

# SAM Sustainable Asset Management

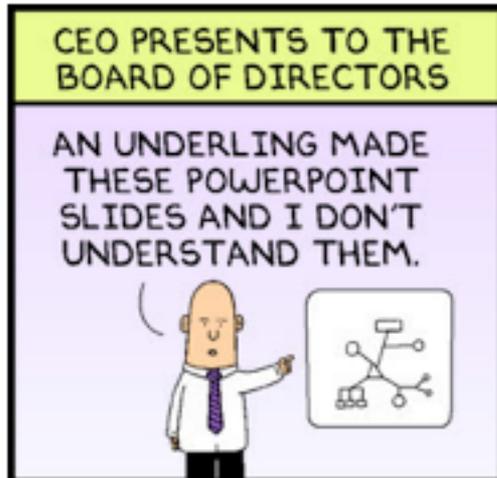
## Corporate Governance Key Factors and Developments

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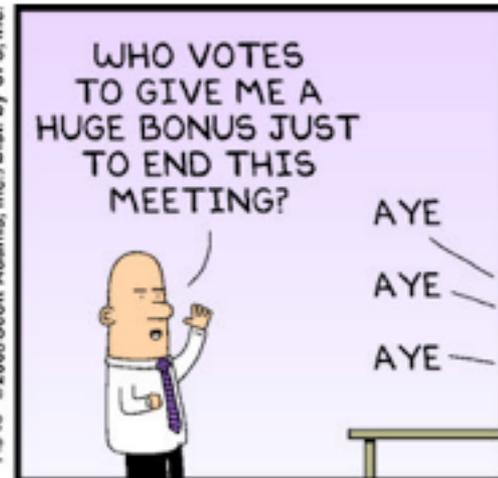
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- Concepts
- Recent History
- Main Issues
  - + Board Structure
  - + Executive Compensation
  - + Directors Liability
- Ideas

- „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?

- Internal Corporate Governance
  - + Shareholder competences and decisions
  - + Board structure
  - + Executive Compensation
  - + Directors' Liability
  
- External Corporate Governance
  - + Regulators
  - + Auditors
  - + Financial Intermediaries
  - + Whistleblowers
  - + Takeovers

- 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

- 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

- 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

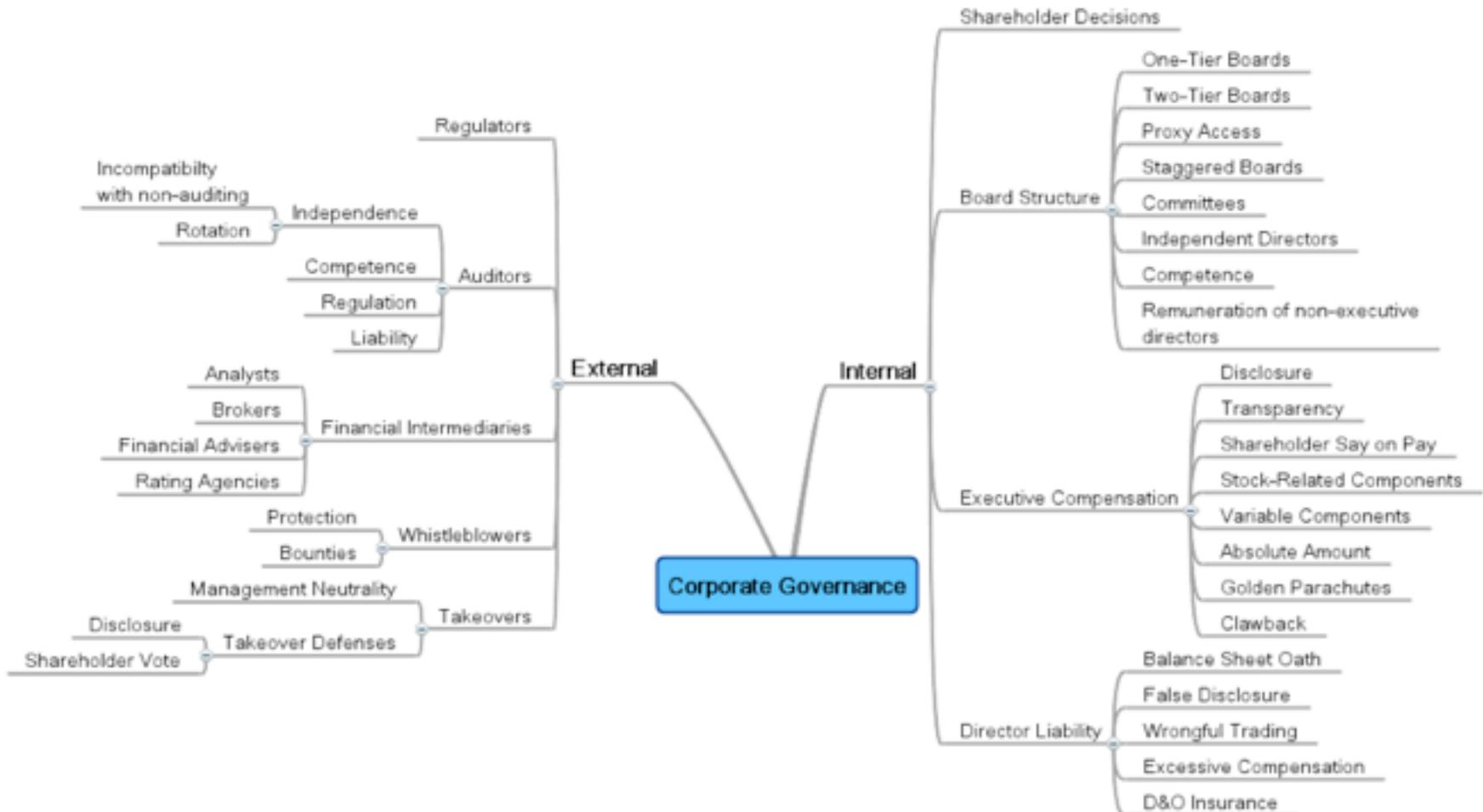
- Framework before Financial Crisis
  - + Disclosure of executive compensation
    - Remuneration policy
    - Remuneration of individual directors
  - + Shareholder approval of share-based remuneration schemes
  
- Financial Crisis showed that this was not sufficient
  - + Focus on short-term performance
  - + Increasingly complex and intransparent systems
  - + Absolute amounts excessive

- 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

- 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

- 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)

- 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



- 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  
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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.