vote for specific matters may be required by way of the articles of incorporation.

Board of Director Meetings

Meetings of the board of directors can also be held within the Republic of Panama or anywhere in the world, unless restricted by the articles of incorporation or the by-laws of the corporation. Directors shall receive notice of all meetings, and may waive notice of the meetings. Directors may also vote by proxy, if the articles of incorporation do not determine otherwise. The default quorum to hold a meeting is a majority of the directors in office. Decisions of the board of directors are commonly adopted by the favourable vote of the majority of the directors present or duly represented at the meeting; nevertheless, the corporation's articles of incorporation may determine a special supermajority and quorum requirements for certain matters. Directors' resolutions may also be adopted by a written resolution in lieu of a meeting.

4. Directors and Officers

4.1 Board Structure

The boards of directors of corporations must be composed of at least three members, who can be individuals (the legal age required is over 18) or legal entities. There is no general nationality or residency requirement for directors, nor are the directors required to be shareholders of the corporation.

The only requirement under the law is that a person has the ability to carry out the commercial activities required due to the commercial nature of the corporation. This merely requires, pursuant to the Commercial Code, that the person must "have the ability to enter into contract and obligations" and not be "otherwise prohibited from acting as a merchant (*profesión del comercio*)". Said differently, under law and practice, any person or entity (regardless of nationality or domicile) can act as a director of a Panama corporation.

However, note that regulated corporations (eg, banks) are subject to additional requirements set forth by the regulations of the respective industry.

4.2 Roles of Board Members

Panamanian law does not specifically provide roles for the individual members of the board of directors. Generally, Panamanian law grants the board of directors the power to control and direct the business of the corporation. Therefore, the board of directors shall exercise all the corporate powers that are not expressly reserved to shareholders by law and the articles of incorporation.

4.3 Board Composition Requirements/Recommendations

There are no further relevant requirements for the composition of the board of directors.

4.4 Appointment and Removal of Directors/Officers

The members of the board of directors are elected and removed by the shareholders of the corporation, although the directors may – by a resolution of the board of directors – fill the vacancies that occur in the board, unless doing so is prohibited by the articles of incorporation. Directors may be removed from office by the shareholders with or without cause.

If the articles of incorporation do not state otherwise, corporate officers are appointed and removed by the board of directors. Panamanian law requires corporations to have at least a president, a secretary and a treasurer, and they may have such other officers as determined by the board of directors or the articles of incorporation. The corporation officers may be the directors, but this is not strictly required. A single person may hold more than one office.

4.5 Rules/Requirements Concerning Independence of Directors

Panamanian law does not require the appointment of independent directors in non-regulated corporations, nor does it require corporate governance practices to ensure the independence of the directors or the prevention of a potential conflict of interest. These rules and requirements, if established by the shareholder(s) or directors, are documented by way of the articles of incorporation or the by-laws of the corporation. As for regulated corporations, by way of example, under the securities regulations, neither an investment manager nor any of its directors, managers or related parties can acquire

assets owned by the investment company it administers, nor shall the investment manager provide loans or guarantees to such investment companies, and vice versa.

The Superintendence of Capital Markets has issued non-binding guidelines that recommend that one out of every five directors of Public Companies is independent. The independent directors are described, by securities regulations, as individuals (or legal entities) who:

- do not directly or indirectly own 5% or more of the voting shares of the Public Company;
- do not participate directly or indirectly in the daily managing duties of the Public Company; and
- are not spouses of, or related by blood to, the individuals described before.

4.6 Legal Duties of Directors/Officers

Generally, the duties of directors and officers are determined by the corporation's articles of incorporation or by-laws.

Under Panamanian law, the relationship between directors, on the one hand, and the corporation and its shareholders, on the other hand, can better be characterised as that of agent and principal. Directors are generally considered to have received a "mandate" to manage the affairs and assets of the corporation. As such, directors are responsible for discharging their mandate with the duty of care owed by agents, and may become personally liable for negligence in the discharge of these duties. The standard of care to which directors are generally subject is that which "ordinarily prudent people would usually exercise in the discharge of their own affairs".

There are a few statutory duties for certain officers under Panamanian law, as follows.

- President – generally, the president serves as chairman of the meetings of shareholders and the board of directors, issues certificates in connection with certain resolutions approved by a shareholder in connection with the amendment of the articles of incorporation, and is required to provide notice to shareholders for shareholder meetings and to directors for board meetings (in each case, unless the articles of incorporation specify otherwise).
- Secretary – generally, the secretary has custody of the corporate records and minutes, issues certificates in connection with the resolutions approved by the shareholders and directors, keeps the shareholder registry up to date, and is required to provide notice of shareholder and board meetings (in each case, unless the articles of incorporation specify otherwise). The secretary, along with the president, is also often responsible for signing share certificates (either pursuant to the articles of incorporation or by delegation of the board of directors).
- Treasurer – the Corporate Law only provides that the treasurer shall have the duty to provide certain certifications upon the dissolution of the corporation.

4.7 Responsibility/Accountability of Directors

As mentioned in **4.6 Legal Duties of Directors/Officers**, directors are responsible for discharging the mandate conferred to them by the shareholders with the duty of care owed by agents, and may become personally liable for negligence in the discharge of these duties. The Panama Code of Commerce describes the general liabilities of the members of the board of directors of the corporation. Directors are not liable for the corporation's obligations, but they are person-

ally or jointly liable, as the case may be, for the following:

- the effectiveness of capitalisations that appear to have been made by the shareholders;
- the true existence of declared dividends;
- the proper management of the accounting; and
- the proper or improper execution or performance of their duties, or any violation of the laws, the articles of incorporation, the by-laws or resolutions of the general meeting.

Directors who were absent with cause or who protested in due time against a resolution adopted by the majority for any matter set forth above shall be exempted from liability. The aforementioned liability of directors may only be demanded by virtue of a resolution of the general shareholder meeting. In the absence of such resolution, only the corporation would be liable to third parties for damages resulting from the acts of its directors.

In addition to the above, the General Corporation Law provides three more personal causes of action against directors, who may become personally liable to creditors of the corporation in the following cases:

- unlawful dividends and distributions – if the board of directors knowingly declares or authorises the payment of dividends or the distribution of assets, if such payment or distribution results in the total assets of the corporation being less than the aggregate amount of its liabilities plus capital;
- unlawful capital reduction – if the board of directors knowingly authorises a reduction in the outstanding capital of the corporation (ie, a repurchase or redemption of shares), if such reduction results in the total assets of the corporation being less than the aggregate amount of its liabilities plus capital; and
- false representations – if a director knowingly makes a false statement on a material fact, or consents that a false statement on a material fact be made in any report issued by the corporation.

In such cases, directors who assent to such actions fraudulently or with knowledge of the fact that they will impair the capital of the corporation or that the statement or report is false as to any material fact would become personally and jointly and severally liable to creditors of the corporation. As opposed to liability arising under the Commercial Code, liability under the General Corporation Law, as referred to above, would not require the prior approval of the shareholders.

Furthermore, the directors are criminally liable in the fraudulent insolvency of the corporation.

Unlike directors, officers of a corporation are not vested with such broad powers of management and responsibility, and Panama's General Corporation Law does not specifically refer to their personal liability. However, in general, officers of a corporation may become personally or jointly and severally liable to the corporation, its shareholders or creditors of the corporation for negligence or wilful misconduct that causes harm to the corporation, the shareholders or the corporation's creditors.

In addition, officers and directors of financial institutions (regulated corporations), such as banks or broker-dealers, may be subject to criminal liability under the Criminal Code of Panama if they commit any of the following crimes:

- embezzlement of financial resources belonging to the financial institution;
- tampering with accounting books, accounting reports or any of the financial institution's financial information;
- approving credits or other financings that exceed legal regulations and directly cause the forced dissolution or permanent insolvency of the financial institution;
- meddling with financial resources belonging to the general public in order to hide a state of insolvency;
- inappropriately using or disclosing confidential information related to securities registered with the Securities Commission or traded in an organised stock exchange in a way that causes harm to another or benefits itself or a third party; or
- manipulating the purchase and sale of registered securities or creating a false image or situation in order to benefit itself or a third party.

4.8 Consequences and Enforcement of Breach of Directors' Duties

A breach of the duties of directors may be enforced as follows:

- with respect to certain duties described in **4.7 Responsibility/Accountability of Directors**, if such enforcement of breach is approved by the shareholders of the corporation or without such approval under the circumstances described above;
- by creditors of the corporation as set forth above; and
- criminally for fraudulent insolvency of the corporation. Officers may also be liable for fraudulent insolvency.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

There are no statutory claims or enforcements against directors or officers of non-regulated corporations, other than as described in **4.8 Consequences and Enforcement of Breach of Directors' Duties**.

Directors who were absent with cause or who protested in due time against a resolution of the majority of directors in which a certain breach of duties was authorised shall be exempted from liability. Furthermore, such specific liability of directors may only be demanded by virtue of a resolution of the general shareholder meeting. In the absence of such resolution, only the corporation would be liable to third parties for damages resulting from the acts of its directors.

For regulated corporations, under the Banking Law, for example, the director, officer or employee of a bank that violates the Banking Law or its regulations is subject to private admonition, public admonition and monetary fines. These sanctions are determined and issued by the Superintendence of Banks with regard to the seriousness of the infringement, its recurrence and the damages caused to third parties.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

There are no statutory required approvals under the Corporate Law for the remuneration, fees or benefits payable to directors and officers, except for those set forth in the corporation's articles of incorporation or by-laws. If there are provisions in the corporation's articles of incorporation or by-laws that require approvals in connection with payments to directors or officers, and any directors and/or officers act in breach of said provisions, they may be liable for their failure

to comply with the mandate received from the shareholders for the management of the corporation.

4.11 Disclosure of Payments to Directors/Officers

There are no disclosure requirements for a corporation in relation to the remuneration, fees or benefits payable to its directors and officers.

However, Public Companies are required to disclose the compensation and benefit plans of their directors, officers, managers and executives in their offering memorandums.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The shareholders' assembly of a corporation is the supreme governing body, and there are certain decisions that are solely reserved to it, as discussed in **3.1 Bodies or Functions Involved in Governance and Management**. There are no particular rules and requirements that govern the relationship between the shareholders and the corporation, other than as already described. There is no mandatory minimum frequency of meetings of shareholders.

Piercing the Corporate Veil

Shareholders are not personally liable for the obligations of the corporation and shall only be liable for the unpaid portion, if any, of the subscription price of the shares that they owe to the corporation; it is unusual for local courts to pierce the corporate veil without clear evidence of fraud. The doctrine of piercing the corporate veil or disregarding the legal personality of an entity under Panamanian law has been reviewed by Panama's Supreme Courts on a few occasions. Generally speaking, courts uphold the limitations of liability imposed by a corporate law, and have allowed the application of the piercing of the corporate veil doctrine only in exceptional fraud and/or criminal cases.

Furthermore, courts have reiterated on several occasions that piercing the corporate veil is a very extreme remedy that must be applied only as a last resort (ultima ratio), under exceptional circumstances, and only in connection with the prosecution of criminal offences made within the territory of the Republic of Panama. Examples cited by the courts include the following:

- when the corporate entity is used to hide assets obtained from crimes committed within the territory of the Republic of Panama, or for liabilities against the State;
- when the corporation was used with the sole intention of defrauding third parties or hiding persons that act fraudulently; and
- for criminal investigations covering simulation, drug trafficking and money laundering.

In addition, the recently enacted Insolvency Law further confirms this principle by stating that the liquidation of an insolvent corporation shall not personally affect shareholders in such capacity. However, shareholders may be liable for any benefit received from an act (eg, fraudulent acts) that is subsequently declared null and void by the courts upon the liquidation of the corporation.

Shareholders' Rights

As a related point, shareholders of Panamanian companies have the following statutory rights vis-à-vis the corporation.

- The right to compel a meeting of shareholders – shareholders that hold 5% or more of a

corporation's total share capital may request a court to call a general shareholder meeting (the percentage requirement may be lower if the corporation's articles state otherwise).

- The right to appoint a reviewer – shareholders that hold 5% or more of a corporation's total share capital may ask a judge to appoint a reviewer of the corporation's books and records (at the petitioners' expense). However, this measure may only be sought by petition to a court once a general shareholder meeting has previously rejected a call to appoint a reviewer.
- Acquired rights – shareholders may also benefit from a provision under Panamanian corporate law that does not permit the vote of any majority of shareholders to deprive (*privar*) other shareholders of any already acquired rights, or otherwise impose upon them matters that would contradict the existing articles of incorporation/by-laws of the corporation; as such, any shareholder (including minority shareholders) might be able to challenge before a court any amendment to the articles of incorporation that deprives them of their acquired rights.
- Request for nullity of impermissible corporate action – shareholders also retain the right to seek an injunction against any resolution approved by the board of directors that violates the law or the articles of incorporation or by-laws of the corporation. Such an action must be brought within 30 days of the shareholder becoming aware of the resolution of the board of directors. If the judge considers the suit to be urgent, they may order an injunction barring the corporation from carrying out the board's resolution.

5.2 Role of Shareholders in Company Management

The board of directors has the power to control and direct the business of the corporation, except for the matters reserved to shareholders by law and the articles of incorporation. From a practical perspective, the shareholders of relatively small corporations may decide to take management roles in executive capacities in such corporation, but that is a matter of practice and not a statutory obligation.

5.3 Shareholder Meetings

Under Panamanian law, there is no requirement regarding the frequency of shareholder meetings, although the articles of incorporation may establish a particular frequency of shareholder meetings with particular rules governing such meetings. Please see **3.3 Decision-Making Processes** regarding the general default rules on meetings of shareholders.

5.4 Shareholder Claims

Shareholders may authorise legal actions against the breach of certain duties by directors of the corporation, for the following matters:

- the effectiveness of capitalisations that appear to have been made by the shareholders;
- the true existence of agreed dividends;
- the proper management of the accounting; and
- the proper or improper execution or performance of the agency, or any violation of the laws, the articles of incorporation, the by-laws or resolutions of the general meeting.

Shareholders may pursue a claim against the corporation for any violation of their rights, as shareholders, established under the law or the

articles of incorporation or other constitutive documents.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Public Companies are subject to the following disclosure requirements set forth under the securities regulations, among others:

- as a condition of the registration of the Public Company's shares, the identity, passport number or personal identification number, the nationality and certain other representations relating to the background of the ultimate beneficial owners of the corporation shall be provided on a confidential basis to the Superintendence of Capital Markets;
- any change of control in the corporation share ownership structure;
- any related party transactions entered into by the Public Company with any of its shareholders; and
- any voting agreements between its shareholders, in effect.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

There are no financial reporting requirements for unregulated corporations under the Corporate Law. However, companies with commercial operations must have their accounting registries in the Spanish language at all times.

Furthermore, corporations in Panama that are engaged in commercial activities are obliged to produce financial statements (and must be audited if they have capital above PAB100,000 or an annual sales volume of more than PAB50,000). Other industry-specific regulations (such as the securities and banking regulations) require the supervised person to disclose audited financial statements annually and interim financial statements quarterly, depending on the regulated activities carried out.

Public Companies must publish interim financial statements on a quarterly basis no later than 60 days after the end of the relevant quarter, and annual audited financial statements no later than 90 days after the end of the first year.

6.2 Disclosure of Corporate Governance Arrangements

There are no requirements for corporations to disclose their corporate governance arrangements under the Corporate Law. Please refer to previous sections with respect to the disclosure of corporate governance arrangements by Public Companies. In addition, Public Companies must provide updates on changes in their corporate governance that constitute relevant facts, and must immediately publish press releases about certain other material events identified in the regulations issued under the securities regulations.

6.3 Companies Registry Filings

Companies shall register any amendments to their articles of incorporation, any changes to the board of directors, any dissolution, any continuation to another jurisdiction, and any mergers and spin-offs, as well as any board of directors and shareholders meeting that is binding on third parties. These filings are publicly available. Certain material filings, such as amendments to the articles of incorporations of the corporation, are required to be made as a condition to their effectiveness, while other filings, such as a change of board of directors, powers of attorney, board and shareholders' resolutions, are gener-

ally enforceable against the corporation but not against third parties until they are recorded.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

In accordance with the Corporate Law, there are no requirements to appoint an external auditor in connection with financial statements, but please note the financial reporting requirements for operative corporations in Panama, as stated in **6.1 Financial Reporting**.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

There are no specific requirements for directors of corporations in connection with the management of risk and internal controls in a corporation under the Corporate Law. Please note that there are additional regulations on the management of risk and internal controls under industry-specific regulations (such as the banking, securities and insurance regulations).

PUERTO RICO

Law and Practice

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Contents

1. Introductory p.529
1.1 Forms of Corporate/Business Organisations p.529
1.2 Sources of Corporate Governance Requirements p.529
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.530

2. Corporate Governance Context p.530
2.1 Hot Topics in Corporate Governance p.530
2.2 Environmental, Social and Governance (ESG) Considerations p.531

3. Management of the Company p.532
3.1 Bodies or Functions Involved in Governance and Management p.532
3.2 Decisions Made by Particular Bodies p.533
3.3 Decision-Making Processes p.533

4. Directors and Officers p.534
4.1 Board Structure p.534
4.2 Roles of Board Members p.534
4.3 Board Composition Requirements/Recommendations p.534
4.4 Appointment and Removal of Directors/Officers p.534
4.5 Rules/Requirements Concerning Independence of Directors p.535
4.6 Legal Duties of Directors/Officers p.535
4.7 Responsibility/Accountability of Directors p.536
4.8 Consequences and Enforcement of Breach of Directors' Duties p.536
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.537
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.537
4.11 Disclosure of Payments to Directors/Officers p.537

5. Shareholders p.537
5.1 Relationship Between Companies and Shareholders p.537
5.2 Role of Shareholders in Company Management p.537
5.3 Shareholder Meetings p.538
5.4 Shareholder Claims p.538
5.5 Disclosure by Shareholders in Publicly Traded Companies p.539

6. Corporate Reporting and Other Disclosures p.539
6.1 Financial Reporting p.539
6.2 Disclosure of Corporate Governance Arrangements p.539
6.3 Companies Registry Filings p.539

7. Audit, Risk and Internal Controls p.539
7.1 Appointment of External Auditors p.539
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.540

Ferraiuoli LLC is one of the leading full-service corporate law firms based in San Juan, Puerto Rico. The firm provides quality and comprehensive legal advice and representation to industry-leading private and publicly owned companies, as well as to financial institutions, on corporate, tax and regulatory issues, among many other matters. Skilled in developing complementary tax and regulatory strategies, Ferraiuoli LLC's corporate attorneys handle entity structuring, formation, registration to do business, governance and fiduciary duty inquiries, and work with sophisticated transaction structures. They also have extensive experience in due diligence initiatives and local and cross-border mergers, asset sales and business unit divestitures, stock sales and capitalisations, and restructurings. The firm provides services to clients from Puerto Rico, the US mainland, and the Caribbean and Latin America.

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Ferraiuoli LLC
Looking Forward

1. Introductory

1.1 Forms of Corporate/Business Organisations

The principal forms of corporate/business organisations in Puerto Rico are "corporations" and "limited liability companies" (LLCs) – the latter having gained popularity among business owners given the particular advantages they offer, including:

- the freedom to structure management (ie, member-managed, manager-managed, or with a centralised management structure such as board-managed);
- not being required to file and disclose financial statements with the Puerto Rico Department of State;
- enjoying streamlined corporate formalities; and
- having the option to be taxed as a pass-through entity or as a regular corporation.

Please note that although there are publicly traded companies organised under the laws of Puerto Rico that trade in national stock markets (ie, NYSE and AMEX) and over-the-counter markets (ie, NASDAQ), this chapter will not cover corporate governance requirements applicable to publicly traded companies under United States federal securities laws and regulations and applicable securities exchanges rules and regulations.

1.2 Sources of Corporate Governance Requirements

There are two main sources of corporate governance requirements.

- Legal sources: Puerto Rico Corporations and LLCs are subject to the requirements of the Puerto Rico General Corporations Act of 2009, as amended (the "Corporations Act") and case law from the Puerto Rico Supreme Court. It is important to note that the Corporations Act is modelled after the Delaware General Corporation Law, and that the Puerto Rico Supreme Court has stated that judicial decisions from Delaware courts in connection with the interpretation of the Delaware General Corporation Law shall be highly persuasive and illustrative before Puerto Rican courts. This principle of interpretation has not been expressly extended by the Puerto Rico Supreme Court to Delaware court decisions interpreting the Delaware Limited Liability Company Act (the "Delaware LLC Act"); how-

ever, it seems highly probable that the same principle would apply.

- Organisational documents: A corporation's or LLC's organisational documents are an important source of corporate governance requirements. A corporation's articles of incorporation, by-laws and shareholders' agreement may include particular provisions regarding voting requirements, transfer restrictions, meetings and shareholder rights, among others. Note that although a shareholders' agreement is an important source of corporate governance for corporations, the Corporations Act does not impose on a corporation or its shareholders the obligation to adopt such a document.

Although the Corporations Act has default provisions applicable to LLCs, an LLC's limited liability company agreement is the principal source of corporate governance requirements. This is because one of the LLC's principal benefits is the freedom provided to the members in determining the governance structure of the company, the formalities (if any) that shall be required, and ultimately how the company is managed.

Under Puerto Rico law, the Corporations Act does not impose on the members of an LLC the obligation to adopt a limited liability company agreement. However, unlike Delaware law, which includes oral, written or implied forms of a limited liability company agreement, the Corporations Act defines this as a written agreement. If no limited liability company agreement is adopted, the LLC will be subject to the default provisions contained in the Corporations Act. For the purpose of this publication, the authors will treat LLCs as if a limited liability company agreement had been adopted.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Puerto Rican publicly traded companies registered with the Securities and Exchange Commission are subject to regulations promulgated under the Securities Act of 1933 and the Securities Exchange Act of 1934, and to such other rules and corporate governance requirements imposed by the exchanges in which their securities are traded.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

A recent development in corporate governance is the amendment of the Corporations Act in December 2015 to allow for the organisation, merger and/or conversion of public benefit corporations ("Benefit Corporations") in Puerto Rico. Benefit Corporations that are organised under the Corporations Act are required to file annual reports and social benefit reports, setting forth the public benefit provided by the corporation.

One of the advantages of organising a Benefit Corporation is that its directors, in making their determinations, are allowed to consider factors other than the best interests of its shareholders (for example, they are allowed to take into consideration, among other things, the general public benefit pursued, the best interests of its employees and the community at large). In addition, directors of Benefit Corporations shall not be liable for any damages caused due to decisions made in good faith and in pursuit of the general public benefit set forth in the certificate of incorporation.

Additionally, in 2017 the Supreme Court of Puerto Rico decided that, in order to require that a corporation liquidate any assets still owned by it after the three-year period granted by the Corporations Act following dissolution has elapsed, the interested party must request that the court appoint one or more of the directors of the corporation to be trustees, or appoint one or more persons to be receivers, of and for the corporation, to take charge of the corporation's property, as provided under Article 9.09 of the Corporations Act.

A major challenge in Puerto Rico is that the majority of private companies in the country are closely held family businesses that generally do not have the sophistication of larger businesses with regard to matters of corporate governance. Thus, given the nature of these companies, corporate governance formalities are not always strictly followed or enforced, and this may cause difficulties or problems when attempting to execute certain types of transactions, such as obtaining commercial financing or a merger and acquisition of an ongoing concern.

Another significant challenge for most closely held family businesses is the adoption and successful implementation of an orderly plan of succession that will smoothly transfer the management of the business from one generation to the next. Often, these companies are founded and managed by one individual who may not take the time to nurture or identify another person or persons to succeed them after their retirement or death. The lack of a generation transition plan has resulted in the termination of many successful businesses in Puerto Rico.

Due to their flexibility regarding governance, LLCs offer family and small businesses the ability to reduce recurring governance and other formalities.

As a result of the COVID-19 pandemic, and despite already being permitted under the Corporations Act, there has been an increase in questions and/or requests to update by-laws, limited liability company agreements and organisational documents to allow for remote meetings of shareholders, members, directors and managers.

2.2 Environmental, Social and Governance (ESG) Considerations

In addition to existing regulations concerning the use of natural resources that extend from federal to local law (for example, regarding air and water pollution) which vary depending on the industry sector, Act 33-2019 adopted a new public policy to:

- address climate change;
- reduce and mitigate the effects of greenhouse gas emissions;
- address deforestation on the island;
- promote a sustainable economy; and
- incentivise renewable energy sources, as part of the government's energy diversification and transformation policies under Act 82-2010 (Renewable Energy and Diversification) and Act 17-2019 (Energy Public Policy Act), among others.

Likewise, as previously mentioned in **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**, in December 2015 the Puerto Rican government enacted Act 233-2015, which amended the Corporations Act to allow the creation of public benefit corporations. Public benefit corporations are required, among other things, to file annual reports and social benefit reports regarding:

- environmental matters (product cycle management, reduction of waste and residues, use of clean technologies, reduction of a negative environmental footprint, and responsible use of natural resources);
- corporate operations (information transparency, economic impact in the communities where the corporation operates, and health and safety initiatives); and
- human capital (policies and practices against discrimination, elimination of work violence, and development of human capital).

Also, the reports must set out the public benefits that the entity brings to the community in which it operates.

In addition, a significant number of companies practise various levels of corporate social responsibility. Generally, Puerto Rican companies and business leaders are actively involved in an array of non-profit entities that provide a wide variety of services and benefits to local communities.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

As a general rule, corporations are managed by or under the direction of a board of directors. This notwithstanding, the certificate of incorporation could establish a different management structure, in which case the person or group of persons designated in the certificate of incorporation would assume all of the powers and responsibilities traditionally granted to the board of directors. Furthermore, the certificate of incorporation may grant to the board of directors the power to execute management agreements – provided, however, that the terms of such management agreement may not exceed three years. It is important to note that the board of directors of a corporation generally does not engage in or manage the daily operations of the corporation; instead, such responsibilities are delegated by the board of directors to the officers that it appoints.

Contrary to a corporation, an LLC is member-managed by default; however, the limited liability company agreement may provide for a centralised management structure similar to that of a corporation (ie, a board of managers and officers). As the name implies, in a member-managed LLC the members are responsible for the day-to-day operations of the company. In certain instances, the members may decide to appoint a manager, who does not have to be a member, to oversee the day-to-day operations of the company.

As previously mentioned, Delaware case law is highly persuasive in Puerto Rico. Although the Puerto Rico Supreme Court has yet to express itself on the following matter, it is important to note that the Delaware Chancery Court has stated in Obied v Hogan, WL 3356851 (2016) that the choice of management structure chosen by the members shall have consequences when drawing case law as an analogy in order to solve a controversy. For example:

- if the members adopted a board of managers structure, corporate law may be applied by a court of law; or
- if the members adopted a member-managed structure, general partnership law may be applied by analogy in deciding the particular controversy.

3.2 Decisions Made by Particular Bodies

The board of directors of a Puerto Rican corporation is responsible for making key decisions and providing strategic direction to the corporation. Some of the major decisions made by the board of directors include the following:

- appointment of officers – the board appoints the Chief Executive Officer (CEO) and/or President, the secretary and any other officers of the corporation, and evaluates their performance regularly;
- financial oversight – the board reviews and approves the company's financial statements, budgets and major financial transactions;
- stock-related decisions – the board makes decisions related to dividends, stock issuances or repurchases;
- extraordinary transactions – the board evaluates and approves extraordinary transactions (such as potential mergers, acquisitions or divestitures, sale of substantially all or all of the corporate assets, or the dissolution or liquidation of the corporation) and recommends any such transaction to the shareholders of the corporation for their consideration and approval; and
- legal and regulatory compliance – the board ensures compliance with applicable laws, regulations and corporate governance.

The governance structure of a Puerto Rican LLC is generally set forth in the limited liability company agreement. The LLC can be member-managed, manager-managed or can even adopt a more traditional corporate board structure. Where the limited liability company agreement is silent, the holders of a majority of the company's membership interest shall control, but any member can bind the company before a third party.

3.3 Decision-Making Processes

The decision-making process for a board of directors and/or other governing bodies typically occurs through one of two methods:

- meetings; or
- written consent.

The Corporations Act does not impose a statutory requirement to hold a minimum number of board of directors' meetings, nor does it provide or establish specific guidelines as to how to conduct the order of business in a board meeting. The Corporations Act simply requires, unless otherwise stated in the certificate of incorporation or the by-laws, that the board of directors' meeting be held in person or by electronic means of communication (such as telephone or video conferences) provided that all members of the board of directors assisting such meeting can listen to each other simultaneously.

Furthermore, unless prohibited by the corporation's by-laws, any action required or permitted to be taken at any meeting of the board of directors may be taken without a meeting, if all members of the board of directors consent thereto in writing, and such consents are filed with the minutes of the proceedings of the board of directors. Thus, any rules governing the meetings of the board of directors, such as minimum notification periods, frequency of meetings and quorum, are most commonly specified in the corporation's by-laws.

The Corporations Act does not govern the meetings of the members of an LLC, nor does it provide or establish rules governing the structure or process for the meetings of the members or any governing body. Given that the Corporations Act does not require that a meeting of the management body of an LLC be held, such requirements

are generally established in the company's limited liability company agreement.

4. Directors and Officers

4.1 Board Structure

A typical board structure of a Puerto Rican corporation consists of natural persons who are elected to act as directors of the corporation by the shareholders. In a standard board structure, all directors are elected for a one-year term, and shareholders vote for the entire board at the annual meeting.

However, a Puerto Rican corporation may choose to implement a staggered board structure, where the board is divided into multiple classes, with each class serving a different term length. For example, the board may be divided into three classes, where one class is elected for a one-year term, another for a two-year term, and the third for a three-year term. Each year, shareholders vote to elect directors for the class that is up for election, and this process is repeated over the years. The purpose of a staggered board structure is to provide continuity and stability to the corporation's leadership.

In the case of an LLC, if the limited liability company agreement provides for a board structure, one salient difference is that a legal entity can be a member of the board of an LLC.

4.2 Roles of Board Members

In a Puerto Rican corporation, there are no set roles for directors; nevertheless, if the corporation is so structured through its by-laws and/or certificate of incorporation, directors may hold various offices with particular roles, such as the following.

- The chairman of the board is usually responsible for leading board meetings and setting the agenda, and often acts as a liaison between the board and senior management.
- The vice-chairman is a senior board member who supports the chairman of the board, and may step in to fulfil their duties in their absence. The vice-chairman often plays a leadership role in board committees and provides guidance to other directors.
- The secretary of the board of directors of a Puerto Rican corporation must be present at all meetings of the board of directors and take minutes of the discussions and decisions taken at any such meetings.
- Committee chairs – directors may serve as chairs of various board committees, such as the Audit Committee, Compensation Committee and Nominating Committee. Committee chairs are responsible for leading committee meetings, overseeing specific areas of corporate governance and making recommendations to the full board.

4.3 Board Composition Requirements/Recommendations

The only requirement is that directors be natural persons of legal age. There are no composition requirements, such as regarding independent directors, etc.

4.4 Appointment and Removal of Directors/Officers

The members of the board of directors of a corporation are elected annually by a majority vote of the shareholders present at the annual meeting of shareholders, in person or via proxy, who have the right to vote at such meeting. It is important to note that the certificate of incorporation may provide for the creation of a staggered board with two or three groups of directors, who may serve for a period of one to three

years. In a staggered board, only one group of directors will be elected at each annual meeting of shareholders.

In a non-staggered board of directors, any one director or the whole board of directors may be removed with or without cause by the holders of a majority of the shares entitled to vote for the election of directors.

In a staggered board of directors, shareholders may only remove a director for just cause, unless otherwise provided in the certificate of incorporation. Furthermore, if the certificate of incorporation authorises cumulative voting, no director may be removed if the cumulative votes against their removal are sufficient to elect such director as a member of the board of directors.

In the event of a vacancy as a result of the removal, resignation or death of a director, the remaining members of the board of directors may designate a director without seeking the approval of the shareholders. A director designated to the board of directors in such a fashion shall serve for the remainder of the former director's term.

Unless otherwise specified in the certificate of incorporation or by-laws, the officers of a corporation are appointed by the board of directors without the need to seek the consent of the shareholders. The board of directors has the exclusive power to appoint and remove corporate officers as they deem to be in the best interests of the corporation.

The members of an LLC may choose to appoint a manager or a group of managers who will have the rights and responsibilities provided in the limited liability company agreement. The authors note that the Corporations Act does not directly address the removal of the manager of an LLC; however, a manager may be removed by the members holding a majority interest in the LLC.

4.5 Rules/Requirements Concerning Independence of Directors

Under the Corporations Act, independent directors are considered objective and free from conflicts of interest that could compromise their judgement, and there are rules and requirements related to the independence of directors and the management of potential conflicts of interest. These rules aim to ensure that directors act in the best interest of the corporation and its shareholders. Among the most salient key considerations are the duty of loyalty and the duty of care, which are discussed in further detail in **4.6 Legal Duties of Directors/Officers**.

4.6 Legal Duties of Directors/Officers

The directors and officers of a corporation are bound by three principal legal obligations:

- to act pursuant to the objectives and purposes of the corporation;
- to perform their duties with the care and attention that a reasonable and competent person would exercise under similar circumstances ("duty of care"); and
- to act in a just manner and exercise their powers with the utmost loyalty and in the best interests of the corporation and its shareholders ("duty of loyalty").

The duty of care includes responsibilities such as:

- the duty to monitor; and
- the duty to make enquiries.

The duty of loyalty imposes upon directors and officers the obligation to act in the best interest

of the corporation and its shareholders, setting aside their own personal interests. In order to comply with this duty of loyalty, the directors and officers must avoid transactions that may result in a conflict of interest with the corporation. The directors and officers of a corporation should not engage in or become involved with businesses that compete with the corporation, nor should they use material non-public information for their personal gain.

The Corporations Act expressly extends the duties set forth above to the members and managers of LLCs.

A director will be found to have violated their duty of care where a plaintiff is able to prove that the actions of the director were grossly negligent. To establish that the director was grossly negligent, the plaintiff must first overcome the presumption provided by the "business judgement rule" – ie, the presumption that in making a decision, the director was informed and acted in good faith and in what they believed were the best interests of the corporation.

Furthermore, the business judgement rule provides that the plaintiff must prove that a reasonable commercial basis for the director's decision did not exist. The underlying purpose of the business judgement rule is to allow directors and officers to make reasonable business decisions without holding them responsible for the success or failure of each venture.

Where the presumption established by the business judgement rule is overcome, the implicated directors are subject to the "entire fairness" judicial standard of review, under which a director must show that the decision was taken with the utmost good faith and that it was inherently fair to the shareholders.

Notwithstanding the foregoing, a corporation's certificate of incorporation may include a provision limiting or eliminating the personal responsibility of a director or officer for breaching their fiduciary duties, with the exception of the duty of loyalty and acts or omissions done in bad faith.

4.7 Responsibility/Accountability of Directors

Fiduciary duties are owed to the corporation and shareholders. In the case of LLCs, members and managers are subject to the same fiduciary duties.

Regularly, in terms of fiduciary duties, the board or management body is required to take into consideration the interests of the entity itself and of its shareholders or members. That said, through the certificate of incorporation or by-laws (for corporations), and especially in the limited liability company agreement (for LLCs), other interests may be agreed upon for consideration by the board or management body. As previously mentioned, in the case of a Benefit Corporation, directors, in making their determinations, are allowed to consider factors other than the best interests of the shareholders; for example, they are allowed to take into consideration the general public benefit being pursued, the best interests of the employees and the community at large (among other things).

4.8 Consequences and Enforcement of Breach of Directors' Duties

Excluding derivative suits, shareholders may bring a direct lawsuit against directors and officers if they can demonstrate that they suffered harm individually as a result of the breach of fiduciary duties. This typically requires a showing of personal loss or injury separate from the harm suffered by the corporation as a whole. The responsible directors and officers can be held

liable for their breach of fiduciary duties through various means, which may include the following.

- Monetary damages – directors and officers found to have breached their fiduciary duties can be held personally liable for monetary damages. This may include compensating the corporation, shareholders or other affected parties for any financial losses incurred as a result of the breach.
- Injunctive relief – courts can issue injunctions to prevent the continuation of the wrongful conduct or to require specific actions to rectify the breach and protect the interests of the corporation or affected parties.
- Rescission or restoration – in cases where the breach involved a transaction or action that harmed the corporation or its stakeholders, the court may order the rescission or undoing of the transaction or the restoration of the corporation to its prior condition.
- Removal or disqualification – in extreme cases of breach of fiduciary duties, the court may even order the removal of directors or officers from their positions.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

See **4.6 Legal Duties of Directors/Officers**.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The Corporations Act does not impose any limitations on the compensation of directors. Unless otherwise specified in the certificate of incorporation or the by-laws, the board of directors has the authority to determine the compensation to be paid to the officers and directors of the corporation. The Corporations Act does not specifically address this matter in connection with LLCs.

4.11 Disclosure of Payments to Directors/Officers

See **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Except for certain extraordinary matters (such as a merger or consolidation, the sale of all or substantially all of the assets, or dissolution) for which shareholder approval is required, generally shareholders do not have corporate governance responsibilities in corporations.

Notwithstanding the foregoing, in situations where a majority shareholder has a conflict of interest with respect to a corporate matter, the Corporations Act imposes upon the controlling shareholder a duty of loyalty. In the case of LLCs, the Corporations Act establishes that members are bound by the same duty of loyalty to the LLC and to the other members as established for directors, officers and shareholders of a corporation. For LLCs, the Corporations Act allows for different responsibilities to be agreed upon in the limited liability company agreement.

5.2 Role of Shareholders in Company Management

One of the basics tenets of corporate law under the Corporations Act is that the business of a corporation shall be managed by or under the direction of a board of directors. Thus, shareholders are generally not involved in the direct management of the corporation. The principal exception to this occurs in the context of close corporations, in which the shareholders may be primarily responsible for the operation and management of the entities, if such governance

structure is so provided for in the articles of incorporation.

Nonetheless, shareholders have the right and the power to elect the board of directors, as well as the right to vote on and approve extraordinary transactions, such as:

- any amendment to the certificate of incorporation or the by-laws;
- a merger, consolidation or conversion;
- the sale of all or a substantial amount of the assets of the corporation; or
- a dissolution.

Contrary to corporations, LLCs are regularly managed in a decentralised fashion by their members (similar to partnerships) and members actively participate in the operation and management of the LLC. The Corporations Act provides that unless otherwise established in the limited liability company agreement, the LLC will be managed by the members owning more than 50% of the equity interests in the LLC.

Notwithstanding the foregoing, the members may choose to implement a centralised management structure, similar to that of a corporation, including the election of a board of managers and the appointment of officers. In such case, the members need to specify in the LLC's limited liability company agreement the particular requirements regarding the management structure, including what rights they wish to retain for themselves and wish to not delegate to the LLC's board of managers and officers.

5.3 Shareholder Meetings

The Corporations Act requires that corporations hold an annual meeting of shareholders, and allows the board of directors to convene special meetings of shareholders to discuss and take action on particular matters. The Corporations Act further provides that the notification period for an annual or special meeting must be no less than ten days and no more than 60 days prior to such meeting. If the notification is for a special meeting, the purpose of said meeting must also be disclosed in the notification.

Also, the by-laws of the corporation may establish additional rules regarding who may convene special shareholder meetings. For example, they could provide that the shareholders holding a majority of the voting rights may convene a special meeting. In annual and special meetings, the shareholders have the right to vote (either in person or via proxy) on the matters brought before them. The Corporations Act also allows for participation via electronic methods.

Contrary to corporations, LLCs are not statutorily required to hold annual or special member meetings; thus, the establishment of such meetings and the rules governing them are subject to the discretion of the members or as otherwise stated in the limited liability company agreement.

5.4 Shareholder Claims

A shareholder may present a direct action against the corporation and its management alleging that they have suffered damages as an individual shareholder.

Additionally, shareholders (and, in certain situations, creditors) may pursue derivative actions against management. In a derivative action, a shareholder or group of shareholders pursues a claim on behalf of the corporation where the directors or officers of the corporation fail to do so or violate one or more of their fiduciary duties. This inaction on the part of management typically takes place where the directors or officers

of the corporation are responsible for the damages alleged under the derivative action.

It is important to note that under a derivative action, any relief or award granted by the courts shall be for the sole benefit of the corporation and not of the shareholder(s) who initiated the action. In the case of an LLC, the Corporations Act expressly states that only a current member of the LLC may file a derivative suit.

5.5 Disclosure by Shareholders in Publicly Traded Companies

See **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

There is no statutory requirement for private companies regarding corporate governance disclosures to private parties, besides compilation of the company's organisational documents (such as the certificate of incorporation and by-laws), the shareholders' agreement (if adopted), the certificate of organisation and the limited liability company agreement, available to the shareholders and members of the corporation and/or LLC.

However, the Corporations Act requires that all corporations file an annual report to the Puerto Rico Department of State, detailing, among other things, the identity of at least two officers and/or directors of the corporation. The Corporations Act does not require such disclosure for LLCs with the Puerto Rico Department of State. Such annual reports are available to the public through the Department of State's website. However, no other requirement for public disclosure on websites exists in Puerto Rico.

6.2 Disclosure of Corporate Governance Arrangements

See **6.1 Financial Reporting**.

6.3 Companies Registry Filings

In addition to annual reports as discussed in **6.1 Financial Reporting**, corporations and LLCs have to register the following with the Puerto Rico Department of State:

- the certificate of incorporation or organisation; and
- amendments, mergers, consolidations and dissolutions.

Additionally, corporations and LLCs are now obligated to file their existence or dissolution with the Registry of Legal Entities. Such filings, including annual reports, are publicly available.

Failure to make such filings would result in such acts being regarded as having not taken place. Not presenting the annual reports or not paying annual dues may result in the cancellation of the entity.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Under the Corporations Act, corporations with an annual business volume in excess of USD3 million are required to file with the Puerto Rico Department of State an audited balance sheet, together with their annual report. LLCs are not required to file financial reports with the Puerto Rico Department of State.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Under Delaware case law, which as previously indicated is highly persuasive in Puerto Rico, directors have certain requirements and responsibilities regarding risk management and internal controls.

While Delaware courts generally afford directors considerable discretion in managing the affairs of the corporation pursuant to the business judgement rule, directors are expected to fulfil their duties of care and loyalty, which encompass risk oversight and internal controls. This involves:

- understanding and assessing the major risks the corporation faces;
- ensuring that appropriate risk management and internal control systems are in place; and
- periodically reviewing the effectiveness of these systems.

Internal controls are systems, processes and policies designed to:

- safeguard the corporation's assets;
- promote accurate financial reporting; and
- ensure compliance with applicable laws and regulations.

SENEGAL

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Contents

1. Introductory p.544
1.1 Forms of Corporate/Business Organisations p.544
1.2 Sources of Corporate Governance Requirements p.546
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.546

2. Corporate Governance Context p.547
2.1 Hot Topics in Corporate Governance p.547
2.2 Environmental, Social and Governance (ESG) Considerations p.547

3. Management of the Company p.548
3.1 Bodies or Functions Involved in Governance and Management p.548
3.2 Decisions Made by Particular Bodies p.549
3.3 Decision-Making Processes p.550

4. Directors and Officers p.551
4.1 Board Structure p.551
4.2 Roles of Board Members p.551
4.3 Board Composition Requirements/Recommendations p.551
4.4 Appointment and Removal of Directors/Officers p.552
4.5 Rules/Requirements Concerning Independence of Directors p.552
4.6 Legal Duties of Directors/Officers p.553
4.7 Responsibility/Accountability of Directors p.553
4.8 Consequences and Enforcement of Breach of Directors' Duties p.554
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.555
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.556
4.11 Disclosure of Payments to Directors/Officers p.557

5. Shareholders p.557
5.1 Relationship Between Companies and Shareholders p.557
5.2 Role of Shareholders in Company Management p.558
5.3 Shareholder Meetings p.558
5.4 Shareholder Claims p.559
5.5 Disclosure by Shareholders in Publicly Traded Companies p.560

6. Corporate Reporting and Other Disclosures p.560
6.1 Financial Reporting p.560
6.2 Disclosure of Corporate Governance Arrangements p.560
6.3 Companies Registry Filings p.560

7. Audit, Risk and Internal Controls p.561
7.1 Appointment of External Auditors p.561
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.562

Houda Law Firm was founded in 1977 in Dakar, Senegal, and consists of a 60-person staff, half of whom are specialised and highly qualified lawyers and legal advisers working to assist clients, such as private companies, public entities and individuals, with all of their legal needs in Senegal and the West African Economic and Monetary Union (WAEMU) member states. The firm opened a branch in Abidjan, Côte d'Ivoire, in 2018, which made it the first foreign law firm from the WAEMU region to be established in the country. The team works on matters related to company incorporation, investment, employment law, taxation, business litigation and arbitration. The firm was certified in September 2020 (ISO 9000-2015).

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Commercial companies are governed in Senegal by the Uniform Act on Commercial Companies and Economic Interest Groups, published on 30 January 2014 (AUSCGIE).

The most commonly used commercial forms are, in order, the *société à responsabilité limitée* (SARL), the *société anonyme* (SA) and the *société par actions simplifiée* (SAS).

The SARL

This company is the simplest of commercial companies, in which the liability of the shareholders is limited to contributions.

The SARL may be established by one natural or legal person, or between two or more natural or legal persons.

It does not require any minimum share capital for its creation, and its capital is divided into shares.

It is often characterised by a fairly strong intuitu personae, which is why transfers of shares are often governed by specific authorisation rules given by the non-transferring shareholder.

The SARL is managed by one or more natural persons, associated or not.

In addition, the SARL is not required to appoint an auditor unless it meets two of the following conditions at the end of the financial year:

- a balance sheet total exceeding XOF125 million;
- an annual turnover exceeding XOF250 million; and/or
- a permanent staff of more than 50 persons.

The shareholders of the SARL meet in a general meeting, either ordinary (each year for the approval of the accounts of the closed financial year) or extraordinary (for any modification of the articles of association).

The SARL is a corporate form adapted to greenfield projects, commercial activities and services. It is also suitable for young entrepreneurs with few resources, due to its low formation cost.

The SA

The SA under the AUSCGIE may be held by a single shareholder.

The founder(s) must choose unequivocally in the articles of association for the management and administration either:

- an SA with a board of directors (from one shareholder); or
- an SA with a managing director (up to three shareholders).

The minimum share capital of an SA is XOF10 million. It must be fully subscribed by the shareholders and may be paid up by at least one-quarter upon incorporation.

The founders of an SA must appoint a statutory auditor, and an alternative, chosen from among experts who are members of the National Order of Chartered Accountants and Chartered Accountants of Senegal.

The SA with a board of directors

The board of directors is composed of a minimum of three persons and a maximum of 12 members, shareholders or not.

The articles of association may require each director to own a number of shares of the company over which they preside.

It is possible to appoint corporate directors, who appoint a permanent representative to the board.

The board appoints the chairman of the board of directors from among the natural persons who are members of the board, as well as the chief executive officer of the company, who may be one-third of the board.

It may also be decided to appoint a chairman and chief executive officer who will combine both functions.

The board of directors determines the orientations of the company's activity and ensures their implementation. It controls and verifies the proper functioning of the company and settles matters regarding the company through its deliberations.

The chairman of the board of directors presides over board meetings and general meetings. He or she must ensure that the board assumes control of the management of the company entrusted to the chief executive officer.

The chief executive officer is responsible for the general management of the company. He or she represents it in its relations with third parties.

On the proposal of the chief executive officer or the chairman and chief executive officer, the board of directors may appoint one or more individuals to assist the chief executive officer, or the chairman and chief executive officer, as deputy chief executive officer.

The SA with a managing director ("administrateur general")

The managing director assumes, under his or her responsibility, the administration and general management of the company. He or she represents it in its relations with third parties, and convenes and chairs the general meetings of shareholders. He or she is vested with the broadest powers to act in all circumstances on behalf of the company and exercises them within the limits of the corporate purpose, and subject to those expressly attributed to shareholders' meetings by the AUSCGIE and, where applicable, the articles of association.

On the proposal of the managing director, the general meeting may mandate one or more deputy managing director(s) to assist the director, as well as to decide other powers delegated to the deputy managing director.

The SA is a suitable form of company for the establishment of joint ventures, for companies with significant investments to make and for companies engaged in regulated banking or financial activities.

The SAS

Recently introduced in the AUSCGIE in 2014, the SAS is defined as a company set up by one or more shareholders whose articles of association freely provide for the organisation and operation of the company, subject to certain mandatory rules (competence of the shareholders' general meeting to approve the accounts or amend the articles of association, for example).

The liability of the shareholders is limited to the contributions and there is no minimum share capital to create an SAS. When created by a single shareholder, it is called a single-person simplified joint-stock company (SASU).

The company is represented by a chairman, appointed under the conditions provided for in the articles of association. The chairman is vested with the broadest powers to act on behalf of the company within the limits of the corporate purpose.

The articles of association freely determine the decisions that must be taken collectively by the shareholders in the forms and conditions they stipulate. Decisions taken in violation of the statutory clauses are null and void.

The appointment of one or more auditors is optional unless the SAS meets two of the following conditions at the end of the financial year:

- a balance sheet total exceeding XOF125 million;
- an annual turnover exceeding XOF250 million; and/or
- a permanent workforce of more than 50 people.

An SAS that controls or is controlled by one or more companies is also required to appoint at least one auditor.

This form of commercial company is appropriate for companies whose shareholders have different profiles: investors and project leaders, equity companies and companies operating in the field of services and new technologies.

1.2 Sources of Corporate Governance Requirements

In Senegal, company law is subject to the Organisation for the Harmonisation of Business Law in Africa (OHADA) law and more specifically to the Uniform Act on Commercial Companies and Economic Interest Groups (AUSCGIE). The articles of association and the shareholders' agreement are also sources of corporate governance.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Companies making a public offering of their shares in one or more contracting states or whose shares are listed on the stock exchange of one or more contracting states are required to have a board of directors.

The boards of directors of the companies must be composed of at least three members and at most 15 members when a company's shares are admitted to the stock exchange.

However, in the event of a merger involving one or more companies whose shares are admitted to the stock exchange of one or more "State Parties", the number of 15 may be exceeded up to the total number of directors in office for more than six months in the merged companies, but may not exceed 20.

No new directors may be appointed, nor may directors who have died or ceased to hold office be replaced, until the number of directors has been reduced to 15 when the shares of the company are admitted to the stock exchange of one or more of the State Parties.

If a company admitted to the stock exchange of one or more State Parties is delisted from that stock exchange, the number of directors shall be reduced to 12 as soon as possible.

Within the various limits set out above, the number of directors is freely determined in the articles of association.

The board of directors of the companies is obliged to have an audit committee (*comité d'audit*).

The audit committee is composed exclusively of directors who are not employees of the company and who do not hold a position as chairman and chief executive officer, chief executive officer or deputy chief executive officer within the company. The board of directors ensures the competence of the directors it appoints to the audit committee.

The main tasks of the audit committee are to:

- review the accounts and ensure the relevance and consistency of the accounting methods used to prepare the company's consolidated and parent-company financial statements;
- monitor the process of preparing financial information;
- monitor the effectiveness of internal control and risk management systems;
- issue an opinion on the auditors proposed for appointment by the General Meeting; and
- report regularly to the board of directors on the performance of its duties and inform it without delay of any difficulties encountered.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The Ministerial Order of 2 September 2022 specifying the modalities of identification, declaration, conservation and control of information on beneficial owners imposes on legal persons and legal arrangements (ie, trusts and fiduciaries):

- an obligation to identify beneficial owners and to keep a register of beneficial owners; and
- an obligation to declare to the tax authorities information on beneficial owners.

It is mandatory to file declarations with the tax authorities:

- on the creation of the taxable person;
- on the anniversary of its incorporation for those not subject to income tax; and
- within 15 days of an event making it necessary to modify the information on the beneficial owners (eg, transfer of shares, death, etc).

A platform has been deployed to enable taxpayers to comply with their obligations: eservices.dgid.sn/formulairecontribuable

Any failure to comply with the above provisions is effectively sanctioned by a fine of XOF1,000,000 due as many times as there are documents or information requested and not produced, or omitted, incomplete or inaccurate.

2.2 Environmental, Social and Governance (ESG) Considerations

There are no regulations on environment, social and governance (ESG) in OHADA law. These provisions will, for example, be provided for by the board of directors or by the internal regulations on a case-by-case basis for companies that can draw on international regulations in this area. In specific sectors such as extractive industries, the most recent legislations impose transparency obligations with regard to revenues paid to the state.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

In general, in commercial companies:

- towards third parties, the management body, officers and board shall have, within the time limits set forth in the AUSCGIE for each type of company, full powers to bind the company without having to produce a special power of attorney, and any limitation of their legal powers by the articles of association shall be unenforceable against bona fide third parties; and
- the company shall be bound by acts of its management body, officers and board that are not within the company purpose, unless it can prove that the third party was aware that the act was unrelated to that purpose or could not ignore it given the circumstances, and the mere publication of the articles of association is not enough to prove it.

In an SARL

The company is managed by one or more managers (*gérants)* who must be natural persons. Managers may or may not be shareholders of the company.

The managers are appointed by the shareholders in the articles of association or by a decision of the general meeting.

In the absence of specific provisions in the articles of associations, the manager(s) is/are appointed for four years and is/are re-electable.

There is no requirement of nationality or residence for managers.

In an SA

The articles of association must specify under which of the following three management structures the company will be managed:

- a board of directors and a single chairman and general manager (*président-directeur général)*, who must be a director of the company and a natural person;
- a board of directors with a chairman of the board and a general manager (*directeur général*) who must be a natural person, who may or may not be a director of the company and who may be assisted by one or more assistant general managers.

In both of the above cases, directors may or may not be shareholders of the company, unless provided for in the articles of association. The board must have at least three and no more than 12 directors.

Companies having fewer than three shareholders may choose not to constitute a board of directors and to appoint a general manager (*administrateur general)* who may or may not be a shareholder of the company) who will be responsible for the administration and direction of the company.

In an SAS

Towards third parties, the SAS is represented by a president, who may be a natural or legal person and who may or may not be a shareholder of the company. The articles of association may provide for the conditions under which one or more individuals other than the president, with the title of general manager or deputy general manager, may exercise the powers entrusted to him or her by these articles. The provisions of the articles of association, and the decisions of legal representatives restricting the powers

of the president, the general manager or deputy general manager, shall not be enforceable against third parties.

It is also possible to set up a board of directors.

3.2 Decisions Made by Particular Bodies

In an SARL

In relations between the shareholders and in the absence of determination of his or her powers by the articles of association, the manager may carry out all acts of management in the interest of the company.

Where there is more than one manager, they shall hold separately the powers provided for in the articles, except for the right of each of them to object to any transaction before it is concluded.

Opposition by one manager to the acts of another manager is without effect with regard to third parties, unless it is established that those third parties have knowledge of it.

In an SA

SA with a board of directors

The board of directors determines the orientations of the company's activity and ensures their implementation. Subject to the powers expressly attributed to the shareholders' meetings and within the limits of the company's purpose, it deals with any issue concerning the proper operation of the company and through its deliberations settles matters that concern it.

The board of directors carries out any such controls and verifications as it deems appropriate.

The board of directors may entrust one or more of its members with special mandates for one or more specific purposes.

The chairman of the board of directors chairs the meetings of the board of directors and the general meetings. He or she must ensure that the board of directors assumes the control of the management of the company entrusted to the general manager.

At any time, the chairman of the board of directors may carry out the verifications he or she deems appropriate and may obtain from the general manager, who is obliged to comply, all the documents he or she deems useful for the accomplishment of his or her purpose.

The general manager is responsible for the general management of the company. He or she represents the company in its relations with third parties.

SA with a general director

The managing director is responsible for the administration and general management of the company. He or she represents the company in its relations with third parties. He or she convenes and chairs the shareholders' meetings. He or she shall be vested with the broadest powers to act in all circumstances in the name of the company and shall exercise them within the limits of the corporate purpose and subject to those powers expressly conferred on shareholders' meetings by the AUSCGIE and, where applicable, by the articles of association.

Meetings in the SA

Extraordinary general meeting

The extraordinary general meeting is the only body empowered to modify the statutes in all their provisions.

The extraordinary general meeting is also competent to:

- authorise mergers, demergers, transformations and partial contributions of assets;
- transfer the registered office to any other city of the contracting state where it is located or to the territory of another state; and
- dissolve the company early or extend its term (see **5.3 Shareholder Meetings**).

Special meeting

The special meeting brings together the holders of shares of a given category.

The special meeting approves or disapproves the decisions of the general meetings when these decisions modify the rights of its members.

Ordinary general meeting

The ordinary general meeting takes all decisions other than those expressly reserved for extraordinary general meetings and those reserved for special meetings (see **5.2 Role of Shareholders in Company Management**).

In an SAS

The SAS is a company set up by one or more shareholders and whose articles of association freely provide for the organisation and operation of the company.

The company is represented with respect to third parties by a president appointed under the conditions provided for by the articles of association.

The president is vested with the broadest powers to act in all circumstances on behalf of the company, within the limits of the corporate purpose.

The articles of association may provide for the conditions under which one or more persons other than the president, bearing the title of chief executive officer or deputy chief executive officer, may exercise the powers conferred on the president by these articles.

The articles of association shall determine the decisions which must be taken collectively by the shareholders in the forms and under the conditions which they stipulate.

However, the powers vested in the extraordinary and ordinary general meetings of joint-stock companies, in matters of increase, amortisation or reduction of capital, merger, demerger, partial contribution of assets, dissolution, transformation into a company of another form, appointment of auditors, and annual accounts and profits, are, under the conditions stipulated by the articles of association, exercised collectively by the shareholders.

3.3 Decision-Making Processes

Decisions are taken by general meetings, which may be ordinary or extraordinary, and which decide according to the majority and quorum rules set out in the AUSCGIE or in the articles of association for the SAS.

These rules differ according to the corporate form (see **5.3 Shareholder Meetings** for the majority and the type of decision).

These general meetings are convened by the corporate representatives according to a formalism prescribed by the AUSCGIE.

The shareholders are convened at least 15 days before the meeting by hand-delivered letter against a receipt or by registered letter with a request for acknowledgement of a receipt, fax or email.

The notice of meeting indicates the date, place and agenda of the meeting.

The meeting cannot deliberate on a question which is not registered on its agenda.

These decisions of the shareholders must be recorded in the minutes, which indicate the date and the place of the meeting, the names and first names of the shareholders present, the agenda, the documents and reports submitted for discussion, a summary of the debates, the texts of the resolutions put to the vote and the results of the votes.

4. Directors and Officers

4.1 Board Structure

An SA may be managed by a board of directors consisting of at least three and not more than 12 members, who may or may not be shareholders. The articles of association may require that each director own a number of shares in the company for which they make determinations.

This provision shall not apply in the case of employees appointed as directors.

Every director must, on the day of his or her appointment or during his or her term of office, hold the number of shares required by the articles of association.

In the case of an infringement, he or she shall resign from his or her office within three months of his or her appointment or, if the infringement occurs during his or her term of office, within three months of the date of the transfer of shares giving rise to the infringement. At the end of this period, he or she shall be deemed to have resigned from his or her mandate and must return the remuneration received, in whatever form, without the validity of the deliberations in which he or she took part being called into question.

The auditors shall exercise a supervisory role and shall disclose any violations in their report to the annual general meeting. The first directors shall be appointed by the articles of association or, where appropriate, by the constituent general meeting.

During the life of the company, the directors shall be appointed by the ordinary general meeting.

However, in the event of a merger, the extraordinary general meeting may appoint new directors.

Any appointment made in violation of the provisions of these articles shall be null and void. The term of office of the directors shall be freely determined by the articles of association, but may not exceed six years in the case of appointment during the life of the company and two years in the case of appointment by the articles of association or by the constituent general meeting.

4.2 Roles of Board Members

The board of directors determines the orientations of the company's activities and ensures their implementation. The board of directors has a chairman.

The board of directors may entrust one or more of its members with special mandates for one or more specific purposes.

4.3 Board Composition Requirements/ Recommendations

The choice of directors is freely determined by the shareholders. There is no longer a quota rule

to be respected between the number of shareholder and non-shareholder directors, as was the case with the pre-2014 AUSCGIE. However, the articles of association may require that each director own a number of shares of the company for which they make determinations. In practice, the composition of the board of directors often mirrors the composition of the company's shareholding.

4.4 Appointment and Removal of Directors/Officers

The directors or officers are appointed by the articles of association at the time of the company's incorporation, or during the company's life, by the general meeting.

The terms of appointment, re-election, replacement and dismissal are freely determined by the articles of association.

The directors may be re-elected unless the articles of association state otherwise.

In an SA, the duration of office of the president and managing director is aligned with that of the directors.

The termination of the functions of the directors must be published in the commercial register.

4.5 Rules/Requirements Concerning Independence of Directors

Two mechanisms are provided for by the AUSCGIE to prevent conflicts of interest between the company and its directors.

The Rules of Non-cumulation of the Functions of Legal Representatives (in an SA)

For directors (in an SA with a board of directors)

Subject to certain reservations, a natural person, a director in his or her own name or a permanent representative of a legal entity director may not simultaneously belong to more than five boards of directors of SA companies which have their registered office in the territory of the same State Party.

Any natural person who, upon taking up a new term of office, finds himself or herself in breach of this rule must, within three months of his or her appointment, resign from one of his or her offices.

For the president and managing director

No person may simultaneously hold more than three offices as president and managing director of an SA which has its registered office in the territory of the same State Party.

Likewise, the function of president and managing director may not be held concurrently with more than two functions of general director or general manager of an SA which has its registered office in the territory of the same State Party. Any natural person who, upon taking up a new term of office, finds himself or herself in breach of this rule, within three months of his or her appointment, shall resign from one of his or her offices.

For the general director

No person may simultaneously hold more than three offices as a general director of corporations which have their headquarters in the territory of the same State Party. Similarly, the office of general director may not be held concurrently with more than two offices of president and gen-

eral manager or general manager of an SA which has its registered office in the territory of the same State Party. A director who, upon taking up a new term of office, is in violation of this rule must, within three months of his or her appointment, resign from one of his or her offices.

The Procedure for Regulated Agreements (in an SARL, an SA and an SAS)

According to Article 438 of the AUSCGIE, the following agreements must be subject to prior authorisation by the board of directors of an SA:

- any agreement between the SA and one of its directors, general managers or assistant general managers;
- any agreement between a company and a shareholder who holds 10% or more of the company's capital;
- any agreement in which a director, general manager, deputy general manager or shareholder with a holding of 10% or more of the company's capital is indirectly interested or in which he or she deals with the company through an intermediary; and
- any agreement between a company and a business or legal entity, if one of the directors, the general manager, the assistant general manager or a shareholder holding a stake equal to or greater than 10% of the company's capital is an owner of the business or an indefinitely liable shareholder, manager, director, general manager, assistant general manager, general manager, assistant general manager or other corporate officer of the contracting legal entity.

Similar provisions are provided for the SARL and the SA; regulated agreements must be approved by the ordinary general meeting (Articles 350 and 853-14 of the AUSCGIE).

4.6 Legal Duties of Directors/Officers

There are no specific provisions in the law regarding the principal legal duties of the directors and officers of a company.

However, Article 480 Section 2 of the AUSCGIE provides that the chairman must ensure that the board of directors assumes control of the management of the company entrusted to the general manager.

Thus, the chairman and the board of directors each has a role.

4.7 Responsibility/Accountability of Directors

In an SARL

The managers shall be liable, individually or jointly and severally, as the case may be, to the company or to third parties, either for infringements of the legal or regulatory provisions applicable to private limited companies, or for breaches of the articles of association, or for faults committed in their management.

If several managers have co-operated in the same acts, the competent court determines the contributory share of each of them in the remedy of the damage (Article 330 of the AUSCGIE).

In an SA

The directors shall be individually or jointly and severally liable to the company or to third parties, either for infringements of the legal or regulatory provisions applicable to an SA, or for violations of the provisions of the articles of association, or for faults committed under their management.

Where several directors have co-operated in the same acts, the competent court shall determine the contributory share of each of them in the

remedy of the damage (Article 740 of the AUSCGIE).

In an SAS

The rules governing the liability of the members of the board of directors of *sociétés anonymes* are applicable to the chairman and the officers of the *société par actions simplifiée* (Article 853-10 of the AUSCGIE).

4.8 Consequences and Enforcement of Breach of Directors' Duties

Liability Actions

Two types of actions are provided for by the AUSCGIE.

The individual action

Pursuant to Articles 161 et seq of the AUSCGIE, third parties or shareholders may take individual action to hold a corporate officer liable for misconduct in the performance of his or her duties, without prejudice to the company's potential liability. If several corporate officers have participated in the same acts, they are jointly and severally liable to third parties.

This individual action is an action for damages suffered by a third party or by a shareholder, where the latter suffers a loss distinct from the loss suffered by the company, as a result of a fault committed individually or collectively by the corporate officers or directors in the exercise of their duties.

This action is brought by the person who suffers the damage.

The corporate action (action sociale) – Article 165 et seq of the AUSCGIE

A corporate action is an action for compensation for the damage suffered by the company as a result of a fault committed by corporate officer(s) in the performance of their duties.

The corporate action filed against one or several corporate officers can be initiated either by the company itself (through the other officers who are not involved), or by one or several shareholders in the case of failure of the competent bodies.

The corporate action is reserved only to the shareholders holding shares on the day it is implemented and who retain the status of shareholder during the whole duration of the procedure.

In the case of an SARL, Article 331 of the AUSCGIE provides that several shareholders may only claim compensation for the damage suffered by the company if they represent one-quarter of the shareholders and one-quarter of the company shares. These two conditions are cumulative. However, in the case of an SA, the shareholders can only exercise the corporate action if they represent at least one-twentieth of the share capital (Article 741 of the AUSCGIE).

Grounds for Liability

A breach of directors' duties would give rise to their liability.

Similar provisions govern the rules pertaining to the liability of corporate officers and directors in the different types of companies that have been described: SARL, SA and SAS.

A distinction must be made between civil and criminal liability.

Civil liability of the manager of an SARL and the directors of an SA
The liabilities are similar for the manager of an SARL and the directors of an SA. They are liable, individually or jointly and severally, as the case may be, to the company or to third parties, either for breaches of the laws or regulations applicable to companies, or for breaches of the articles of association, or for misconduct in their management. If several managers or directors have co-operated in the same acts, the competent court shall determine the contribution of each of them to the compensation for the damage.

In addition to the action for compensation for the damage suffered personally, the shareholders representing one-quarter of the shareholders and one-quarter of the shares may, either individually or by grouping together, proceed with the social action for liability against the manager or director(s). No clause in the articles of association may make the exercise of the corporate action subject to the prior notice or authorisation of the meeting or entail a waiver in advance of the exercise of this action.

No decision of the meeting may have the effect of extinguishing an action for liability against the managers for misconduct committed in the performance of their duties. Any decision to the contrary is null and void.

Civil liability of the chief executive officer of an SA
The same rules of individual and social responsibility apply to the chief executive officer.

Civil liability of the directors of an SA
Directors are individually or jointly and severally liable to the company or to third parties, either for breaches of the laws or regulations applicable to an SA, or for breaches of the provisions of the articles of association, or for misconduct in their management.

Civil liability of the president/chairman of an SAS
The same rules of individual and social responsibility as those mentioned for the manager and the chief executive officer apply to the president.

Criminal liability
The AUSCGIE contains criminal provisions in the event of offences committed by corporate officers:

- the incorporation of companies;
- the management, administration and direction of the company;
- general meetings;
- changes in the capital of an SA, capital reductions;
- company control;
- dissolution of companies;
- liquidation of companies; and
- in the event of a public offering for savings.

Law No 2018-13 of 27 April 2018 describes the penalties incurred for the offences referred to in the AUSCGIE.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers
Other bases for claims or enforcement against directors or officers for breaches of corporate governance requirements that exist in Senegal are as follows.

The Management Expertise
Pursuant to Article 159 of the AUSCGIE, one or more shareholders representing at least one-tenth of the share capital may, either individually or by grouping together in any form whatsoever, request the competent court of the registered

office, ruling within a short period of time, to appoint one or more experts to present a report on one or more management operations.

The Provisional Administration

When the normal functioning of the company is made impossible, either because of the management, executive or administrative bodies, or because of the shareholders, the competent court, ruling within a short period of time, may decide to appoint a provisional administrator for the purpose of temporarily managing the company's affairs (Article 160-1 of the AUSCGIE).

Since, according to the general law of civil liability, the potential liability of directors is likely to be implemented as soon as it can be established that they have committed errors in the performance of their duties and that these have had harmful consequences for the company, the shareholders or third parties, the liability of a director or officer can only be limited by proving that the damage results either from a force majeure or from a fault of the victim or a third party.

Any clause to the contrary in the articles of association is deemed to be unwritten.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Article 325 of the AUSCGIE

In an SARL, the duties of a manager may be performed free of charge or with remuneration, under the conditions laid down in the articles of association or in a collective decision of shareholders. The manager, when he or she is a shareholder, shall not take part in the vote on the deliberation relating to his or her remuneration and his or her votes shall not be taken into account for the calculation of the majority. Any deliberation taken in violation of Article 325 of the AUSCGIE shall be void.

The determination of the remuneration is not subject to the regime of related-party agreements.

In an SA, the ordinary general meeting may allocate to the directors, as remuneration for their activities, a fixed annual sum that it determines at its own discretion (commonly called "*jeton de présence*" in French).

Unless otherwise provided for in the articles of association, the board of directors is free to allocate the compensation among its members.

The board of directors may also allocate to its members exceptional remuneration for the missions and mandates entrusted to them, or authorise the reimbursement of travel expenses and expenses incurred in the interest of the company, subject to the provisions concerning regulated agreements.

A director may enter into an employment contract with the company if that contract corresponds to actual employment.

Apart from sums received under an employment contract, the directors may not receive, in respect of their duties, any other remuneration, permanent or otherwise, than that provided for by the board of directors (Articles 430, 431 and 432 of the AUSCGIE).

The chief executive officer may be bound to the company by a contract of employment. The terms and amount of the remuneration of the chairman and managing director are fixed by the board of directors. Where necessary, the benefits in kind granted to him or her shall be fixed

in the same manner as his or her remuneration. The chief executive officer may not receive any other remuneration from the company (Article 466 of the AUSCGIE).

In an SAS, the remuneration and benefits of the chairman and of the potential other directors are determined by the articles of association and the shareholders.

4.11 Disclosure of Payments to Directors/Officers

No public disclosure obligations in relation to the remuneration, fees or benefits payable to directors and officers for companies have been identified, except for publicly traded companies. Indeed, Article 831-2 of the AUSCGIE requires the disclosure of the report prepared by the chairman of the board of directors containing, in addition to the composition of the board of directors and its operating conditions, the compensation allocated to the corporate officers.

Regarding other disclosures, pursuant to Article 432 of the AUSCGIE, the exceptional remuneration of directors for missions and mandates entrusted to them, or the reimbursement of travel expenses and expenses incurred in the interest of the company, must be the subject of a special report by the auditor to the general meeting.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

A shareholder is a natural or legal person who makes a contribution (in kind, cash or industry) to the company. In return, the company delivers shares (Articles 7 and 51 of the AUSCGIE).

The status of shareholder is regulated by Articles 7 to 9 of the AUSCGIE.

Those persons who cannot be a shareholder are:

- any natural or legal person who is subject to a prohibition, incapacity or incompatibility provided for by a legal or regulatory provision; and
- minors and incapable adults in companies where they would be liable for the company's debts beyond their contributions.

Company shares are called "*actions*" (in French) in joint-stock companies and "*parts sociales*" in other companies (Articles 7 and 51 of the AUSCGIE).

The contribution made by the shareholders determines their rights and obligations within the company:

- a right on the profits made by the company;
- a right on the net assets of the company at the time of their distribution, dissolution or at the time of a reduction of the company's capital of information and intervention in the social affairs of the company;
- an obligation to contribute to the losses in certain forms of company; and
- the right to participate in the vote of shareholders' collective decisions.

The rights and obligations of the shareholders are proportional to their contribution.

In addition, according to Article 54 of the AUSCGIE, clauses that attribute to a shareholder all of the profit made by the company or exempt him or her from all of the losses, as well as those that exclude a shareholder entirely from the prof-

it or make him or her responsible for all of the losses, are deemed unwritten.

Disagreement between shareholders constitutes a cause for dissolution of commercial companies within the meaning of Article 200 of the AUSCGIE.

In limited liability companies, the shareholders are only liable for the company's debts up to the amount of their contributions.

The limited liability companies are:

- the SARL;
- the SAS; and
- the SA.

In the case of debts in such a company, the liability of the shareholder is limited to the loss of the total amount of his or her contributions in share capital and his or her contributions in the shareholders' current account.

Shareholders who hold management positions within the company may also be liable, individually or jointly, to the company or third parties, either for breaches of the law or the articles of association (civil or criminal liability), or for faults committed in their management.

5.2 Role of Shareholders in Company Management

The shareholders have a certain right of control over the management of the company, which differs according to the type of company.

In an SARL

Any non-managing shareholder can, twice a year, ask the manager, in writing, questions about any fact that could jeopardise the continuity of the business.

The manager must then provide answers within 15 days, in writing, to the questions asked by the shareholder. Within the same time limit, he or she must send a copy of the questions and his or her answers to the auditor, if there is one (Article 157 of the AUSCGIE).

In an SA and an SAS

Any shareholder who does not have managerial status may, twice a year, ask questions, in writing, of the chairman of the board of directors, the chief executive officer or the managing director, as the case may be, on any fact likely to jeopardise the continuity of the business. The chairman of the board of directors, the chief executive officer or the chief executive officer (as the case may be) must then reply, in writing, within 15 days, to the questions asked by the shareholder. Within the same period, he or she must send a copy of the questions and his or her answers to the auditor (Article 158 of the AUSCGIE).

The shareholder is also able to direct the actions of the corporate officers, thanks to:

- the holding of ordinary general meetings, during which the corporate documents are controlled and approved (summary financial statements, management reports, the auditor's report, the auditor's special report on regulated agreements if any, inventories, draft resolutions);
- individual action (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**); and
- corporate action (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**).

5.3 Shareholder Meetings

All shareholders have the right to participate in the voting of collective decisions (Article 125 of the AUSCGIE).

There are two kinds of collective decisions: ordinary decisions and extraordinary decisions (Article 132 of the AUSCGIE).

These decisions can be taken within the framework of general meetings or by written consultation (Article 133 of the AUSCGIE). All the deliberations of the shareholders are noted by a minute (Article 134 of the AUSCGIE).

The manager is in charge of convening the general meeting. In the event of their failure to do so, the auditor may substitute for him or her. Failing this, the shareholders may request the convening of the meeting in court.

The methods of convening the meeting are set out in the articles of association.

The ordinary general meeting meets at least once a year (within six months of the end of the financial year). An extension of the deadline may be requested from the president of the competent court ruling on a petition.

The purpose of the ordinary general meeting is:

- to approve the summary financial statements, the management report and the inventory (Article 140 of the AUSCGIE for the SA, SARL and SAS) – to this end, the aforementioned documents are communicated at least 15 days before the meeting by the company directors;
- to decide on the allocation of the result (Article 142 of the AUSCGIE); and
- to determine the allocations to optional reserves, the share of profits to be distributed, and the amount of any retained earnings (Article 144 of the AUSCGIE).

In an SARL and an SA, the decisions are made by a majority of the votes present and represented.

The extraordinary general meeting takes extraordinary collective decisions, ie, decisions to amend the articles of association. It decides by a majority of three-quarters of the capital in an SARL and two-thirds in an SA.

However, unanimity is required in the case of:

- an increase of the shareholders' commitments;
- transformation into an SAS; and
- transfer of the registered office to a state other than a State Party of the AUSCGIE.

In the event of a loss of half of the share capital, an extraordinary general meeting must be convened within four months of the general meeting which recorded this loss, on pain of penal sanctions or request by any interested party for dissolution of the company.

In an SAS, the rules of majority and quorum are set by the articles of association.

5.4 Shareholder Claims

The bases of claim that exist for shareholders against the company or directors are as follows:

- against the company – the shareholders do not have a liability claim against the company; and
- against the directors – see **5.2 Role of Shareholders in Company Management** (social action, individual action, alert procedure).

5.5 Disclosure by Shareholders in Publicly Traded Companies

As far as is known, there are no disclosure or other obligations on shareholders in publicly traded companies.

There are disclosure obligations regarding beneficial owners of companies generally (see **2.1 Hot Topics in Corporate Governance**).

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Pursuant to Article 137 of the AUSCGIE, at the close of each fiscal year, the manager or the board of directors or the managing director, as the case may be, shall prepare and close the financial statements in accordance with the provisions of the Uniform Act on the Organisation and Harmonisation of Companies' Accounting.

As required by the revised Article 140 of the AUSCGIE, for an SA, an SAS and, where applicable, an SARL, the annual summary financial statements and the management report shall be sent to the auditors at least 45 days before the date of the ordinary general meeting.

These documents are presented to the general meeting of the company approving the financial statements, which must be held within six months of the end of the financial year.

6.2 Disclosure of Corporate Governance Arrangements

Pursuant to Article 138 of the AUSCGIE, the manager, the board of directors or the managing director, as the case may be, draws up a management report in which he or she describes the situation of the company during the past financial year, its foreseeable evolution, the important events which occurred between the closing date of the financial year and the date on which it is drawn up and, in particular, the prospects for the continuation of the activity, the evolution of the cash-flow situation and the financing plan.

This report is therefore financial, but the AUSCGIE allows for the creation of committees, composed of directors, within the board and under the direction of a director, to deal with particular aspects of the life of the company (Article 437).

Thus, according to Article 437 Section 2: "It [the board of directors] may decide to create committees composed of directors to study the questions that it or its chairman submits to them for advice. It shall determine the composition and powers of the committees, which shall carry out their activities under its responsibility."

The AUSCGIE also provides for the mandatory presence of audit committees in companies issuing stock to the public, in order to ensure better corporate governance. The audit committee shall report regularly to the board of directors on the performance of its duties and shall inform it without delay of any difficulties encountered (Article 829-1).

In addition, agreements entered into directly or through an intermediary between the company and one of its managers, directors or shareholders are the subject of a special report by the auditor at the general meeting.

6.3 Companies Registry Filings

Commercial companies are required to make filings with the companies registry of the registered office when there is:

- the appointment or termination of the functions of company executives (Article 124 of the AUSCGIE);
- a draft merger or demerger (filed in the Trade and Personal Property Credit Register of the registered office of the companies concerned at least one month before the date of the first general meeting called to decide on the operation) (Article 194 of the AUSCGIE);
- the dissolution of the company, by filing in the Trade and Personal Property Credit Register the deeds or minutes deciding upon or recording the dissolution and by amending the entry in the Trade and Personal Property Credit Register (Article 202 of the AUSCGIE);
- liquidation of the company by the deposit of the final accounts drawn up by the liquidator, with either the decision of the meeting of shareholders ruling on these liquidation accounts, the discharge of the liquidator's management and the discharge of his or her mandate, or, failing this, the court decision referred to in the preceding article in order to obtain the striking-off of the company from the Trade and Personal Property Credit Register (Articles 219 and 220 of the AUSCGIE);
- approval of the company's accounts by filing the summary financial statements, ie, the balance sheet, the profit-and-loss account, the financial table of resources and uses and the annexed statement of the past financial year within one month of their approval by the competent body (Article 269 of the AUSCGIE);
- transferable securities (for their enforceability against third parties); or
- transfer of shares (for the enforcement of their rights against third parties) (Articles 319 and 763-1 of the AUSCGIE).

The filings relating to the incorporation or the modification of the company (merger, liquidation of a company) as well as the pledges or the collective procedure are publicly available upon request to the companies registry.

However, specific documents such as financial statements are not available.

Failure to make these filings entails the unenforceability of the modifications/actions carried out.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

In the SA, the appointment of an auditor is mandatory. It takes place during the constitutive general meeting (for the first appointment).

An SA making a public appeal for savings is required to appoint at least two auditors and two deputies.

An SA that does not make a public offering is required to appoint one auditor and one substitute.

As regards the other corporate forms, this appointment is optional, except where the company exceeds certain thresholds (see **1.1 Forms of Corporate/Business Organisations**).

The auditor's duties include:

- evaluating the contributions in kind realised at the time of the constitution of an SARL or an SA;
- drafting the summary financial statements;
- presenting the agreements between the company and its shareholders or its directors to the general meeting or the board of directors; and

- making requests to the company's directors on all facts likely to compromise the continuity of the operation that he or she has noted during the examination of the documents which are communicated to him or her, or of which he or she has knowledge in the exercise of his or her duties.

The auditor is responsible, with respect to the company and third parties, for the harmful consequences of the faults and negligence he or she may commit in the performance of his or her duties (insufficient investigation or certification of an inaccurate balance sheet, for example).

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The Management Report (Article 138 of the AUSCGIE)

The manager, the board of directors or the managing director, as the case may be, is required to prepare a management report in which he or she describes the situation of the company during the past financial year, as well as its future situation. This management report is submitted for the approval of the shareholders at the annual general meeting.

Agreements Between the Company's Directors and the Company

In an SA with a board of directors (Article 438 of the AUSCGIE), and an SA with a managing director (Article 502 of the AUSCGIE), the regulated agreements are subject to the authorisation of the members of the board of directors and to the approval of the general meeting ruling on the summary financial statements. For an SARL (Article 350 of the AUSCGIE) and an SAS (Article 853-14 of the AUSCGIE), these agreements are subject to approval by the general meeting.

Prohibited Agreements

The managers of an SARL (Article 356 of the AUSCGIE) and the directors of an SA (Article 450 of the AUSCGIE) are prohibited from contracting loans from the company in any form whatsoever, from being granted an overdraft on a current account or otherwise, as well as from being guaranteed or endorsed by the company in respect of their commitments to third parties. These acts are null and void.

Trends and Developments

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Houda Law Firm was founded in 1977 in Dakar, Senegal, and consists of a 60-person staff, half of whom are specialised and highly qualified lawyers and legal advisers working to assist clients, such as private companies, public entities and individuals, with all of their legal needs in Senegal and the West African Economic and Monetary Union (WAEMU) member states. The firm opened a branch in Abidjan, Côte d'Ivoire, in 2018, which made it the first foreign law firm from the WAEMU region to be established in the country. The team works on matters related to company incorporation, investment, employment law, taxation, business litigation and arbitration. The firm was certified in September 2020 (ISO 9000-2015).

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The Obligation to Declare Beneficial Owners in Senegal Extended to All Sectors

Declaration of beneficial owners and the global context

The implementation of the obligation to disclose beneficial owners is part of a global context of the fight against corruption, conflicts of interest, tax evasion, money laundering and illicit financial flows, which has increased since the "Panama Papers" scandals. Senegal has initiated public policies and made regional and international commitments that have led it to take important steps such as joining the Extractive Industries Transparency Initiative (EITI), which aims to strengthen good governance in resource-rich countries by making available to the public all information related to payments made by mining, oil and gas companies.

Therefore, the establishment of the obligation to declare beneficial owners in Senegal was initially aimed at respecting Article 25-1 of the Senegalese Constitution, which enshrines the right of ownership of natural resources to the People. Indeed, knowing the beneficial owners was of particular interest in terms of allowing the public authorities to guarantee the ownership of natural resources to the People, to reduce the possibilities of loss of income for the State, and to mobilise more revenues in order to finance development.

Secondly, as far as civil society is concerned, the identification of beneficial owners was a transparency issue and provided opportunities to engage the responsibility of the holders of mining rights in case of failure to fulfil their obligations. Thirdly, for extractive companies, the disclosure of beneficial owners allowed for healthy competition through the knowledge of the identity of all commercial partners.

Requirement 2.5 of the EITI Standard provides for the establishment by each State, as of 1 January 2020, of "a public register of beneficial owners of companies that apply for or have a direct interest in oil, gas or mining licences or contracts, production or exploration, and this should include the identity of their beneficial owners, the extent of their ownership, and the manner in which they exercise such ownership or control". In other words, all companies in the extractive sector are required to declare the beneficial owners of their activities within the specified timeframe.

The obligation to declare beneficial owners was initially enshrined in the extractive sector

This obligation to disclose beneficial owners has been enshrined in Senegal by Decree No. 02020-791 on the ORBE Beneficial Owner Register of 19 March 2020, by Article 95 of the Mining Code and by Article 55 of the Petroleum Code.

Requirement 2.5 of the EITI Standard requires countries to have a legal framework that identifies the competent authority to receive the declaration, defines beneficial owners, lists the reporting entities, collects information on the identity of beneficial owners, verifies the data, regulates public access to the data, and applies sanctions in the event of false declaration or refusal to disclose.

In light of these considerations, we can consider that Decree no. 02020-791 integrated the fundamentals of the obligation to declare beneficial owners.

Indeed, Article 11 of the said decree defined the beneficial owner(s) as the natural person(s) owning or controlling, directly or indirectly, the legal or natural person registered or declaring its activity.

Under the decree, the following must be declared as beneficial owners:

- all natural persons who hold, directly or indirectly, at least 2% of the capital or voting rights of the declaring company; and
- all individuals who exercise, by other means, a power of control over the management, administration or executive bodies of the reporting company or over the General Meeting of its partners or shareholders.

In the absence of identification according to the two criteria above, the beneficial owners are the natural persons occupying directly or indirectly, in particular through one or more legal persons, the position of legal representative of the reporting company.

Also, it provided for which entities are the reporting entities:

- companies, sole proprietorships, economic interest groups, contractors and other entities registered, or declared in Senegal, involved in the extractive sector value chain; and
- companies operating and not registered in Senegal.

With respect to the declaration medium, it was notably foreseen that the Beneficial Owner Register would be created at the Registrar's Office in charge of the Trade and Personal Property Credit Register (RCCM) and that the declaration of beneficial owners would be made at the Registrar's Office in charge of the RCCM and under the supervision of the judge in charge of the RCCM, at the time of registration. The declaration is made on the basis of a form established by order of the Ministry of Justice and must be signed by the legal representative of the legal entity making the filing.

The obligation to declare beneficial owners was then extended to all sectors of activity

Subsequently, Law no. 2021-29 of 5 July 2021 (the "Amending Finance Law") extended the obligation to declare beneficial owners, initially provided for only in the extractive sector, to all sectors.

Indeed, it should be noted that the beneficial owner(s) of a legal entity, following the Amending Finance Law, was then understood as (a) the natural person(s) holding directly or indirectly more than 25% of the shares or voting rights of the legal entity, or (b) if no individual of the type mentioned in (a) can be identified as the beneficial owner or if there are doubts as to the beneficial ownership of the persons identified pursuant to (a), the beneficial owner(s) are the individuals controlling by any means, in fact or in law, the legal entity. Finally and exceptionally (c), the beneficial owner(s) are understood to be the natural person(s) who directly or indirectly occupy the position of manager of the legal person when no natural person mentioned above has been identified as beneficial owner. An exception is made in the extractive sector, where the threshold of ownership of the beneficial owner remains fixed at 2%.

Therefore, it can be noted that a beneficial owner is necessarily a natural person and that in order to identify the beneficial owner, the regulation does not hesitate to refer to direct and indirect ownership and control. The regulation also relies on a cascade approach to identify beneficial owners. The definition of control is intended to cover all forms of control. The definitions also clarify that nominees cannot be considered as beneficial owners.

The Amending Finance Law provided in particular that the content of the information relating to

the identity of the beneficial owners as well as the modalities and scope of the control of legal entities should be specified by order of the Minister of Finance.

On this point, an order dated 2 September 2022 provided some answers, including the following:

- Legal entities are required to obtain and keep in a register held for this purpose adequate, accurate and up-to-date information on their beneficial owners as well as the methods of determining the beneficial owners and the supporting documents obtained;
- Legal entities have an obligation to verify the information contained in the register;
- Information relating to legal entities that must be entered in the register of beneficial owners (name of the legal entity, address of the head office, RCCM and tax registration numbers, copy of articles of association, legal form, name and address of its representatives, number of bank accounts held in Senegal and abroad);
- Information relating to the beneficial owners that must be registered and kept in the register: surname and first name, nationalities, date and place of birth, country of residence, Senegalese national identification number (or for foreigners the passport number), the Senegalese or foreign tax identification number, the control method used, and the date on which the natural person(s) became or ceased to be a beneficial owner;
- The obligation to keep the register of beneficial owners as well as the supporting documents in Senegal throughout the life of the legal entity and up to ten years after the date of cessation of activity. This obligation is incumbent on the legal representatives;
- The register of beneficial owners may be subject to control by the tax authorities with an obligation to provide any information requested by the tax authorities within eight days;
- Legal entities or, where applicable, their agents must declare to the tax authorities the information relating to their beneficial owners when they file their declaration of existence or within one month of their incorporation; at the time of the annual income tax return for legal entities subject to tax; and within 15 days of the legal entity becoming aware of an event that makes it necessary to modify the information on beneficial owners. This declaration is made by means of a form provided by the tax authorities; and
- The tax authorities shall keep a central register of beneficial owners for the purpose of keeping and making available information on the beneficial owners of legal persons and legal arrangements.

The decree allowed a period of six months from its entry into force for legal persons to comply with its provisions. This period has now expired and any failure to comply with the above provisions is punishable by a fine of XOF1,000,000, payable as many times as there are documents or information requested and not produced, or omitted, incomplete or inaccurate.

Forecast

The State of Senegal has thus complied with requirement 2.5 of the EITI Standard. This requires each state to establish, by 1 January 2020, “a public register of beneficial owners of companies that apply for or have a direct interest in oil, gas or mining licences or contracts, production or exploration, and this should include the identity of their beneficial owners, the extent of their ownership, and the manner in which they exercise such ownership or control”.

Better still, it went further by strengthening the legal framework and extending this obligation to declare beneficial owners to all sectors of activity in Senegal and not just the extractive sector.

However, from now on, it will be a question of going even further than the simple normative requirement in order to apply the legal texts as well as possible. This could be achieved through better communication and awareness-raising among companies.

Above all, it will be important to facilitate public access to information on the Register of Beneficial Owners. This point also poses a problem of transparency, which can also be seen as a limitation of the system relating to the Register of Beneficial Owners, where the stakes are high. Indeed, as mentioned in the first paragraph of this article, access to information on beneficial owners is first and foremost a national security issue for the public authorities. Indeed, knowing the real identity of the beneficial owners allows them to guarantee the ownership of the natural resources of the Senegalese people, to reduce the possibility of loss of revenue for the State, to mobilise more revenue in order to finance development, and to control and engage the responsibility of those who hide behind companies.

In order to make this beneficial ownership disclosure obligation effective, the following recommendations should be considered:

- demonstrate greater rigour in the effective application of the provision relating to the Register of Beneficial Owners; and
- carry out a communication, awareness-raising and explanation campaign on the existence of the provision on the Register of Beneficial Owners and on the issues involved in declaring beneficial owners.

SOUTH AFRICA

Law and Practice

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Contents

1. Introductory p.573
1.1 Forms of Corporate/Business Organisations p.573
1.2 Sources of Corporate Governance Requirements p.574
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.575

2. Corporate Governance Context p.575
2.1 Hot Topics in Corporate Governance p.575
2.2 Environmental, Social and Governance (ESG) Considerations p.576

3. Management of the Company p.578
3.1 Bodies or Functions Involved in Governance and Management p.578
3.2 Decisions Made by Particular Bodies p.579
3.3 Decision-Making Processes p.580

4. Directors and Officers p.581
4.1 Board Structure p.581
4.2 Roles of Board Members p.581
4.3 Board Composition Requirements/Recommendations p.582
4.4 Appointment and Removal of Directors/Officers p.582
4.5 Rules/Requirements Concerning Independence of Directors p.583
4.6 Legal Duties of Directors/Officers p.584
4.7 Responsibility/Accountability of Directors p.584
4.8 Consequences and Enforcement of Breach of Directors' Duties p.585
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.585
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.586
4.11 Disclosure of Payments to Directors/Officers p.587

5. Shareholders p.588
5.1 Relationship Between Companies and Shareholders p.588
5.2 Role of Shareholders in Company Management p.588
5.3 Shareholder Meetings p.588
5.4 Shareholder Claims p.590
5.5 Disclosure by Shareholders in Publicly Traded Companies p.590

6. Corporate Reporting and Other Disclosures p.592
6.1 Financial Reporting p.592
6.2 Disclosure of Corporate Governance Arrangements p.592
6.3 Companies Registry Filings p.592

7. Audit, Risk and Internal Controls p.593
7.1 Appointment of External Auditors p.593
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.594

ENSafrica is Africa's largest law firm, with over 600 specialist practitioners. It has the capacity to deliver on clients' business requirements across all major industries and the African continent. The firm is able to leverage its resources to deliver legal solutions that suit clients' pricing preferences and timeframes. Over many years, ENSafrica has developed a large knowledge base of resources and a deep understanding of local nuances and ways of doing business. The firm has practical experience working on the ground and direct access to high-end, professional contacts across the continent, ensuring consistent quality and world-class service. Some of its practitioners are qualified to practise English and French law and have extensive experience in the legal codes of OHADA used in West and Central Africa. ENSafrica is recognised in the top legal rankings (the firm has 35 ranked departments and 75 ranked lawyers in Chambers Global 2023) and is committed to creating enduring client relationships, which are founded in a values-driven culture, and to providing to-the-point, jargon-free advice.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

A company incorporated in terms of the Companies Act, No 71 of 2008, as amended (the "Companies Act"), is the principal form of corporate/business organisation used in South Africa. Companies are separate legal entities with shareholders that provide share capital (equity) and in certain instances debt finance to the company, and have a board of directors that manages the company and its affairs. The Companies Act distinguishes between two broad categories of companies, namely: profit companies and non-profit companies.

Profit Companies

Profit companies include the following entities with their suffixes shown alongside:

- public companies - Limited/Ltd;
- private companies – Proprietary Limited/(Pty) Ltd;
- personal liability companies – Incorporated/ Inc.; and
- state-owned companies – SOC Ltd.

A private company cannot offer its securities to the public and its memorandum of incorporation (MOI) must restrict the transferability of its shares/securities.

A public company can freely transfer its shares to any member of the public. Public companies are ordinarily listed on a stock exchange, with the primary stock exchange in South Africa being the Johannesburg Stock Exchange (JSE).

Personal liability companies are private companies in which former and current directors may be held jointly and severally liable for any debts and liabilities incurred during their tenure in office. Businesses offering professional services, such as audit and law firms, are examples of such entities.

Non-profit Companies

In addition to the various types of profit companies discussed above, the Companies Act provides for the incorporation of non-profit companies which may be incorporated with or without members. Names of non-profit companies end with the expression "NPC". Non-profit companies are also limited liability corporations and exempt from various provisions of the Companies Act.

Ring-Fenced Companies

When a company is ring-fenced (indicated by "(RF)" in its title), third parties are regarded as having notice and knowledge of any restrictive conditions contained in its MOI.

Other Business Entity Models

Further business entity models used in South Africa include:

- partnerships (which are not separate legal entities distinct from persons comprising the partnership);
- trusts (which have a separate legal personality for certain purposes usually provided in the deed of trust such as taxation and perpetual succession);
- sole proprietorships (in which, a sole proprietor trades under their own name with no limited liability – ie, there is no separation between their personal assets and liabilities and those of the business); and
- close corporations (which are corporations that do not exceed a limited number of shareholders and are simplified limited liability corporations – it should be noted that the

ability to form new close corporations ceased as of 1 May 2011).

Foreign Companies

Foreign companies that carry on business activities within South Africa may be required to register as an external company in South Africa and are only required to comply with certain sections of the Companies Act.

1.2 Sources of Corporate Governance Requirements

For this chapter and unless otherwise specified, the term "corporate governance" is used widely to include the laws listed below as well as practices and rules, effectively guidelines that are imposed through instruments, such as the stock exchange rules and the King Report on Corporate Governance for South Africa (the "King IV").

The principal sources of corporate governance in South Africa are the following:

- the Companies Act, which replaced the 1973 Companies Act with effect from 1 May 2011, and which (with certain surviving provisions from the 1973 Companies Act applicable to the winding-up and liquidation of companies) is the regime that governs the incorporation and management of companies in South Africa;
- the common law and under the Companies Act with respect to the regulation of the fiduciary duties of directors of companies;
- the Companies Regulations, 2011 (the "Regulations"), which came into effect with the Companies Act on 1 May 2011 and have subsequently been amended by the Companies Amendment Regulations 2023;
- the JSE Listings Requirements (the "Listings Requirements") which applies to public companies listed on the JSE (see **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**);
- the Financial Markets Act, No 19 of 2012, which, amongst other things, regulates financial markets and exchanges, and contains the South African Insider Trading and Market Abuse Legislation;
- King IV, issued by the Institute of Directors in Southern Africa – King IV (the latest iteration of the code) which came into effect on 1 April 2017 (see **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares** and **2.1 Key Corporate Governance Rules and Requirements** for further details);
- the common law (derived from case law);
- sector-specific legislation and/or codes that regulate corporate governance of entities within the same industry, for example the Code for Responsible Investing in South Africa prescribes governance standards for institutional investors as asset owners (pension funds and insurance companies, etc), and their service providers (asset managers, fund managers, etc); and
- the Public Finance Management Act, No 1 of 1999 containing financial governance measures and the responsibilities of persons entrusted with financial management of state-owned entities.

The key source of a company's corporate governance requirements is its constitutional document (eg, MOI, articles of association or trust deeds). The Companies Act contains both mandatory "unalterable" provisions and default "alterable" provisions, in terms of which the latter allows for variation by a company in its MOI. Significantly, certain provisions relating to corporate governance concerns (such as shareholder rights, annual disclosure requirements in

the case of regulated companies and directors duties) cannot be altered by the MOI.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

In addition to the requirements of the sources referred to in **1.2 Sources of Corporate Governance Requirements**, companies with shares which are publicly traded and listed on the JSE, are required to comply with the following.

The Listings Requirements

The Listings Requirements impose continuing obligations on issuers including standards of disclosure and specific corporate governance practices relating to (i) the board composition of a company; (ii) the appointment of various board committees such as the remuneration committee, as well as statutory committees such as the audit and social and ethics committees; and (iii) the adoption of particular governance-related policies and compliance with King IV.

King IV

King IV is South Africa's authoritative corporate governance code. While King IV compliance is voluntary, the Listings Requirements oblige issuers to adopt certain of its recommendations, with the remainder being implemented in accordance with King IV's "apply and explain" disclosure policy. In order to give effect to this policy a company should (i) apply the recommended practices meticulously, with common sense, and proportionally in accordance with the company's size, resources, and the extent and complexity of its activities; and (ii) provide a narrative explanation of that application with reference to the recommended practices. It is important to note that non-compliance with the principles of King IV can be interpreted as non-compliance with the Listings Requirements, and result in sanctions being imposed by the JSE.

In addition to the annual reporting requirement, certain facets of governance as set out in King IV must be complied with in terms of the Listings Requirements.

Whilst King IV is intended to apply to companies it is also intended to apply to other organisations irrespective of their form of incorporation, to broaden acceptance of corporate governance by making it accessible and relevant so that it can be applied across various sectors, organisations and organs of State.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

Greylisting of South Africa

In late February 2023, South Africa was "greylisted" by the Financial Action Task Force (FATF) for failing to comply with certain international standards relating to the combatting of money laundering and other serious financial crimes. In response to the 2021 FATF mutual evaluation report, which placed the country on the list of states that failed to meet these standards, the General Law (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, No 22 of 2022 (GLAA) was signed into law in December 2022. The GLAA amends various pieces of legislation, including the Companies Act and the Trust Property Control Act, No 57 of 1988 (TPCA), which has an impact on corporate governance.

For instance, the GLAA has broadened the legislation set out in Section 69(8)(b)(iv) of the Companies Act, which would disqualify a person from being a director, to include the Protection of

Constitutional Democracy Against Terrorist and Related Activities Act, No 33 of 2004 and the Tax Administration Act, No 28 of 2011, in addition to the Companies Act, the Insolvency Act, No 24 of 1936, the Close Corporations Act, No 69 of 1984, the Competition Act, No 89 of 1998, the Financial Intelligence Centre Act, No 38 of 2001 (FICA), the Financial Markets Act, No 19 of 2012, Chapter 2 of the Prevention and Combating of Corrupt Activities Act, No 12 of 2004 if such person is convicted of an offence thereunder. Furthermore, if such person is subject to a resolution adopted by the Security Council of the United Nations providing for financial sanctions, they would be disqualified from being a director of a company.

Regarding trusts, the GLAA introduces new offences, in the case of the TPCA, for trustees who fail to comply with the newly introduced provisions relating to the establishment, maintenance and submission of prescribed information relating to beneficial owners of trusts and accountable institutions used by trustees, and for trustees who fail to make specified disclosures to accountable institutions. A trustee who fails to comply with the above obligations will have committed an offence and on conviction can be liable to a fine not exceeding ZAR10 million, or imprisonment not exceeding five years, or both.

Key Corporate Governance Rules and Requirements

There is a Companies Amendment Bill currently in progress in South Africa (the Companies Amendment Bill, 2021) which was published for public comment on 1 October 2021, by the Minister of Trade, Industry, and Competition. The Companies Amendment Bill seeks to amend the Companies Act in several respects and to provide for greater transparency and the achievement of equity as between directors and senior management on the one hand, and shareholders and workers on the other hand, as well as addressing public concerns regarding high levels of inequality in society. Certain of the proposed amendments are designed to achieve more disclosure of senior executive remuneration and the reasonableness of the remuneration. The Companies Amendment Bill also seeks to enhance efforts to counter money laundering and terrorism.

2.2 Environmental, Social and Governance (ESG) Considerations

Now more than ever, companies globally and in South Africa are recognising the need to implement a corporate strategy that is aligned with ESG best practice, taxonomies and disclosure requirements. Africa, as is the rest of the world, is affected by the global shift towards a more sustainable global economy.

The attainment of sustainable development, a just energy transition, black economic empowerment, climate change resilience, employment equity, improved governance and the introduction of anti-corruption practices are important ESG issues.

Obligations of JSE-Listed Companies

The majority of ESG disclosures or reporting obligations are voluntary. However, companies listed on the JSE have mandatory reporting obligations with respect to sustainability.

In this regard, the Listings Requirements suggest that integrated reporting on sustainability is to be applied on an “apply and explain basis”.

King IV requires companies to report annually in an integrated manner and promote good governance and transparency in leadership and

decision-making. King IV emphasises sustainability reporting. In July 2021, a King IV Guidance document was published relating specifically to climate change. As noted above, compliance with aspects of King IV is mandatory for companies listed on the JSE.

Building on the requirements of King IV, the JSE released a notice and comment process including various documents titled *Leading the way for a better tomorrow: JSE Sustainability Disclosure Guidance* and *Leading the way for a better tomorrow: JSE Climate Change Disclosure Guidance* The documents are based on international best practice and are an important distillation of the recommendations of multiple global initiatives on sustainability and climate risk disclosure, including GRI Sustainability Reporting Standards, the Taskforce on Climate-related Financial Disclosures recommendations, the IFRS Foundation's ISSB prototypes and the Value Reporting Foundation's Integrated Reporting Framework and Sustainability Accounting Standards Boards. Also not mandatory, they bring much-needed guidance for consistent, comparable, transparent and reliable disclosures.

Regulation 28 of South Africa's Pensions Funds Act, No 24 of 1956 requires funds to consider all factors (including ESG) that may be relevant to the long-term success of a fund. A guidance note published in 2019, sets out the Financial Sector Conduct Authority's expectations regarding certain disclosure and reporting requirements relating to sustainability.

The Companies Act requires certain companies to have a social and ethics committee. As part of its functions contemplated in the Regulations, this committee may report on the UN Global Compact's ten principles on human rights, labour, environment and anti-corruption or other matters within its mandate.

South Africa's first national Green Finance Taxonomy was published in April 2022. Although reporting against the taxonomy is not yet mandatory, it provides a useful benchmark for investors, issuers, lenders and other financial sector participants to track, monitor, and demonstrate the credentials of their green activities in a more consistent and efficient way.

ESG reporting requirements are also contained in specific legislation that seeks to deal with environmental impact. For example reporting obligations stipulated as conditions to environmental authorisations under the National Environmental Management Act, No 107 of 1998 or conditions to atmospheric emission licences under the National Environmental Management: Air Quality Act, No 39 of 2004. Further, certain categories of emitters are required to report on their emissions under the National Greenhouse Gas Emission Reporting Regulations (published in GN 275 of 3 April 2017) (GHG Reporting Regulations). Sectors covered by the GHG Reporting Regulations include energy, transport, industry, agriculture and forestry.

Specific reporting obligations are also imposed on "designated employers" subject to the Employment Equity Act, No 55 of 1998, as amended (the "Employment Equity Act"), which aims to eliminate unfair discrimination in the workplace and implement affirmative action measures for "designated groups", including black people, women or people with disabilities. A designated employer means an employer who employs 50 or more employees, or has a total annual turnover as reflected in Schedule 4 of the Employment Equity Act, municipalities and organs of state. Employers can also volunteer

to become designated employers. Designated employers are required to form an Employment Equity Committee and submit an annual Employment Equity Report to the Department of Labour.

Broad-Based Black Economic Empowerment (B-BBEE) is a policy of the South African government, which is aimed at increasing participation by previously disadvantaged South Africans in economic activities. The Broad-Based Black Economic Empowerment Act 53 of 2003, as amended (the "B-BBEE Act") is the primary legislation through which this B-BBEE policy is implemented. In terms of the B-BBEE Act, B-BBEE consists of measures and initiatives that are aimed at increasing levels of equity ownership by black people in businesses operating in South Africa, increasing the numbers of black people who participate in management roles in business, improving the skills of black employees, assisting small and medium-sized businesses that are majority-owned by black people, procuring goods and services from businesses that are good contributors to B-BBEE and corporate social investment and development. To aid the South African government to assess the state of transformation of publicly listed companies, the B-BBEE Act, read together with the B-BBEE Regulations, requires that all companies listed on the JSE and government entities report to the B-BBEE Commission annually on their compliance with B-BBEE.

Other sector specific reporting regulations include the Consumer Protection Act, No 68 of 2005, which requires the establishment of national norms and standards relating to consumer protection that promote a fair, accessible and sustainable marketplace, including consumer education concerning the social and economic effects of consumer choices.

Sustainability Reporting/Environmental, Social and Governance (ESG) Guide

A significant development in the field of ESG is the recent publication of the second Code for Responsible Investing in South Africa (CRISA 2) by the CRISA Committee. The first Code for Responsible Investing in South Africa (CRISA) was published in 2011 and aimed to encourage institutional investors and service providers to incorporate ESG issues into their investment decisions. CRISA 2 builds on CRISA and sets out five voluntary principles for stewardship and investment as a key component of the governance framework in South Africa. CRISA 2 has since been endorsed by various institutions including the Financial Sector Conduct Authority (FSCA).

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies and functions involved in the governance and management of a company in South Africa are as follows.

The Board of Directors

The Companies Act entrusts the board of directors with the authority to direct and regulate the business and affairs of the company, save to the extent that the Companies Act or the MOI provides otherwise. The board can delegate functions to individual directors, committees, management and employees.

The Company Secretary

A public company or state-owned company is required to appoint a company secretary in terms of the Companies Act and the Listings Requirements. A company secretary must maintain independence from the board and amongst

other activities, is tasked with providing guidance to the board on their roles, responsibilities and powers, compliance with applicable laws and the company's MOI.

Prescribed Officers

The Companies Act and Regulations include the concept of a prescribed officer. A prescribed officer is a person who (i) exercises general executive control over, and management of the whole or a significant portion of, the business and activities of the company; or (ii) regularly participates to a material degree in the exercise of general executive control over and management of the whole, or a significant portion, of the business and activities of the company. Prescribed officers have the same fiduciary responsibilities as directors, notably a responsibility of care, skill, and diligence and the duty to avoid a conflict of interest. Alongside directors, prescribed officers can be held personally liable for breaching their duties.

Social and Ethics Committee

These committees are a relatively new structure in South African company law also introduced by the Companies Act and Regulations. The social and ethics committee is not a sub-committee of the board and therefore does not enjoy all of the common law powers that a sub-committee of the board would otherwise enjoy. It is, however, entitled to require any information or explanation from any director or prescribed officer and may request from any employee any information or explanation necessary for the performance of its functions; attend any annual general meeting(s) of shareholders (AGM(s)) and receive all notices and other communications relating thereto; and be heard at AGMs on any part of the business of the meeting that concerns the committee's functions. Its functions are limited to those set out in the Regulations which are, inter alia, (i) to monitor the company's activities having regard to any relevant legislation, other legal requirements or prevailing codes of best practice; (ii) good corporate citizenship (iii) to draw matters within its mandate to the attention of the board as occasion requires; and (iv) to report, through one of its members, to the shareholders of a company at the AGM on the matters within its mandate.

Shareholders

Ownership and control of a company vests with the shareholders whose primary governance role relates to monitoring and holding the board accountable (see **3.2 Decisions Made by Particular Bodies**, **3.3 Decision-Making Processes**, **5.1 Relationship Between Companies and Shareholders** and **5.2 Role of Shareholders in Company Management** for further details).

Other Stakeholders

King IV endorses a "stakeholder-inclusive approach", in which the board takes into account the legitimate and reasonable needs, interests and expectations of all material stakeholders in exercising its duties in the best interests of the organisation. Employees are viewed as a key constituency of a company and are afforded the right to apply to a court in order to prevent a company from doing anything inconsistent with the Companies Act, and a trade union or employee representative may invoke the statutory derivative action.

3.2 Decisions Made by Particular Bodies

A company's MOI ordinarily designates the decision-making powers to the board of directors (although there are some decisions that are reserved for shareholder consideration). The main decisions made at each level of the management of the company are as follows:

- The board of directors – makes the majority of decisions which are customarily related to a company's strategy and general management. In this regard, the business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the Companies Act or the company's MOI provides otherwise.
- Management – in instances where the board of directors is different to the management team, the latter will make decisions on a company's day-to-day operations within the ambit of the powers delegated to management by the board.
- The shareholders – in accordance with the Companies Act, there are a number of decisions that are specifically reserved for shareholders and that can only be passed by either a special or ordinary shareholder resolution (see **3.3 Decision-Making Processes** for further details). A company's MOI might include matters in addition to those required in terms of the Companies Act. In certain instances, the shareholders' approval relates to decisions of directors.

3.3 Decision-Making Processes

The board of directors, management team and shareholders ordinarily make decisions in the following ways.

The Board of Directors

The board acts through board resolutions, and makes decisions by a majority vote, with each director normally carrying one vote although this may be varied in the MOI. Board meetings must be called on reasonable notice, and the quorum necessitates the presence of a majority of directors at the meeting. It is important to note that a company's MOI may require unanimous or another consent threshold, if the default position (ie, the majority requirement) in the Companies Act is altered. Moreover, instead of holding a board meeting, the board can make decisions via "round robin" written resolutions, which require approval by a majority of directors of the subject matter of the round robin resolutions. These resolutions generally have the same status as if passed at a meeting of the board.

The board of directors may appoint as many committees as it deems necessary and assign any of its authority to them (while maintaining ultimate accountability for their decisions and conduct). Refer to **1.2 Sources of Corporate Governance Requirements** for mandatory committees to be appointed by public companies.

Management

The management team implements board decisions within its delegated and prescribed authority. Management may include prescribed officers of a company which are discussed further in **3.1 Bodies or Functions Involved in Governance and Management**.

The Shareholders

The following matters require shareholder approval by a special resolution (generally by 75% of shareholders; however, the threshold may be higher or lower if specified in terms of a company's MOI, provided it must be 10% higher than the threshold for an ordinary resolution):

- amending (or ratifying a consolidated revision) of the MOI;
- ratifying ultra vires acts by the board;
- providing financial assistance to directors or to related companies (such as group companies);

- providing financial assistance to acquire securities of the company or of a related company;
- approving certain "fundamental transactions" such as major asset disposals, schemes of arrangement or statutory mergers/amalgamations;
- certain issues of shares, securities or options;
- certain share repurchases;
- remunerating directors in that capacity; and
- winding up the company on a voluntary basis.

Shareholders must approve, by way of an ordinary resolution (generally 50% plus one vote), the appointment of auditors and an audit committee where applicable. A company's MOI may stipulate particular "reserved matters" that can only be considered after shareholder approval. Moreover, the Listings Requirements require shareholder approval before the implementation of certain transactions, either by ordinary resolution (eg, a category 1 major transaction) or by special resolution (eg, a share buy-back). The approval threshold of JSE listed companies for special resolutions is 75% and 50% for ordinary resolutions.

4. Directors and Officers

4.1 Board Structure

South African company law provides for a single-tier, unitary board structure. The Companies Act does not distinguish between executive and non-executive directors and both are full board members. King IV does, however, distinguish and recommend specific roles for executive and non-executive directors.

In terms of the Companies Act, a private company or personal liability company must have a minimum of one director, whereas a public, a non-profit and a state-owned company must have a minimum of three directors. Certain industries, such as the banking and financial sector, may impose additional governance requirements on boards.

King IV recommends that the governing body (ie, the board of directors) should assume responsibility for its composition, including setting out the processes required for it to achieve the appropriate balance of knowledge, experience, skills, independence and diversity to effectively and objectively perform its governance responsibilities. King IV recommends that the board should consist of a majority of independent non-executive members. In determining the required number of board members, King IV recommends that the board consider, inter alia, the appropriate mix of executive, non-executive and independent non-executives; diversity; and the need for a sufficient number of members that qualify to serve on the committees of the board. In relation to committees, King IV recommends an audit committee (which is a statutory requirement for some companies), nominations committee, risk governance committee, remuneration committee and a social and ethics committee. The audit committee is primarily responsible for providing independent oversight of the integrity of the annual financial statements (AFS). The nominations committee is primarily responsible for the process of nominating, electing and appointing the board of directors.

4.2 Roles of Board Members

Position Under King IV

King IV recommends that the board of directors comprise a combination of executive, non-executive and independent non-executive directors. As a minimum requirement, King IV recommends that a chief executive officer (CEO) and one other executive (for example a chief financial officer

(CFO)) should be appointed to the board of directors of a company so as to ensure that the board of directors has more than one point of direct contact with management.

In addition to the role of CEO (and CFO), it is recommended that the board of directors elect an independent non-executive director as chair to lead the board of directors in the effective and objective discharge of their governance role and responsibilities. The CEO leads the implementation and performance of a board-approved strategy and policies and should serve as the main link between management and the board of directors.

4.3 Board Composition Requirements/ Recommendations

The Companies Act prescribes a minimum number of directors for, inter alia, private and public companies as set out in **4.1 Board Structure**. A company's MOI may require a higher number of directors than the minimum number required by the Companies Act.

King IV recommends that a board of directors should possess the appropriate mix of skill, knowledge, expertise and experience, including the business, industry and commercial experience needed to govern a company (see also **4.1 Board Structure** for further details).

Concept of B-BBEE

B-BBEE encourages companies to constitute diverse boards of directors as this has an impact on a company's ability to conduct business or conclude contracts with the state or state-owned companies (see also **2.2 Environmental, Social and Governance (ESG) Considerations** for further details on B-BBEE).

4.4 Appointment and Removal of Directors/Officers

Position Under the Companies Act

Appointment of directors

Directors are generally elected to the board by a majority vote of the shareholders. The company's MOI can allow directors to be appointed directly by any party specified in it, or it can allow directors to serve as ex officio directors. The Companies Act specifically provides that at least 50% of the directors of a profit company; ie, a company incorporated for purposes of financial gain for its shareholders, must be elected by shareholders.

Removal of directors

In terms of the Companies Act, directors can resign or be removed by shareholders or the remainder of the board.

Shareholder removal

The Companies Act contains an unalterable provision providing for the removal of directors from the board by an ordinary resolution of shareholders at a general meeting. Before this resolution is considered by the shareholders, the director(s) concerned must be given proper notice of the proposed meeting and the resolution, and the director(s) must be afforded a reasonable opportunity to make a presentation to the shareholders, either in person or through a representative.

Board removal

Furthermore, if a director becomes incapacitated, ineligible or disqualified, or has neglected or been derelict in the performance of their duties, the board will be able to remove the director in question. Moreover, a company's MOI may indicate additional processes for the removal of a director.

A shareholder, director, prescribed officer or company secretary can also approach the High Court to remove a director by:

- invoking the oppression remedy in terms of the Companies Act; or
- having a director declared a delinquent in accordance with the Companies Act, if they are in material or gross breach of their duties.

4.5 Rules/Requirements Concerning Independence of Directors

Position Under the Companies Act

Conflicts of interest

Avoiding a conflict of interest is one of the central fiduciary duties of a director. The Companies Act provides that in the event that a director has a material/substantial personal financial interest in a matter before the board, or knows that a "related person" has an interest, such director must disclose such interest to the board and recuse themselves from the board deliberations on that matter. Family members within specific degrees of consanguinity or affinity, second entities of which the contemplated director is also a director, and organisations under the director's control or influence are all regarded as "related persons".

In relation to the audit committee of a public or state-owned company, the test for independence under the Companies Act is that the director must not be:

- involved in the day-to-day management of the company's business or have been so-involved at any time during the previous financial year;
- a prescribed officer or full-time employee of the company and must not have held such office during the previous three financial years;
- a material supplier or customer of the company such that a reasonable and informed third party would conclude that the director's integrity, impartiality or objectivity is compromised by that relationship; and
- related to any person who falls within any of the above categories.

If the company appoints an audit committee with persons not considered as "independent" in terms of the Companies Act, any functions undertaken by such audit committee will be considered as not performed by a suitably constituted audit committee.

Position Under King IV

Independence and conflicts

King IV recommends that at least a majority of the company's non-executive directors should be independent and that the chair of the board should be independent. King IV sets out certain factors to consider when determining whether a director is considered "independent", including whether:

- the director holds any equity interest in the company or group that is material to their personal wealth;
- the director holds directorships on a number of other group companies;
- the director is a material lender or financier to the company; or
- the director's remuneration is in any way based on the performance of the company.

Position Under the Takeover Regulations

The Takeover Regulations (Chapter 5 of the Regulations) (the "Takeover Regulations") require an independent board to be established in certain circumstances in relation to affected transactions, which include certain fundamental transactions, such as major disposals, schemes of

arrangement and mergers, as well as the acquisition of control of a regulated company.

4.6 Legal Duties of Directors/Officers

Directors and prescribed officers are subject to a number of duties under both the Companies Act and the common law. These duties can be traditionally categorised into two groups:

- fiduciary duties; and
- the duty of care, skill and diligence.

Position Under the Companies Act and the Common Law

Fiduciary duties

The Companies Act, in part, codified the common law principles regulating fiduciary duties and mandates that all directors, alternate directors, prescribed officers and members of board or audit committees must, amongst other things:

- exercise their powers and functions in good faith, for a proper purpose, and in the "best interests of the company";
- disclose personal financial interests in certain instances; and
- not use their office or position to secure an advantage or knowingly cause harm to the company.

Directors remain subject to their common law fiduciary duties to the extent that the Companies Act does not specifically deal with particular duties. These common law duties encompass the fiduciary duties to:

- act within designated powers;
- maintain and exercise unfettered discretion and independent judgement; and
- avoid conflicts of interest.

The duty of care, skill and diligence

Each director should act with the degree of care, skill and diligence that may reasonably be expected of a person:

- carrying out the same functions in relation to the company as those carried out by that director; and
- having the general knowledge, skill and experience of that director.

4.7 Responsibility/Accountability of Directors

Under South African law, directors owe their fiduciary duties and the duty to act with reasonable care, skill and diligence to the company (this entails acting only in the bona fide interests of the company and its shareholders as a body). Directors as such owe no fiduciary duty to the shareholders individually.

Furthermore, King IV endorses a stakeholder inclusive model (or enlightened shareholder value approach), in terms of which the needs and interests of stakeholders should be taken into account by the board, alongside those of the shareholders.

Directors do not owe fiduciary duties to third parties and creditors; however, the Companies Act provides that a company may not trade recklessly, with gross negligence or with the intent to defraud any creditors. In the event of a breach of the relevant provisions of the Companies Act, directors may be held personally liable to creditors or other third parties where loss or damage was suffered as a result of the transgression.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Position Under the Companies Act

The Companies Act provides, inter alia, that a director may be held responsible (i) in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of their duties; or (ii) in accordance with the principles of the common law relating to delict for any loss, damages or costs sustained by the company as a consequence of any breach by the director of their duty of care, skill and diligence, certain other provisions of the Companies Act, or any provision of the company's MOI.

Note that the liability above, for example for a breach of a fiduciary duty by the director, is to the company and not to third parties under the Companies Act. This is consistent with the principle of reflective loss, which principle has recently been reaffirmed in South African courts. In other words where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss, and a shareholder does not have the right to claim for a reduction in the value of its shares as this loss merely reflects the loss suffered by the company itself as the result of wrongdoing (see **5.4 Shareholder Claims** (Statutory Derivative Action)).

Furthermore, defaulting directors are jointly and severally liable to the company for any loss. The Companies Act provides a legal avenue to pursue an action on behalf of a company in order to recover losses associated with a breach of directors' legal duties (further details on such actions is set out in **5.4 Shareholder Claims**).

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Position Under the Companies Act

A director is liable for any loss, costs or damages suffered by a company as a direct or indirect consequence of a director, inter alia, having:

- acted on behalf of the company without the requisite authority, despite knowing that the director lacked the authority to do so;
- acquiesced in the reckless trading of the company's business;
- engaged in conduct calculated to defraud stakeholders; or
- being party to false or misleading communications in financial statements and/or in a prospectus.

Directors may be subjected to criminal penalties in limited circumstances, with stricter consequences designated for offences including false statements or reckless behaviour.

Directors may not be relieved of any legal duties, liabilities or any legal consequences arising from an act or omission constituting wilful breach of trust or wilful misconduct on the part of a director negated or limited by virtue of a company's MOI, any agreement or any resolution of a company.

Limitation of Liability

Business judgement rule

The Companies Act provides for the business judgement rule, which is a protective and defensive mechanism for directors who face liability for potential breaches of their legal duties (see **4.6 Legal Duties of Directors/Officers** for a further discussion).

In terms of the Companies Act, the defence is available to a director (other than for breaches

of duties of good faith) if the following requirements are met:

- the director took reasonably diligent steps to become informed about the matter at hand;
- the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter, or had dealt with those personal financial interests as required by law; and
- the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

Director's indemnity insurance

Companies are prohibited from providing indemnity or insurance to a director for wilful misconduct or for a wilful breach of trust. Nevertheless, on a case-by-case basis, the company may indemnify its directors, or purchase insurance policies that safeguards directors in the event that they have contravened their legal duties in a non-wilful manner. This is subject to certain restrictions, for example, a company is prohibited from indemnifying or insuring its director for:

- fines arising from criminal offences;
- reckless or fraudulent trading; or
- acting without proper authority.

A director is allowed to obtain insurance against personal liability. If a company obtains the requisite approvals, they may also pay the insurance premium for the directors.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Position Under the Companies Act

The Companies Act provides that, except to the extent provided otherwise by a company's MOI, directors may be remunerated for their services (as director) subject to the passing of a special resolution of shareholders, which in turn, must be approved two years prior to such remuneration being paid.

The Companies Act also contains certain matters which require shareholder approval so as to limit benefits that may go to directors and prescribed officers, such as:

- an issue of shares if the class of shares being issued (including as a result of a transaction or series of transactions) will be equal to or exceed 30% of the voting power of all the shares of that class held by shareholders immediately held before the transaction(s);
- a decision by the board determining that the company may acquire a number of its own shares; and
- a decision by the board for the company to provide financial assistance to a director or prescribed officer.

Listings Requirements and King IV

The Listings Requirements have endorsed the King IV recommendation that shareholder approval in respect of remuneration is to be pursued as follows.

Where either the remuneration policy or the implementation report, or both were voted against by 25% or more of the non-binding advisory voting rights exercised at the AGM, King IV advocates that the following should be disclosed

in the background statement of the remuneration report succeeding the voting:

- persons whom the company engaged, and the manner and form of engagement to ascertain the motives for dissenting votes; and
- the nature of steps taken to address legitimate and reasonable objections and concerns.

Consequences for Failing to Comply With Approval Requirements

The company may not pay remuneration to its directors for their service as directors, except to the extent that the MOI provides otherwise. Remuneration may be paid only in accordance with a special resolution approved by the shareholders within the previous two years (note that this is not salary but payments to directors for their services as such). If the board of a company proceeds to remunerate its directors without first obtaining the requisite shareholder approval, such payment is unlawful (see **4.6 Legal Duties of Directors/Officers** for further discussion) and could be liable to the company for any loss, damages or costs suffered by the company as a result. The shareholders could challenge the board decisions relating to director remuneration (see **5.4 Shareholder Claims** for and **4.4 Appointment and Removal of Directors/Officers** for a further discussion).

4.11 Disclosure of Payments to Directors/Officers

A company that is required to have its AFS audited in terms of the Companies Act must disclose all remuneration and other benefits paid to its directors and prescribed officers in its AFS. This should be done on an individualised basis.

Furthermore, the Companies Act requires that the AFS of a company contain the following particulars relating generally to directors and prescribed officers:

- their remuneration and benefits received;
- the amount of any pensions paid to them by the company;
- any amount paid or payable by the company to a pension scheme;
- the amount of any compensation paid to them in respect of loss of office;
- the number and class of any securities issued to them, and the consideration received by the company for those securities; and
- details of their service contracts.

All remuneration paid to or receivable by a director or prescribed officer must be disclosed and this encompasses not only the remuneration paid to or received by the director or prescribed officer for services to the company, but also all other remuneration received by the director or prescribed officer for services rendered as a director or prescribed officer to any other company within the same group of companies.

Companies Amendment Bill, 2021

The Companies Amendment Bill proposes that companies, whose AFS are required in terms of the Companies Act to be audited, publish the names of company directors and prescribed officers who have received remuneration and benefits. The Companies Amendment Bill further proposes that public and state-owned companies prepare and present a director's remuneration report for the approval of shareholders at an AGM. Furthermore, a remuneration policy is to be presented at an AGM for approval of shareholders.

According to the Companies Amendment Bill, companies will also be required to publish details of the average and median remuneration of all employees, and the remuneration gap reflecting the ratio between the total remuneration of the top 5% highest paid employees and the total remuneration of the bottom 5% lowest paid employees.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The relationship between the company and its shareholders is statutory and contractual in nature as it is generally regulated by the Companies Act and the company's MOI, which generally sets out rights attaching to shares. The relationship between shareholders and the company may also be regulated by a shareholders' agreement but nothing contained in such a shareholders' agreement may conflict with or be inconsistent with the MOI and the Companies Act.

Generally, the principle of separate legal personality entails that shareholders are not liable for the company's acts or omissions. Shareholders do not owe any legal duties under the common law or the Companies Act to the company.

Only in exceptional circumstances can a court impose personal liability on shareholders who have flouted the common law principle of separate corporate personality, or the court may invoke the Companies Act's statutory mechanism to pierce the corporate veil in cases of "unconscionable abuse" of a company's separate legal personality.

Shareholders are entitled to a share of the company's distributed profits in proportion to their respective shareholdings and, in the event of a company winding-up, to the surplus assets after the company's creditors have been fully paid. Typically, preference shareholders are entitled to receive their respective portions before ordinary shareholders upon winding up of a company.

5.2 Role of Shareholders in Company Management

Position Under the Companies Act

As mentioned in **4.4 Appointment and Removal of Directors/Officers**, shareholders are responsible for the appointment of a certain percentage of directors to the board of a company. As set out in **4.2 Roles of Board Members**, the management of a company is primarily done by the directors but in addition to matters and actions that require shareholder approval in accordance with the Companies Act provisions, a company's MOI may set out certain actions that may not be carried out unless approved by a majority approval of shareholders. Such actions are generally known as reserved matters.

The Companies Act enables shareholders to perform their duty of oversight by allowing them to invoke their right to a statutory derivative action (see **5.4 Shareholder Claims** for a further discussion). This statutory derivative action can also be brought against any third parties who have committed any wrongdoing towards the company.

5.3 Shareholder Meetings

Position Under the Companies Act

The Companies Act provides that a public company must convene an AGM initially, no more than 18 months after the company's incorporation and thereafter, must convene annually (and within 15 months after the preceding year's AGM). AGMs are not required for private corpo-

rations; however, they are commonly included in the company's MOI.

The following matters must, at a minimum, be covered at an AGM of a public company:

- the presentation of the directors' report, the audited financial statements of the company for the immediately preceding financial year and an audit committee report;
- the election of any directors, to the extent required by the Companies Act or the company's MOI;
- the appointment of the company's auditor for the ensuing financial year and an audit committee (in the case of public and state-owned companies only); and
- the AGM must also address any other issue presented by shareholders, irrespective of whether the company was given notice of the subject matter.

Furthermore, shareholders' meetings may be convened to deliberate on specific company matters, such as the approval of a fundamental transaction, as and when requisitioned by the board, a person indicated in the company's MOI or rules, or shareholders who, in aggregate, hold at least 10% of the voting rights entitled to be exercised on the subject matter to be voted on (except where a court decides that the subject matter in question is frivolous, vexatious, or has already been decided by shareholders).

Any general meeting of shareholders can be conducted entirely or partially by electronic communication provided that the electronic medium allows all shareholders to participate reasonably effectively as set out in the Companies Act.

Default positions

In terms of the Companies Act, the following are the default or standard positions, which can be altered by the company's MOI:

- for a public and non-profit company, the notice period is 15 business days (and in any other case, the notice period is ten business days);
- the quorum prerequisite for shareholders' meetings for any company is shareholders representing at least 25% of the total votes exercisable at the meeting, whether the shareholders are physically present or represented by proxy;
- at minimum, three shareholders must be present in person or by proxy, if the company has three or more shareholders;
- in the event that a quorum is not attained at the first assembly, the meeting will be postponed by a week and those present at the postponed meeting will be considered to comprise a quorum; and
- for JSE-listed companies, the Listings Requirements permit round robin resolutions only for very limited shareholder decisions and the balance of shareholder decisions must be approved at general meetings.

The board of a company, or any other person specified in the company's MOI or rules, may call a shareholders' meeting at any time. The board of directors must call a shareholders' meeting if a shareholder, or a group of shareholders, with a combined holding of at least 10% of the voting rights, demand the board to convene a shareholders' meeting to discuss a specific issue or demands are made for substantially the same purpose. If the board fails, the shareholders may pursue an order of the court. Moreover, any two shareholders can require that the company include particular proposed resolutions on the

agenda of a meeting demanded as aforesaid or at the next shareholders' meeting or by round robin.

5.4 Shareholder Claims

Position Under the Companies Act

In terms of the Companies Act, a shareholder who has been subjected to oppressive or prejudicial conduct due to, inter alia:

- any act or omission of a company; or
- the exercise of a director's powers,

may seek judicial relief, and a court may make any order it deems appropriate, including an order restraining the conduct complained of or setting aside an agreement or transaction.

Furthermore, shareholders may approach the court for any order sufficient to safeguard any of their rights or to remedy any harm done to them by:

- the company due to a violation of, inter alia, the Companies Act or the MOI; or
- a director insofar as that director may be liable for a breach of their legal duties.

Moreover, in limited instances, a shareholder may launch an application with the court to impede:

- the company from breaching any provision of the Companies Act; or
- the company or the directors from violating any constraint included in the MOI regarding the company's capacity or the directors' authority.

A claim for damages may also be brought by shareholders who have endured a loss due to a breach of the Companies Act by directors.

Statutory Derivative Action

The Companies Act empowers shareholders to mandate a company to institute legal proceedings, or take related steps, to protect the legal interests of the company. A company, however, within 15 business days may launch an application to set aside the shareholders' demand only on the grounds that it is frivolous, vexatious or devoid of merit.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Position Under the Companies Act

The new amendments to the Companies Act (see below) have inserted the definition of an "affected company", which essentially means a regulated company and a private company that is controlled by or a subsidiary of a regulated company.

In terms of Section 122, a person must notify an affected company in the prescribed manner and form within three business days after that person

- acquires a beneficial interest in sufficient securities of a class issued by that company such that, as a result of the acquisition, the person holds a beneficial interest in securities amounting to 5%, 10%, 15%, or any further whole multiple of 5%, of the issued securities of that class; or
- disposes of a beneficial interest in sufficient securities of a class issued by a company such that, as a result of the disposition, the person no longer holds a beneficial interest in securities amounting to a particular multiple of 5% of the issued securities of that class.

Upon having received the notice above, an affected company must file a record of that notice with the CIPC.

A regulated company must, upon receiving such notice:

- file a copy with the Takeover Regulatory Panel (TRP); and
- report the information to the holders of the relevant class of securities unless the notice concerned a disposition of less than 1% of the class of securities.

The Takeover Regulations require a mandatory offer to be made to the remaining shareholders when a party (operating alone or in concert) acquires securities in a regulated company that increases the acquiring party's beneficial interest in the voting rights of such company to 35% or more.

New Amendments to the Companies Act

The GLAA was introduced in December 2022 in order to strengthen South Africa's system of anti-money laundering (AML) and combating the financing of terrorism (CFT). These laws are intended to strengthen the fight against corruption, fraud and terrorism, and also assist South Africa in meeting the international standards on AML/CFT. The GLAA amends five different Acts, including the TPCA; the Non-profit Organisations Act, No 71 of 1997; the FICA; the Companies Act; and the Financial Sector Regulation Act, No 9 of 2017. See **2.1 Hot Topics in Corporate Governance** (Greylisting of South Africa).

The Companies Act has been amended to include the definition of a "beneficial owner" and to provide for a mechanism through which the Companies and Intellectual Property Commission (CIPC) can keep accurate and updated beneficial ownership information. The amendments will require a company to keep a record of a natural person who owns or controls the company in terms of the definition of "beneficial owner", and it prescribes specified timelines within which the company must record any changes in this information. Companies must also file a record of any natural person who owns or controls the company in terms of the definition of "beneficial owner", with CIPC. Finally, persons who are convicted of offences relating to money laundering, terrorist financing, or proliferation-financing activities or are subject to a resolution of the UN Security Council are prohibited from registering as company directors.

Whilst these amendments are not specific to M&A, it is expected that these changes to the Companies Act will feature strongly in due diligence investigations in M&A matters for the foreseeable future, as well as the other legislation amended by the GLAA.

Listings Requirements

The Listings Requirements mandate issuers to disclose shareholdings of 5% or more in their annual report and circulars.

Companies Amendment Bill

The amendments proposed to the Companies Act aim to identify the true owner of shares of a company, on not only the first level of beneficial holders but also to require companies to identity the ultimate beneficial owners of their shares.

The effect of the amendments is the following:

- it places an obligation on all companies (and not only public companies) to determine from their registered shareholders details of the identity of persons who hold beneficial interests in the company's shares;
- they strengthen the prevailing provisions relating to companies establishing and maintaining a register of the owners of beneficial interests in their shares and disclosure by

shareholders relating to the persons who hold beneficial interests in their shares; and
- it requires all companies to publish in their AFS details of all persons who, alone or in aggregate, hold beneficial interests amounting to 5% or more of a particular class of shares.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Position Under the Companies Act

On an annual basis, a company must prepare AFS within six months after the end of its financial year or such shorter period as may be appropriate in accordance with the Companies Act.

The Companies Act provides that the AFS of a public company must be audited and in the case of profit and non-profit companies, the AFS may:

- be audited if it is in the public interest to do so under the Regulations;
- be audited voluntarily if the company's MOI so provides; or
- be independently reviewed in a manner required by the Companies Act.

The AFS must be approved by the board and be presented to the first shareholders' meeting after the AFS have been approved by the board and generally includes the following information:

- a director's report detailing the state of the company; and
- an auditor's report.

The AFS must satisfy financial reporting standards as to form and content if such standards are prescribed.

6.2 Disclosure of Corporate Governance Arrangements

Position Under the Listings Requirements

In addition to the requirements discussed in **6.1 Financial Reporting**, the Listings Requirements impose a number of ongoing obligations on public companies.

As a result, issuers must comply with financial reporting and disclosure requirements in critical areas such as periodic financial information, price sensitive information, profit forecasts, and major company activities.

As per King IV, good governance can be attained through its "apply and explain" disclosure framework, which requires a company to:

- apply the recommended practices thoughtfully, with common sense, and proportionally (ie, in line with its size, resources, and the scope and complexity of its operations); and
- provide a descriptive account of that implementation with reference to the recommended standards.

This account, together with the company's AFS (and other external reports), code of conduct and ethical codes, and integrated reports, should be published on the company's website (or other widely accessible media or platforms).

6.3 Companies Registry Filings

Position Under the Companies Act

In terms of the Companies Act, all companies (including external companies and close corporations) are required to file annual returns with the CIPC within a specified time period. Companies must file their annual returns within 30 business days after the anniversary date of their registration date, irrespective of whether they were active or not. Notably, the new amendments to

the Companies Act require companies to include in their annual returns a copy of their AFS and a copy of their securities registers and, in the case of affected companies, a copy of the register of disclosure of beneficial interest.

If annual returns are not filed within the specified time frame, the company may be deregistered as CIPC will assume that the company is inactive. The deregistration procedure has the legal consequence of terminating the juristic personality of the company or close corporation, with the effect that the company or close corporation ceases to exist.

Furthermore, all entities are required by law to file their taxable returns with the South African Revenue Services to determine their taxable income.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Position Under the Companies Act

The Companies Act prescribes that only certain types of companies require an external auditor to be appointed to audit its financial statements. In terms of the Companies Act, it is mandatory for public and state-owned companies to appoint an auditor and to have their financial statements audited.

The appointment of an auditor must occur upon incorporation of the company by the incorporators or, within 40 business days of incorporation by the directors of the company. The first auditors of a company will hold office until the first AGM of the company, and are re-appointed on an annual basis at every AGM.

An appointed auditor may not be a:

- director, prescribed officer, employee or consultant of the company;
- director, officer or employee of the person appointed as company secretary;
- person who habitually or regularly performs the duties of accountant or bookkeeper of the company; or
- person appointed in the immediately preceding five years as the auditor of the company.

The Companies Act provides that the same individual is prohibited from serving as an auditor or designated auditor of a company for more than five consecutive financial years.

It is not mandatory for a private or personal liability company to appoint an auditor, unless the company is required to produce audited financial statements (see **6.1 Financial Reporting**).

The Regulations set out a guideline to determine when it is in the public's interest to have the financials of a company audited. The Regulations provide that a private profit company's financials must be audited if they meet any one of the following criteria:

- if such a company, in the ordinary course of its primary activities, holds assets in a fiduciary capacity for persons who are not related to the company, and the aggregate value of such assets held at any time during the financial year exceeds ZAR5 million;
- any other company whose public interest score in that financial year is 350 or more; or
- any other company whose public interest score in that financial year is at least 100 (but less than 350) and whose AFS for that year were internally compiled.

Certain categories of private, personal liability and non-profit companies that are not subject to

audit requirements may be required to have its AFS independently reviewed by an accountant.

If a company is not required to be audited but is not exempt in terms of the Companies Act, then its AFS must be independently reviewed.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

King IV

Generally speaking, this requirement would fall under the general duty of care, skill and diligence under the Companies Act. In addition, King IV recommends the board of directors of a company to appoint a risk committee that will be in charge of overseeing and mitigating all of the company's potential risks. King IV recommends that the risk committee should comprise of at least three directors, the majority being non-executive directors. The chairperson of the committee should be a non-executive director. The chairperson of the board may chair this committee. It is advised that the committee generates reports that are reviewed and signed by the whole board as acknowledgement that their duties have been appropriately performed in this respect.

King IV emphasises the board's role in risk and opportunity oversight, proposing that the risk committee's membership intersects with that of the audit committee for greater efficiency, and that the meeting agenda should address audit, risk, and opportunity as distinct agenda items if the risk and audit roles are integrated in a single committee.

SWITZERLAND

Law and Practice

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Contents

1. Introductory p.598
1.1 Forms of Corporate/Business Organisations p.598
1.2 Sources of Corporate Governance Requirements p.598
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.600

2. Corporate Governance Context p.600
2.1 Hot Topics in Corporate Governance p.600
2.2 Environmental, Social and Governance (ESG) Considerations p.601

3. Management of the Company p.603
3.1 Bodies or Functions Involved in Governance and Management p.603
3.2 Decisions Made by Particular Bodies p.604
3.3 Decision-Making Processes p.605

4. Directors and Officers p.606
4.1 Board Structure p.606
4.2 Roles of Board Members p.606
4.3 Board Composition Requirements/Recommendations p.607
4.4 Appointment and Removal of Directors/Officers p.607
4.5 Rules/Requirements Concerning Independence of Directors p.607
4.6 Legal Duties of Directors/Officers p.609
4.7 Responsibility/Accountability of Directors p.609
4.8 Consequences and Enforcement of Breach of Directors' Duties p.609
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.610
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.610
4.11 Disclosure of Payments to Directors/Officers p.611

5. Shareholders p.612
5.1 Relationship Between Companies and Shareholders p.612
5.2 Role of Shareholders in Company Management p.612
5.3 Shareholder Meetings p.612
5.4 Shareholder Claims p.613
5.5 Disclosure by Shareholders in Publicly Traded Companies p.613

6. Corporate Reporting and Other Disclosures p.613
6.1 Financial Reporting p.613
6.2 Disclosure of Corporate Governance Arrangements p.614
6.3 Companies Registry Filings p.615

7. Audit, Risk and Internal Controls p.615
7.1 Appointment of External Auditors p.615
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.616

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Schellenberg Wittmer

1. Introductory

1.1 Forms of Corporate/Business Organisations

The principal forms of corporate organisations in Switzerland are the stock corporation *Aktiengesellschaft* (AG) and the limited liability company *Gesellschaft mit beschränkter Haftung GmbH* (or LLC). The stock corporation is the most important company form; it is suitable for all sizes and types of business and is the only company form that can be listed on a stock exchange. Both the AG and LLC feature a separate legal personality, a predetermined capital divided into shares or quotas and a limitation of liability to their own assets.

1.2 Sources of Corporate Governance Requirements

Primary Sources

The primary sources of law relating to corporate governance are the Swiss company law (Article 620 et seq of the Swiss Federal Code of Obligations (CO)) and, for listed corporations, the Swiss Federal Act on Financial Market Infrastructure and Market Conduct in Securities and Derivatives Trading (the "Financial Market Infrastructure Act" or FinMIA).

Swiss Company Law

Swiss company law has undergone a comprehensive revision, which came into force on 1 January 2023 (for a summary of the new provisions, see **2.1 Hot Topics in Corporate Governance**).

FinMIA

The FinMIA regulates the organisation and operation of financial market infrastructure, and the conduct of financial market participants in securities and derivatives trading.

The FinMIA is further specified by three ordinances on stock exchanges and securities trading:

- the Financial Market Infrastructure Ordinance (FinMIO) is issued by the Swiss government (Federal Council) directly;
- the FINMA Financial Market Infrastructure Ordinance (FinMIO-FINMA) is issued by the Swiss Financial Market Supervisory Authority (FINMA); and
- the Takeover Ordinance (TOO) regulating public takeovers is issued by the Swiss Takeover Board (TOB).

In addition to the issuance of ordinances in its field of competence, the regulatory body FINMA

also has the authority to issue directives (circulars). The following are relevant:

- the FINMA circular "Remuneration schedules" (2010/01, as amended 4 November 2020), addressing the minimum standards for remuneration schemes of financial institutions; and
- the circulars "Corporate Governance – insurers" (2017/02, of 1 January 2017) and "Corporate Governance – banks" (2017/01, as amended 4 November 2020), both addressing corporate governance, risk management and the internal control system at insurance companies and banking institutions, respectively.

Listing Rules

The two Swiss stock exchanges, SIX Swiss Exchange AG (SIX) and the smaller BX Swiss AG (BX), are both self-regulatory organisations under the FinMIA, and have issued listing rules with specific reporting and disclosure requirements, partially amended by the new Financial Services Act (FinSA) as of 1 August 2021. To improve transparency on corporate governance, SIX Exchange Regulation, the regulatory division of SIX, has enacted the "Directive on Information Relating to Corporate Governance" ("SIX Directive Corporate Governance"), as last amended on 1 January 2023. It requires issuers with a main Swiss listing to disclose, in a separate chapter of their annual report, important information on the management and control mechanisms at the highest corporate level, or to give valid reasons for not doing so ("comply or explain").

In addition, the SIX "Directive on the Disclosure of Management Transactions" as amended 1 May 2018 obliges issuers with a main Swiss listing and (indirectly) their members of the board of directors and of the executive management to disclose and report transactions in their respective securities.

Furthermore, the former Ordinance against Excessive Compensation in Listed Companies (OaEC), which had introduced a binding say-on-pay regime back in 2014, was comprehensively integrated into revised Swiss company law, while the OaEC was formally repealed on 1 January 2023. As a consequence, the statutory say-on-pay provisions continue to apply solely to members of the board of directors, executive management and advisory board (if any) of public Swiss companies, – ie, stock corporations incorporated under Swiss company law whose shares are listed, either on a stock exchange in Switzerland or abroad. The statutory provisions do not apply, in particular, to Swiss companies that have solely listed debt securities or non-voting participation certificates outstanding, and, in general, not to any privately held companies.

Corporate Governance Standards

Moreover, the Swiss Code of Best Practice for Corporate Governance as amended on 6 February 2023 (SCBP), following the entry into force of the revised Swiss company law and issued by *economiesuisse* the most important association of Swiss businesses from all sectors of the economy, sets corporate governance standards in the form of non-binding recommendations ("comply or explain"). The SCBP primarily addresses Swiss public companies, but also serves as a guideline for non-listed Swiss companies and organisations of economic significance. Being an effective instrument of self-regulation, it structures, integrates and reflects various Swiss law provisions on corporate governance and accepted corporate practice and sets corporate governance standards which are, while only soft law, accepted and observed by many companies in Switzerland (see **2.1 Hot Topics in Corporate Governance**).

Guidelines for Institutional Investors

In addition, an important group of representatives of Swiss institutional investors (such as the Swiss Association of Pension Fund Providers and the Federal Social Security Funds), Swiss businesses (including the Swiss Business Federation, *economiesuisse* and proxy advisers (Ethos)) have issued the "Guidelines for institutional investors governing the exercising of participation rights in public limited companies". Unlike the SCBP, which primarily addresses listed companies, these non-binding guidelines are directed towards institutional investors and aimed at enhancing good corporate governance by describing best practices for the exercise of participation rights in Swiss-listed companies. The Guidelines' importance increased when Swiss pension funds became obliged to exercise their voting rights and to disclose their voting decisions under the former OaEC on 1 January 2014. Upon the repeal of the OaEC, this obligation continued to apply, newly integrated into the Federal Act on Occupational Old Age, Survivors' and Invalidity Pension Provision (OPA).

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Companies with publicly traded shares have to comply with additional corporate governance requirements. In particular, the election and remuneration of the board of directors is more strictly regulated. The chairperson, as well as each member of the board of directors, the members of the compensation committee and the independent proxy, have to be appointed individually and annually by the shareholders' meeting.

The board's proposal on the compensation of directors and of the executive management (and, if any, of an advisory board) has to be submitted annually to the shareholders for a binding vote (binding say-on-pay). Further, the Listing Rules of the SIX and BX provide for specific reporting and disclosure requirements. In addition, the SIX Directive Corporate Governance requires SIX-listed companies to disclose, in annual business reports, important information on the management and control mechanisms at the highest corporate level, or to give valid reasons for not doing so ("comply or explain").

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The main hot topic of 2023 is the enactment of the revised Swiss company law on 1 January 2023.The revised company law includes the following corporate governance related key changes:

- shareholders' meetings may be newly held virtually or in a hybrid form (see **5.3 Shareholder Meetings**);
- a new concept of a capital band was introduced;
- the former OaEC was formally integrated into statutory company law (see **1.2 Sources of Corporate Governance Requirements**); and
- various ESG reporting obligations were introduced (discussed in **2.2 Environmental, Social and Governance (ESG) Considerations**).

Further points of the revision are addressed throughout the guide.

Moreover, the revised SCBP (see **1.2 Sources of Corporate Governance Requirements**) emphasises the importance of sustainability and sustainable growth as a guiding principle of corporate governance: "Good corporate governance

therefore serves the goal of the sustainable interest of the company." Other key additions relate to the role of compliance, corporate culture, the regulation of conflicts of interest and greater specificity with regard to the composition and diversity of boards of directors.

2.2 Environmental, Social and Governance (ESG) Considerations

According to the Swiss Corporate Social Responsibility Action Plan, the Swiss government's approach focuses on:

- sensitising domestic companies to ESG;
- offering support to companies seeking to address relevant issues;
- promoting transparency; and
- establishing a best practice based on international standards.

At the same time, the following ESG related legislative changes were recently introduced, taking into account the respective international legislative developments.

Gender Representation on the Board of Directors and in the Executive Management

Swiss-listed companies which meet a certain threshold in terms of balance sheet total exceeding CHF20 million, revenues exceeding CHF40 million, and the number of employees (at least 250 FTE in an annual average) for the last two business years are required to implement certain gender quotas for the board of directors (at least 30% of each gender) and the executive management (at least 20% of each gender) under a "comply or explain" concept (Article 734f CO).

The threshold is calculated on the group level. Any company that does not meet the mentioned provisions will be required to state in its remuneration report the reasons for such imbalance, and the actions that are being taken to improve the situation. Privately held stock corporations may voluntarily submit to the gender quotas (opt-in). The introduction of the quotas is subject to multi-year conformance periods (2026 for boards of directors and 2031 for executive managements) but in practice significant changes in the composition of boards and senior managements are underway.

Disclosure Obligations Relating to Raw Material Companies

The provisions regarding transparency in raw material companies have been in force since 1 January 2021 and require major companies (ie, those which have to undergo an ordinary audit by law) that are either themselves or through a company that they control involved in the extraction of minerals, oil or natural gas, or in the harvesting of timber in primary forests, to issue a yearly report on any payments made to state bodies (Articles 964d–964i CO).

Non-financial Reporting Obligations

As of 1 January 2022, the Swiss Parliament implemented new rules regarding "transparency on non-financial matters" encompassing new respective reporting obligations for non-financial matters (Articles 964a–964c CO).

The reporting obligations apply to Swiss "companies of public interest" – ie, Swiss-listed companies and certain FINMA-supervised financial institutions – if they meet certain thresholds on annual average in two successive financial years:

- regarding the number of employees (at least 500 FTE); and
- with either a balance sheet total exceeding CHF20 million or revenues exceeding CHF40 million.

If within scope, the respective companies are obliged to report on the risks of their business activities in the areas of the environment (in particular, CO2 targets), social concerns, labour concerns, human rights and the fight against corruption, as well as on the measures taken against these risks. Violations of these reporting duties are punishable by criminal sanctions (fines). The newly introduced rules are largely based on known international provisions, such as Directive 2014/95/EU (the "Non-Financial Reporting Directive") concerning non-financial reporting.

The first report for non-financial matters needs to be published with respect to the financial year 2023.

In this context and against the background of the EU's revised Corporate Sustainability Reporting Directive (CSRD) (Directive (EU) 2022/2464), it is worth mentioning that the Swiss Federal Council considers that there is already a need to adapt the newly introduced Swiss regulation. A consultation draft also examining the consequences for the Swiss economy is supposed to be prepared by July 2024 at the latest.

In order to further specify the environmental aspects of the reporting obligations on non-financial matters, on 23 November 2023 the Swiss Federal Council adopted the Implementing Ordinance on Climate Disclosures, which will enter into force as of 1 January 2024. The Ordinance provides for the mandatory implementation of the internationally recognised recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Qualifying Swiss companies must report on:

- the financial risk that a company incurs through climate-related activities; and
- the impact of the company's business activities on the climate and the environment.

This so-called double materiality perspective also corresponds to the approach of the EU.

Due Diligence and Disclosure Obligations Regarding Minerals and Metals From Conflict-Affected Areas and Child Labour Companies whose registered office, head office or principal place of business is in Switzerland and whose business involves so-called conflict minerals or that offer products/services that are prone to child labour must further comply with special and far-reaching due diligence and reporting obligations (Articles 964j–964l CO). In particular, the due diligence and reporting obligations in the supply chain arise if a company:

- imports minerals or specific metals containing tin, tantalum, tungsten or gold from conflict-affected and high-risk areas into or processes them in Switzerland; or
- offers products and services in relation to which there is a reasonable suspicion that they have been manufactured or provided using child labour.

In these cases, companies are obliged to set up an adequate management system and stipulate their supply chain policy and a system by which the supply chain can be traced, in order to identify and assess the risks of harmful impacts in their supply chain. In addition, these companies must draw up a risk management plan and take measures to minimise the risks identified. The report on the company's compliance with the due diligence obligations must be approved and signed by the board of directors. The board of directors must ensure that the report is published electronically immediately after approval

and remains publicly available for at least ten years.

The Federal Council has additionally issued an Implementing Ordinance on Due Diligence and Transparency for Minerals and Metals from Conflict-affected Areas and Child Labour (DDTrO), which also entered into force on 1 January 2022.

Reporting Obligations on Wage Inequality
In July 2020, the Federal Act on Gender Equality was modified to include reporting obligations on wage inequality. In broad terms, companies with 100 or more employees will be required to complete an equal-pay analysis every four years. The analysis must be audited by an independent, approved third party. The results of the analysis must be shared with the workforce and, if the company is listed, with its shareholders (in the appendix to the annual report).

Private Sector ESG Disclosure Directives and Initiatives
Since 2017, SIX Swiss Exchange offers listed issuers the opportunity, by means of opting in, to publish an issuer's commitment ESG principles by way of an annual sustainability report in accordance with an internationally recognised standard either in their annual report or a separately published report. Currently, issuers may use as a reporting standard the Global Reporting Initiative, the Sustainability Accounting Standards Board, the UN Global Compact and the EPRA (European Public Real Estate Association) Sustainability Best Practices Recommendations.

In practice, the number of companies listed on the SIX which do not report on responsibility or sustainability in their annual report is decreasing. In addition, there are several initiatives from the private sector, such as from the Swiss Bankers Association, which has declared sustainable finance as one of its strategic priorities. Among other things, this led to the development of guidelines for the advisory process for private clients. In addition, certain Swiss proxy advisors have developed corporate governance and responsibility guidelines in connection with their voting guidelines.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management
In a Swiss stock corporation, three bodies are involved in the governance and management:

- the shareholders' meeting;
- the board of directors; and
- the statutory auditors.

Shareholders' Meeting
The shareholders' meeting is the supreme body. It decides the fundamental organisation of the company, elects the board of directors and takes the fundamental decisions.

Board of Directors
The board of directors is the executive body. Swiss company law provides that the board may pass resolutions on all matters not reserved by law or the articles of association to the shareholders' meeting and shall manage the business of the company to the extent it has not delegated such management to individual members or to an executive management in accordance with organisational regulations.

Statutory Auditors
The statutory auditor is a controlling body, elected by the shareholders' meeting. However, in small companies with less than ten full-time employees, shareholders may unanimously

decide not to appoint an auditor. The scope of an auditor's duties depends on the nature and size of the enterprise; listed, large and mid-sized corporations are subject to an ordinary audit, while smaller corporations may be subject to a more limited financial audit only.

3.2 Decisions Made by Particular Bodies

Shareholders' Meeting

The shareholders' meeting defines the framework of the company's business activities. In doing so, the shareholders' meeting has to decide upon the following matters, as they are fundamental, non-transferable competences conveyed to the shareholders' meeting by law:

- adoption and amendment of the articles of association, including changes in the share capital, issuance of preferred shares, approval of mergers and changes in the company's corporate structure;
- approval or rejection of the annual business report, including the consolidated financial statements;
- approval or rejection of the use of the balance sheet profit and, in particular, the declaration of dividends;
- election of the members of the board of directors;
- removal of the members of the board;
- election of the external auditors;
- release of the members of the board of directors from liability (discharge);
- passing of the resolution on repaying the statutory capital reserve; and
- all other matters that are by law or by articles of association reserved to the shareholders' meeting (special audit pursuant to shareholders' information rights, liquidation of the company, etc).

For listed companies, the following additional non-transferable competences are conveyed to the shareholders' meeting:

- direct election of the chairperson or the board of directors;
- election and removal of the members of the compensation committee and of the independent proxy;
- delisting of the company's equity securities; and
- approval or rejection of the compensation of the board, the executive management and, if any, the advisory board.

The Board of Directors

The board of directors is responsible for the ultimate management and representation of the company. Its main duty is to determine the corporate strategy and allocate corporate resources (strategic governance). In general, the board is authorised to decide all matters that are not reserved to the shareholders' meeting or to the auditors by law or by the articles of association, or that are delegated to the executive management based on organisational regulations.

Statutory law enumerates certain fundamental matters specifically reserved to the board. The following board responsibilities are non-delegable and inalienable:

- the ultimate management of the company – in particular, the duty to determine the corporate strategy and allocate the corporate resources (strategic governance);
- defining the fundamental organisational structure;
- setting up an accounting and financial control system (including an internal control system for medium-sized and larger businesses) as

well as financial planning as far as necessary to manage the company;
- appointing and removing the management as well as granting of signing authority to the individuals authorised to act on behalf of the company;
- ultimately monitoring the individuals entrusted with management responsibilities, in view of compliance with the applicable law, the articles of association, regulations and directives;
- preparing annual business reports and shareholders' meetings as well as implementing their resolutions;
- issuing the annual compensation report on the board's and executive management's compensation (only for listed companies); and
- filing an application for a debt restructuring moratorium and notifying the bankruptcy court if the company's liabilities are no longer covered by its assets (over-indebtedness).

Notwithstanding the non-delegable and inalienable nature of these responsibilities, the board of directors may delegate the preparation and execution of its resolutions to committees, but not the decision-making itself ("delegation of decision-shaping but not decision-making"). Listed companies often establish an audit committee, a compensation committee and/or a nomination committee.

Statutory Auditors

The statutory auditors serve as a controlling body by reviewing the annual accounts and the motions made by the board to the shareholders' meeting on the allocation of the balance sheet profit and by reporting to the shareholders' meeting whether the annual accounts comply with the statutory provisions, the articles of association and the applicable financial reporting standards.

3.3 Decision-Making Processes

The shareholders' meeting is convened by the board of directors. The notice must include the agenda items and the boards' motions (and shareholders' motions, if any). The board of directors is required to briefly explain its proposals. In the case of shareholders' motions, there is an option, but not an obligation, to provide a brief explanatory statement. Resolutions can only be made on motions relating to agenda items that were duly notified (see **5.3 Shareholder Meetings**). In general, the absolute majority of the votes represented is necessary to pass a resolution and conduct elections.

Resolutions

For certain important resolutions (such as the amendment of the company's purpose, the introduction of conditional capital or of a capital band, and of transfer restricted shares, etc) the law requires a qualified majority – ie, two thirds of the voting rights represented and the absolute majority of the nominal value of shares represented. A requirement for a qualified majority may also be increased for other matters by a resolution of the shareholders' meeting which satisfies the proposed majority requirement.

With the entry into force of the company law revision, resolutions of the shareholders' meeting may also be passed in writing or by electronic means, unless a shareholder or its representative requests oral deliberation. In addition, the owners or representatives of all the company's shares may, if no objection is raised and provided that the owners or representatives of all the shares participate, hold a plenary meeting – ie, a shareholders' meeting without complying with the applicable regulations on convening meetings.

In most companies, the principle of "one share, one vote" applies. The articles of association may, however, also provide for voting shares. These can often be found in family-controlled companies, both private and listed.

According to Swiss company law, the board of directors' resolutions may be made by a (relative) majority of the votes cast at the meeting. However, the articles of association and the organisational regulations may also require a quorum regarding the presence of a minimum of board members as well as a specific vote of the board. It is important to note that in the case of a tie, the chairperson has a casting vote, unless the articles of association provide otherwise.

Resolutions of the board of directors may be passed in writing by way of circular resolution or electronically (without signatures), provided that no member of the board requests oral deliberation.

4. Directors and Officers

4.1 Board Structure

Swiss company law generally provides for a one-tier board model. In practice, however, day-to-day management (except for the non-delegable and inalienable competencies of the board, see **3.2 Decisions Made by Particular Bodies**) is common, and typically in listed companies, delegated from the board to an executive management, thus leading to a two-tier board structure. Such rightful delegation excludes the directors' liability for damages relating to the delegated day-to-day management (but not the core duties) provided that the board applied the necessary care in selecting, instructing and supervising the management.

As a particularity and exception, banks and private insurance companies are required by law to establish a two-tier structure with a functional and personal separation of operative management and supervision.

4.2 Roles of Board Members

Swiss company law generally does not specify the roles of the members of the board of directors in much detail. These roles have to be specified in the organisation regulations.

Chairperson

The chairperson of the board should ensure the timely and appropriate information of the board members and the preparation of its meetings. The chairperson also:

- acts as a primary contact person to the executive management;
- chairs the shareholders' meeting;
- represents the company internally and externally; and
- generally ensures the proper functioning of the board.

As previously stated, the duties of the chairperson are usually further specified in the organisational regulations.

Even though the law does not mention the position of the vice-chairperson, it is advisable to appoint one in case the chairperson is prevented from performing their duties. Again, the scope of the vice-chairperson's duties are to be defined in the organisational regulations.

Other Appointments

In addition, the board of directors may appoint a secretary, who does not need to be a member of the board. The secretary's duties are of a mere

administrative nature relating to the board's tasks, such as taking the minutes.

The SCBP also recommends the role of a lead independent director, in particular to prevent or address any potential conflict of interest situations. The lead independent director, an experienced non-executive member of the board, may be appointed in the event that a single individual assumes the functions of chairperson and CEO. The appointment of lead directors is not uncommon for listed companies in Switzerland.

4.3 Board Composition Requirements/Recommendations

Regarding the composition of the board, current Swiss company law is flexible and the shareholders enjoy broad discretion. Swiss company law contains no rule on the maximum number of seats and no age restrictions on board members. However, listed Swiss companies must observe the newly implemented gender representation guidelines for the board of directors in listed companies (see **2.2 Environmental, Social and Governance (ESG) Considerations**).

Regulated Industries

In regulated industries – in particular, the financial industry – regulation strictly requires the members of the executive bodies of supervised institutions to grant assurance of proper business conduct and required knowledge and experience ("fit and proper"). According to FINMA, the main purpose of these requirements is to maintain public confidence in those institutions and to safeguard the reputation of the Swiss financial centre.

Assurance of proper business conduct covers matters of personal character (including criminal records) and professional qualifications required for the proper management of a supervised entity. The principal criterion used in assessing a person's suitability is their past and present business activity. As to the requirements regarding the composition of the board relating to independent directors, see **4.5 Rules/Requirements Concerning Independence of Directors**.

4.4 Appointment and Removal of Directors/Officers

Only the shareholders may vote on the appointment or the removal of any of the directors. This is permissible whenever a shareholders' meeting is held and its agenda provides for the respective election or removal. Significant shareholders (see **5.3 Shareholder Meetings**) are entitled to request the board to convene an extraordinary shareholders' meeting and put the requested items on the agenda.

For listed companies, the chairperson of the board of directors, each member of the board of directors and the members of the compensation committee must be appointed and (re-)elected individually and annually by the shareholders' meeting. In non-listed companies, the elected board members may resolve on the board's organisation, constitution and its members' functions, and notably may appoint the chairperson among its elected members without a shareholders' vote.

Unless otherwise provided by the articles of association, the shareholders' meeting passes resolutions on the election and removal of any director by an absolute majority of the votes represented at the respective meeting.

4.5 Rules/Requirements Concerning Independence of Directors

Swiss company law does not require business corporations to have independent directors.

The SCBP, however, emphasises that well-founded decisions can emerge only by exchanging ideas and critical views between the board of directors and the executive management. It recommends that the majority of the board should consist of independent members. The independent members are deemed to be the non-executive members of the board who:

- have never been a member of the executive management or were a member more than three years ago;
- have never served as lead auditor or who served as lead auditor more than two years ago; and
- have no or only minor business relations with the company.

According to the SCBP, the board of directors may define further criteria of independence. Where there is cross-involvement with other boards of directors, the independence of the member in question should be carefully examined on a case-by-case basis.

According to the SCBP, the nomination committee should be predominantly composed of independent directors. For the compensation committee, only independent members of the board of directors should be proposed for election to the shareholders. Members who have reciprocal board memberships should not be proposed – ie, in the case of a committee member responsible for co-determining the compensation of a member of the board of directors or the executive management under whose supervisory or directive authority the committee member serves in another company.

Banking and Insurance

For banking and insurance entities, FINMA has issued rules in its circulars “Corporate Governance – banks” (2017/01) and “Corporate Governance – insurers” (2017/02). Pursuant to these rules, at least one third of the board of a banking entity must consist of non-executive and independent directors. Board members are generally considered to be independent if they are not (and have not been during the past two years) engaged in any other function for the respective entity (including as auditor). Independent directors should not maintain significant business relations with the entity that could lead to conflicts of interest and/or should not act on behalf of significant shareholders.

Conflicts of Interest

The statutory duty of care and loyalty requires that directors perform their duties with due care and safeguard the interests of the company in good faith, including avoiding and properly addressing conflicts of interest. If a director fails to comply with its duty and favours its own interests over those of the company, any shareholder may hold such a director, and potentially the board, liable for any damage caused by such a breach of the duty of loyalty, and seek indemnification (for D&O liability claims, see **4.8 Consequences and Enforcement of Breach of Directors’ Duties**).

The members of the board of directors and the executive management should undertake to inform the board of directors immediately of any conflicts of interest affecting them. However, the members of the board are not required to be completely “disinterested”; for the conflict to be relevant, it needs to be of a certain intensity. The board of directors must then take the measures required to safeguard the company’s interests. The SCBP, in particular, can be consulted for an overview of such measures and further guidance.

In practice, companies' organisational regulations often provide for appropriate rules and measures in the case of a director's conflict of interest (such as disclosure of conflict, and possible abstention from voting and/or meetings).

4.6 Legal Duties of Directors/Officers

The board of directors is responsible for the ultimate management and representation of the company. Its main duty is to determine the corporate strategy and allocate corporate resources (strategic governance). In general, the board is authorised to decide on all matters that are not reserved to the shareholders' meeting or the auditors (by law or by the articles of association), or that are delegated to the executive management based on organisational regulations.

Statutory law enumerates certain fundamental matters specifically reserved for the board for decision-making (see **3.2 Decisions Made by Particular Bodies** for more details).

4.7 Responsibility/Accountability of Directors

The board owes its fiduciary duties primarily to the company, and must represent it and act in its best interests. When determining the best interests of the company, the board, according to the prevailing legal opinion in Switzerland, should consider the long-term interests of the shareholders as well as those of other stakeholders, such as the company's employees or creditors.

4.8 Consequences and Enforcement of Breach of Directors' Duties

The board members and the "de facto directors" (ie, persons not formally appointed as directors but who factually act as directors and significantly influence the company's decision-making process), as well as the members of executive management, are liable for damages caused by intentional or negligent breach of their duties. As a rule, directors' and officers' (D&O) liability is joint and several, and each director may be held personally liable. Under the business judgement rule as developed by Swiss case law, it is generally accepted that any business decision taken in a proper, unbiased and reasonably informed manner does not constitute a breach of obligations, even if it turns out to have been materially wrong in retrospect.

The expected level of care is generally assessed under an objective standard. Specialist knowledge may however lead to a raised standard when assessing the actions of an individual board member.

Liability Actions

D&O liability actions may be brought by the company, the shareholders, and, in the event of its bankruptcy only, the company's creditors. Shareholders' actions can be either direct if they suffered direct damage or as a derivative suit on behalf of the company if a shareholder has suffered indirect damage (ie, damage to the value of their shares resulting from damage suffered by the company). However, formal actions against board members are rather rare in practice. Many conflicts end with out-of-court settlements, frequently facilitated (and financed) by D&O insurers.

In addition, while Swiss company law contains some rules to address and ease the cost concerns that typically arise in the event of shareholder lawsuits, these rules do not effectively foster shareholders' actions, mainly because they are inapplicable to payments of advances to the courts. Finally, plaintiffs may also prefer actions against auditors, where deemed possible, in search of "deep pockets".

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

In addition to the potential claims mentioned under **4.8 Consequences and Enforcement of Breach of Directors' Duties**, the board of directors or the executive management of listed companies may be subject to criminal sanctions pursuant to the Swiss Criminal Code, if they pay or accept prohibited remuneration (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**). It follows that decisions on remuneration for the board and executive management and their subsequent payment or receipt, respectively, have to be carefully prepared in compliance with Swiss company law and related criminal law.

As a principle, companies cannot validly preclude the liability of directors and executive management in advance. The annual shareholders' meeting may, however, grant discharge to the directors and executive management, for the preceding business year. As a consequence, the company itself and all shareholders voting in favour of the resolution are precluded from bringing an action against the directors and executive management with regard to facts known to the shareholders' meeting at that time.

Often, companies seek D&O insurance coverage for their members of the board of directors and executive management.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

For private companies, it is generally the exclusive competence of the board to determine the remuneration of its members and of the executive management.

The Swiss Federal Supreme Court has persistently stated that the remuneration must be justifiable with a view to the general financial situation of the company as well as to the relative contributions of the individual board members to the company. This principle also follows from the duty of care and loyalty of board members, which only vaguely limits the board's discretion in determining the remuneration. The Swiss Federal Supreme Court exercises restraint in reviewing remuneration decisions as it considers the companies' governing bodies to be best suited to address such issues.

Say-on-Pay

Swiss companies with shares listed on a Swiss or foreign stock exchange, however, are obliged to annually submit the board's proposal on executive compensation to the shareholders for a binding vote (binding say-on-pay). The shareholders' meeting has to vote separately on the proposed aggregate amount of compensation for each member of the board of directors, the executive management and, if any, the advisory board. However, in contrast to certain foreign legislations on executive pay, the CO does not impose a limit or maximum amount (cap) on remuneration.

Companies are required to set out the details of the vote on compensation in their articles of association. Various models are possible. It is, for example, possible to vote on fixed compensation for the term until the next ordinary shareholders' meeting (prospective vote) or on a performance-based compensation for the closed financial year (retrospective vote). Often, major Swiss-listed companies provide in their articles of association for a vote on a compensation cap, whereby the shareholders shall in advance vote on the maximum amounts of compensation for the respective governing bodies for the

coming business year (prospective vote). If variable remuneration is voted on prospectively, the remuneration report must be submitted to the shareholders' meeting for a consultative vote.

According to the revised SCBP, the board of directors may link variable remuneration to specific compliance and other sustainability objectives. Furthermore, the remuneration system should be designed in such a way that total compensation is reduced if certain objectives are not achieved ("malus"). The remuneration system may additionally provide that in the contracts with top executives, beyond the requirements of the law, the right is reserved to claw back compensation that has already been paid under certain conditions ("claw-back").

Specific types of executive benefits and compensations – such as loans, credits and pension benefits outside the occupational pension – require an explicit basis in the company's articles of association. This also applies to the maximum terms and the maximum notice periods for service or employment agreements with members of the board of directors and of the executive management. In any event, notice periods or fixed contract terms exceeding one year are impermissible.

Certain types of compensation to members of the board and executive management – eg, sign-on bonuses that do not compensate for an actual financial disadvantage, non-statutory severance payments ("golden parachutes"), undue advanced compensation ("golden hello") or certain types of transaction bonuses – are not allowed. The payment or receipt of such impermissible compensation by members of the board of directors, the executive management or the advisory board (if any) are punishable by imprisonment and fines.

Special Requirements During Public Bids

Following the launch of a public takeover offer, any amendments to executive agreements with executive management members may qualify as defensive measures and as such may not be altered subject to the approval by the shareholders' meeting and a review and approval by the TOB. Even in a pre-bid phase, the TOB may, as case law demonstrates, declare changes to agreements of executive management null and void if fundamental principles of company law – in particular, the duty to act in the company's best interests – are disregarded.

4.11 Disclosure of Payments to Directors/Officers

Privately held companies are not required by law to specifically disclose the remuneration, fees or benefits payable to their directors and executive management. For publicly held companies, however, Swiss company law requires the disclosure of the respective aggregate remuneration amounts for both the board and the executive management, and in addition the total compensation of each of the board members as well as the highest total compensation among the members of executive management (but not the specific compensation of the other members of executive management). Further specific disclosure requirements apply. That information is to be disclosed in a separate audited compensation report to the shareholders.

The SIX Directive Corporate Governance extends the above-mentioned requirement to all issuers with a primary listing at the SIX Swiss Exchange (ie, with no other main listing) whether incorporated in Switzerland or not. In addition, it requires disclosure of information on the basic principles and elements of compensation and share-ownership programmes as well as of the method of its determination.

For banking entities, insurances, funds and branches thereof, FINMA has issued rules in its circular "Remuneration Schedules". These rules contain the basic principles and general elements of compensation with regard to all employees, directors and officers of the company. However, implementation of these rules is only compulsory for larger banks and insurance companies.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The shareholders' meeting is the paramount body of a company. The shareholders are entitled to elect and remove the board of directors and the statutory auditors.

Swiss company law provides for a variety of rights of shareholders that may be categorised in participation and property rights, including the right to information and inspection, and the right to set the dividends. The SCBP emphasises the importance of comprehensive information of shareholders to enable them to exercise their rights on a fully informed basis.

5.2 Role of Shareholders in Company Management

The management of a company is by statutory law conveyed to the managing body (board of directors and executive management). Consequently, shareholders are not supposed to be involved in the management of the company (for their competences, see **3.2 Decisions Made by Particular Bodies**). Shareholders may, however, try to exert pressure and thus indirectly influence the decision-making process and actions of the board – for example:

- by formally requesting additional information or a non-binding vote in a shareholders' meeting on a specific issue that falls within the competence of the board; or
- by threatening or bringing removal motions relating to certain board members, or through shareholders' claims against the company to protect their rights, or against liable directors or officers to penalise non-compliance with statutory duties and to recover damages.

Some shareholder activists also use the media to make the relevant position of the (dissident) shareholder known to the public.

5.3 Shareholder Meetings

Ordinary and extraordinary shareholders' meetings are a core element of corporate governance in Switzerland. The ordinary shareholders' meeting takes place either physically, virtually or in a hybrid form once a year within six months of the end of the financial year. The in-person meeting may also be held abroad if explicitly provided for in the articles of association and if the chosen venue does not make it unreasonably difficult for shareholders to exercise their rights. Provided that the interventions of the participants are broadcasted to all venues, it will also be feasible to hold a shareholders' meeting simultaneously at several venues in Switzerland and/or abroad.

At a hybrid shareholders' meeting, shareholders who are unable to attend the meeting in person may exercise their rights electronically. It is further feasible to hold shareholders' meetings entirely virtually without an in-person meeting, provided that the articles of association contemplate this format.

Further, extraordinary shareholders' meetings may be convened as and when required.

Convening a Meeting

In general, the board of directors convenes the shareholders' meeting. In order to validly hold a shareholders' meeting, the notice convening the meeting must be given at least 20 days before such meeting date. Further, shareholder(s) of a listed company may request the convening of a shareholders' meeting, provided they hold at least 5% of the share capital or the voting power in the company. If the board of directors receives a request to convene a shareholders' meeting, the board must act within an appropriate timeframe. In privately held companies, the convocation of a shareholders' meeting may be requested by shareholder(s) holding at least 10% of the share capital or the voting power in the company.

The notice must include the agenda items and the motions of the board of directors, and, if any, of the shareholders who have requested an extraordinary meeting to take place or solely requested an item to be placed on the agenda. These formal invitation rules may be disregarded in the case of a universal meeting where all shareholders or representatives of all the company's shares are present.

Shareholder Participation

When conducting the meeting, shareholders are entitled to participate and exercise their rights personally (see **5.3 Shareholder Meetings**) or by a proxy. Shareholders of listed companies may also authorise an institutional proxy, the so-called independent proxy. Such an independent proxy needs to be elected by the shareholders' meeting and is obliged to exercise the voting rights granted by the shareholders in accordance with their respective instructions. The independent proxy must keep the voting instructions of shareholders confidential. Where the shareholders' meeting has not appointed an independent proxy and there are no specific rules in the articles of association, the board should appoint one ahead of a next shareholders' meeting.

5.4 Shareholder Claims

Under Swiss company law, D&O liability actions may be brought against the members of the board and executive management by:

- the company;
- the shareholders (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**); and
- in the event of the company's bankruptcy, the company's creditors (see **4.8 Consequences and Enforcement of Breach of Directors' Duties**).

5.5 Disclosure by Shareholders in Publicly Traded Companies

FinMIA requires that significant shareholders who acquire or sell equity securities (shares, any kind of rights to buy or sell including options or other financial instruments) of a Swiss-listed company (or foreign company primarily listed on a Swiss stock exchange), thereby reaching or crossing the thresholds of 3%, 5%, 10%, 15%, 20%, 25%, 33.33%, 50% or 66.66% of the voting rights of the company, must notify the company and the stock exchange within four trading days. Within two additional trading days, the company should publicly disclose to the market any reports it has received concerning such changes in the ownership of its shares.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

All Swiss companies are obliged to prepare an annual report with the annual accounts, com-

posed of the balance sheet, the profit and loss statement, and the notes to the accounts. Larger companies must additionally draw up a cash flow statement and a management report. In general, the annual report must be made available to the company's shareholders. In private companies, however, it does not have to be disclosed to the public.

SIX-listed companies must publish (by ad hoc announcement) audited annual reports and unaudited half-yearly interim financial reports in accordance with International Financial Reporting Standards or, where permitted in the respective trading segment, with alternative recognised accounting standards (such as US GAAP or Swiss GAAP-FER).

6.2 Disclosure of Corporate Governance Arrangements

Contrary to privately held companies, listed companies and their shareholders have to fulfil certain reporting and disclosure requirements provided for by the SIX Listing Rules, starting with a duty to disclose significant shareholdings (see **5.5 Disclosure by Shareholders in Publicly Traded Companies**). Further requirements include the following.

Ad Hoc Publicity

As a rule, the company must immediately disclose to the market not-publicly-known, price-sensitive facts that occur in connection with the business activities of a listed company. A fact is considered price-sensitive if its disclosure is capable of triggering a significant change in market prices and of affecting a reasonable market participant in its investment decision (ex ante determination). A price change is significant if it is considerably greater than the usual price fluctuations.

The SIX Listing Rules and the SIX Directive on Ad Hoc Publicity were partially revised in 2021, with the following main changes:

- the new regulations repeal the practice of per se price-sensitive information and leave the determination of whether information is price-sensitive to the issuer (other than for the annual and interim reports);
- ad hoc announcements containing price-sensitive information must now be flagged as such ("Ad hoc announcement pursuant to Article 53 SIX Listing Rules") and be made separately available and easily identifiable on the issuer's website; and
- additionally, issuers are required to implement adequate and transparent internal rules or processes to ensure the confidentiality of price-sensitive facts whose disclosure has been postponed.

Information on Management and Control Mechanisms

The SIX Directive Corporate Governance requires SIX-listed issuers to include in their annual report a separate corporate governance section concerning important information on the management and control mechanisms at the highest corporate level. Although information on remuneration is compulsory (see **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**), other broad categories of information – such as group and capital structure, board of directors, auditors, shareholder participation rights, change of control or defence measures, and information policy – may be dealt with in accordance with the principle of "comply or explain".

Management Transactions

The SIX Directive on the Disclosure of Management Transactions imposes obligations on listed

issuers to disclose any buy-or-sell transactions concluded by their directors and members of the executive management (including related parties) in the respective issuer's equity securities or financial instruments. Each issuer has to ensure that its members of the board and executive management report each management transaction to the issuer within two trading days. The issuer has to publish the notified transaction via the SIX electronic reporting platform for the disclosure of management transactions within three trading days following such notification; the report will be shown without mentioning the individual's name.

6.3 Companies Registry Filings

Swiss companies must file relevant corporate information and changes thereof with the competent Cantonal commercial registry; in particular, changes to the articles of association, such as a change of the corporate purpose or the capital structure, any share transfer restriction and appointments to the board, as well as of other individuals authorised to sign on behalf of the company. This information is publicly available from the competent commercial registry. Filings must be made upon occurrence and are also published electronically in the Swiss Official Gazette of Commerce.

Anyone who is obliged to register a fact in the commercial register and fails to do so intentionally or negligently shall be liable to anyone for damage caused thereby. The same applies to failure to register any changes to such fact. Furthermore, anyone who causes a commercial registry to make a false entry or withholds information, may be liable to a custodial sentence of up to three years or to a monetary penalty.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

Depending on the size of the entity, a company has to submit its accounts and financial statements to an ordinary (ie, full) audit or a limited audit. No audit requirement exists for smaller companies with less than ten full-time employees, if their shareholders unanimously resolve to opt out of the audit requirement. If there is an audit requirement, the company has to elect an appropriate qualified independent auditor. An ordinary audit of the annual accounts, and, if applicable, the consolidated accounts, is required for the following companies:

- public companies that trade their shares at a stock exchange, have bonds outstanding, or contribute at least 20% of the assets or of the turnover to the consolidated accounts of a listed company;
- companies that exceed two of the following thresholds in two consecutive financial years – a balance sheet total of CHF20 million, sales revenue of CHF40 million, and/or 250 full-time positions on annual average;
- companies that are required to prepare consolidated accounts;
- where the company's shareholders who represent at least 10% of the share capital so request; or
- where the articles of association provide for it or the shareholders' meeting decides that the annual accounts are subject to an ordinary audit, even if the law does not require so.

An ordinary audit must be carried out by the elected external auditor. If the company is not subject to an ordinary audit, it has to submit its annual accounts for a limited audit by a licensed independent auditor. With consent of all shareholders, a limited audit may be waived if the

company does not have more than ten full-time employees.

Auditors are accountable and may be liable to the company and to the shareholders and creditors for losses arising from any intentional or negligent breach of their duties.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Swiss financial reporting rules require that companies or groups of companies that have to submit their annual accounts to an ordinary (full) audit (see **7.1 Appointment of External Auditors**) are subject to a review (to be confirmed by the auditors) as to the existence of an appropriate internal control system. There are, however, no statutory requirements for the specific establishment and effective organisation of the internal control system. This responsibility lies with the board of directors. An exception applies for banks and private insurance companies, for which FINMA has set forth specific requirements regarding risk management and internal controls in the relevant circulars ("Corporate Governance – banks" and "Corporate Governance – insurers", respectively).

Such companies additionally have to report on the company's risk assessment process and the identified material risks in the management report accompanying the annual financial statements. These provisions should ensure that the corporate risk of medium-sized and large enterprises is regularly monitored and analysed. The ultimate responsibility lies with the board of directors, which has to evaluate material business-related risks in a forward-looking and systematic manner.

In addition, the SCBP also recommends that the board of directors should provide internal control and risk management systems that are suitable for the company; it should encompass risk management, compliance and financial monitoring. In addition, the effectiveness of the internal control system should be assessed by an internal audit.

UAE

Law and Practice

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Contents

1. Introductory p.620
1.1 Forms of Corporate/Business Organisations p.620
1.2 Sources of Corporate Governance Requirements p.620
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.620

2. Corporate Governance Context p.621
2.1 Hot Topics in Corporate Governance p.621
2.2 Environmental, Social and Governance (ESG) Considerations p.621

3. Management of the Company p.621
3.1 Bodies or Functions Involved in Governance and Management p.621
3.2 Decisions Made by Particular Bodies p.622
3.3 Decision-Making Processes p.622

4. Directors and Officers p.622
4.1 Board Structure p.622
4.2 Roles of Board Members p.622
4.3 Board Composition Requirements/Recommendations p.625
4.4 Appointment and Removal of Directors/Officers p.625
4.5 Rules/Requirements Concerning Independence of Directors p.625
4.6 Legal Duties of Directors/Officers p.626
4.7 Responsibility/Accountability of Directors p.627
4.8 Consequences and Enforcement of Breach of Directors' Duties p.627
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.627
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.627
4.11 Disclosure of Payments to Directors/Officers p.628

5. Shareholders p.628
5.1 Relationship Between Companies and Shareholders p.628
5.2 Role of Shareholders in Company Management p.629
5.3 Shareholder Meetings p.629
5.4 Shareholder Claims p.629
5.5 Disclosure by Shareholders in Publicly Traded Companies p.629

6. Corporate Reporting and Other Disclosures p.630
6.1 Financial Reporting p.630
6.2 Disclosure of Corporate Governance Arrangements p.630
6.3 Companies Registry Filings p.630

7. Audit, Risk and Internal Controls p.630
7.1 Appointment of External Auditors p.630
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.630

Matouk Bassiouny is a leading, full-service MENA region law firm with offices in Egypt (Matouk Bassiouny & Hennawy), the United Arab Emirates (Matouk Bassiouny), Sudan (Matouk Bassiouny in association with AIH Law Firm) and Algeria (Matouk Bassiouny in association with SH-Avocats), as well as a country desk covering its Libya practice. The firm consists of 28 partners and over 200 fee earners. The firm's attorneys specialise in advising multinationals, corporations, financial institutions and governmental entities on all legal aspects of investing and doing business in the MENA region. The firm's UAE team is fully committed to understanding its clients' businesses and needs. It is organised within four main practice groups and has developed core sector focus capabilities organised into 17 specialised sector groups.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

In the UAE, the principal forms are: public joint stock companies, joint stock companies, limited liability companies, professional licences and free zone entities.

1.2 Sources of Corporate Governance Requirements

Corporate governance requirements in the UAE primarily emanate from the following regulations:

- the Central Bank of UAE's Corporate Governance Regulations and Standards, issued on 18 July 2019, which aimed to standardise corporate governance practices for banks in the UAE;
- the Securities & Commodities Authority's Decision No 3 (Chairman) of 2020 concerning the Joint Stock Companies Governance Guide;
- the UAE Cabinet's Decision No 2 (9w) of 2020 on the Governance System for Federal Government Boards;
- the Dubai International Financial Centre's Rulebook (Chapter 2); and
- Abu Dhabi Global Market's Rule Book (Chapter 2).

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Listed companies that are not regulated by specific financial regulators and or other regulators (such as the Central Bank, DIFC and ADGM) are governed by the Securities & Commodities Authority's Decision No 3 (Chairman) of 2020 concerning the Joint Stock Companies Governance Guide. These regulations are mandatory to listed companies in the UAE.

Said regulations are mandatory in nature to listed companies as they preview certain sanctions for breaches to the regulations that can also have a criminal aspect, since the SCA (Securities and Commodities Authority), the regulator, has the authority to refer breaches to the public prosecutor. Applicable sanctions are as per the following:

- addressing a warning to the company, board member, managers and/or accounting auditors;

- imposing a financial fine that does not exceed the maximum mentioned in the Companies Law; and
- referring the breach to the public prosecution.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

There has been an increase in focus by regulators on Sanctions, Anti Money Laundering and Terrorist Financing. More and more attention is drawn on these topics, namely by the ministry of justice, the ministry of economy, the Central Bank, ADGM and DIFC regulators ensuring that not only financial institutions are in compliance but also non-financial institutions such as law firms, auditing firms, insurance companies, etc. As a matter of fact, several licences were withdrawn from licensed Exchange Houses for non-compliance reasons.

The Russo-Ukrainian war had its impact as well on the way business is conducted in the UAE, namely where a Russian component to the transaction is added where there has been an increased scrutiny on the counterparty to ensure that there are no sanctions implications, which has created an additional challenge to businesses in the UAE when onboarding new counterparties, namely that complex corporate structures may be involved, making it very challenging to identify clearly the UBO.

2.2 Environmental, Social and Governance (ESG) Considerations

Environmental and social corporate responsibility are governed by the SCA's Chairman Decision No 3 related to corporate governance, as well as the UAE Cabinet Resolution No 2/2018. The key issues and requirements for companies are as follows.

- The General Assembly of listed companies shall, in the light of a board recommendation, set a policy to ensure a balance between the objectives of the company and those of the community in order to promote the socioeconomic conditions of the community.
- The board shall develop the programmes and determine the means necessary for proposing socioeconomic initiatives by the company, including:
  - (a) developing indicators that link the company performance with its socioeconomic initiatives, and comparing them with other companies involved in similar activities;
  - (b) disclosing social responsibility objectives of the company to its employees and raising their awareness and knowledge of social responsibility;
  - (c) disclosing the plan of achieving social responsibility in periodic reports on the activities of the company; and
  - (d) developing awareness programmes for the community to introduce the company's social responsibility initiatives.

It is worth noting that the above is to be also included within the audit programmes of each listed company, and it is the internal audit's responsibility to ensure that these requirements are being adhered to.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The General Assembly, the board and its committees, the company secretary and the chairman of the board have ultimate responsibility for the governance and management of a company.

3.2 Decisions Made by Particular Bodies

The General Assembly is responsible for setting the corporate governance framework and electing the board.

The board is responsible for drafting and approving the corporate governance policies and for the formation of the board's sub-committees (ie, audit, nomination and remuneration, and risk).

The sub-committees are required to have their charters approved by the board and are required to act upon these charters.

3.3 Decision-Making Processes

The General Assembly should have on its agenda at the end of each term (or upon the constitution of the company) an item pertaining to the election of the board of directors, as per the articles of association of the company. Thereafter the General Assembly members (shareholders) will vote on the election of the board. The vote is secret and cumulative. If a government entity is a holder of 5% or more of the shares of a company, it may appoint its board representatives (pro rata).

The majority of the board members and the chairman must be UAE nationals.

The board, upon constitution/election, shall approve and adopt the corporate governance policies and appoint the sub-committees; such decisions are taken by a majority.

4. Directors and Officers

4.1 Board Structure

A board of directors shall be composed of a minimum of three members and a maximum of 11 members, provided the number of members is always an odd number.

The board may be composed of executive, non-executive, independent and non-independent members, provided that the majority of board members shall be non-executive independent board members. A recent amendment to the Corporate Governance Framework in the UAE made it mandatory by 2022 for all listed companies to have 20% female representation on the board.

4.2 Roles of Board Members

The roles of boards of directors are as follows.

- Taking the necessary procedures to ensure compliance with applicable laws, regulations and resolutions, as well as the requirements of the supervisory authorities.
- Adopting the strategic approaches and main objectives of the company, and supervising implementation thereof. This includes:
  - (a) setting the company's comprehensive strategy and main work plans and reviewing thereof constantly;
  - (b) setting risk management strategy and reviewing thereof constantly;
  - (c) specifying the best capital structure, strategies and financial objectives of the company, and approving the annual budgets;
  - (d) supervising the company's main capital expenses and ownership and disposal of assets;
  - (e) setting performance objectives and monitoring implementation and the overall performance of the company; and
  - (f) conducting periodic reviews of the company's organisational and occupational structures and adopting these structures.

- Taking the necessary procedures to ensure efficient internal auditing of the work flow in the company, including:
  - (a) setting a clear policy approved by the board to ensure efficient internal auditing of the work flow in the company; and
  - (b) setting written and detailed regulations and procedures for internal auditing, which determines the duties and responsibilities in compliance with the policy approved by the board and the general requirements and objectives stipulated in the applicable legislations.
- Establishing an internal auditing department to follow up compliance with the applicable laws, regulations, resolutions and requirements of the supervisory bodies, the internal policy, regulations and procedures set by the board.
- Setting written procedures to manage and address conflict of interests and dealing with potential cases of such conflict for board members, the senior executive management and shareholders, and setting the procedures to be taken in cases of misuse of the company assets and facilities or misconduct resulting from transactions with related parties.
- Ensuring the soundness of administrative, financial and accounting systems, including the systems related to preparation of financial reports.
- Ensuring the use of appropriate regulatory systems for risk management by outlining potential risk and discussing it with transparency.
- Setting clear and precise standards and procedures for board membership and putting them in force subsequent to approval by the general assembly.
- Setting a clear delegation policy in the company to determine delegated persons and the powers assigned thereto.
- Setting a policy regulating the relationship with stakeholders in a manner ensuring the company's fulfilment of its obligations towards them, preserving their rights, providing them with required information, and establishing sound relations with them. Such policy shall cover the following aspects:
  - (a) mechanisms for indemnifying stakeholders in the event of violation of their rights approved by laws and protected by contracts;
  - (b) mechanisms for settling complaints or disputes that may arise between the company and stakeholders;
  - (c) maintaining confidentiality of the information related to them; and
  - (d) the company policy towards the local community and environment.
- Setting a code of conduct for the board members, the staff, auditor and persons to whom some of the company works are assigned.
- Setting procedures to apply governance rules in the company, review of such procedures and assessment of compliance thereto on annual basis.
- Establishing appropriate development programmes for all board members to develop and update their knowledge and skills, ensure effective involvement in the board and ensure implementing any training or qualification programmes as determined by the Authority or the market.
- Familiarising a newly appointed board member with all the company departments and sections and providing them with all the information required to ensure correct understanding of the company activities and works and full realisation of their responsibilities, all that enables them to perform their duties duly in accordance with the applicable legislations, all other regulatory requirements and the company policies in its field of business.

- Setting procedures to prevent insiders in the company from using the confidential internal information to make tangible or intangible gains.
- Setting a mechanism for receiving shareholders' complaints and proposals, including their proposals to add particular issues in the general assembly agenda in a manner that ensures studying such proposals and making the right decisions about them.
- Adopting criteria for granting incentives, bonuses and privileges to board members and senior executive management in a manner that serves the company interest and realises its objectives.
- Setting the company disclosure and transparency policy and following up its implementation in accordance with the requirements of the supervisory authorities and applicable legislations. Such policy shall include the following:
  - (a) a commitment to disclose periodic reports, material information, insiders and their relatives' ownership of securities issued by the company, related parties transactions performed with the company, and the benefits of the board members and senior executive management;
  - (b) providing information to shareholders and investors precisely, clearly and punctually so as to enable them to make their decisions;
  - (c) using the company website to enhance disclosure and transparency; and
  - (d) setting a clear policy for distribution of the company profits in a manner that serves the interests of both the shareholders and the company; such policy shall be displayed to shareholders in the general assembly meeting and mentioned in the board report.
- Ensuring the availability of resources required to achieve the company's objectives.
- Ensuring the protection of shareholders' interests and the company's assets.
- Ensuring the establishment of a compliance function to follow the compliance with applicable laws, regulations and decisions, as well as regulatory requirements, internal policy, regulations and procedures established by the board.
- Determining the extent of the company-wide risk appetite, including specific targets, maximum limits or indicators of risk appetite.
- Supervising the company's human resources polices.
- Ensuring the accuracy and validity of the disclosed data, statements and information according to the applicable policies and regulations in relation to disclosure and transparency.
- Determining and recommending potential new board members for election by shareholders.
- Recommending the remuneration policy of the board for approval by shareholders.
- Evaluating the overall performance and effectiveness of the board, its committees and members and taking corrective actions as appropriate.
- Ensuring that the board communicates with stakeholders through the investor relations function.
- Forming specialised committees from the board according to the resolutions that determine the duration of these committees and their powers, functions and responsibilities, as well as the method used by the board for monitoring these committees. Such resolutions shall determine names, duties, rights and obligations of the members.
- Evaluating the performance and works of the board and its members.

4.3 Board Composition Requirements/ Recommendations

It is recommended that a board of directors, in addition to the above criteria, be composed of a homogenous member with enough experience (ie, subject matter experts with business acumen) to lead listed companies along a successful path.

4.4 Appointment and Removal of Directors/Officers

Appointment of directors is done via election by the General Assembly; the vote is secret and cumulative. If a government entity is a holder of 5% or more of the shares of a company, it may appoint its board representatives (pro rata).

The majority of the board members and the chairman must be UAE nationals.

The General Assembly may dismiss the board chairman or any board member or all the board members. In this case, the General Assembly shall authorise those it deems appropriate to chair the meeting of the General Assembly and take the procedures for opening the nomination and invite the General Assembly to elect new board members instead of those who have been dismissed.

It is not permissible to re-nominate those who have been dismissed for membership of the board before the lapse of three years from the date of issuance of the decision of dismissal.

In the event of a judicial judgment proving that the chairman or any of the board members or any of its executive management have concluded deals or transactions involving conflicts of interest, they shall be dismissed from their position and shall not be nominated for the chairmanship or membership of the board or to perform any duties in the executive management in any joint stock company until the lapse of three years at least after the date of his dismissal, and Article 145 of the Companies Law on occupying the new position on the board shall apply.

If all the board members are dismissed, SCA or its delegate shall conduct the management of the company until the first general assembly is held.

In the event of issuing a judgment of imprisonment and/or fine due to a complaint of a shareholder against the chairman or any member of the board or the executive committee, including dismissal or removal from office, the member shall not remain in office or run for board membership of this company or any other company until expiry of three years from the date of the judgment.

4.5 Rules/Requirements Concerning Independence of Directors

For a board member to be qualified as independent, the member should have no relationship with the company, any of its senior executive management persons or its auditor, parent company, subsidiaries, sister company, or affiliate company in a manner that may lead to financial or moral benefit that may affect its decisions.

Board members shall act at all times in the interest of the company, regardless of the interests of any other parties. Board members shall perform their duties and conduct the affairs of the company in a manner that supports the confidence of the general public in the company. They shall also refrain from actions that lead or may lead to a conflict of interest with the company. In the event of a conflict of interest, the board members shall disclose the same immediately to the chairman and remove themselves from any position

of decision-making authority in respect of any such conflict of interest involving the company.

A board member shall, upon assuming the office, disclose to the company all interests and relationships that may, or may be deemed to, affect their ability to perform their duties as a board member. Any such declared interests shall be recorded by the board secretary.

In particular, board members shall disclose partnerships, related employment or the main interests of relatives that may create a conflict or potential conflict in interests. Each board member shall notify the company of any changes in their interests and shall complete a form prepared by the company for this purpose on a quarterly basis and as may be necessary to determine specifically their interests.

The board secretary shall request the board members to review the form on a quarterly basis to verify its accuracy and completeness.

At the beginning of each board meeting, each board member shall declare their interests, if any, to avoid any possible conflict of interests.

If a board member or a person representing a body in the board has a joint interest or a conflict of interest with the company in a deal or transaction submitted to the board for a resolution, they must inform the board and record the same in the minutes. Furthermore, they shall not participate in the voting on the decision relating to the deal or transaction.

If a board member fails to inform the board, the company or any of its shareholders may resort to the competent court to invalidate the contract or order the member who acted in contravention of these provisions to return to the company any profit or benefit obtained as a result of entering into this contract.

If it is not entirely clear that there is a conflict of interest, the board member who is the subject of the potential conflict shall disclose these circumstances to the chairman or its designee, who decides whether or not there is a conflict of interest.

The company shall maintain a special register for conflicts of interests in which the cases are recorded in detail together with the measures taken in this regard.

A board secretary shall record the interest conflict in the related board minutes. In this case, the remaining board members presenting shall consider whether it is appropriate for the board member involving in the conflict issue to participate in discussing that agenda item or not before the board after reviewing whether the conflict may affect the objectivity of the member and/or their ability to properly perform their tasks/duties towards the company. If they decide that it is not appropriate for the member to participate, they may ask the board member to leave the meeting room during these discussions. The board member is not entitled to use their personal influence in issue, whether in or outside the meeting. The board member shall not vote on the decision.

4.6 Legal Duties of Directors/Officers

The legal duties of board members are to have a fiduciary responsibility towards the company and to act within the best interest of the company (for further details, please refer to **4.2 Roles of Board Members**).

4.7 Responsibility/Accountability of Directors

The directors owe their duties to the company, and its shareholders must take into account the interests of the company exclusively.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Shareholders can enforce any breaches of the directors' duties; internal audit can also investigate any breach by any board member and has the duty to report the same to the board and/or the chairman of the board.

The SCA has also the authority to investigate any breach of the corporate governance rules by any director and to impose adequate sanctions accordingly.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Members of the board of directors shall be liable towards the company, shareholders and third parties for fraudulent acts and misuse of power, as well as for any violation of the law or the company's articles of association, mismanagement, and any provision made to the contrary hereof shall be null and void.

Liability stated above shall apply to all board members, if such error arises from a decision taken by unanimous agreement.

However, if the decision in question was issued by majority vote, members who objected to the same shall not be held liable, so long that their objections have been established in minutes of the meeting. A member's absence from the session in which the decision in question was issued shall not relieve them from liability, unless proven unaware of such decision or unable to object to the same.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

The board can recommend a remuneration policy applicable for its members to be approved by the General Assembly.

In general, the remuneration of the board chairman and members shall consist of a percentage of the net profit, provided that it may not exceed 10% of the net profits for such fiscal year after deducting all consumption and reserves.

The company may also pay expenses, fees, additional bonus or a monthly salary to any board member, consistent with the polices suggested by the nomination and remuneration committee, reviewed by the board and approved by the general assembly.

If such member serves in any committee, makes special efforts or performs additional work to serve the company in excess of their regular duties as a member of the company board, attendance allowance may not be paid to the chairman or a board member for attending board meetings.

Fines that may have been imposed on the company by the Authority or the relevant competent authority due to violations by the board of the law or the articles of association during the previous fiscal year shall be deducted from the remuneration.

The General Assembly may decide not to deduct such fines, or some of them, if it deems that such fines were not the result of default or error of the board.

4.11 Disclosure of Payments to Directors/Officers

The company shall submit a governance report signed by the chairman in accordance with the form prepared by the Authority and available on the Authority's website.

The annual report shall include a corporate governance report which features the following, at least:

- the names of board members, chairman, vice-chairman and other persons occupying main jobs in the company, a brief biography of each member including their qualifications and experience, and the identification of the independent member(s) as well as other positions in the board or senior management they hold in other companies or institutions;
- committee and board members, the authorities and assignments entrusted thereto and activities carried out during the year;
- the number of meetings held by board and board committees as well as names of the attendees;
- the names of the major shareholders who directly or indirectly own more than 5% of the company shares, in addition to a brief summary of the changes in the company capital structure;
- a report on the risk management framework and internal controls, including the following:
  - (a) the applicable corporate governance rules; and
  - (b) the self-evaluation approach of the board performance;
- internal audit procedures and the scope of their full application by the board, and details and reasons for any compensation and allowances received by each board member and board committees for the financial year;
- a statement of the company directors and the first and second grades as stated in the organisational structure of the company and their functions, dates of appointment, details of salaries, bonuses received by each of them separately and any other compensation received from the company, clarifying the consideration for these compensations; and
- compensation of the board members and all members of the company administrative body, including remuneration and any incentive programmes related to securities issued or guaranteed by the company.

The board shall make this report available to all company shareholders before submitting an application to the Authority to approve holding of the Annual General Meeting.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

The Corporate Governance Framework in the UAE sets the rules for the company accountability towards all shareholders and stakeholders, and directs the board to develop strategy, perform supervision and guide and control the administration.

The company shall oblige itself to protect shareholders' rights, ensure fair treatment for all shareholders, including minority shareholders, and give all shareholders enough compensation for any damage caused by the board to shareholders' rights.

The company shall ensure that accurate and timely disclosures are made on all material matters related to the company, including its financial affairs, performance, ownership of its shares

and governance in an accessible manner by all concerned parties.

The company shall recognise the rights of other stakeholders in accordance with laws and regulations, and encourage co-operation between the company and stakeholders in establishing a sustainable and solvent company.

The company shall ensure it applies the investor relationships policy to support regular, effective and fair communication with shareholders.

5.2 Role of Shareholders in Company Management

In general the shareholders of a company have no control or interference in management of a company. The General Assembly of shareholders play the following part in annual meetings:

- receive and approve board of directors' report on company's activities and financial standing during the last fiscal year, auditor's report and report of internal sharia control board, if the company exercises any activity according to sharia;
- set and approve balance sheet and profit and loss account;
- elect board members whenever required;
- appoint members of sharia control board, if the company exercises any activity according to sharia provisions;
- appoint auditors and determine their remunerations; and
- consider proposals submitted by the board of directors in relation to distribution of profits, whether in cash or bonus shares.

5.3 Shareholder Meetings

Shareholder meetings are required at least once a year to conduct business as per **5.2 Role of Shareholders in Company Management**. However a general assembly may be called to conduct business that requires special resolutions, namely when it comes to a decision to merge, dissolute, increase or decrease the capital, amendment of the articles of association.

5.4 Shareholder Claims

A shareholder in the company may file a lawsuit against the company, its board chairman, any board member, or its executive management for breach of the company's bylaws and/or the Corporate Governance Rules, as well as for fraud or mismanagement. If a case is filed before a competent court, the shareholder shall have the right to obligate the defendant (s) to do the following:

- provide the information which the defendant has based their defence thereon before the court, the information that directly proves specific facts of the claim which the plaintiff shareholder has filed with the court, and any other information relevant to the claim subject;
- a shareholder who files a liability lawsuit against the board or any board member shall be entitled to question the defendant and/or defendants and their testimonies directly during the court sessions.

5.5 Disclosure by Shareholders in Publicly Traded Companies

The company has obligation to disclose withholding of 5% or more of shares by a given shareholder, in addition to disclosure related to the Ultimate Beneficial Ownership. UAE Cabinet Resolution No 58 of 2020 on the regulation of the Procedures of the Real Beneficiary (the UBO Resolution) was published on 24 August 2020. Companies licensed to operate in the UAE are required to create and maintain a Register of Real Beneficial Owners (UBOs). The UBO Resolution also requires that the company submits

the information from its Register of Shareholders and the Register of UBOs to its competent licensing authority. The competent licensing authorities are under an obligation to maintain the confidentiality of information submitted to them under the UBO Resolution.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Listed companies are under the obligation to announce their quarterly, semi-annual and annual financial performance, in addition to disclosing any information that is or might be price-sensitive information.

6.2 Disclosure of Corporate Governance Arrangements

Please refer to **4.11 Disclosure of Payments to Directors/Officers**.

6.3 Companies Registry Filings

Each emirate in the UAE has its own Department of Economy where companies incorporated on that respective Emirate have to file the incorporation. This information is available for the public. Further, each listed company is under the obligation to have its articles of association filed and registered with SCA.

The UAE has introduced a new Corporate Tax regime as of June 2023. Accordingly an obligation to submit Audited Financials to the Tax Authorities yearly will become mandatory for tax filings purposes. Therefore companies will add the filing for tax purposes to the list of its annual returns to the authorities; failing to do so will expose companies to different fines and/or administrative sanctions issued by the Federal Tax Authority.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The company shall assign the function of auditing its annual accounts to an independent external auditor having the necessary experience and qualifications to prepare an objective and independent report to the board and shareholders, indicating whether the financial statements of the company clearly and impartially reflect the financial position and performance of the company in key areas.

The board shall nominate one or more auditor(s) upon the recommendation of the audit committee. The auditor shall be appointed and their remuneration shall be fixed under a resolution of the general assembly of the company. Such auditor shall be recorded in the Authority's register of professional auditors. The auditor shall be selected based on criteria of efficiency, reputation and experience.

None of the employees of the auditing office may be appointed at the company senior executive management before the lapse of two years at least as of the date of such employee leaving the auditing of the company accounts.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Management of risk and internal control is normally within the scope of the audit and risk committee, that is either a combined committee or segregated committees. In any case, whether combined or segregated, the directors' audit and control management shall be performed via the committee and will be directed towards the following tasks and duties.

- To review the company's financial and accounting policies and procedures. To monitor and review the integrity of the company's financial statements and reports (annual, semi-annual and quarterly) and its control regulation as part of its normal operation during the year. It shall concentrate in particular on the following:
  (a) note any changes in accounting policies and practices;
  (b) ensure that the company annually updates its policies, procedures and control systems;
  (c) make substantive amendments resulting from the audit;
  (d) assumption of business continuity;
  (e) compliance with the accounting standards established by the Authority;
  (f) compliance with listing and disclosure rules and other legal requirements related to financial reporting.
- Co-ordinate with the company board, senior executive administration, the financial manager or the manager delegated with the same duties in the company, in order to perform its duties.
- Consider any significant and unusual terms contained or to be contained in such reports and accounts, and give due consideration to any matters raised by the company's chief financial officer, the manager delegated with the same duties, the compliance officer or the auditor.
- Raise recommendations to the board regarding the selection, resignation or dismissal of the auditor. In case the board does not approve the audit committee recommendations in this regard, the board shall attach to the governance report a statement explaining the audit committee recommendations and the reasons why the board has not followed them.
- Develop and implement the policy of contracting with the auditor, and submit a report to the board, outlining the issues that it deems necessary to be taken, along with providing recommendations for steps to be taken.
- Ensure that the auditor meets the conditions stated in the applicable laws, regulations and decisions and in the company articles of association, along with following up and monitoring its independence.
- Meet the auditor of the company, without the presence of any of the senior executive management personnel or its representatives, and discuss the same with regard to the nature and scope of the audit process and its effectiveness in accordance with the audited standards.
- Approve any additional works made by an external auditor for the company and the fees received in consideration for that work.
- Examine all matters related to the auditor's work, their work plan, correspondence with the company, observations, suggestions and reservations, and any substantial queries raised by the auditor to the senior executive management regarding the accounting records, financial accounts or control systems, in addition to following up the response of the company management and provision of the necessary facilities to do their work.
- Ensure that the board responds in a timely manner to the clarifications and substantive issues raised in the auditor letter.
- Review and evaluate the company's internal auditing and risk management systems.
- Discuss the internal auditing system with the board, and make sure it performs its duty with regard to establishing an effective internal control system.
- Consider the results of the main investigations regarding the internal auditing matters

assigned to it by the board or at the initiative of the committee and the approval of the board.
- Review the auditor evaluation of the internal control procedures and ensure that there is co-ordination between the internal and external auditors.
- Ensure of the availability of necessary resources for the internal auditing department, review and monitor the effectiveness of such department.
- Examine internal auditing reports and follow up implementation of corrective actions of the observations contained therein.
- Establish controls that enable the company's employees to report confidentially on any potential violations in the financial reports, internal auditing or other matters, and the steps to ensure making an independent and fair investigation of such violations.
- Monitor the company's compliance with the rules of professional conduct.
- Review related party transactions with the company, ensure that there are no conflicts of interest and raise recommendations about them to the board before concluding them.
- Ensure the application of the business rules of its functions and the powers entrusted to it by the board.
- Submit reports and recommendations to the board on the above matters.

As per risk management, the directors will undertake the following.

- Develop a comprehensive risk management strategy and policies that are consistent with the nature and volume of the company's activities, monitor its implementation, review and update it, based on the company's internal and external changing factors.
- Identify and maintain an acceptable level of risk that the company may face, and ensure that the company does not exceed such level.
- Supervise the risk management framework of the company and evaluate the effectiveness of the framework and mechanisms of identifying and monitoring the risks that threaten the company, in order to identify areas of inadequacy and adequacy.
- Provide guidance to management, as needed, to assist them in improving their risk management practices and/or mitigating certain risks, including the presence of qualified management personnel to carry out risk management activities effectively.
- Obtain assurance from the executive management and internal audit that the risk processes and systems operate effectively with appropriate controls, in addition to compliance with approved policies.
- Prepare detailed reports on the level of exposure to risks and recommend procedures for managing such risks, along with submitting them to the board.
- Make recommendations to the board on matters relating to risk management.
- Ensure the availability of adequate resources and systems for risk management.
- Report regularly to the board on the company's risk profile and promptly inform the board of any significant changes in the volume of the risk.
- Verify that the risk management personnel are apart from the activities that may expose the company to risks.
- Review any matters raised by the audit committee that may affect the company's risk management.
- Review appointment, performance and replacement of the chief risk officer and monitor the effectiveness of the risk management unit in general.

Trends and Developments

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Matouk Bassiouny is a leading, full-service MENA region law firm with offices in Egypt (Matouk Bassiouny & Hennawy), the United Arab Emirates (Matouk Bassiouny), Sudan (Matouk Bassiouny in association with AIH Law Firm) and Algeria (Matouk Bassiouny in association with SH-Avocats), as well as a country desk covering its Libya practice. The firm consists of 28 partners and over 200 fee earners. The firm's attorneys specialise in advising multinationals, corporations, financial institutions and governmental entities on all legal aspects of investing and doing business in the MENA region. The firm's UAE team is fully committed to understanding its clients' businesses and needs. It is organised within four main practice groups and has developed core sector focus capabilities organised into 17 specialised sector groups.

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In 2022 the Ukraine war impacted the world economy and contributed to the rise in inflation, energy price fluctuations, and an enhanced stress on supply chain that had been there since the pandemic started.

The Ukraine war was followed by a re-enforcement of alliances around the world: those who are supporting Ukraine and those who are against the war and still adopting a non-hostile approach towards Russia. Eventually the US and European Sanctions against Russians and Russian businesses led to an increase in the international business environment, namely within the gas and energy sector, where prices and availability of inventory became volatile. This volatility and uncertainty had its impact on the trends and developments in corporate governance.

Responding to Macroeconomic Uncertainty

We witness an unusual economic situation that is paving the way to a potential recession. It is obvious that inflation is on the rise, and interest rates also in an attempt to bring inflation down and create growth in consumer spending. This can only intensify the uncertainty and volatility in 2023.

We all remember the credit crunch and the recession we witnessed a decade ago, and the risks associated therewith pushed companies to leverage their longer tenured directors whilst maintaining their approach to mix board with fresh blood.

Last year, as the world was recovering from the pandemic, some companies began to implement a new process to tackle enterprise-related risk (ERM). However, in light of the current environment and uncertainty, companies are now considering strategic developments in response to the downturn and are more focused on long-term decisive initiatives necessary for growth.

According to a survey published by PWC, it was noted that despite the macroeconomic uncertainty, 83% of executives are focusing business strategy on growth as they confront today's economic challenges.

It is true that efforts focused on cost-cutting measures, like hiring freezes, for example, may have unintended consequences; hence the need to balance between cost-cutting and strategic hires or retention, because during this process

many companies lose good talents to competitors who would seize the opportunity.

Therefore it is important to focus on short-term uncertainty at the expense of long-term sustainability, and instituting a hiring freeze or headcount reduction without accounting for existing shortages in key business areas is to be avoided.

Enhanced Transparency in Light of Increasing Responsibilities and Pressures

As early as 2020 we have witnessed an increase in focus on transparency and good governance to be exercised by board members in the discharge of their duty.

Shareholders and regulators, through regulations and circulars as well as through their inspections and reviews undertaken, have shown increasing interest in understanding how boards execute their oversight responsibilities.

It is expected that this trend will continue throughout 2023 and beyond.

It is a fact that boards are currently looking to increase their knowledge and their request collectively and continuously for training. We therefore are seeing increasing demand for board educational programmes. Besides traditional topics, more up-to-date and discrete topics are in demand more and more, such as cryptocurrency, cybersecurity, climate change, and sustainability.

The focus by boards and companies on increasing their knowledge will only support the goal of achieving higher transparency and better governance.

It is also evident that boards are now required to identify directors with varied expertise, not only based on traditional nomination criteria. Increasingly companies and boards, when recommending candidates for board nomination, are now considering internal resources which could avail such position. In all cases when boards are referring to the external search of board members, they are focusing on whether (1) directors have the credentials, and (2) existing disclosures effectively document their existing credentials and processes. Providing visibility into how directors meet their responsibilities – while holding themselves publicly accountable -– is paramount in creating trust with stakeholders.

Potential blind spots:

- not evaluating if the board's competencies align with how the business has evolved;
- oversight of new trends, like cybersecurity and cryptocurrency, is a risk that needs to be mitigated;
- relying on a programme or certificate to establish expertise in a topical area that is evolving quickly, leading to an overestimation of abilities;
- identifying a single board member as the expert in a topical area instead of collectively elevating the knowledge of all directors is also a risk that needs to be avoided.

ESG, Climate Risk, and Diversity, Equality and Inclusion (DEI)

Companies expect regulatory and investor focus on climate change, DEI topics, and other ESG and CSR issues to continue in 2023 as they were in 2022. The way these risks are to be addressed is very critical for businesses to capitalise and monetise such initiatives in the long-run. The reality of climate change has a physical impact, as it is frequently causing severe floods, wildfires, rising sea levels, and droughts, all of which

can cause a financial risk to businesses (supply chain, import, transport, etc).

In the UAE, the following initiatives were designed, in small or large part, to contribute to a long-term plan for a sustainable future:

- The recent COP26 summit (October-November 2021) brought parties together to accelerate action towards the goals of the Paris Agreement and the UN Framework Convention on Climate Change. Cop28 (2023) will be hosted in Abu Dhabi.
- EXPO 2020 Dubai has brought the UAE to the forefront of countries advocating for a sustainable future. Its sustainability policy engages the global community to take collective action to address sustainability challenges. The UAE continues its initiatives in advocating for sustainability.
- UAE Vision 2021 is in alignment with the UAE Green Agenda 2015-2030, the Dubai Plan 2021, Paris Agreement (COP21) and the 17 UN Sustainable Development Goals (SDGs).
- Abu Dhabi Vision 2030 aims to build a sustainable and diversified economy, while improving accessibility and providing higher-value opportunities. The Abu Dhabi Global Market (ADGM) has also set up the Zayed Sustainability Prize Initiative. The prize is inspired by Sheikh Zayed's vision of "uplifting vulnerable communities across the world through technology and sustainable solutions."
- The Dubai Financial Market (DFM) updated its Sharia standards to cater to the growing interest in sustainability. The standards cover the issuance of green instruments such as green sukuk, shares and green investment funds.

From a regulatory perspective, the UAE's Securities and Commodities Authority (SCA) actively supports the achievements of the national sustainability agenda. The SCA has mandated all public joint stock companies listed in the country to disclose a sustainability report. This goes in line with Article (76) of the Chairman of Authority's Board of Directors' Decision no. (3/Chairman) of 2020 concerning the Approval of Joint Stock Companies Governance Guide. The SCA has also published the Securities and Commodities Authority Master Plan for Sustainable Capital Markets covering the key pillars required for companies to meet their ESG objectives.

Engaging Proactively with Stakeholders

Given the intense stakeholder focus on climate risk, ESG and DEI – particularly in the context of long-term value creation – engagement with stakeholders should be a priority.

Therefore, the board should request periodic updates from management on the effectiveness of the company's engagement activities:

- Does the company understand and engage with the priorities of its largest shareholders and key stakeholders?
- Are the right people engaging with these stakeholders and how is the investor relations (IR) role changing (if at all)?
- What is the board's position on meeting with investors and stakeholders? Which independent directors should be involved?

Strategy, executive remuneration, management performance, climate risk, ESG initiatives, human capital management, and board composition and performance will remain on investors' radar during the 2022 AGM season. Investors and stakeholders may also focus on the strategies that address economic and geopolitical uncertainties shaping the business and risk environment in 2022.

Talent Management

Companies are shifting their modus operandi as to how and where work is getting achieved, namely with a new generation of employees and millennials on the rise. This is a generational shift that we are witnessing. Young and ambitious millennials are increasingly being hired with different modus operandi, namely with the new trend of working from home and/or remote work where hot desks are now replacing traditional offices.

Therefore it is crucial for expanding boards to deeply understand their organisational and generational structure. When undertaking C-suite succession and strategies of overhaul, boards should be mindful to identify young leaders and of the overall pressure to succeed.

Even against economic headwinds, companies should identify gaps in their talent and have upskilling plans to fill in the gaps. A talent pool that is diverse in many respects addresses this and other needs in appropriate and various methods.

The gap analysis and filling should not be limited to the C-suite level but rather to cover other critical areas such as finance, legal and internal audit. If shortages in these positions and areas are not tackled properly, companies and boards fail to achieve their goals. This poses risks for companies, for example, in ensuring appropriate internal controls are in place or advising on certain complex transactions that could lead to losses. Although outsourcing such functions can still be a solution, a holistic approach to these matters is, and should be, on the radar of boards going forward.

Potential blind spots:

- Failing to align talent discussions with the ERM process: this could mean companies do not have the right talent for the risks identified.
- Misunderstanding what motivates the next generation: flexibility, culture, well-being, reputation, and impact are key decision points for the next set of outperformers.

Conclusion

The uncertainty and volatility period and the increased risk of recession requires boards and companies not to lose focus on governance and to be geared to tackle all the challenges and uncertainty they are facing.

It is not easy to keep the balance and to emerge from such a situation with minimal disruption and impact on companies' governance, but at the end of the day the board is in the driver's seat and it is expected that boards continue increasing their knowledge to manage such risks as their enterprise faces when navigating through this rough and turbulent period in time.

UK

Law and Practice

Contributed by:
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Contents

1. Introductory p.642
1.1 Forms of Corporate/Business Organisations p.642
1.2 Sources of Corporate Governance Requirements p.642
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.643

2. Corporate Governance Context p.645
2.1 Hot Topics in Corporate Governance p.645
2.2 Environmental, Social and Governance (ESG) Considerations p.645

3. Management of the Company p.646
3.1 Bodies or Functions Involved in Governance and Management p.646
3.2 Decisions Made by Particular Bodies p.647
3.3 Decision-Making Processes p.647

4. Directors and Officers p.648
4.1 Board Structure p.648
4.2 Roles of Board Members p.648
4.3 Board Composition Requirements/Recommendations p.649
4.4 Appointment and Removal of Directors/Officers p.650
4.5 Rules/Requirements Concerning Independence of Directors p.650
4.6 Legal Duties of Directors/Officers p.651
4.7 Responsibility/Accountability of Directors p.651
4.8 Consequences and Enforcement of Breach of Directors' Duties p.651
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.652
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.652
4.11 Disclosure of Payments to Directors/Officers p.652

5. Shareholders p.653
5.1 Relationship Between Companies and Shareholders p.653
5.2 Role of Shareholders in Company Management p.653
5.3 Shareholder Meetings p.653
5.4 Shareholder Claims p.654
5.5 Disclosure by Shareholders in Publicly Traded Companies p.655

6. Corporate Reporting and Other Disclosures p.655
6.1 Financial Reporting p.655
6.2 Disclosure of Corporate Governance Arrangements p.657
6.3 Companies Registry Filings p.657

7. Audit, Risk and Internal Controls p.657
7.1 Appointment of External Auditors p.657
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.658

Herbert Smith Freehills operates from 25 offices across Asia Pacific, Europe, the Middle East, Africa and North America. The firm is at the heart of the new global business landscape, providing premium-quality, full-service legal advice. Herbert Smith Freehills provides many of the world's most important organisations with access to market-leading dispute resolution, projects and transactional legal advice, combined with expertise in a number of global industry sectors, including banks, consumer products, energy, financial buyers, infrastructure and transport, mining, pharmaceuticals and healthcare, real estate, TMT, and manufacturing and industrials. The dedicated corporate governance advisory team comprises governance specialists with technical expertise who provide practical advice to clients on the full spectrum of governance issues. The team advises listed and privately held companies on the regulatory, reporting and governance standards applicable to them. The firm draws on its wide-ranging experience to advise on legal and regulatory requirements, emerging trends and market best practice.

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1. Introductory

1.1 Forms of Corporate/Business Organisations

Anyone choosing to set up a business in the UK may choose between a broad range of business structures.

The most common type of company in England and Wales is a private company limited by shares. A company limited by shares is one in which, in the event that the company goes into liquidation, the liability of its shareholders is limited to the amount paid or payable when subscribing for those shares (that is, limited liability). Private limited companies are not able to offer shares to the public, meaning they cannot offer shares if they consider those shares might become available to anyone other than those receiving the offer.

Companies that wish to offer securities to the public are most commonly registered as a public company limited by shares. UK legislation also affords limited liability to shareholders in public companies but imposes certain additional restrictions for the protection of shareholders and creditors. More detail on public companies can be found in **3. Management of the Company**.

Other less frequently used forms of company structure include the following.

- Private unlimited companies, which do not have any limit on the members' liability in the event of the company going into liquidation and being unable to pay its debts.
- Companies limited by guarantee, in which the liability of the subscribers is limited to the amount they have agreed to guarantee. These are commonly used by non-profit making organisations.
- Partnerships, whereby persons come together to carry on a business with a view to a profit. A general partnership does not have its own legal personality and therefore cannot hold assets other than in the name of the partners. Other forms of partnership in England and Wales are limited partnerships (LP) and limited liability partnerships (LLP). In an LP, one or more partners have limited liability and one or more partners have unlimited liability. An LLP has a separate legal personality and all partners have limited liability.

1.2 Sources of Corporate Governance Requirements

The key sources of law governing the operation of a company incorporated in England and Wales include the following.

- Companies Act 2006 (the "Companies Act") – the UK company law regime is set out in the Companies Act 2006, which is the principal body of legislation governing the formation and management of companies in the UK. The Companies Act has been fully in force since 1 October 2009.
- Insolvency Act 1986 – this Act contains provisions relating to the insolvency and winding up of companies.
- Common law – this includes the parts of the law relating to English companies that have no statutory basis but have been established by judges through case law. This body of case law is known as the common law.
- Financial Services and Markets Act 2000 (FSMA) – this Act sets out the UK regime for financial services and securities law. In particular, there are restrictions on offering securities and a requirement for companies to produce a prospectus when they offer their

securities to the public (subject to certain exceptions).

In addition, general partnerships, LPs and LLPs are governed by the Partnerships Act 1890, the Limited Partnerships Act 1907 and the Limited Liability Partnerships Act 2000, respectively.

A key source of a company's corporate governance requirements is its articles of association. The articles of association govern the internal affairs of the company and regulate a great range of matters (subject to the requirements of the Companies Act). These include the rights attached to the company's shares (including voting rights), the powers of the directors, the regulation of shareholders' and directors' meetings, the alteration of capital and the transfer of shares.

The key corporate governance codes and principles in the UK include the following.

- The UK Corporate Governance Code (the "Governance Code"), which applies to premium listed companies and is produced and overseen by the Financial Reporting Council (FRC) (see **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares** for further details). The most recent edition was published in July 2018. The FRC launched a consultation on changes to the Governance Code in May 2023, with the proposed changes intended to apply as from financial years starting on or after 1 January 2025.
- The Wates Corporate Governance Principles for Large Private Companies (the "Wates Principles"), which sets out corporate governance principles for non-listed companies in the UK. They provide private companies with a framework for complying with reporting requirements imposed on very large UK-incorporated companies to state which corporate governance code, if any, they have applied and how that corporate governance code was applied. The most recent edition was published in December 2018.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

In addition to the requirements of the sources identified in **1.2 Sources of Corporate Governance Requirements**, companies whose shares are publicly traded need to consider the following.

- The Governance Code, which applies to premium listed companies. It sets out principles and provisions relating to board leadership and company purpose; division of responsibilities; composition, succession and evaluation; audit, risk and internal control; and remuneration. The provisions of the Governance Code apply on a "comply or explain" basis that allows for flexibility in the implementation of the provisions by listed companies. However, in practice, the majority of companies to which the Governance Code applies comply with all, or nearly all, of the provisions. The FRC has issued a number of publications which sit alongside the Governance Code:
  (a) Guidance on Board Effectiveness, which aims to assist companies implementing the Governance Code and includes guidance on the role of the chair, the executive directors and non-executive directors, as well as on issues including board composition and board evaluation;
  (b) Guidance on Audit Committees, which contains best practice guidelines relating to audit committees and the provisions of

the Governance Code relating to audit;
(c) Guidance on Risk Management, Internal Control and Related Financial and Business Reporting;
(d) the Stewardship Code, which aims to improve long-term returns to beneficiaries by enhancing the quality and quantity of engagement between investors and companies; and
(e) the Minimum Standard for audit committees in relation to the external audit process and relations with the external auditor, which was adopted on a comply or explain basis for FTSE 350 companies with immediate effect in May 2023.

- The Listing Rules, which are issued by the Financial Conduct Authority (FCA). They set out the requirements for obtaining a listing of securities on the Official List and the mandatory continuing obligations that apply once a company is listed. These rules also govern the need for shareholder approval of significant transactions and the disclosure of relevant information to investors. The listing requirements and continuing obligations which apply to a company depend on whether it has a premium or standard listing. All companies with a premium listing of equity shares, regardless of where they are incorporated, are required under the Listing Rules to disclose how they have applied the principles of the Governance Code and to confirm that they have complied with the provisions of the Governance Code, or to the extent that they have not complied, explain what has not been complied with and the reasons for this. The FCA is consulting on changes to the structure of the UK listing regime. The scope of the final changes are not yet known, but, if the FCA's current proposals are implemented, they will have a significant impact on the continuing obligations imposed on listed companies.
- The Transparency Rules, which are also issued by the FCA. They require companies to include a corporate governance statement in their annual report, setting out certain prescribed information. They also contain requirements in relation to audit committees (or the body responsible for performing similar functions), setting out the minimum functions the body must carry out and requirements as to the composition of that body. For the most part, the requirements contained in the Transparency Rules derive from the EU Transparency Directives in force when the UK was an EU member state.
- The UK version of the EU Market Abuse Regulation (UK MAR), which is part of UK law by virtue of the European Union (Withdrawal) Act 2018, sets out requirements relating to the disclosure of inside information by listed companies and governs the related offences of insider dealing and unlawful disclosure of inside information. UK MAR also restricts when directors may deal in the company's securities and requires directors (and persons closely associated with them) to disclose their share dealings to the relevant company. It is worth noting that the government published a Financial Services and Markets Bill in July 2022 which, once passed, will revoke UK MAR making way for the FCA to set the rules on the definition and disclosure of inside information.
- The AIM Rules, which are published by the London Stock Exchange (LSE) apply to companies with shares admitted to trading on AIM (the market for smaller growing companies in the UK). Additional corporate governance requirements were introduced into the AIM Rules in 2018 requiring AIM companies to state on their website which recognised

corporate governance code they apply and to report, on a "comply or explain" basis, against that code.

A number of institutional investor bodies, including The Investment Association and the Pensions and Lifetime Savings Association, produce their own corporate governance guidelines that listed companies need to be aware of, and The Chartered Governance Institute UK & Ireland also regularly publishes guidance notes on corporate governance issues.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The transition to a greener, more sustainable future and the role of companies in that transition continues to be one of the dominant topics in corporate governance in the UK (see **2.2 Environmental, Social and Governance (ESG) Considerations** for details of the various initiatives being pursued).

Diversity and inclusion at board and senior management levels are also issues that the largest companies in the UK are being requested to focus on, in order to seek to improve how reflective these bodies are of society at large (see **4.3 Board Composition Requirements/Recommendations**).

A final hot topic to be highlighted is the increased transparency disclosures in relation to the beneficial ownership of companies following the invasion of Ukraine by Russia and the sanctions regime adopted in response by the UK government (see **5.5 Disclosures by Shareholders in Publicly Traded Companies**).

2.2 Environmental, Social and Governance (ESG) Considerations

Environmental, social and governance (ESG) issues remain an area of significant focus in the UK. Institutional investors and stakeholders alike are paying particular attention to ESG issues, including climate change, workforce and supply chain issues. Amendments introduced to the Stewardship Code in 2020, for example, require ESG issues to be taken into account in the investment decision-making process.

Climate-related matters and disclosures are a significant focus for investors, regulators and others. This is particularly so following the Paris Climate Agreement, the establishment of the International Sustainability Standards Board by the IFRS (announced at COP26) and the publication of the recommendations produced by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) in June 2017 to help businesses disclose climate-related financial information in their financial reports (the "TCFD Recommendations").

Listed companies are required to include a statement in their annual financial report which sets out whether the report contains disclosures consistent with the TCFD Recommendations and to explain why if they do not. Separately, the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 impose mandatory climate-related disclosure obligations on traded companies and certain LLPs, AIM and large private companies. In-scope entities are required to make disclosures broadly in line with the TCFD Recommendations for financial years beginning on or after 6 April 2022, in the non-financial information statement which forms part of the strategic report in their annual report and accounts (see **6.1 Financial Reporting** for more information on the strategic report).

These climate-related disclosures supplement the existing requirements for certain listed companies to include prescribed non-financial information, including on environmental, workforce and social matters and respect for human rights, in their annual report (see **6.1 Financial Reporting** for more information).

Companies subject to the Governance Code or the Wates Principles are also required to report on certain non-financial aspects of their business and stakeholders. Workforce and social matters are also an area of considerable investor focus, in particular regarding the ways in which boards consider and assess workforce matters. Workforce engagement was a key theme when the Governance Code was updated in 2018. ESG issues relating to supply chain management, in particular regarding human rights, also remain an area of focus.

There are a number of reporting requirements for companies relating to ESG issues. Companies that meet certain thresholds must now publish statements explaining:

- how their directors have performed their duty under Section 172 of the Companies Act to have regard to the various stakeholder factors listed in Section 172(1) (including employees, customers and suppliers, the community and environment);
- how their directors have engaged with employees and how the directors have had regard to UK employee interests, and the effect of that regard, including on the principal decisions; and
- how their directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions.

For a number of years, commercial organisations operating in the UK that meet certain size requirements have been required under the Modern Slavery Act 2020 to publish a statement discussing the steps they have taken to ensure that slavery and human trafficking is not taking place in their business or supply chain. The UK government has indicated that it intends to strengthen this reporting obligation, including by mandating certain contents requirements and requiring publication on a government-sponsored website.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

The principal bodies and functions involved in the governance and management of a company in the UK are set out below.

- The board of directors – as discussed in **4.3 Board Composition Requirements/Recommendations**, a company is required to appoint directors. The articles of association of the company will typically delegate management of the company to the directors, enabling them to execute all the powers of the company. The composition and activities of a board of directors will vary depending on the company's circumstances. Publicly listed company boards will include a number of non-executive directors in accordance with the provisions of the Governance Code. For companies which are not listed, the board is usually comprised of executive directors who are involved in the day-to-day management of the business. An unlisted company may appoint non-executive directors to the board, and the Wates Principles encourage companies to consider this.

- The company secretary – it is a requirement under the Companies Act for a public company to have a company secretary. Private companies are not required to have a company secretary. The role of the company secretary is to support the board and advise on corporate governance issues.
- The executive management team – the responsibility of the executive team is to implement the board's decisions and policies, and deal with the day-to-day management of the company. In unlisted companies, the executive team will often comprise the same individuals as the board of directors. In a publicly listed company, the CEO and CFO will usually be directors of the company, with the remaining members of the executive team forming/sitting on an executive committee or equivalent.
- Shareholders – the shareholders are the owners of the company, and those who hold the board of directors to account. The articles of association and the Companies Act provide that a number of decisions are reserved for shareholders (see **3.2 Decisions Made by Particular Bodies**).

3.2 Decisions Made by Particular Bodies

Decision-making by a company is generally delegated to the board of directors in the company's articles of association (although there are some decisions that are reserved for the shareholders). The key decisions made at each level of the management of a company are as follows.

- The board of directors – most decisions are made by the board of directors and will typically relate to the strategy and general management of the company.
- The management team – where the management team is different to the board of directors, it will make decisions on the day-to-day business of the company pursuant to powers delegated by the board of directors.
- Shareholders – under the Companies Act, there are a number of decisions (eg, amending the articles of association and certain share capital matters) that are reserved for shareholders and that can only be passed by shareholder resolution. In some cases, these decisions can be delegated to the board of directors under a company's articles of association.

3.3 Decision-Making Processes

The board of directors, management team and shareholders make decisions in the following ways.

- The board of directors – decisions by the board are taken in the form of board resolutions and are typically taken at a board meeting. The procedures for board meetings and the voting requirements for board resolutions are set out in the company's articles of association. Resolutions are typically passed by a simple majority. Board resolutions may also take the form of written resolutions, meaning a board meeting does not have to be physically convened. When making decisions, the directors must have regard to their general duties under the Companies Act (see **4.6 Legal Duties of Directors/Officers**).
- The management team – the management team implements decisions made by the board but acts through delegated authorities from the board. As such, decisions must be made within the terms of the delegation.
- Shareholders – decisions by shareholders are taken in the form of shareholder resolutions at a general meeting (or for private companies only, they may be taken by written resolution, in which case a physical meeting will not be required). In order to convene a general

meeting to pass a shareholder resolution, a company must provide shareholders with notice of the meeting, including information about the issues that are to be resolved. The Companies Act stipulates the approval threshold for each type of shareholder decision to be passed, which is typically either a simple majority (required to pass an ordinary resolution) or not less than 75% of shareholders (required to pass a special resolution). Most shareholder resolutions can be passed by an ordinary resolution though some, such as an amendment to the articles of association or a disapplication of pre-emption rights on an allotment of shares, require a special resolution. Public companies, but not private companies, are required under the Companies Act to hold an annual general meeting of shareholders (AGM). Standard business for an AGM includes the re-election of directors, appointment of an auditor and authorisation of certain matters in relation to a company's share capital.

4. Directors and Officers

4.1 Board Structure

Requirements in Law

In terms of board structure, companies have a single-tier, unitary board. Executive and non-executive directors are both members of the board, in contrast to other jurisdictions where non-executive directors sit on a separate supervisory body.

Under the Companies Act, private companies must have at least one director, and public companies at least two directors and a company secretary.

Requirements Under the Governance Code

The Governance Code provides that at least half the board, excluding the chair, should be comprised of independent non-executive directors. The Governance Code also provides that companies should form three committees: a nomination committee, a remuneration committee and an audit committee. The nomination committee should lead the process for making and recommending appointments to the board. The main role of the audit committee is to monitor the integrity of the company's financial statements and review the company's internal controls. The remuneration committee should have responsibility for determining the policy for executive director remuneration and setting remuneration for the chair, executive directors and senior management. The remuneration and audit committees should be comprised entirely of independent non-executive directors and the nomination committee should have a majority of independent non-executive directors.

4.2 Roles of Board Members

Directors can be executive (with a service contract) or non-executive. The board of directors will typically comprise the following.

- Chair of the board – the role of the chair is to chair board meetings and take on a leadership role to ensure the effectiveness of the board. The Governance Code states that the chair should not be the same person as the CEO, to ensure independence.
- Non-executive directors – the Governance Code provides that at least half the board, excluding the chair, be independent as assessed by reference to various criteria set out therein. The Governance Code says that the role of non-executive directors is to challenge and advise the board on the company's strategy and policies. The Wates Principles

state that privately held companies should have due regard to the benefits independent non-executive directors can bring.

- Senior independent director – the Governance Code provides that the board should appoint one of the independent non-executive directors to be the senior independent director, who should provide a sounding board for the chair and serve as an intermediary for the other directors and shareholders.
- Executive directors – executive directors on the board may include a CEO, CFO and chief operating officer (COO). There are no specific legal requirements regarding which executive directors a company should appoint. The number and type of executive directors appointed will depend on the business needs of the company. The role of the executive directors is to implement the decisions made by the whole board and to discharge overall managerial responsibilities. For example, a CEO is typically responsible for the overall management of the company, while a CFO is responsible for the company's accounts and finances, and a COO is responsible for the overall operations and administration of the company. The executive directors will be supported in their role by members of the executive team, who are not part of the board.

4.3 Board Composition Requirements/Recommendations

Subject to the provisions of the Companies Act, the articles of association may prescribe a maximum or minimum number of directors. Subject to certain requirements, corporate directors are permitted, but at least one director must be an individual. However, restrictions are expected to be brought into force in the near future (pursuant to a Bill which at the time of writing is being debated in Parliament) which will prohibit the use of corporate directors, except in limited circumstances.

The Governance Code recommends that the directors have appropriate skills, experience, independence and knowledge of the business to discharge their responsibilities properly and effectively. The Governance Code also recommends that directors are appointed with regards to the benefits of diversity, including diversity of gender, social and ethnic backgrounds, cognitive and personal strengths.

There has been a focus on board diversity for a number of years in the UK and various initiatives have been launched in this area. These include the FTSE Women Leaders Review, which recommends that by 2025, for FTSE 350 companies, a minimum of 40% of both the board of directors and leadership team should be female. In addition, the Parker Review recommends that each FTSE 100 board should have at least one director from a minority ethnic group by the end of 2021 and that for FTSE 250 companies this target should be met by the end of 2024. The Parker Review announced a new recommendation earlier in 2023 for FTSE 350 companies to set themselves a target for the percentage of their senior management which self-identifies as being from an ethnic minority group. Companies should set these targets by December 2023 and meet them by December 2027. Aligning with these reviews, the FCA introduced changes to the Listing Rules for financial years starting on or after 1 April 2022, requiring premium and standard listed companies to make certain disclosures in relation to gender and ethnic diversity at board and executive management level. These changes include reporting against four diversity targets on a "comply or explain" basis. Both the FTSE Women Leaders Review and the Parker Review have extended their recommendations

regarding board diversity to the top 50 private companies in the UK by sales.

4.4 Appointment and Removal of Directors/Officers

The Companies Act sets out the requirements for appointing directors upon incorporation of a company but is silent on subsequent appointments. Therefore, the process will be set out in the company's articles of association, which usually stipulate that directors can be appointed by a decision of the board of directors or by shareholders, in each case by simple majority.

In line with the provisions of the Governance Code, listed companies typically have a nomination committee that has responsibility for recommending board appointments. The Governance Code recommends that all directors of premium listed companies stand for re-election annually at the company's AGM, regardless of the size of the company.

There are a number of ways a director can be removed from office. The Companies Act provides that a director may be removed by ordinary resolution (before the expiration of the director's term). If a director is to be removed before the expiration of their term, the Companies Act sets out a number of protections that must be complied with, including that the ordinary resolution cannot be a written resolution and that the director has the right to be heard by the shareholders at the general meeting. In addition, a company's articles of association typically set out grounds for removal.

4.5 Rules/Requirements Concerning Independence of Directors

Independence

There are no requirements at law regarding independence of directors. However, the Governance Code provides that at least half the members of the board of a premium listed company should comprise independent non-executive directors, determined in accordance with the Governance Code. Independent non-executive directors should not:

- have been employees of the company or group within the last five years;
- have had a material relationship with the company in the last three years;
- have close family ties with any of the company's advisers, directors or senior employees;
- have served on the board of the company for more than nine years; or
- represent a significant shareholding.

However, a company may, notwithstanding the existence of these circumstances, determine a director to be independent. If they do so, this should be explained in the company's annual report.

Conflicts of Interest

Under the Companies Act, directors have a duty to avoid situations in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. The duty is stated to apply, in particular, to the exploitation of any property, information or opportunity. A director will therefore need to consider carefully whether an opportunity rightfully belongs to the company before exploiting it personally.

There are a number of exceptions to this duty, including where the matter has been authorised by the company's directors, where the company has given authority to the directors for something to be done or where the articles of association contain a provision for dealing with conflicts

and the directors are acting in accordance with that provision.

Directors have three related duties, including the duty not to accept benefits from third parties, the duty to declare any interest in a proposed transaction and the duty to declare an interest in an existing transaction (see **4.6 Legal Duties of Directors/Officers**). These interests would typically be declared at the board meeting authorising the transaction.

4.6 Legal Duties of Directors/Officers

The rules governing directors' duties are set out in the Companies Act.

The Companies Act includes a statutory statement of the duties a director owes to the company. The statutory directors' duties are:

- to act within the powers conferred by the company's constitution;
- to promote the success of the company for the benefit of the members as a whole;
- to exercise independent judgment;
- to exercise reasonable care, skill and diligence;
- to avoid conflicts of interest;
- not to accept benefits from third parties; and
- to disclose an interest in a proposed transaction with the company.

The duties apply to all the directors of a company. However, the statutory statement of duties does not cover all the obligations of a director. Other obligations are contained throughout the Companies Act, such as the duty to deliver accounts and the obligation to disclose an interest in an existing transaction with the company. There are also obligations contained in other statutes; for example, the Insolvency Act 1986. In addition, directors have a general fiduciary duty to their shareholders that arises from the relationship of trust and confidence between them and their shareholders.

4.7 Responsibility/Accountability of Directors

The directors' statutory duties as set out in the Companies Act are owed directly to the company (not to any individual shareholder(s) or to any stakeholder(s)). However, embedded within them is a requirement to have regard to the interests of a number of stakeholders. The duty to promote the success of the company requires directors to have regard to the interests of its employees, community and the environment, and to foster the company's relationships with suppliers, customers and others when considering this duty.

In addition, the directors owe a fiduciary duty under the common law to shareholders to provide them with information that is sufficient, clear and not misleading, to enable them to make an informed decision as to how to vote at a shareholder meeting. Directors also have a common law duty to consider the interests of the company's creditors when a company is facing actual, imminent or probable insolvency (ie, the "creditor duty"), which was recently affirmed by the Supreme Court.

4.8 Consequences and Enforcement of Breach of Directors' Duties

As a general rule, a company is the only person able to bring a claim against one of its directors for breach of duty, since the duty is owed by the directors to the company itself. This means that a shareholder (acting on their own behalf) cannot bring an action against a director for breach of duty. This results in practical difficulties, in so far as the board is unlikely to approve the company bringing an action against one of its own

for breach duty. To mitigate this, the Companies Act contains a statutory procedure pursuant to which a shareholder may, in certain circumstances, bring a derivative claim on behalf of the company. Further detail on such actions is set out in **5.4 Shareholder Claims**.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

In addition to liability relating to breaches of duty, directors may also be liable for breaches of statutory provisions within the Companies Act, such as those relating to unlawful distributions or unlawful directors' remuneration payments. In certain circumstances, directors may also be subject to criminal penalties, particularly in relation to health, safety and environmental matters; competition and anti-competitive behaviour; and bribery, corruption and fraud.

Directors can, to an extent, protect themselves from the liabilities arising from their role; however, there are some limitations on public policy grounds. A company may generally indemnify directors against liability incurred towards a third party in the performance of their role. However, companies may not indemnify their directors for breaches of duties or negligence. Similarly, there are limitations to the extent to which a company can indemnify directors in circumstances where criminal proceedings are being brought against them.

A company may also purchase D&O insurance for directors.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

At law, approval by shareholders is required for any director's service contract for which the guaranteed term is longer than two years. Failure to obtain approval makes the relevant contractual provision void and allows the company to terminate the service contract at any time by giving reasonable notice.

A quoted company (that is, a company whose equity share capital is listed on the Official List in the UK, a company officially listed in an EEA state or admitted to dealing on NASDAQ or the NYSE) may not make any remuneration payment to a director or former director unless that payment is in accordance with its latest remuneration policy approved by shareholders (or the payment has been separately approved by shareholders). The directors' remuneration policy is a binding policy and must be approved by an ordinary resolution of shareholders at least once every three years. In addition, shareholders are required to vote on a statement disclosing the directors' remuneration for the previous year. This vote is indicative and does not have the effect of clawing back any payment that has already been made. However, if the directors' remuneration report is not approved by shareholders, the company is required to table a new remuneration policy the following year. These requirements also apply to non-quoted traded companies, that is companies with voting shares admitted to trading on a UK regulated market or an EU regulated market.

4.11 Disclosure of Payments to Directors/Officers

The Governance Code also places additional reporting requirements on a company's remuneration committee in relation to the pay of directors and senior managers. The remuneration committee is required to provide a full description of its strategic rationale in making remuneration decisions, including explaining:

- why the remuneration is appropriate;

- how the committee addressed issues such as clarity, risk and proportionality; and
- whether any shareholder engagement or workforce engagement has been sought.

A quoted company must also publish the pay difference between its CEO and its average UK employee.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

A shareholder's relationship with the company in which they hold shares is a contractual one. Under the Companies Act, the articles of association bind the company and its members to the same extent as if they were covenants on the part of the company and each member to observe the provisions. The articles of association therefore constitute a form of contract between the company and its shareholders, and between the shareholders themselves. The shares held by the members give a right of participation in the company on the terms of the articles of association.

A shareholder does not have a proprietary interest in the underlying assets of a company. Shareholders are entitled in proportion to their respective shareholdings to a share of the distributed profits of the company and, on a winding-up, to the surplus assets of the company after the company's creditors have been repaid in full. Shareholders are not liable for the acts of the company, except in very limited circumstances when the corporate veil can be pierced, where a company's limited liability status is set aside and a shareholder is liable for the company's acts.

5.2 Role of Shareholders in Company Management

The articles of association usually delegate to the directors the exercise of the powers of the company, save for those powers that are required by the articles or the Companies Act to be exercised by the shareholders in a general meeting or by shareholder resolution. Therefore, it is rare for shareholders in their capacity as such to have involvement in the day-to-day running of the company. Shareholders in joint venture companies may agree contractually that certain actions will not be taken by the company unless agreed by a particular number, or majority, of shareholders.

If desired, shareholders can direct the management of a company to take, or refrain from taking, certain actions in the business by directing the directors to call a general meeting. Shareholders must hold more that 5% of the voting rights to make this request and must explain the general nature of the issues they wish to raise at the meeting. Directors will not be required to table a resolution if it is defamatory, frivolous or vexatious, or if it would not be effective if passed.

5.3 Shareholder Meetings

A public company is required to hold an AGM every year within six months of its financial year-end. There is no statutory requirement for a private company to hold an AGM (unless they are traded companies) but there may be an express requirement to hold one in the company's articles of association. For public companies, 21 clear days' notice of the AGM is required, unless all who are entitled to attend and vote consent to shorter notice being given.

Any shareholder meeting other than an AGM is a general meeting. The minimum statutory notice period required for a general meeting of a private

company (which is not a traded company) is 14 clear days. For public companies, the minimum statutory notice period for general meetings other than AGMs is 14 clear days, however it is 21 clear days for public companies which are traded companies. Traded companies can reduce the minimum notice period for these meetings to 14 clear days if (i) shareholders have passed an annual resolution to shorten the notice period to 14 clear days, and (ii) the company allows shareholders to appoint a proxy by electronic means via a website.

Shareholders holding 90% (in the case of private companies) or 95% (in the case of public companies) of the nominal value of shares giving a right to attend and vote may agree to shorter notice of general meetings. The articles of association may specify a longer notice period (but the articles of association cannot specify a shorter period).

Until recently, shareholder meetings were almost exclusively physical meetings and there were very few examples of virtual, electronic meetings (that is, a shareholder meeting held exclusively through the use of online technology, with no physical meeting) or hybrid shareholder meetings (that is, a physical shareholder meeting with the option for electronic participation through the use of online technology).

Whilst certain relaxations were accepted during the COVID-19 pandemic, these relaxations no longer apply and, in the absence of such relaxations, there are questions as to the validity of virtual or electronic-only shareholder meetings under English law. Investor bodies, such as the Investment Association, have expressed concerns over virtual only meetings. These bodies are generally more amenable to hybrid meetings, though there are practical issues with hybrid meetings which limit their popularity with companies. In all instances, companies are required to comply with the provisions of their articles of association in relation to proceedings at shareholder meetings. Many companies have therefore amended their articles of association in order to facilitate the holding of hybrid shareholder meetings should the need for such flexibility arise again in the future.

5.4 Shareholder Claims

As noted in **4.8 Consequences and Enforcement of Breach of Directors' Duties**, as a general rule, a company is the right person to bring a claim against one of its directors for breach of duty, since the duty is owed to the company. However, the Companies Act contains a statutory procedure under which a shareholder may bring a derivative claim – that is, proceedings on behalf of a company – against a director, for negligence, default, breach of duty or breach of trust.

The factors that the court will look at when deciding whether to allow a derivative claim include whether a director who is acting to promote the success of the company would proceed with it, whether the relevant act or omission was previously authorised by the company, whether the breach has been ratified and the views of independent shareholders.

In addition, shareholders can apply to the court for protection against unfair prejudice if they believe the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of its members or a group of its members.

Claims against the company may also arise if a publicly traded company does not behave properly in relation to the treatment of the release of

information to the market. In particular, under Section 90A of the FSMA, a company is liable to pay compensation to a person who acquires, continues to hold or disposes of, the securities in reliance on information disclosed by the company using recognised means and who suffers loss in respect of the securities as a result of either any untrue or misleading statement in that published information, or the omission from that published information of any information required to be included in it. The company is then only liable if a person discharging managerial responsibilities knew that the statement was untrue or misleading, or was reckless as to whether it was, or knew the omission was a dishonest concealment of a material fact.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Any shareholder whose interest in the voting rights of a publicly traded company reaches, exceeds or falls below 3%, 4%, 5% and each 1% threshold thereafter must disclose this to the company, which must notify the market. Where the company is listed on the LSE's Main Market, the shareholder must also send a notification to the FCA.

The Takeover Code (which governs takeovers and mergers in the UK) requires that for any public listed company, if any person, or group of persons acting in concert, acquires 30% or more of the company's voting rights, they will trigger an obligation to make a general takeover bid to acquire the remainder of the shares.

All companies incorporated in the UK are required to maintain a register of persons with significant control (PSCs), which is effectively a register of beneficial ownership, and register the details of its PSCs with Companies House. Various amendments to the relevant legislation are being considered to improve transparency around ownership and control in UK corporate structures (for example, the introduction of identity verification for all existing and new PSCs). Disclosure obligations have also been extended recently in relation to the beneficial ownership of overseas companies which own, or wish to own, land or property in the UK and which are now required to be entered on a register held by Companies House.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Companies are required to publish an annual report and accounts for each financial year, unless an exemption applies. A public company must do so within six months of the end of its financial year, whereas a private company must do so within nine months. The Companies Act sets out the content requirements of the annual report and accounts, which is supplemented by various regulations, including, The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended). Generally, the Companies Act requires the annual report and accounts to comprise a directors' report, a strategic report and financial statements. Quoted companies and traded companies are also required to include a directors' remuneration report. Listed companies also include a corporate governance statement discussing their corporate governance arrangements.

The purpose of the strategic report is to inform members of the company and help them assess how the directors have performed their duty under Section 172 (duty to promote the success of the company). It must contain a fair review

of the company's business and a description of the principal risks and uncertainties facing the company. It must also contain an analysis of the development and performance of the company's business during the financial year and the position of the company's business at the end of the year, consistent with the size and complexity of the business. Certain companies must also include in the report a statement of how the directors applied the principles of Section 172 during the financial year, information on their environmental impact, workforce gender diversity statistics, and board consideration of employee and supplier matters. The strategic report may also contain key performance indicators on various financial and non-financial matters. Companies which are "public interest entities" (that is, companies whose transferable securities are admitted to trading on a regulated market, insurers and credit institutions) with more than 500 employees are required to include prescribed non-financial information in their strategic report. The required information includes:

- disclosures in relation to anti-corruption and anti-bribery matters, environmental matters, employees, social matters and respect for human rights;
- a description of the company's policies in relation to the non-financial matters; and
- the principal risks relating to the non-financial matters arising in connection with the company's operations.

The TCFD-aligned disclosures required by the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 for financial years starting on or after 6 April 2022 must also be included by in-scope companies in the strategic report.

The directors' report is now, in practice, a repository for a number of miscellaneous statutory disclosures, including in relation to the directors, company constitution, share capital and political donations.

See **4.11 Disclosure of Payments to Directors/Officers** for discussion of the content requirements of the directors' remuneration report; and see **6.2 Disclosure of Corporate Governance Arrangements** for discussion of the content requirements of the corporate governance statement.

For listed companies, the content requirements set out above are supplemented by the provisions contained in the Transparency Rules. In particular, these provide that the annual report must include consolidated audited accounts, a management report and a responsibility statement. The Transparency Rules require a company to publish an annual report as soon as possible and in any event within four months of the end of each financial year. The Transparency Rules also require listed companies to produce a half-yearly report within three months of the half-year end comprising a condensed set of financial statements, an interim management report and responsibility statements. The Transparency Rules also set out the requirements in respect of the format for annual reports, which include that the annual report must be prepared and published in structured electronic format.

A company must also file certain information with the UK companies registry, Companies House, on an annual basis. This includes the annual report and accounts. The annual filing requirements also include a confirmation statement confirming information in respect of its shareholders, directors and PSCs.

6.2 Disclosure of Corporate Governance Arrangements

Pursuant to the Listing Rules, companies are required to state how they have applied the principles of the Governance Code in a manner that would enable shareholders to evaluate that application and state whether they have complied with the provisions of the Governance Code, and if not, explain the reasons for this.

The Governance Code also sets out certain information that should be included in the corporate governance statement contained in the annual report. This includes discussion of matters such as board composition, the remuneration of directors and the relationship between a company and its auditor. The Governance Code does not have the force of law but, as noted in **1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares**, premium listed companies are required to report annually on their compliance with the Governance Code and explain any extent to which they have not complied, providing reasons for that non-compliance.

Private companies over a certain size are required to include in their annual report a statement on the company's governance arrangements.

6.3 Companies Registry Filings

A company must notify Companies House as and when there are any changes to its particulars, such as the registered office, directors or changes in share capital. In addition, all special resolutions must be filed at Companies House within 15 days of being passed and the Companies Act specifies certain ordinary resolutions that are required to be filed at Companies House (eg, an ordinary resolution authorising directors to allot shares). All documents filed with Companies House will be publicly available for free online.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

A company is required to appoint an external auditor when preparing its annual accounts unless it is subject to an exemption. Small and dormant companies are exempt from audit unless a sufficient number of members require an audit. A company will be classed as small if it is not exempt and meets two of the following three thresholds:

- it must have an annual turnover of not more than GBP10.2 million;
- it must have a balance sheet total of not more than GBP5.1 million; or
- its average number of employees must be not more than 50.

Directors are responsible for the preparation of the company accounts in accordance with all relevant law and regulations. Auditors report on whether the accounts meet the requirements as asserted by the directors, but this does not relieve the directors of their responsibilities.

There are additional requirements that govern the relationship between publicly listed companies and their auditors, such as the mandatory rotation of auditors after a maximum of 20 years, the requirement to run a tender process of audit services and the auditor being prevented from undertaking certain non-audit services for the company.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The Governance Code places requirements on premium listed companies to confirm within their annual report that they have carried out a robust assessment of the company's risks. Directors are also required to confirm that:

- they have assessed the company's "emerging risks" in addition to its principal risks;
- they have assessed the prospects of the company; and
- they have a reasonable expectation that it will continue in operation and meet its liabilities as they fall due over the period of its assessment.

In addition, to assess the company's financial risks and controls, premium listed companies are required to appoint an audit committee of non-executive directors, whose role is to ensure that shareholder interests are properly protected in relation to financial reporting.

USA

Law and Practice

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Contents

1. Introductory p.663
1.1 Forms of Corporate/Business Organisations p.663
1.2 Sources of Corporate Governance Requirements p.664
1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares p.665

2. Corporate Governance Context p.667
2.1 Hot Topics in Corporate Governance p.667
2.2 Environmental, Social and Governance (ESG) Considerations p.668

3. Management of the Company p.669
3.1 Bodies or Functions Involved in Governance and Management p.669
3.2 Decisions Made by Particular Bodies p.670
3.3 Decision-Making Processes p.671

4. Directors and Officers p.671
4.1 Board Structure p.671
4.2 Roles of Board Members p.672
4.3 Board Composition Requirements/Recommendations p.673
4.4 Appointment and Removal of Directors/Officers p.673
4.5 Rules/Requirements Concerning Independence of Directors p.674
4.6 Legal Duties of Directors/Officers p.674
4.7 Responsibility/Accountability of Directors p.674
4.8 Consequences and Enforcement of Breach of Directors' Duties p.675
4.9 Other Bases for Claims/Enforcement Against Directors/Officers p.675
4.10 Approvals and Restrictions Concerning Payments to Directors/Officers p.676
4.11 Disclosure of Payments to Directors/Officers p.676

5. Shareholders p.677
5.1 Relationship Between Companies and Shareholders p.677
5.2 Role of Shareholders in Company Management p.677
5.3 Shareholder Meetings p.678
5.4 Shareholder Claims p.678
5.5 Disclosure by Shareholders in Publicly Traded Companies p.679

6. Corporate Reporting and Other Disclosures p.680
6.1 Financial Reporting p.680
6.2 Disclosure of Corporate Governance Arrangements p.680
6.3 Companies Registry Filings p.681

7. Audit, Risk and Internal Controls p.681
7.1 Appointment of External Auditors p.681
7.2 Requirements for Directors Concerning Management Risk and Internal Controls p.681

Sullivan & Cromwell LLP has a record of success and client service, which has been perfected over 140 years and made the firm one of the models for the modern practice of law. Today, it is considered one of the leaders in each of its core practice areas and geographic markets. S&C advises a diverse range of clients on corporate transactions, litigation and estate planning matters. It comprises more than 875 lawyers, who conduct a seamless, global practice through a network of 13 offices located in Asia, Australia, Europe and the USA.

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SULLIVAN & CROMWELL

1. Introductory

1.1 Forms of Corporate/Business Organisations

In the USA, there are three principal forms of business organisations: corporations, partnerships and limited liability companies. Some small-business proprietors do not form a business organisation and therefore operate with no liability shield between the business and its proprietor (sometimes referred to as a sole proprietorship).

Corporations

A corporation is an entity owned by stockholders, managed by a board of directors and established by the filing of a certificate of incorporation or similar filing with the secretary of state of a US state. Corporations can be privately held or publicly traded on a stock exchange, with public corporations having more stockholders. The board of directors typically delegates day-to-day management to the corporation's executive officers while exercising oversight over management. A corporation is liable for the obligations of its business, and its stockholders are generally not held liable for such obligations.

State law typically requires a corporation to hold board meetings and annual stockholder meetings. Although corporations have comparatively less governance flexibility and are subject to certain other disadvantages compared to other entity forms (including entity-level taxation), large and widely held public companies are usually organised as corporations, as they are recognised as the traditional corporate form and tend to be the preferred investment vehicle for investors. Certain states provide for other forms of for-profit corporations, such as public benefit corporations and statutory close corporations.

A public benefit corporation is organised for the purpose of a public benefit rather than for the primary purpose of enhancing stockholder value. Statutory close corporations (which are required to have fewer than a specified number of stockholders) are typically subject to fewer governance formalities than ordinary corporations.

Partnerships

There are two forms of partnerships: general partnerships and limited partnerships. A general partnership is an entity in which two or more persons carry on the entity's business. Although not mandated by state law, sophisticated parties often enter into a partnership agreement to specify the rights and obligations of the partners.

In a general partnership, each partner has the authority to undertake transactions, execute contracts and incur liabilities on behalf of the partnership, and is also personally responsible for the obligations of the partnership. Certain states provide for a limited liability partnership, which is a special type of general partnership. In a limited liability partnership, each partner is only personally responsible for liabilities arising from his or her own conduct on behalf of the partnership.

A limited partnership is an entity with two classes of partners, general partners and limited partners, which is formally established by the filing of a certificate of limited partnership or similar filing with the secretary of state. A general partner manages the day-to-day affairs of a limited partnership and is personally liable for the obligations of the limited partnership. Limited partners are mostly passive investors, and their liability is capped at their investment as long as they do not exert active control over the limited partnership.

State law governing limited partnerships is generally flexible, and the governance of limited partnerships can be customised to the preferences of the contracting parties.

Limited Liability Companies

A limited liability company (LLC) is an entity formed by one or more members by filing a certificate of formation or similar filing with the secretary of state. Similar to a corporation, members of an LLC benefit from limited liability. As with a limited partnership, state law generally permits governance of an LLC to be customised to the parties' preferences in an operating agreement.

1.2 Sources of Corporate Governance Requirements

The principal sources of corporate governance requirements for US companies are state statutory and common law, an entity's organisational documents, federal securities laws and regulations, the stock exchange regulations and influential (but non-binding) non-legal materials, such as proxy advisory firms' guidelines and institutional investor voting policies.

State Law

State law is derived from a state's corporate code and related case law. In the USA, the most common state of incorporation for Fortune 500 public companies is Delaware, which has enacted the Delaware General Corporation Law (DGCL) to govern the affairs of Delaware corporations. The DGCL consists of a set of default and mandatory rules. Incorporators may opt out of the DGCL's default rules in a corporation's organisational documents, but a corporation is required to adhere to the DGCL's mandatory rules.

The expertise of the Delaware judiciary and its active role in the development of corporate case law is a source of perceived advantage for Delaware corporations. Entity forms other than corporations are governed by other statutes and case law under state law.

Organisational Documents

An entity's organisational documents set forth its governance rules. For example, a Delaware corporation is governed by a certificate of incorporation and by-laws, and, in certain circumstances, a stockholders' agreement. A general partnership and limited partnership will be governed by a partnership agreement, and an LLC will be governed by an operating agreement.

Federal Securities Laws

For public companies, the Securities Act of 1933 and the Securities Exchange Act of 1934 (Exchange Act), as amended by the Sarbanes-Oxley Act of 2002 (SOX) and the Dodd-Frank Act of 2010 (Dodd-Frank), establish certain rules and disclosure requirements pertaining to corporate governance. Historically, the federal securities laws indirectly regulated the corporate governance of public companies through a disclosure regime. However, SOX and Dodd-Frank added substantive corporate governance rules, such as independence requirements for audit committee members.

Proxy Advisory Firms

Proxy advisory firms, such as Institutional Shareholder Services (ISS) and Glass, Lewis & Co (Glass Lewis), issue guidelines to advise stockholders of public companies on how to vote their shares on corporate governance matters. Passive institutional investors often vote on corporate governance matters in accordance with such guidelines, as well as their investors' published voting policies. Given the trend towards shares being held passively, these guidelines and policies play a significant role in the governance of public companies.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

The USA has two primary national stock exchanges: the New York Stock Exchange (NYSE) and the Nasdaq Stock Market (Nasdaq). US companies with publicly traded shares are generally required to follow the corporate governance rules and disclosure requirements set forth in the applicable stock exchange rules and the federal securities laws. These requirements are mandatory, although the stock exchanges provide exemptions for certain companies, such as those with a controlling stockholder, limited partnerships, companies in bankruptcy, smaller reporting companies, registered investment companies, and foreign private issuers.

Director Independence

The NYSE and Nasdaq require a majority of a listed company's board of directors to be composed of independent directors, and boards are required to make the affirmative determination as to whether each director qualifies as independent. The NYSE definition of independence requires that a director have no material relationship with the company. Nasdaq's definition of independence turns on whether the director has a relationship that would interfere with the exercise of the independent judgement of the director in carrying out his or her responsibilities. Although these determinations generally require an assessment of all relevant facts and circumstances, each of the stock exchanges also includes bright-line tests that, if satisfied, disqualify a director from being independent.

These tests relate to:

- whether the director or an immediate family member has been employed by or received compensation from the company;
- whether the director or an immediate family member is employed by another company that makes or receives payments above a certain threshold from the listed company;
- whether the director or an immediate family member is employed by the company's auditor; and
- whether the director or an immediate family member is employed by another company where any of the listed company's executive officers serve on the other company's compensation committee.

Executive Sessions

The NYSE and Nasdaq require independent directors to hold executive sessions once and twice a year, respectively, without the presence of management. The NYSE requires disclosure of the name of the presiding director at each executive session or the method by which that presiding director was selected. The NYSE also requires a listed company to disclose the method for interested parties (not just stockholders) to communicate with the presiding director of the executive session or the independent directors as a group.

Composition of Board Committees

The stock exchanges generally require public companies to have three board committees – audit, compensation and nominating and corporate governance. Stock exchange rules and the federal securities laws include extensive rules regarding the composition and responsibilities of these committees.

Audit Committee

Listed companies must have an audit committee with at least three members who are independent under the stock exchange rules and Rule 10A-3 under the Exchange Act. In order to be considered independent under Rule 10A-3

under the Exchange Act, audit committee members must not accept any consulting, advisory or other compensatory fee from the listed company or its subsidiaries, or be affiliated with the listed company or its subsidiaries. In addition, Nasdaq precludes a director who participated in the preparation of the financial statements of the company or its subsidiaries in the past three years from serving as an audit committee member.

The NYSE and Nasdaq require all audit committee members to have a certain level of financial literacy and one member to have a certain level of financial expertise. The NYSE also restricts service on multiple audit committees, providing that if a director serves on the audit committee of more than three public companies, the board must determine that such service would not impair the director's ability to serve effectively on the listed company's audit committee, and the board must disclose that determination publicly.

Stock exchange rules and the federal securities laws specify certain powers and responsibilities of the audit committee, including:

- appointing and overseeing outside auditors;
- establishing procedures for the receipt and treatment of complaints regarding accounting matters;
- authority to engage and pay independent advisers; and
- reviewing related-person transactions.

The NYSE mandates additional responsibilities of audit committees that are not otherwise required by Nasdaq, including:

- annually reviewing the independent auditor's report relating to the auditor's quality control procedures, any quality control issues identified and measures taken to address such issues;
- reviewing and discussing the company's annual and quarterly financial statements with management and the independent auditor;
- discussing the company's earnings press releases and guidance provided to analysts and rating agencies;
- discussing policies with respect to risk assessment and risk management;
- meeting separately and periodically with management, the internal auditors and outside auditors;
- reviewing with the independent auditor any audit issues and management's responses to such issues;
- setting clear hiring policies for employees or former employees of the independent auditor; and
- reporting regularly to the board of directors.

The NYSE also requires listed companies to maintain an internal audit function, which may be satisfied by an internal department or an outside third party who is not the independent auditor, and the internal audit function must be overseen by the audit committee. The NYSE and Nasdaq rules also govern what types of matters must be addressed in audit committee charters.

Compensation Committee

Listed companies must have a compensation committee composed entirely of independent directors (subject to a limited exception for Nasdaq companies). Nasdaq requires such a committee to be comprised of at least two members. Boards of NYSE companies must take into account the following factors (in addition to the factors outlined under the Director Independence heading above):

- the source of compensation of a director, including any consulting, advisory or other compensatory fee to be paid by the company to the director; and
- whether the director is affiliated with the company or any affiliate of the company.

NYSE and Nasdaq require listed companies to have compensation committee charters, which must, among other things, include: the duty of the committee to review and approve and/or make recommendations to the board relating to executive officer compensation; and the ability of the compensation committee to retain and pay compensation advisers.

Nominating and Corporate Governance Committee

NYSE requires listed companies to have a nominating and corporate governance committee composed entirely of independent directors. In contrast, Nasdaq permits listed companies to approve director nominations by either a majority of a company's independent directors or a nominating and corporate governance committee composed entirely of independent directors (subject to a limited exception set forth in Nasdaq's rules). The NYSE and Nasdaq rules also have requirements relating to nominating and corporate governance committee charters.

Board Evaluations

NYSE generally requires listed companies to conduct self-evaluations of their boards and their audit, compensation, and nominating and corporate governance committees at least annually. However, the NYSE does not provide specific requirements on how these evaluations should be conducted. Nasdaq does not require its listed companies to conduct a board evaluation.

Ethics and Code of Conduct

Stock exchange rules and the federal securities laws require listed companies to adopt a code of conduct applicable to its directors, officers and employees, addressing matters relating to conflicts of interest, fair dealing, compliance with law and enforcement of the code of conduct. Any waivers of the code of conduct for directors or executive officers are required to be publicly disclosed.

Corporate Governance Guidelines

Any company listed on NYSE must adopt and disclose corporate governance guidelines that address certain matters, including director qualification standards and responsibilities, director access to management and independent advisers, director compensation, director orientation and continuing education, management succession and annual performance evaluation of the board.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

In Delaware, directors and officers of a corporation have fiduciary duties of care and loyalty to the corporation and its stockholders. Other states have adopted constituency statues pursuant to which directors and officers are in certain circumstances permitted to consider the interests of constituents other than stockholders, such as customers, employers, the community, suppliers or creditors.

Duty of Care

The duty of care requires a director to act in an informed and considered manner and take the care that a prudent businessperson would take when considering a business decision. A director should review all material information reasonably

available when making a decision on behalf of the corporation and should have sufficient time to review the information in advance of making such a decision. A director should be afforded the opportunity to ask questions of management and outside advisers and should take advantage of this opportunity in the event the director does not understand something or believes there is an omission.

A director is entitled to rely upon information provided by management and outside advisers in satisfying this duty, unless the director has knowledge that the reliance is unwarranted.

Duty of Loyalty

The duty of loyalty requires a director to act in the best interests of the corporation and its stockholders rather than in the director's own self-interest or the interests of some other constituency, such as a particular stockholder. A director should either avoid a conflict of interest or disclose the substance of the conflict to the full board. In Delaware, the duty of loyalty also generally requires directors to make good faith efforts to oversee the corporation's operations through the implementation and monitoring of a board-level system for overseeing critical risks (known as the "Caremark" duty). A recent Delaware case confirmed that the Caremark duty of oversight also applies to officers with respect to matters within their areas of oversight.

Judicial Standards of Review

If directors have discharged their duties of care and loyalty, their decisions will generally be protected by the presumption of the business judgement rule, pursuant to which courts will not rescind an action of the board so long as it can be attributed to any rational business purpose. However, if a plaintiff satisfies the burden of showing that directors failed to discharge the duty of care or the duty of loyalty (such as by showing the existence of a conflict of interest) or satisfies the burden of showing gross negligence or bad faith on the part of directors, the board could lose the protections of the business judgement rule and its actions could be subject to a higher standard of scrutiny from the courts. For example, recent decisions by Delaware courts have demonstrated an increased willingness to permit Caremark duty of loyalty claims to survive the motion to dismiss stage when the directors' failure to oversee the corporation rises to the level of bad faith.

In certain states, including Delaware, courts apply enhanced scrutiny to board actions under certain circumstances, such as a decision to enter into a transaction constituting a change of control of the company or the adoption of a defensive action by the board.

See **4.8 Consequences and Enforcement of Breach of Directors' Duties** and **4.9 Other Bases for Claims/Enforcement against Directors/Officers** for more information about the standards of review and legal implications in connection with fiduciary duty breaches.

2.2 Environmental, Social and Governance (ESG) Considerations

In the USA, there is a significant amount of rulemaking currently underway related to ESG-related disclosures. Although the federal securities laws do not currently mandate any specific ESG-related disclosures, the Securities and Exchange Commission (SEC) is in the process of developing prescriptive disclosure requirements related to certain ESG topics, such as climate change, human capital management and board and workforce diversity. In the absence of such prescriptive requirements, ESG matters are subject to the same principles-based approach and

materiality standard that applies to other types of disclosure under the federal securities laws.

Over the last few years, as regulatory rulemaking in this area remained slow, institutional investors, proxy advisory firms, stockholders and other stakeholders have called on companies to provide ESG disclosures and/or enhance their ESG practices through public statements, voting guidelines and stockholder proposals. Stockholder proposals, in particular, generally serve as a low-cost way for stockholders to influence corporate behaviour and, since 2020, the number of stockholder proposals related to environmental and social matters has significantly increased year-over-year.

Additionally, over the last few years, major institutional investors, including BlackRock, State Street and Vanguard, have revised their proxy voting guidelines to highlight a number of key ESG focus areas, including climate change and the transition to a net zero economy, board and workforce diversity, and effective human capital management, each of which is viewed as playing a critical role in long-term company performance. Failure to provide appropriate disclosures and policies related to such issues can result in votes against the company, both on stockholder proposals and in director elections. For a discussion of examples of topical ESG issues, including director qualifications and workers' freedom of association rights, see the USA Trends & Developments chapter in this guide.

On 21 March 2022, the SEC took a major step toward developing a mandatory ESG reporting framework by proposing new rules that would require public companies to provide certain climate-related information in their public reports. Modelled on the framework recommended by the Task Force on Climate-Related Financial Disclosures, the proposed rules would, among other things, require companies to disclose, over a phase-in period, the following:

- how their boards and management oversee, identify and manage climate-related risks and how such risks impact the company (including its financial statements);
- Scope 1 and Scope 2 GHG emissions (and Scope 3, if material); and
- any climate-related targets or goals adopted by the company, including how the company plans to achieve them and relevant data to assess the company's progress.

It is now expected that the SEC will adopt final versions of its climate disclosure rules during the second half of 2023.

To keep pace with the increased focus on ESG issues, companies have increasingly engaged with investors on ESG matters through a broad array of channels, including periodic sustainability reports, enhanced ESG disclosures in proxy statements and other public filings and ESG-related conference calls. As Regulation FD prohibits selective disclosure of material, non-public information, companies may be required to make additional public disclosure on ESG matters in order to satisfy their obligations under Regulation FD.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

Corporations

In the USA, state law generally delegates the authority to manage the business and affairs of a corporation to a board of directors. A board

of directors typically delegates day-to-day management of a corporation to its executive officers while exercising oversight over management. The boundaries of a board's delegation to management may be documented by a board-approved delegation of authority that sets forth what types of decisions and transactions require board approval (such as transactions above a specified threshold).

A board may also delegate certain responsibilities to its committees, including its standing committees and/or new committees established by the board for the purpose of pursuing certain objectives, such as a transaction committee to manage the execution of certain strategic transactions or a special litigation committee to address stockholder derivative litigation. However, because the board as a whole remains responsible for ensuring it is satisfying its fiduciary duties, including its oversight responsibilities, it is important for the board to receive periodic updates regarding material issues it has delegated to management or its committees.

Stockholders do not actively manage the business and affairs of a corporation, but instead exert influence on a corporation by voting, making stockholder proposals, acquiring board seats by nominating directors or settling with the board and publicly or privately communicating to the board and/or management.

Limited Liability Companies

The governance structure of an LLC depends on whether the LLC has one or more members and whether it is managed by its members or managers. A single-member LLC will typically be managed by its sole member. A multi-member LLC may be managed by its members or by outside managers. Freedom of contract is a fundamental principle of US LLCs, so management authority in a multi-member LLC can generally be tailored in the operating agreement to the contracting parties' needs.

Partnerships

In a general partnership, each partner has the authority to undertake transactions, execute contracts and incur liabilities on behalf of the partnership, and is responsible for the day-to-day affairs of the partnership. In a limited partnership, management authority is delegated to a general partner, and limited partners will not have management authority over the business. Similarly to LLCs, limited partnerships follow the freedom of contract principle, so management authority in a limited partnership may also be tailored to the contracting parties' preferences in the limited partnership agreement.

However, limited partners may lose the protection of limited liability if they participate in day-to-day management of the business.

3.2 Decisions Made by Particular Bodies

A board of directors of a corporation in the USA typically makes decisions relating to the following matters:

- mergers and acquisitions;
- charter amendments;
- issuances of securities or equity awards;
- declarations and payments of dividends;
- selection, replacement and compensation of key executives;
- dissolution; and
- other material corporate actions in which there is a determination that board action would be desirable.

Stockholders typically have approval rights under state law or the stock exchange rules for the following actions:

- charter amendments;
- a merger involving the company as a target or a sale of all or substantially all of a company's assets;
- issuance of more than 20% of a company's outstanding shares of common stock;
- conversion to another entity form;
- domestication to a foreign jurisdiction; and
- dissolution of a company.

In an LLC or a partnership, decision-making authority may be tailored to the contracting parties' preferences within certain parameters set forth in the LLC operating agreement or the partnership agreement.

3.3 Decision-Making Processes

A board of directors of a corporation in the USA (including its committees) makes decisions by passing resolutions at a board or committee meeting or by written consent. In advance of a board or committee meeting, management or the board's outside advisers typically provide directors with a meeting agenda and written materials to ensure the directors are properly informed on the topics to be discussed at the meeting. Board meetings often include management presentations on the relevant topics and an executive session in which the board deliberates without the presence of management or any directors that are employed by the corporation.

At the meeting, the secretary of the corporation will typically keep board minutes as the official record of board deliberation and action.

Recent Delaware cases have emphasised the importance of boards adhering to corporate formalities (such as documenting board actions through minutes, resolutions and official letters). For example, stockholders are increasingly making demands in reliance on Section 220 of the DGCL, which gives stockholders the right to inspect a corporation's books and records for certain purposes, in order to gather information to criticise a company's decisions and decision-making processes in advance of filing lawsuits or launching activist campaigns. Under these cases, companies that observe formalities can generally satisfy a Section 220 demand by producing those formal records only. However, companies that instead correspond through informal channels (such as emails and text messages) may need to produce those electronic communications.

Stockholder action may be taken at annual or special meetings or, if permitted by applicable state law and the company's organisational documents, by written consent. See **5.3 Shareholder Meetings** for more information about stockholders' rights to call special meetings or act by written consent.

In an LLC or a partnership, action may be taken at meetings or by written consent, as may be set forth in the LLC operating agreement or the partnership agreement. There is generally no requirement to hold meetings.

4. Directors and Officers

4.1 Board Structure

A typical board structure for a US company is a single class of directors elected annually with standing committees that are delegated authority by the board to be responsible for certain matters such as audit, compensation and corporate governance matters. The board's authority to delegate matters to committees is typically broad, and committees will generally have the full authority to exercise the power of the board, subject to limited exceptions.

Most directors in the USA are elected annually. However, many states, including Delaware, permit boards to be staggered into separate classes that are up for election less frequently than annually, with each class generally limited to a term of no longer than three years. As a result, stockholders of companies with staggered boards only elect a portion of the board each year (eg, a third of the board). Staggered boards have become less common among US public companies, largely due to opposition from proxy advisory firms and institutional investors who argue that such structures diminish director accountability to stockholders and promote entrenchment. See **4.4 Appointment and Removal of Directors/Officers** for more information regarding the election of directors.

4.2 Roles of Board Members

A board of directors of a public company is typically comprised of management directors (ie, directors who also serve as employees or officers of the company) and independent directors. However, there may be other directors who are not independent but also not management directors (eg, directors who are employed by a controlling stockholder of the company). See **1.3 Corporate Governance Requirements for Companies with Publicly Traded Shares** for a discussion of how the independence of directors is determined.

Management directors generally have more intimate knowledge of the corporation's affairs as compared to independent directors. Certain states hold management directors to a higher standard of care due to their knowledge of and active involvement with the business. Independent directors are generally permitted to rely, within reasonable limits, on information provided by management and outside advisers in satisfying their fiduciary duties.

The board will also appoint a chair from amongst its members to generally serve as the leader of the board. The chair can either be an independent director or a non-independent director. When the chair of the board is non-independent (such as the CEO of the company), public companies generally appoint a lead independent director that has similar responsibilities as the chair to help ensure independent oversight of management. The specific responsibilities of the board's chair are typically laid out in the company's corporate governance guidelines or other organisational documents, but usually include duties such as presiding at board and stockholder meetings, establishing meeting schedules and agendas, serving as liaison between the board and management and being available, as needed, to meet with stockholders. In addition to the board chair, the board also appoints chairs of each board committee.

Investors are increasingly focused on directors having a diversity of expertise to enable them to serve as effective board and committee members and make informed decisions regarding the management of the corporation. Although there are limited requirements on the specific skills and qualifications directors must have, stockholders have submitted a number of proposals over the last few years seeking the representation of specific skills on the board, such as environmental, cybersecurity, human rights or corporate governance experts.

To highlight the skills and experiences represented on their boards, public companies are increasingly publishing board skill matrices in their proxy statements that identify which directors possess certain key skills such as finance and accounting, international, risk management and cybersecurity/technology expertise. Rather than providing skills matrices, some companies

prefer to disclose only aggregated data that shows the number of directors that possess each skill (without identifying which specific directors qualify).

4.3 Board Composition Requirements/Recommendations

Composition requirements of US boards are driven by stock exchange rules, federal securities laws, state law, and proxy advisory firm guidelines.

Stock Exchange Rules

Subject to certain exceptions, both the NYSE and Nasdaq rules require a majority of a public company's board to be independent, and only independent directors may serve on the audit, compensation and/or nominating and corporate governance committees. The NYSE and Nasdaq have bright-line tests relating to whether a director qualifies as independent, which must be affirmatively determined by the board. See **1.3 Corporate Governance Requirements for Companies with Publicly Traded Shares** for a detailed discussion of the NYSE and Nasdaq requirements on director independence. Nasdaq rules now also require each listed company to (a) publicly disclose board-level diversity matrices and (b) have, or explain why it does not have, at least one director who self-identifies as female, an under-represented minority or as LGBTQ+ by 2023, and two such directors by 2025.

Federal Securities Laws

The federal securities laws require each member of an audit committee to be independent and provide an overlay of independence requirements for audit committee members. See **1.3 Corporate Governance Requirements for Companies with Publicly Traded Shares** for a discussion of independence requirements under Rule 10A-3.

State Law

State law typically does not require directors to be independent. Having independent directors, however, may be favourable to a company and its directors from a stockholder litigation perspective. For example, in the context of a conflicted corporate transaction (ie, a transaction in which an officer or director has an interest on both sides of the transaction), review and approval (or ratification) by disinterested directors (along with the implementation of other procedure protections, such as stockholder approval) may subject such a transaction to a more deferential standard of review by the courts.

Proxy Advisory Firms Guidelines

The proxy advisory firms have published extensive guidelines that relate to board composition. ISS guidelines stress board independence, the existence of audit, compensation and nomination committees composed of independent directors and establishing leadership positions for independent directors, including as board chairs. ISS and Glass Lewis have also adopted board diversity policies in their proxy voting guidelines that generally provide for negative vote recommendations against the chair of the nominating and corporate governance committee of companies that fail to maintain a specified level of board diversity (either in terms of gender or racial/ethnic diversity). The specific minimum diversity thresholds differ between ISS and Glass Lewis, with Glass Lewis generally imposing a higher threshold.

4.4 Appointment and Removal of Directors/Officers

Directors of US public companies are typically elected by a majority of the stockholders entitled to vote at a meeting (although some companies may have plurality voting depending on state law and the company's organisational docu-

ments). In majority voting, a nominee generally must receive more "for" votes than "against" votes to be elected (or re-elected) to the board. In plurality voting, the nominees who receive the most "for" votes are elected (or re-elected) to the board until all board seats are filled. For companies that use plurality voting, in an uncontested election, where the number of nominees and available board seats are equal, every nominee is elected upon receiving just one "for" vote.

In the event of a vacancy or a newly created directorship, a majority of directors then in office are generally permitted to fill that vacancy or newly created directorship unless otherwise provided by the corporation's organisational documents. Typically, stockholders may remove a director with or without cause by a majority vote of stockholders, unless the board is staggered or the corporation has cumulative voting. If the board is staggered, a director may only be removed for cause unless otherwise provided for in its certificate of incorporation.

Officers are appointed by the board or other governing body of the corporation, and the offices of a corporation are typically set forth in the corporation's by-laws or in board resolutions. An officer may be removed by the board with or without cause, subject to contractual protections in that officer's employment agreement.

4.5 Rules/Requirements Concerning Independence of Directors

See **1.3 Corporate Governance Requirements for Companies with Publicly Traded Shares** and **4.3 Board Composition Requirements/Recommendations** for a discussion of rules and requirements relating to director independence.

The federal securities laws and state law provide rules relating to director conflicts of interest. Under the federal securities laws, public companies are required to disclose any transaction over USD120,000 that has occurred since the last fiscal year or is currently proposed, in which the company is a participant and any related person (defined to include directors) has or will have a direct or indirect material interest. Whether a director's interest in a transaction is "material" is a fact-specific determination; however, the federal securities laws do provide a number of "per se immateriality standards", including if the director's interest arises solely from the director's position as a director at the other company and/or ownership of less than 10% of either company's stock. The federal securities laws also mandate the disclosure of a company's internal related-party transactions policies and the directors responsible for applying such policies.

Under state law, conflicted transactions may be voidable and/or subject to a duty of loyalty claim by a stockholder. However, most states have adopted safe harbour statutes for conflicted transactions, which provide that such transactions are not per se voidable if the material facts relating to the conflict are disclosed to the board, the transaction is approved by non-conflicted directors or stockholders and/or the transaction is fair to the company. A company will also be in a better position to defend a stockholder's duty of loyalty claim if it takes any or all of the steps outlined in the preceding sentence.

4.6 Legal Duties of Directors/Officers

See **2.1 Hot Topics in Corporate Governance**.

4.7 Responsibility/Accountability of Directors

In Delaware and many other states, directors and officers owe fiduciary duties to the corporation as an entity and to its stockholders. See **2.1 Hot**

Topics in Corporate Governance for more information regarding general fiduciary duties. In the case of insolvent corporations, that duty requires directors and officers to manage the company for the benefit of all residual beneficiaries, and creditors of insolvent companies may enforce these fiduciary duties against directors.

Certain other states have various forms of constituency statutes, which permit the board in certain circumstances to balance the interests of stockholders against interests of other constituents, including customers, employers, suppliers or creditors. In addition, directors of public benefit corporations are required to consider the interests of the public, not just those of the stockholders.

4.8 Consequences and Enforcement of Breach of Directors' Duties

Fiduciary duty claims against a director may be claims brought directly by the corporation or by its stockholders on behalf of the corporation or, in some instances, on their own behalf. The consequences of a breach of fiduciary duty may be monetary damages or equitable relief.

A director is typically protected from personal monetary liability arising out of duty of care claims in several ways.

Firstly, courts typically apply the business judgement rule when reviewing the business decisions of a director. Because this standard of review is highly deferential to the board, it is rare for a court to find a fiduciary duty breach in decisions subject to the business judgement rule. (Note that duty of loyalty claims are generally subject to a heightened standard of review in the absence of the satisfaction of certain requirements, which means such claims are more likely to result in liability for directors.)

Secondly, states typically permit corporations to adopt provisions in their organisational documents that provide for the exculpation and/or indemnification of directors for losses and expenses incurred in connection with a duty of care claim. Indemnification rights generally apply to officers as well, and recently adopted amendments to the DGCL now permit companies to exculpate certain senior officers in connection with direct duty of care stockholder suits (but not for claims brought by the company or derivative suits). However, state corporation law statutes generally preclude companies from exculpating and/or indemnifying duty of loyalty claims.

Thirdly, states typically permit corporations to purchase liability insurance for their directors to cover losses resulting from fiduciary duty claims, including duty of care and loyalty claims.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

Courts evaluate board action under different standards of review, depending on the facts and circumstances underlying the board action. As discussed in **2. Corporate Governance Context**, business judgement review is the default standard for courts to review board action. If a plaintiff satisfies the burden of rebutting a presumption underpinning the business judgement rule, courts in most states apply "entire fairness", the most onerous standard of review, to board action, which requires the board to establish that a transaction was a product of fair dealing and fair price.

Courts in certain states, such as Delaware, apply enhanced scrutiny (which is an intermediate standard of review) to board action in certain circumstances, regardless of whether the presumptions underlying the business judgement rule have been satisfied, such as a board's

decision to enter into a transaction constituting a change of control of the company or to adopt a defensive action, such as adopting a poison pill. In circumstances where enhanced scrutiny applies, boards are required to take certain actions that they would not otherwise be required to take, such as seeking a transaction offering the best value reasonably available to stockholders in a change-of-control scenario.

Breaches of Corporate Governance Requirements

In addition to the core fiduciary duties of care and loyalty, Delaware and many other states recognise certain other corporate law doctrines supporting claims against directors or officers for breaches of corporate governance requirements. For example, in Delaware, board action intended primarily to interfere with the stockholder "franchise" – ie, core rights incident to share ownership, such as voting rights – must be justified by demonstrating a compelling justification for taking such action. Another example is the corporate waste doctrine, under which directors have a duty not to approve a "wasteful" transaction, which no person of ordinarily sound business judgement would find fair or acceptable.

Delaware law also imposes on directors a duty to disclose all material information in certain circumstances, including self-dealing transactions.

For a discussion of limitations on director and officer liabilities, see **4.6 Legal Duties of Directors/Officers**.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

Compensation for executive officers and directors is generally determined by the board of directors, and this responsibility is often delegated to compensation committees (or nominating and corporate governance committees, in the case of director compensation). In Delaware, the board's decisions regarding executive compensation are protected by the more deferential business judgement rule. A conflict of interest resulting in application of the entire fairness standard (which often survives a motion to dismiss) may arise where directors approve compensation arrangements for themselves.

The federal securities laws require a public company to convene a stockholder vote to approve the compensation of the company's named executive officers (generally, the CEO, CFO and three other most highly compensated executive officers), commonly referred to as the "say-on-pay" vote, at least once every three years and a separate vote to determine how often the say-on-pay vote will be held ("say-when-on-pay") at least once every six years.

The NYSE and Nasdaq listing standards require listed companies to receive stockholder approval for most equity compensation plans (and material amendments thereto).

4.11 Disclosure of Payments to Directors/Officers

The federal securities laws require extensive disclosure regarding the compensation of executive officers and directors in a public company's proxy statement. The disclosure focuses on compensation for the company's named executive officers (as described in **4.10 Approvals and Restrictions Concerning Payments to Directors/Officers**); however, additional executives may be included in this group because of turnovers during the applicable year.

The company's Compensation Discussion and Analysis (CD&A) in its annual proxy statement must explain the material elements of the company's compensation for its named executive officers and is intended to facilitate investors' understanding of the numbers in the requisite tables that follow the CD&A. A short compensation committee report is also required to be included in the proxy statement. Disclosure of any policies or practices regarding the ability of employees and directors to engage in hedging transactions with respect to the company's securities is also required.

Summary Compensation Table

The main table required to be included in a company's proxy statement is the Summary Compensation Table, which generally discloses the compensation earned by each named executive officer for each of the prior three fiscal years by category: salary, bonus, stock awards, options awards, non-equity incentive plan compensation, change in pension value and non-qualified deferred compensation earnings, other compensation and total compensation. The SEC's new "pay-for-performance" rules also require companies to include a table containing specific executive compensation and financial performance measures for the five most recent fiscal years as well as narrative disclosure explaining the relationship between the compensation paid to each named executive officer and the performance of the company. Other required tables must include information relating to grants of equity and bonus awards made to each named executive officer in the last fiscal year, outstanding equity awards at the end of the last fiscal year, stock options exercised by the named executive officers and stock awards that have vested during the last fiscal year, pension benefits, and non-qualified deferred compensation. Narrative or tabular disclosure regarding the circumstances in which a named executive officer may be entitled to compensation upon termination of employment or in connection with a change in control, including estimates of potential payouts is also required.

Companies must also disclose the ratio between the CEO's annual total compensation and the median of the annual total compensation of all other employees.

Director Compensation

Director compensation for the most recent fiscal year is also required to be disclosed in a table that is similar to the Summary Compensation Table, along with related narrative disclosure.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Stockholders are the owners of a corporation. This ownership relationship is governed by state law. If the corporation is public and listed on a stock exchange, this relationship will also be governed by stock exchange rules and the federal securities laws. Some corporations (but few public companies) may also have stockholder agreements in place that impose additional rights or restrictions on stockholders.

5.2 Role of Shareholders in Company Management

Under state law, stockholders have no involvement in the management of a corporation, which is vested in a board of directors and often delegated to executive officers by the board. State law generally enumerates certain actions that require stockholder approval, which is further discussed in **3.1 Bodies or Functions Involved in Governance and Management**.

5.3 Shareholder Meetings

Annual meetings of stockholders of a corporation are generally required under state law for the election of directors. For example, in Delaware, if a corporation fails to hold its annual meeting 30 days after the date designated for the annual meeting or 13 months after its last annual meeting, the Delaware Court of Chancery may order a stockholder meeting upon the application of any stockholder or director. Special meetings of stockholders may be called by the board of directors or any other person authorised by a corporation's organisational documents, such as stockholders. Corporations may explicitly prohibit the ability of stockholders to call special meetings in their organisational documents as a defence against stockholder activism. Most companies that permit stockholders to call special meetings impose certain procedural requirements in their organisational documents that restrict such a right (such as ownership thresholds, informational requirements and blackout periods). Such restrictions are contained in the company's certificate of incorporation or by-laws.

State law governs the mechanics of holding a stockholder meeting. In Delaware, the location and time of annual meetings may be established in a corporation's organisational documents or by the board. Such meetings can also be held virtually (by means of remote communication) if permitted by the company's organisational documents. Written notice of a meeting must be given to stockholders entitled to vote no later than ten days and no earlier than 60 days before the date of the meeting. The board is required to fix a record date for the purpose of establishing which stockholders are entitled to notice and the right to vote at a stockholder meeting, which must be no later than ten days and no earlier than 60 days before the date of the meeting.

Quorum requirements may be set in a corporation's organisational documents but may not be less than one third of the shares entitled to vote at the meeting. Delaware law generally does not govern the type of business to be conducted at a stockholder meeting, but corporations may include rules in their organisational documents or publish rules and/or agendas. For example, it is common for public companies to adopt advance notice by-laws, which require stockholders wishing to nominate a director or make a stockholder proposal to satisfy rigorous procedural and substantive requirements in order for their nomination or proposal to be properly raised at a stockholder meeting.

In Delaware, stockholders may take action by written consent without holding a stockholder meeting unless prohibited by the corporation's certificate of incorporation. Most public company certificates of incorporation prohibit stockholder action by written consent.

5.4 Shareholder Claims

A stockholder may file (a) direct claims against the corporation or its officers and directors for actions that directly harm the stockholder or (b) derivative claims against the corporation's officers and directors for actions that harm the corporation. A common example of a derivative claim brought by a stockholder is a claim alleging a breach of fiduciary duty by the board.

Prior to filing a derivative claim, a stockholder must demand that the board pursue the claim or, in most states, including Delaware, demonstrate that such a demand is futile because of the board's disinterest or conflict of interest with respect to the litigation. This procedural requirement does not exist for direct claims, so stockholders at times try to refashion derivative claims as direct claims.

5.5 Disclosure by Shareholders in Publicly Traded Companies

Federal Securities Law

The federal securities law requires an investor or group of investors who acquire beneficial ownership of more than 5% of a public company's voting equity securities to file reports relating to their ownership on Schedule 13D, or if eligible, on Schedule 13G. Passive investors that own less than 20% of a company's equity securities are eligible to report that ownership on Schedule 13G and are otherwise subject to a less onerous reporting regime than that applicable to Schedule 13G filers. An investor who acquires more than 5% of a public company's voting equity securities, and is not eligible to file a Schedule 13G, must report the acquisition on a Schedule 13D with the SEC within ten days of crossing the 5% threshold.

Schedule 13D requires the disclosure of the identity of the investor, information about the investor's ownership of the company's securities and sources of funds, any of the investor's arrangements with respect to securities of the company and the purpose of the acquisition, including any plans or proposals which the investor may have to make changes to the board or management or to consummate a corporate transaction. The Schedule 13D must be amended promptly as a result of any material changes in the disclosure to the original Schedule 13D, which include the acquisition or disposition of 1% or more of the class of equity securities of the company. Subject to certain exceptions, an investor eligible to file a Schedule 13G must file the report within 45 days after the end of the calendar year in which the investor first became obliged to make such a filing.

On 10 February 2022, the SEC proposed new disclosure rules that would, among other things:

- shorten the filing deadlines for Schedule 13D and 13G filings to five days from the date the investor crosses the 5% threshold;
- expand the definition of beneficial ownership to cover certain cash-settled derivative securities; and
- broaden the "group" concept pursuant to which securities owned by multiple individuals can be aggregated by clarifying that there does not need to be an express or implied agreement between two individuals for them to qualify as a "group".

Institutional Investment Managers

Institutional investment managers that have assets under management of at least USD100 million must report to the SEC their holdings of exchange-traded equity securities, certain equity options and warrants, shares of closed-end investment companies and certain convertible debt securities on Form 13F within 45 days of the end of each calendar quarter. Form 13F requires disclosure of the name of the manager, the name and class of security holdings and the number of shares and the market value of such shares as of the end of the calendar quarter.

Beneficial Owners

Beneficial owners of more than 10% of any class of equity security of a public company (as well as directors and officers) must report their beneficial ownership of equity securities on Section 16 forms. Transactions in equity securities by such stockholders, directors and officers must generally be reported within two business days. These parties may be required to disgorge to the company any profits made in connection with the purchase and sale of company securities within a six-month period.

Acquisitions of Voting Securities

Certain acquisitions of voting securities by an investor must be reported to the Federal Trade Commission (FTC) and the Department of Justice (DOJ) prior to consummation if the transaction value and the sizes of the investor and issuer exceed certain thresholds pursuant to the Hart-Scott-Rodino Antitrust Improvements Act. Upon the investor making the filing, the FTC and DOJ have a 30-day period in which to request further information from the investor to determine whether the acquisition violates the US antitrust laws.

The contents of the filing are confidential. Stockholders should be mindful of other regulatory regimes that may be implicated by a stockholder's acquisition of shares, including:

- the Committee on Foreign Investment in the United States for certain acquisitions by foreign persons;
- the Federal Energy Regulatory Commission for acquisitions of the shares of regulated utilities; and
- the Federal Communications Commission for acquisitions of the shares of regulated telecommunication companies.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

The federal securities laws require public companies to file publicly annual, quarterly and current reports relating to the occurrence of certain events material to stockholders. Annual and quarterly reports must be certified as accurate and complete by a company's CEO and CFO. Public companies are also required to file proxy statements in connection with their stockholder meetings.

6.2 Disclosure of Corporate Governance Arrangements

The federal securities laws require public companies to disclose the following information relating to corporate governance in their proxy statements:

- director biographical and qualification information;
- director independence and the methodology for determining director independence;
- board meeting attendance and related policies;
- committee information, including membership, purpose and function, and number of meetings held;
- board leadership structure;
- description of the board's role in company risk oversight;
- applicable hedging policies regarding director ownership of stock;
- code of ethics or rationale for non-adoption;
- compensation of the named executive officers;
- compensation discussion and analysis;
- certain pay ratios and say-on-pay policies; and
- independent auditor information.

Public companies must also disclose the occurrence of certain events in a current report, including:

- a change in control;
- the election or departure of a director or officer;
- any amendment to a company's certificate of incorporation or by-laws;

- any amendment to a company's code of ethics, or waiver of a provision of the code of ethics;
- submission of matters to a vote of security holders;
- stockholder director nominations; or
- changes in a company's certifying accountant.

The federal securities laws also require a public company to post on its website its nominating committee, audit committee and compensation committee charters or include the charters as an appendix to its proxy statement every three years. NYSE requires listed companies to make its code of business conduct and ethics publicly available on or through its website.

6.3 Companies Registry Filings

State law generally requires corporations and certain other entity forms to file the charter for a corporation with the Secretary of State. Certain states also require corporations and certain other entity forms to file annual or biannual reports, which generally require basic information about the entity, such as its legal name, address, registered agent and names of directors and officers. States typically make these filings publicly available.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

The federal securities laws require public companies to have an independent auditor review their financial statements and disclosures and provide an opinion as to their fairness and compliance with the Generally Accepted Accounting Principles (GAAP).

The SEC considers the independence of an auditor impaired if the auditor is not, or if a reasonable investor with knowledge of all attendant facts and circumstances would conclude that the auditor is not, capable of exercising impartial judgement on all issues encompassed within the audit engagement. In addition, certain actions and arrangements between a company and its outside auditor are not permitted, including contingent fee arrangements, direct or material indirect business arrangements between a company and its outside auditor and a company hiring certain employees of the independent auditor during a one-year cooling-off period.

SEC rules prohibit independent auditors from providing certain non-audit services to a company, including but not limited to bookkeeping, management or human resource functions or legal services and unrelated expert advice. Independent auditors may provide other non-audit services to a company that are not specifically prohibited by SEC rules as long as the audit committee provides pre-approval. A company's audit committee is responsible for the oversight of its independent auditor.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

The federal securities laws require a public company to maintain adequate internal controls over financial reporting (ICFR) in order to provide reasonable assurances with respect to the reliability of the company's financial reporting and compliance with GAAP measures. A company's principal executive and financial officers are responsible for the design and implementation of the internal ICFR regime and must report control deficiencies and related findings to the audit committee and the company's independent auditor. Subject to certain exceptions, com-

panies are required to include a management-drafted internal control report with their annual report and a related attestation by the company's independent auditor.

NYSE requires a company's audit committee to discuss policies with respect to risk assessment and risk management, but states that the audit committee is not required to be the sole body responsible for risk oversight. Federal securities laws only require disclosure of the board's role in the company's risk oversight process. However, in response to investor, proxy adviser and stakeholder pressure, corporate disclosures about risk oversight, particularly in proxy statements, have become increasingly detailed, often including descriptions of the risk oversight processes of specific, critical risks facing the company (such as cybersecurity, environmental and social risks) and/or describing the number of directors the company has that have risk oversight experience.

Trends and Developments

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Sullivan & Cromwell LLP has a record of success and client service, which has been perfected over 140 years and made the firm one of the models for the modern practice of law. Today, it is considered one of the leaders in each of its core practice areas and geographic markets. S&C advises a diverse range of clients on corporate transactions, litigation and estate planning matters. It comprises more than 875 lawyers, who conduct a seamless, global practice through a network of 13 offices located in Asia, Australia, Europe and the USA.

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Caremark Duties of Corporate Officers

Corporate governance reforms continue to be an important topic for US companies. This article will cover the key topical issues in early 2023.

Over the last few years, there has been a series of Delaware cases focused on the duty of oversight, often referred to as Caremark duties, which require directors, in order to satisfy their duty of loyalty, to make good faith efforts to oversee their company's operations by implementing board-level oversight and monitoring of critical risks facing the company. Caremark cases are typically brought by shareholders after a significant adverse corporate event and allege that the event occurred because the company's directors failed to fulfil this oversight duty.

In late January 2023, the Delaware Court of Chancery issued a decision in holding for the first time that officers, in addition to directors, owe a Caremark duty of oversight. Shareholders of McDonald's sued the former head of the McDonald's human resources function for breaching his fiduciary duties by allowing a corporate culture to develop that condoned sexual harassment and misconduct. Specifically, the shareholders alleged that the officer breached a Caremark duty by consciously ignoring "red flags" signalling misconduct, citing to, among other things, the fact that the officer himself was engaging in such misconduct. The officer moved to dismiss the claim, arguing that Delaware law did not impose oversight duties on corporate officers. However, the Delaware court declined to dismiss the claim, instead clarifying that officers do owe Caremark duties of oversight comparable to those of directors that require them to (i) make a good faith effort to establish an information system to identify red flags and significant corporate issues, and (ii) address and report upward any red flags they discover. The court did recognise that this duty, as applied to officers, is context-driven and will differ depending on the role of the officer. For example, for officers that have particular areas of responsibility, such as a CFO or Human Resources Officer, their oversight duty will generally be limited to establishing information systems and addressing red flags within their departments whereas other officers, such as CEOs, have a company-wide oversight duty.

Shareholders seeking to bring Caremark claims against officers will still face significant challenges, including the need to demonstrate demand futility, which generally requires a showing that a majority of the board was conflicted with respect to the lawsuit and demonstrating bad faith on the part of the applicable officer, which is one of the highest pleading standards in Delaware practice. Nevertheless, this decision could encourage shareholders to seek corporate books and records about officers or even make litigation demands on boards concerning officer oversight claims.

Prior to the McDonald's litigation, in August 2022, the Delaware General Assembly amended Section 102(b)(7) of the Delaware General Corporation Law to permit companies to adopt charter provisions exculpating certain senior officers (in addition to current exculpation provisions, in favour of directors) for monetary damages arising out of breaches of their fiduciary duties of care. Previously, Delaware companies could adopt exculpation provisions only for the benefit of directors. In order to adopt an officer exculpation provision, a Delaware company needs to amend its charter, which requires shareholder approval. There are also certain limits to the scope of such provisions, including that they cannot be used to exculpate duty of loyalty breaches or intentional misconduct (among

other limitations), which means that they do not apply to claims involving Caremark breaches. Still, the McDonald's decision signalled the willingness of the Delaware courts to expand officer liability, which could have contributed to the decision by hundreds of companies to include an officer exculpation proposal in their proxy statement this proxy season.

For example, as of 5 May 2023, approximately 200 companies have filed proxy statements seeking shareholder approval of an officer exculpation proposal. While only a fraction of the proposals have been voted at this point in the proxy season, a significant majority of the officer exculpation proposals that have gone to a vote have passed (after receiving average support of 92% of the votes cast). In fact, only five officer exculpation proposals have failed so far, and in each case the determinative factor for such failure appears to be low voter turnout (eg, high numbers of broker non-votes) that prevents the proposal from receiving approval from the requiring percentage of shares outstanding, rather than shareholder disapproval of officer exculpation, as all of these proposals received approval from over 90% of votes cast. ISS has also generally supported the adoption of officer exculpation proposals; only recommending against such proposals at non-Delaware companies or Delaware companies with dual class stock. In light of the high levels of support such proposals have received to date as well as general concerns over the potentially increasing risk of officer liability, we are likely to see an increase in the number of companies seeking to adopt officer exculpation provisions next year.

Director Qualifications

Recent regulatory developments, high-profile corporate failures and challenging macro-economic conditions have heightened the focus on director qualifications, with investors and other stakeholders increasingly looking for assurances that boards have adequate skill sets to ensure effective oversight. Shareholders have submitted a number of proposals over the last few years requesting increased disclosure of director qualifications and/or the appointment of directors with specific skills, such as environmental, cybersecurity or human resources experience. Recent proxy contests have also focused more on individual director qualifications following the SEC's adoption of the universal proxy rules, which mandate the use of a "universal" proxy card listing both the company's and the dissident shareholder's nominees in contested board elections held after 31 August 2022. Under these new rules, shareholders are now able to "pick and choose" a mix of nominees from both slates (whereas, previously, shareholders voting by proxy had to choose between voting on the company's proxy card or the dissident shareholder's), thereby making it easier for activists and shareholders to target and replace specific directors whom they view as underqualified or underperforming.

Taking advantage of these new rules, the first few universal proxy campaigns have become more individual-focused, with the activists focusing more on comparing the perceived weakest company nominees with their own nominees in order to garner support, rather than the differentiation of their overall platform.

In response to this growing scrutiny, boards have begun to prioritise the appointment of directors with experience in more functional areas that are viewed as increasingly important to stakeholders, such as technology and human resources. A June 2022 Spencer Stuart survey of 107 S&P 500 and MidCap 400 nominating/governance committee chairs found that adding new skills to

the board was the most important factor driving board refreshment, while another Spencer Stuart survey conducted in May 2022 of 590 directors found that 21% were seeking to appoint new directors with ESG expertise. Future regulatory changes could also add pressure to boards to seek out directors with particular practical experience. For example, both of the SEC's proposed climate-related and cybersecurity rules would require companies to disclosure whether they have climate-related or cybersecurity experts on their boards, which, if adopted, could ultimately provide activists with additional information to scrutinise directors in future campaigns.

"Pass-Through" Voting

In 2022, amidst growing criticism of BlackRock's ESG practices, BlackRock became the first major institutional investor to unveil a voting choice or "pass-through" voting programme that gave certain institutional investors the option to decide how BlackRock would vote their underlying shares with respect to certain matters, like ESG, and BlackRock has since announced that it is expanding this programme to include retail investors in select mutual funds this year. State Street and Vanguard soon followed suit, announcing that they would launch their own voter choice programmes beginning this year.

Although each programme differs slightly, eligible investors under these programmes are generally given certain options to choose from regarding how their shares will be voted, including (i) deferring to the fund's stewardship team to make the voting decisions; (ii) having their shares voted in accordance with certain third-party, off-the-shelf policies (such as ISS and/or Glass Lewis policies); or (iii) following the applicable company's board recommendation with respect to each proposal to be voted on.

By dispersing the voting power held by these large institutional investors, these programmes could have significant consequences in future proxy seasons. For example, because each programme allows investors to choose to vote pursuant to proxy advisory firm policy, if this option is selected by a large number of investors, it could significantly increase the voting influence of major proxy advisory firms like ISS and Glass Lewis. These programmes could also amplify the voting influence of certain select shareholders, like activists pushing short-term interests, particularly as they expand to retail investors.

Advance Notice By-law Litigation

Advance notice by-laws have taken on renewed importance following the SEC's adoption of the universal proxy rules, which generally make it less costly and time-consuming to launch a proxy contest. Following recent SEC guidance confirming that the notice and disclosure obligations imposed on shareholders under the universal proxy rules apply in addition to any requirements imposed under a company's advance notice by-law, over 500 public companies decided to review and update their advance notice by-laws to ensure that they will provide the company with sufficient time and information to evaluate any dissident shareholders or proposed nominee during a proxy contest. Expanded requirements have focused both on the categories of information that must be disclosed, as well as extending the types of persons about whom disclosure must be made.

In general, recent Delaware cases confirm that Delaware companies have broad discretion to impose disclosure obligations under their advance notice by-laws. These cases have repeatedly emphasised that robust advance notice by-laws will be upheld so long as they are reasonable, unambiguous, applied equitably and

adopted on a "clear day" when no threat was present. However, some companies have instituted aggressive requirements that have tested the boundaries of what constitutes a reasonable advance notice by-law.

In one notable situation in October 2022, Masimo Corporation was sued after it amended its advance notice by-law in response to an activist campaign to impose a number of informational requirements viewed by the activist and many other stakeholders as being "draconian", including requirements for a shareholder seeking to make a nomination to disclose (i) the identity, and certain investment holdings of, their financial backers, like limited partners, even though such information is often subject to confidentiality requirements and (ii) the shareholder's future plans to nominate individuals and/or submit proposals at other companies, which could reveal the shareholder's investment plans or strategies. The activist alleged in its lawsuit that these changes were egregious and would effectively preclude certain shareholders from nominating directors due to their hesitation to disclose such pieces of information. Ultimately, Masimo amended its by-laws to remove the enhanced disclosure requirements before the court came to a decision on the validity of the by-laws. However, companies seeking to enhance advance notice by-laws may look to Masimo as an illustrative example of a by-law that could be viewed as going too far.

Workers' Rights and Freedom of Association

Employee retention issues and other employee-related challenges spurred by the aftermath of the COVID-19 pandemic have translated into an enduring shareholder focus on company human capital practices and workers' rights. While workers' rights issues cover a broad range of topics ranging from minimum wage, to paid sick leave policies, to workforce safety, freedom of association and collective bargaining rights have recently taken the main stage. Just last year, Amazon workers at a Staten Island warehouse made headlines when they voted to join a union, despite the company's aggressive campaign against unionisation efforts.

Demands to protect workers' freedom of association have translated into an increase in shareholder proposals. For example, in early February, the New York State Comptroller and NYC Retirement Systems submitted several proposals at major companies (including Walmart, CVS and Netflix) that have faced numerous labour controversies regarding workers' freedom of association and collective bargaining rights. In particular, these proposals request the target company to (i) adopt and publicly disclose a policy on their commitment to respecting workers' rights (for those companies that do not currently have such a policy) or (ii) conduct a third-party audit of the company's adherence to its stated commitment to such risks (for those companies that have already adopted policies). A similar proposal passed (after receiving 52% support) at Starbucks earlier this year while another was withdrawn at Apple after Apple agreed to conduct the third-party assessment of its labour practices.

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