SAM Sustainable Asset Management

Corporate Governance
Key Factors and Developments

Zürich, 14 March 2011

Prof. Dr. Olaf Müller-Michaels

Rechtsanwalt, Orrick Hölters & Elsing, Düsseldorf

Professor, FOM Hochschule für Oekonomie & Management, Essen

Intro


CEO PRESENTS TO THE BOARD OF DIRECTORS
AN UNDERLING MADE THESE POWERPOINT SLIDES AND I DON'T UNDERSTAND THEM.
www.dilbert.com scottadams@aol.com
BUT IT DOESN'T MATTER BECAUSE ALL OF YOU ARE TOO PREOCCUPIED WITH YOUR DAY JOBS AND MISTRESSES TO PAY ATTENTION.
©2008 Scott Adams, Inc./Dist. by UFS, Inc.
WHO VOTES TO GIVE ME A HUGE BONUS JUST TO END THIS MEETING?
AYE
AYE
AYE

Overview

- Concepts
- Recent History
- Main Issues
  + Board Structure
  + Executive Compensation
  + Directors Liability
- Ideas

ORRICK HÖLTERS & ELSING

Studium neben dem Beruf FOM Hochschule für Oekonomie & Management University of Applied Sciences

Concepts

- „Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders." (OECD Principles of Corporate Governance)

- Anglo-saxon tradition more narrowly focusses on interests of shareholders and sees management as „agent" of shareholders

- Issues resulting from the separation of ownership and control
  + Shareholders and management
  + Controlling and minority shareholders
  + Other stakeholders?

Concepts

- Internal Corporate Governance
  + Shareholder competences and decisions
  + Board structure
  + Executive Compensation
  + Directors‘ Liability

- External Corporate Governance
  + Regulators
  + Auditors
  + Financial Intermediaries
  + Whistleblowers
  + Takeovers

Recent History

- Landmark Developments

- Post Enron
  + USA: Sarbanes-Oxley Act
  + EU: Commission Recommendations and member state legislation
  + Focus on disclosure, board structure and auditors

- Post Financial Crisis
  + G20 Resolutions
  + EU: Dodd-Frank Act
  + Europe: Commission Recommendations
  + Focus on executive compensation and rating agencies

Board Structure

- One-tier boards
  + Board of Directors with executive and non-executive directors
  + Chairman of the Board and Chief Executive Officer should not, but legally can be the same person

- Two-tier boards
  + Management Board with executive directors responsible for the operation of the company
  + Supervisory Board with non-executive directors responsible for hiring, firing, remuneration and oversight over management
  + Employee and union representatives mandatory in Supervisory Board in Germany
  + No directions between boards and shareholders and boards
  + Incompatibility between the two boards

Board Structure: Independence

- Secure loyalty and prevent permanent conflicts of interest

- Issues:
  + Additional remuneration from the company
  + Business relationships with the company
  + Representative of controlling shareholder
  + Employees of the company
  + Partner or employee of external auditor
  + Cross-directorships
  + Total tenure of more than 12 years

- Trade-off between independence and competence

Board Structure: Size and Committees

- Empirical research shows negative correlation between board size and board efficiency

- Important decisions prepared by or transferred to committees

- Mandatory committees in many jurisdictions:
  + Audit Committee
  + Nomination Committee
  + Remuneration Committee

- Majority of members of mandatory committees should be independent

Executive Compensation

- Framework before Financial Crisis
  + Disclosure of executive compensation
    • Remuneration policy
    • Remuneration of individual directors
  + Shareholder approval of share-based remuneration schemes

- Financial Crisis showed that this was not sufficient
  + Focus on short-term performance
  + Increasingly complex and intransparent systems
  + Absolute amounts excessive

Executive Compensation

- New framework after Financial Crisis

- Shareholder „say on pay“ on all elements of compensation (non-binding)

- Improved disclosure
  + Relationship between executive compensation and performance of company
  + Multi-year graph on relationship between executive compensation and shareholder yield
  + Ratio between median employee and CEO compensation

Executive Compensation

- Restriction of variable components
  + Linking to long-term performance and inclusion of non-financial criteria
  + Deferral for a certain period subject to performance conditions
  + Vesting period for share-based components of at least three years
  + Cap
  + Ability to reclaim variable components paid as a result of misstated performance (clawback)
  + Remuneration of non-executive directors should not include share options

- Limits on termination payments („golden parachutes“)
  + Two-years fixed remuneration

Directors Liability

- Balance-sheet oath of CEO and CFO (US Sarbanes-Oxley Act)

- Claims of shareholders against executives for false disclosure

- Claims of shareholders to have management actions investigated by independent auditors or lawyers (wrongful trading)

- Claim of company against directors responsible for granting excessive compensation to executive officers

- Minimum deductible for directors and officers liability insurance (D&O)

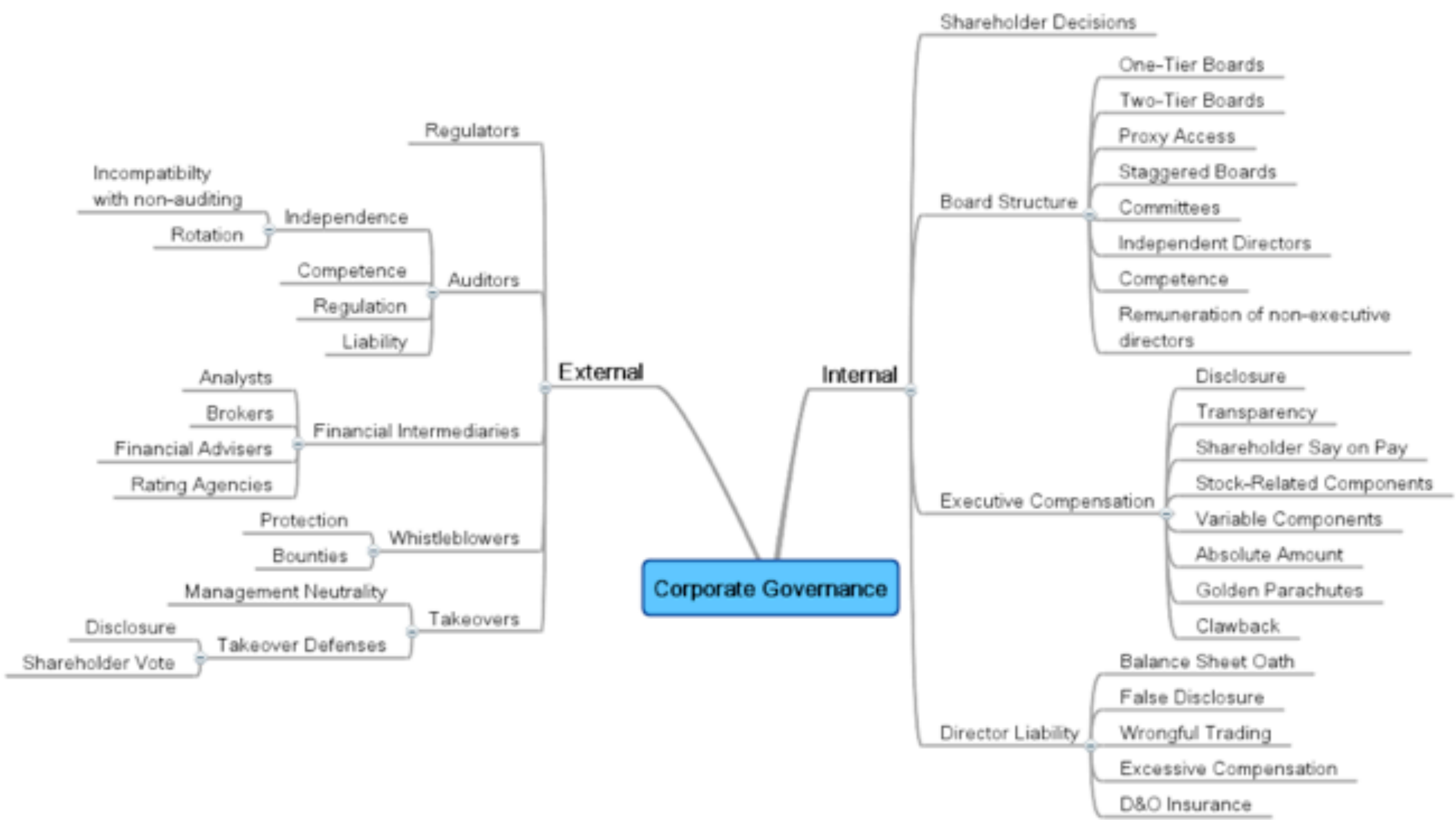
Ideas

- Consider shareholder dimension
  + Disclosure of shareholders with controlling interest (exceeding directly or indirectly 30%)
  + Policies to avoid private benefits of control

- Update questions on executive compensation
  + Relationship of executive compensation to financial performance of company, yield of shareholders and median employee compensation
  + Linking or variable components to long-term performance and non financial indicators
  + Vesting period and cap on variable components, including stock options

- Include training for non-executive board members

Summary


Corporate Governance
External
Regulators
Auditors
Independence
Incompatibilty with non-auditing
Rotation
Competence
Regulation
Liability
Financial Intermediaries
Analysts
Brokers
Financial Advisers
Rating Agencies
Whistleblowers
Protection
Bounties
Takeovers
Management Neutrality
Takeover Defenses
Disclosure
Shareholder Vote
Internal
Shareholder Decisions
Board Structure
One-Tier Boards
Two-Tier Boards
Proxy Access
Staggered Boards
Committees
Independent Directors
Competence
Remuneration of non-executive directors
Executive Compensation
Disclosure
Transparency
Shareholder Say on Pay
Stock-Related Components
Variable Components
Absolute Amount
Golden Parachutes
Clawback
Director Liability
Balance Sheet Oath
False Disclosure
Wrongful Trading
Excessive Compensation
D&O Insurance

Links

- OECD Corporate Governance Principles
- Global Corporate Governance Forum
- Index of corporate governance codes worldwide
- European Corporate Governance Institute
- European Commission: Modernisation of Company Law and Enhancement of Corporate Governance
- Standard & Poor‘s Governance Services (GAMMA)

Professor, FOM 2009
Rechtsanwalt since 1997
Dr. jur., Ruhr-Universität Bochum 1996

Chambers Europe 2009: Highly Regarded (Corporate/M&A)

Professor Dr. Olaf Müller-Michaels

Rechtsanwalt
Orrick Hölters & Elsing

Immermannstraße 40, 40210 Düsseldorf
tel **+49 (0) 211 36787 211**
fax **+49 (0) 211 36787 177**
omueller-michaels@orrick.eu

Prof. Dr. Olaf Müller-Michaels is attorney in the Düsseldorf office of Orrick. He focusses on corporate transactions and on corporate and capital markets law. Olaf Müller-Michaels advises on strategic measures, privatizations, shareholder disputes as well as on corporate governance and compliance. He is chairman of the supervisory board of Murphy&Spitz Green Capital AG, a listed private equity company focussed on renewable energies. Moreover, he is arbitrator and counsel in national and international arbitration.

Prof. Dr. Olaf Müller-Michaels has published numerous articles in legal books, law journals and newspapers, and operates the legal blog „Verschmelzungsbericht".

Since 2009, Olaf Müller-Michaels is a regular professor for business law at FOM Hochschule für Oekonomie & Management in Essen. Besides corporate law he teaches European and International Business Law as well as legal drafting and negotiation.