LEXOLOGY
Getting The Deal Through

CORPORATE GOVERNANCE 2023

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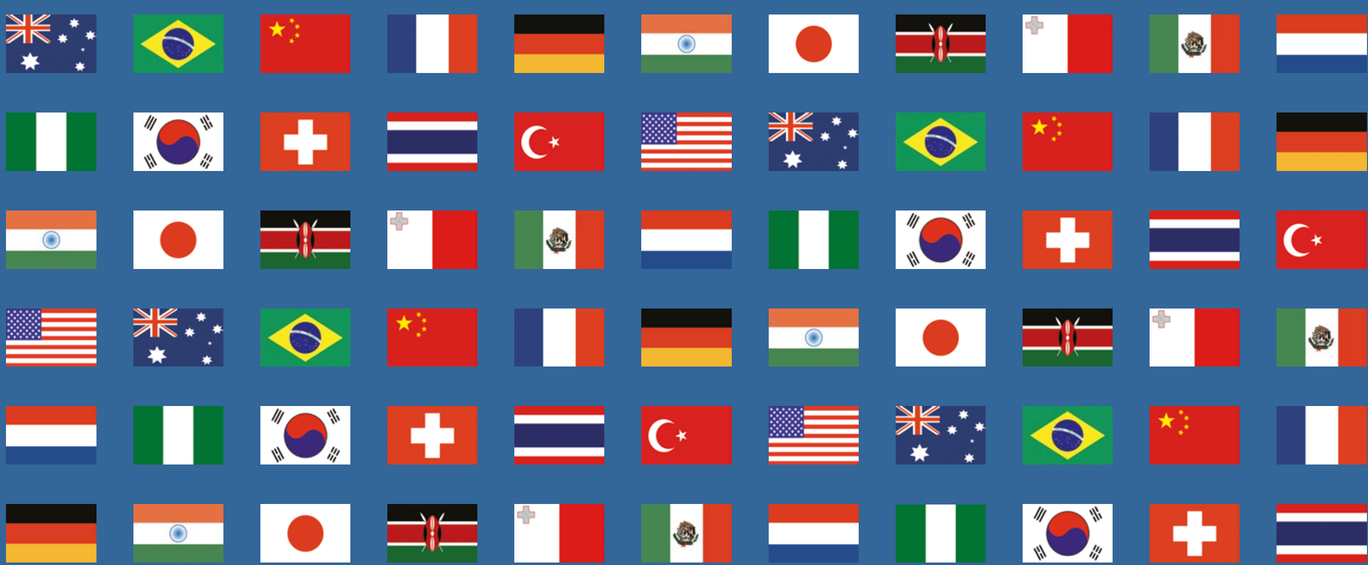

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Summary

SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The main elements of Australia's corporate governance framework are as follows:

- legislation, including the Corporations Act 2001 (Cth), which governs all companies;
- rules, including the Australian Securities Exchange (ASX) Listing Rules; and
- non-binding guidelines, including:
  - the ASX Corporate Governance Council's Principles and Recommendations;
  - guidance and commentary published by the Australian Securities and Investment Commission (ASIC); and
  - guidelines published by the Australian Institute of Company Directors, the Governance Institute of Australia, the Financial Services Council, and the Australian Council of Superannuation Investors.

Public companies listed on the ASX must comply with the ASX Listing Rules.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The main government agencies in Australia's corporate governance framework are ASIC, which enforces the Corporations Act 2001 (Cth), and the ASX, which enforces the ASX Listing Rules and the ASX Principles.

The following groups are influential on the corporate governance practices of companies and whose views are often considered:

- shareholder lobby groups, which advise specific industry shareholder groups (eg, the Australian Shareholders Association and the Australasian Centre for Corporate Responsibility);
- institutional investors, which have large shareholdings (eg, superannuation and managed funds); and
- proxy advisory groups, which provide advice to shareholders about voting during the annual general meeting season (eg, Glass Lewis).

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

The Corporations Act 2001 (Cth) sets out the procedure for the appointment and removal of directors.

Shareholders of a proprietary company can appoint and remove directors by a simple majority vote at a general meeting. A company's constitution can modify or replace this rule.

Shareholders of public companies can appoint and remove directors at a general meeting by an ordinary resolution. If the directors appoint a new director, the shareholders must confirm that appointment at the company's next annual general meeting.

Usually, a company's constitution will vest the power of management in the company's board. Therefore, shareholders generally do not have the right to require the board to pursue a particular course of action.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

Shareholders can make decisions only on those matters expressly reserved to them under the company's constitution, or those reserved under the Corporations Act 2001 (Cth), which include:

- adopting or altering the company's constitution;
- consolidating or subdividing shares and reducing share capital;
- altering the rights attached to shares; and
- initiating a shareholders' voluntary winding up.

Some reserved decisions are passed by a majority resolution but some require the support of 75 per cent of shareholders.

Australian law does not permit shareholders to propose an advisory resolution or shareholder vote to express an opinion, except in relation to the remuneration report for listed companies.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

The Corporations Act 2001 (Cth) allows proprietary companies to issue different types or classes of shares with different rights, including voting rights, attached to each type of share. The rights attached to shares are usually set out in the company's constitution.

Classes of shares include ordinary shares and preference shares. Ordinary shares usually have one vote for each share held. Preference shares may carry no voting rights or the right to only vote on certain matters.

Australian listed companies have less flexibility. Usually, they have a single class of ordinary voting shares in accordance with the ASX Listing Rules. One vote is allocated for each fully paid ordinary share.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

The procedure for shareholder participation in general meetings of shareholders is set out in Part 2G.2 of the Corporations Act 2001 (Cth).

For a proprietary company, at least 21 days' written notice must be given to each shareholder of a shareholders' meeting; for a listed company, at least 28 days' written notice must be given. The notice must be in the prescribed form.

If all shareholders sign a document stating that they are in favour of a resolution set out in the document, then a shareholders' meeting is not required.

The Corporations Amendment (Meetings and Document) Act 2022 (Cth) makes permanent changes to the Corporations Act 2001 (Cth) from 1 April 2022 that will allow companies to hold a meeting of their members:

- at one or more physical venues;
- at one or more physical venues and using virtual meeting technology; or
- using virtual meeting technology only, if this is expressly permitted under the company constitution.

Members must be given a reasonable opportunity to participate in the meeting.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

The Corporations Act 2001 (Cth) contains a number of ways for shareholders to influence the board's actions, including:

- shareholder(s) with at least 5 per cent of the company's votes may request the board to call a general meeting or call one themselves, at their cost;
- shareholder(s) with at least 5 per cent of the company's votes can provide the company with notice of a resolution that they will seek to move at the next general meeting (Australian case law has confirmed that if a resolution seeks to direct the board on the exercise of its powers, then the board is entitled to dismiss the resolution and is not required to put it to shareholders for consideration);
- shareholder(s) with at least 5 per cent of the company's votes can request the company to give to its shareholders a statement about any resolution that is proposed to be moved at a general meeting or a matter to be considered at a general meeting; and
- subject to a company's constitution, shareholders can appoint and remove directors by an ordinary resolution.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Shareholders, even controlling shareholders, do not owe a fiduciary duty to the company. Therefore, a shareholder is not required to act in a manner that promotes the best interests of the company.

This is in direct contrast to directors, who do owe a fiduciary duty to the company.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Generally, shareholders are not liable for the acts or omissions of the company because the incorporation of a company creates a separate legal entity that has an existence distinct from its shareholders. However, in exceptional circumstances, the courts can lift the corporate veil and impose liability on shareholders and directors. This has been done in cases where it was found that corporate structures were used to avoid legal liabilities.

If a subsidiary of a holding company trades while insolvent, then, in certain situations, the holding company's shareholders can be liable for the subsidiary's debts (part 5.7B, division 5 of the Corporations Act 2001 (Cth)).

Employees

10 What role do employees have in corporate governance?

Directors rely on the company's management to manage their corporation.

An executive director, often a managing director, is usually an employee of a company who has executive functions in the management and administration of a corporation. A managing director is usually the chief executive who is a director of the board to which they report. Usually, a managing director of a company has delegated powers from the board for the management of the corporation's business.

General employee participation in corporate governance, at least at a formal level, is limited. Even directors, as individuals, cannot exercise their position in isolation. Decisions are generally made by the board acting either unanimously or by a majority.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

Anti-takeover devices are generally not permitted in Australia.

Lock-up devices, such as break fees and no-shop or no-talk provisions, are generally permitted, provided that they are not an unacceptable deterrent to an alternative takeover proposal and they comply with any guidance notes issued by the Australian Takeovers Panel.

The Australian Takeovers Panel is the main forum for resolving takeover disputes. It determines whether a target company has engaged in any actions that would frustrate a takeover. It has issued guidance notes on how it will exercise its powers, including on lock-up devices and break fees. For example, the Australian Takeovers Panel will generally accept break fees that do not exceed 1 per cent of the target's equity value.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Under the Corporations Act 2001 (Cth), the board has the power to issue shares.

Shareholders' approval of share issues is required, if:

- the company's constitution or shareholders' agreement requires shareholder approval;
- the Corporations Act 2001 (Cth) requires shareholder approval, for example, if the issue:
    - creates a new type of class shares which requires shareholders to amend the company's constitution;
    - varies the rights attaching to existing shares; or
    - is a related party transaction; or
- the company is listed on the Australian Securities Exchange (ASX) and the ASX Listing Rules require shareholder approval.

The Corporations Act 2001 (Cth) requires newly issued shares to be offered pro rata to existing shareholders. This right can be modified by a company's constitution or shareholders' agreement.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

The constitution of a private company and shareholders' agreements can restrict the transfer of shares by including the following provisions:

- pre-emptive rights in favour of existing shareholders;
- drag and tag along rights;
- the right of the board to refuse a transfer of shares; and
- compulsory transfer rights triggered by specified events (eg, the death or bankruptcy of a shareholder).

An ASX-listed company cannot restrict the transfer of shares unless it is permitted to do so by the ASX Listing Rules (for example, the imposition of a holding lock in certain situations) or is required to do so by law.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

There is no general right permitting shareholders to require the company or its other shareholders to purchase their shares. However, a contractual right to purchase can arise if a shareholders' agreement or a company's constitution requires the company or the other shareholders to buy back the shares in certain circumstances (eg, on the death of a shareholder or if drag or tag along rights are activated).

Shareholders can be forced to sell their shares in certain circumstances under the Corporations Act 2001 (Cth) (eg, by the compulsory purchase of minority holdings under the takeover provisions).

Dissenters' rights

15 | Do shareholders have appraisal rights?

There are no general appraisal rights available to Australian shareholders under the Corporations Act 2001 (Cth). However, courts have a very wide discretion to provide remedies for conduct which is oppressive or unfairly prejudicial to minority shareholders. These remedies include requiring a majority shareholder or the company to purchase the shares of a minority shareholder at fair value.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

Australian companies that are listed on the Australian Securities Exchange (ASX) usually adopt a one-tier board model, being a board of directors. In some circumstances, a company may decide to form an advisory board (aka advisory panel, advisory committee or advisory council) which is distinct from the board of directors. An advisory board will generally support a board of directors in providing expert advice, specialist experience, insights, knowledge and recommendations regarding certain functions or facets of the company. They, however, are not directors in the sense that they do not owe any fiduciary duties to the company and are generally not authorised to act on behalf of the company.

Board's legal responsibilities

17 What are the board's primary legal responsibilities?

As fiduciaries, directors owe duties to the company that are enshrined in the Corporations Act 2001 (Cth) and in common law.

A board's legal responsibilities are broad-ranging and include the following:

- the duty to prevent insolvent trading (section 588G of the Corporations Act 2001 (Cth));
- the duty to meet pay-as-you-go obligations under the Tax Administration Act 1953 (Cth);
- the duty to avoid a breach by the organisation of the Fair Work Act 2009 (Cth);
- the duty arising under the Competition and Consumer Act 2010 (Cth);
- the duty under state work, health and safety legislation; and
- the duty under various state-based environment protection legislation.

Directors may personally face civil and criminal penalties for breaches of their obligations under the above Acts.

Board obligees

18 Whom does the board represent and to whom do directors owe legal duties?

The board represents shareholders, who appoint directors to act on their behalf.

Directors owe a fiduciary duty to the company and must act at all times in the interests of the company. Although directors do not owe a duty to creditors, directors may need to consider creditors when acting in the interests of the company.

Obligations of directors also exist under various legislation. For example, under the Competition and Consumer Act 2010 (Cth) directors can be held personally liable for breaches of the Act.

Enforcement action against directors

19 Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Directors owe duties to the company and to shareholders as a whole but do not owe duties to individual shareholders.

Enforcement action against persons to whom duties are owed is likely to occur in the context of a shareholders' oppression action where conduct is contrary to the interests of a minority shareholder or shareholders or is oppressive, unfairly prejudicial or discriminatory against a shareholder or shareholders (section 232 of the Corporations Act 2001 (Cth)).

The Australian Securities and Investment Commission (ASIC) has enforcement powers under the Corporations Act 2001 (Cth) and under the Australian Securities and Investment Commissions Act 2001 (Cth).

The business judgment rule is enshrined in section 180 of the Corporations Act 2001 (Cth), which provides that a director or officer who makes a business judgment is taken to be acting with the required degree of care and diligence if they, among other things, make the judgment in good faith for a proper purpose and do not have a material personal interest in the subject matter.

However, this applies only to a claim for breach of the duty of care and diligence and not generally to the conduct of directors.

Care and prudence

20 Do the duties of directors include a care or prudence element?

A relationship between a director and their company is a fiduciary relationship. At all times, a director must act in the interests of their company.

Directors owe a duty of care and diligence to that company, which is enshrined in common law and set out in the Corporations Act 2001 (Cth).

Section 180(1) of the Corporations Act 2001(Cth) requires a director or officer of a corporation to exercise their powers and discharge their duties with the degree of care that a reasonable person would use in the same circumstances.

A director who makes a business judgment is taken to have exercised care if the judgment is made in good faith for a proper purpose, the director has no material personal interest in the subject matter, informs themselves of the subject matter and believes the judgment is in the best interest of the company. (Section 180(2) of the Corporations Act 2001 (Cth)).

Board member duties

21 | To what extent do the duties of individual members of the board differ?

Directors bring their life experiences to their role on the board. Qualifications and life experience will assist directors to perform their duties effectively.

Although different directors will necessarily bring different skill sets to their role, their duties as directors are fundamentally the same.

Board committees may be formed to consider and advise on particular issues. However, all board members are responsible for the ultimate decisions of the board.

A company's constitution may allow directors to have different duties.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

Directors of a company may delegate any of their powers to a committee of directors, employees of the company, or any other person unless the company's constitution provides otherwise in accordance with section 198D of the Corporations Act 2001 (Cth). Any delegation of responsibilities or powers must be recorded in the company's minute book.

If a director delegates a power, they will be responsible for how the delegate exercises that power as if the director had exercised it themselves. Pursuant to section 190 of the Corporations Act 2001 (Cth), the only time a director will not be considered responsible for the actions of a delegate is if the director believed:

- on reasonable grounds that the delegate would exercise the power in conformity with the duties imposed on directors of the company by the Corporations Act 2001 (Cth); and
- on reasonable grounds and in good faith, and after making a proper inquiry if the circumstances indicated the need for an inquiry, that the delegate was reliable and competent in relation to the responsibility delegated.

Non-executive and independent directors

23 | Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

A non-executive director is not employed by the organisation for which he or she is a director, but may be related to the organisation in another capacity (ie, as a shareholder).

An independent director may not have a relationship with the organisation other than being a director. That is to say, they do not have a material relationship with the company, are not part of the company's executive team, are not involved in the day to day operations of the company and are not otherwise linked to the organisation in any way (eg, by way of a contractual relationship or family ties with a person involved in the organisation). A material relationship is one that may interfere, or be perceived to interfere, with a director's independent judgment.

The ASX Corporate Governance Principles and Recommendations state that a majority of directors of a board of a listed company should be independent directors (Recommendation 2.4).

Generally, a company's constitution will set out the requirements for the composition of its board, including the minimum number of directors and non-executive directors.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The Corporations Act 2001 (Cth) provides that:

- private companies must have at least one director who 'ordinarily resides' in Australia; and
- public companies must have at least three directors, two of which must 'ordinarily reside' in Australia.

The Corporations Act 2001 (Cth) does not specify a maximum number of directors for private or public companies.

A company's constitution usually outlines the circumstances in which the board or shareholders may appoint a replacement or additional directors to the board. In the absence of any such provision and provided that the replaceable rules set out in the Corporations Act 2001 (Cth) apply, the replaceable rules allow shareholders or the directors of a company to appoint other directors to the board in certain circumstances.

There are no express requirements or limitations regarding the expertise, gender or diversity of directors of Australian companies, however, the ASX Corporate Governance Council recommends that publicly listed companies should adopt a diversity policy and make public disclosures concerning the diversity of their board's composition.

To be eligible to act as a director, a person must be at least 18 years of age and must not be disqualified from managing a company under the Corporations Act 2001 (Cth) (eg, as a result of undischarged bankruptcy, insolvency or having been convicted of certain fraud or insolvency offences).

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

The Corporations Act 2001 (Cth) does not specify any requirements for the separation or amalgamation of the roles of a board chairperson and a chief executive. However, for listed companies, the ASX Corporate Governance Council recommends that the chairperson should be an independent director and not a person who is the CEO of the company.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

There are no mandatory board committees for private companies, however, the Corporations Act 2001 (Cth) provides that the directors of a private company may delegate any of their powers to a committee of directors (unless the company's constitution provides otherwise).

Publicly listed companies that are included in the S&P All Ordinaries Index must establish and conduct audit and remuneration committees.

The Governance Council recommends that all publicly listed companies establish committees in respect of audits, remuneration and nomination. However, these committees are not mandatory.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

The Corporations Act 2001 (Cth) and the ASX Listing Rules do not prescribe a minimum number of board meetings to be held by private or public companies per year. However, it is common for a company's constitution or shareholders' agreement to specify a minimum number of board meetings to be held annually.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

There are no obligations on private companies to make public disclosures in respect of their board practices.

The ASX Listing Rules require a publicly listed company to prepare an annual corporate governance statement disclosing the extent to which it has followed the recommendations of the ASX Corporate Governance Council during the relevant financial year, and, should such recommendations not be followed, explain the reasons why and provide details of any alternative practices that were adopted.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

There are no obligations on private companies to conduct evaluations of the board, its committees or individual directors.

The ASX Corporate Governance Council recommends that all publicly listed companies:

- have and disclose a process for periodically evaluating the performance of the board, its committees and individual directors; and
- in each reporting period disclose whether a performance evaluation was undertaken in accordance with that process.

While compliance with the ASX Corporate Governance Council's recommendations is not mandatory, the ASX Listing Rules require publicly listed companies to benchmark their corporate governance practices against the Governance Council's recommendations. If a publicly listed company does not comply with the Governance Council's recommendations, such non-compliance must be disclosed and explained in the company's annual corporate governance statement.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

The general practice is that, per section 202A of the Corporations Act 2001 (Cth), directors of a company are to be paid remuneration in an amount as determined by a resolution by the board or the members (usually referred to as shareholders). This, however, can be varied by the company's constitution, which may set out how directors are to be paid. In the case of large publicly listed companies, the board is required to present a pool of fees it proposes will be paid to the board as a whole to the company's shareholders for acceptance. Some companies may appoint a remuneration committee to advise on the appropriate amount and structure of fees.

If a director is terminated for any reason, the Corporations Act 2001 (Cth) (and the ASX Listing Rules, for publicly listed companies) limit certain payments that can be made to directors or senior management. Payment of termination benefits is prohibited by Listing Rule 10.18 if a change occurs in the shareholding or control of the company generally. Further, if a termination benefit exceeds 5 per cent of the company's equity interests, shareholders' approval must be obtained in accordance with Part 2D.2 of the Corporations Act 2001 (Cth) and ASX Listing Rule 10.19.

If a director incurred any liabilities to the company during their time as a director, the company must not exempt nor indemnify them of such liabilities.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

It is the responsibility of the board to determine senior executive remuneration, including bonuses, similar to the way in which director remuneration is determined. Senior managers are, therefore, bound by the same process as the directors.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

For listed companies, shareholders are required to vote on whether or not to accept a pool of fees proposed by the board. If approved, the pool is then split between the directors as agreed by the board. The limit that shareholders approve as the remuneration limit for the board continues to apply until another vote is held to increase or decrease the limit.

The allocation of fees and remuneration (including salaries and bonuses) for directors and senior management for listed companies must be published in an annual report and presented to shareholders to adopt. If the annual report is not adopted by at least 25 per cent of the shareholders at two consecutive annual general meetings, it is considered a 'second strike' and shareholders may resolve to 'spill' the board and re-elect directors by ordinary resolution at the second annual general meeting.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is common practice and is highly recommended. A company can pay the premiums of such insurance.

Insurance may provide cover for both executive and non-executive directors, the company secretary, executive officers and employees involved in management by listing either their role or their name.

Cover can include defence costs, compensation awarded against a director and costs awarded against a director. In some instances, the cover will also include reimbursement of the company for indemnities it provides to directors. Ideally, the cover should continue to apply after a director ceases to hold office.

Cover will depend on the policy and boards should review their insurance periodically to ensure the cover is adequate.

Personal director and officer insurance that protects an individual director is also available.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Corporations may indemnify their directors and officers through an indemnity deed. The scope of directors' and officers' conduct that may be protected is limited. Generally, directors' and officers' insurance exists alongside an indemnity deed.

Typically, indemnity deeds limit the scope of an indemnity 'to the maximum extent permitted by law', which acknowledges limitations imposed by the Corporations Act 2001 (Cth).

Section 199A(2) of the Corporations Act 2001 (Cth) prohibits a company from indemnifying a director or officer for:

- liabilities owed to the company;
- liabilities for a pecuniary penalty; and
- liabilities that did not arise out of conduct in good faith.

Section 199A(3) of the Corporations Act 2001 (Cth) limits the circumstances in which a director can be indemnified for legal costs.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Companies may indemnify directors and officers for legal costs with proceedings arising from their role as a director through a deed of indemnity and through directors' and officers' insurance. It is usual for both a deed of indemnity and directors' and officers' insurance to be in place.

However, section 199A(3) of the Corporations Act 2001 (Cth) limits the circumstances in which a director can be indemnified for legal costs.

It is common in litigation for a party that calls a witness to cover the witness's travel expenses. If they are being called in their professional capacity, a witness may be paid for their time to appear in proceedings.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

Corporations may indemnify their directors and officers through an indemnity deed. The scope of directors' and officers' conduct that may be protected is limited. Generally, directors' and officers' insurance exists alongside indemnity deeds.

Typically, indemnity deeds limit the scope of an indemnity 'to the maximum extent permitted by law', which acknowledges limitations imposed by the Corporations Act 2001 (Cth). Section 199A(2) of the Corporations Act 2001 (Cth) sets out prohibitions on a company indemnifying a director or officer and section 199A(3) limits the circumstances in which a director can be indemnified for legal costs.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The constitution of a company deals with its internal governance. Whether the constitution is publicly available depends on the type of company.

Listed public companies must disclose their constitution to the public on the Australian Securities Exchange (ASX).

An unlisted public company must lodge a copy of its constitution, together with any changes to its constitution, with the Australian Securities and Investment Commission (ASIC) within the time frames prescribed by the Corporations Act 2001 (Cth).

The constitutions of proprietary companies are not publicly available, because proprietary companies are not required to lodge or disclose a copy anywhere. However, such a company must keep a copy of its constitution in its records and provide a copy to a shareholder within seven days of receiving a request.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

The ASX Listing Rules require listed companies to:

- disclose certain transactions (eg, issuing dividends);
- issue half-yearly and annual financial reports and publish annual reports; and
- immediately disclose information that will have a material effect on the price or value of the company's shares to the ASX.

Public unlisted companies have less demanding reporting requirements. They are required to prepare and lodge their financial reports, directors' reports and audit reports with ASIC. Unlisted companies and managed investment schemes that are 'disclosing entities' (as defined in section 111AC of the Corporations Act 2001 (Cth)) must meet the continuous disclosure obligations in section 674 of the Corporations Act 2001 (Cth).

Proprietary companies have limited financial reporting obligations.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

The ability of shareholders to appoint nominee directors will usually be set out in a shareholders' agreement or the company's constitution. Although appointed by a shareholder, nominee directors must act in the best interests of the company. Directors of listed companies are subject to the election and re-election requirements set out in Rule 14.4 of the ASX Listing Rules.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

There is no general rule determining the extent or level of engagement with shareholders that a company must undertake. Therefore, the level and extent of shareholder engagement can vary significantly between companies. Generally, there is a greater degree of shareholder engagement in publicly listed companies than in proprietary companies.

Usually, the board is the entity with the main responsibility for encouraging and advancing shareholder engagement. The quality of the board's engagement with shareholders often depends on the efforts of the individual board members, especially the chairperson, to keep in touch with shareholder concerns and views.

An annual general meeting provides a forum for shareholders to participate in, and engage with, the company, especially in director accountability and scrutiny of company management.

Sustainability disclosure

41 | Are companies required to provide disclosure with respect to corporate social responsibility matters?

Corporate social responsibility refers to the practice of measuring and reporting on a business' economic, social and environmental performance.

Various legislation at both state and Federal level mandates the reporting on specific social responsibility issues.

For example, the National Greenhouse and Energy Reporting (NGER) Scheme, established under the National Greenhouse and Energy Reporting Act 2007 (Cth), is a framework for reporting and publishing information about greenhouse gas emissions, energy production, and energy consumption of Australian companies. Controlling corporations that meet a threshold under the Scheme must apply to be registered under section 12 of the NGER Act, failure to do so attracts severe penalties.

CEO pay ratio disclosure

42 | Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

In Australia, companies are not required to disclose the pay ratio between the chief executive's annual total compensation and the annual total compensation of other workers.

Gender pay gap disclosure

43 | Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

Australia's Workplace Gender Equality Agency (WGEA) was established by the Gender Equality Act 2012 (Cth). The WGEA aims to promote gender equality in the workplace and sets up reporting requirements for large employers (ie, non-public sector employers with 100 or more employees) and registered higher education providers.

Employers covered by the Act must supply the WGEA with annual reports that include a set of gender equality indicators, including:

- the gender composition of the workforce;
- the gender composition of governing bodies;
- equal remuneration between women and men; and

- the availability and utility of employment policies relating to flexible working arrangements and to working arrangements supporting employees with family or caring responsibilities.

Once a report is submitted to the WGEA, employers must notify their employees to enable them to review and comment on it.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

New development

The Privacy Legislation Amendment (Enforcement and Other Measures) Act 2022 (Act) commenced on 13 December 2022. The Act imposes stricter penalties on companies for data and privacy breaches and it has increased the maximum penalty imposed on companies for serious or repeated interference with the privacy of an individual, to the greater of:

- A$50 million;
- three times the value of any benefit obtained or attributable to the breach; or
- 30 per cent of the company's 'adjusted turnover' during the relevant period (if the court cannot determine the value of the benefit obtained).

The Act has increased the regulatory powers available to the Office of the Australian Information Commissioner (OAIC). For example, the OAIC can now request information from a company regarding its compliance with the Notifiable Data Breach scheme or following an actual or suspected data breach of that company.

The Act removes the prior requirement for an entity to collect or hold personal information in Australia to have an Australian link. Therefore, any foreign entity carrying on a commercial activity in Australia will be subject to the Privacy Act 199 (Cth).

Trends in shareholder interest

Recent shareholder activist campaigns led against large Australian companies, including airlines, supermarkets and the 'Big Four' banks (Commonwealth Bank of Australia, Westpac Banking Corp, National Australia Bank, and Australia and New Zealand Banking Group), demonstrate the increased interest shareholders are taking in the social and environmental implications of their businesses' operations and decision-making processes.

Investors are also taking a keen interest in businesses' responses to environmental, social and governance issues to guide their decisions regarding making investments.

The manner in which a business addresses issues such as climate change may be an indicator of the financial value of the business and its long-term viability.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The primary sources of law are the Civil Code (Law No. 10,406/2002), the Corporations Law (Law No. 6,404/1976), the Securities Law (Law No. 6,385/1976) and the Capital Markets Law (Law No. 4,728/1965).

The Civil Code regulates a wide range of topics, such as those related to property, family and obligations. However, it also sets forth the basic corporate governance legal framework applicable to limited liability companies. Although limited liability companies are the most common type of company in Brazil, this type of company cannot go public or raise funds in the capital markets.

The Corporations Law regulates both closely held and listed corporations. It regulates, in a comprehensive way, corporate governance matters that are important for corporations, including shareholder rights, board structures, duties and responsibilities of board members and officers, tag-along rights, public offerings, financial statements and shareholders agreements, among other things. The Corporations Law may also apply to limited liability companies on a subsidiary basis if the articles of association of the limited liability company so provide.

In addition, there are other regulations and best practices related to corporate governance that may be enforceable according to the specific characteristics of the corporation. For instance, the Securities and Exchange Commission of Brazil (CVM) is the securities market authority in Brazil, which regulates the capital markets and its participants and has the competence to issue rules, directions, opinions, decisions and releases. The CVM's rules are usually called 'instructions' and are mandatory for listed corporations.

One of the main rules enacted by the CVM in connection with corporate governance is Resolution No. 80/22, which applies to all listed corporations. The resolution regulates a wide range of matters, such as mandatory filings, disclosure of information and financial statements.

The main stock exchange of Brazil, Brasil, Bolsa e Balcão SA (B3), is the most important institution that enables the country's capital markets to function, organising and allowing the activities of trading, post-trading and registration enforceable for listed corporations. B3 is also responsible for issuing corporate governance guidelines applicable according to the companies' listing segment, such as Novo Mercado, Level 2, Level 1, Bovespa Mais and Bovespa Mais Level 2.

Lastly, the Brazilian Institute of Corporate Governance (IBGC) also plays an important role in the Brazilian corporate governance framework. Although the IBGC's rules are non-binding, they are widely adopted by the most important market players. Periodically, the IBGC reviews its Code of Best Practices for Corporate Governance, which has proved to be an important guide on corporate governance in Brazil.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The National Monetary Council (CMN) is the supreme agency of the National Financial System of Brazil. The CMN is responsible for issuing the rules and guidelines for all financial institutions of the country. In addition, the CVM is an independent agency that regulates the capital markets and its listed companies, with powers to investigate, prosecute and impose sanctions.

In addition, the IBGC, founded in 1995, is referenced across the country and is one of the world's best corporate governance organisations. One of its purposes is to produce and spread knowledge about best practices in corporate governance by contributing to the sustainable development of organisations. The IBGC publishes the Best Practices Code and coordinates a group called the Interacting Working Group, which was responsible for creating the Code of Corporate Governance – Listed Corporations, now incorporated into the regulations enacted by the CVM. The Code presents the best practices of the market as a critical benefit of investment in Brazil and a source of attraction to the country for listed corporations.

The main stock exchange of Brazil (B3) has different listing segments for the trading of shares according to the corporate governance practices adopted by the companies. The

Novo Mercado is a segment composed of companies that voluntarily adopt corporate governance practices in addition to those required by law.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Shareholders of corporations can appoint and remove directors or officers by at least a majority vote, or a higher quorum, subject to the specific provisions set forth in the by-laws of the company.

In the case of limited liability companies, shareholders can appoint and remove non-shareholder directors or officers by at least a majority vote if the corporate capital is fully paid, or by the approval of 2/3 of the corporate capital if the corporate capital is not fully paid. A higher quorum may be outlined in the by-laws of the company.

If the corporation only has a board of executive officers (closely held companies are not required to have a board of directors), their members shall be elected and removed by the shareholders. However, if the corporation has both a board of directors and a board of executive officers (which is mandatory for public companies), directors shall be elected and removed by the shareholders, and the officers shall be elected and removed by the board of directors.

The purpose of appointing directors is to enable the separation between the ownership and management of the corporation. Listed corporations, mixed capital corporations and those corporations with authorised capital must have a board of directors to avoid conflicts of interest with the shareholders.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

According to the Corporations Law, the shareholders, whose votes are binding, shall make the following decisions in the shareholders' meeting:

- amending the by-laws;
- electing and removing directors or officers;
- approving annually the company's accounts and financial statements from the past year;
- issuing debentures;
- suspending shareholders' rights;
- approving the valuation of the shareholders' assets for the purpose of paying up the share capital;

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- issuing participation certificates;
- approving the transformation, merger, spin-off, dissolution or liquidation of the company, and the appointment and destitution of liquidators and approving the company's accounts;
- approving the administrator to request bankruptcy or request financial reorganisation; and
- voting, in public companies, about contracting with related third parties, selling or asset contributing to another company if the value of the operation is over 50 per cent of the company's total assets as demonstrated in the last approved balance sheet.

In Brazil, non-binding shareholder votes do not apply.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

As a general rule, each common share corresponds to one vote in the resolutions of the shareholders' general meeting. The shareholder principle of 'one share, one vote' has the purpose of promoting the alignment of interests among all shareholders by making the power represented by the right to vote proportional to the economic rights attributed to each share.

Nonetheless, closely held companies and listed corporations that have not negotiated their shares in the stock exchange can issue ordinary shares with up to 10 voting rights each, subject to compliance with a range of legal requirements. The issuance of shares bearing disproportionate voting rights requires, among others, a majority shareholder vote approval; said approval may also determine a defined term, conditions for losing the disproportionate voting rights and the number of additional voting rights conferred to each share.

Under Brazilian law, corporations are also allowed to issue preferred stock, normally with no voting rights, that must be provided for in the by-laws of the company. However, preferred stock shall grant other benefits to their bearers, such as priority in the distribution of dividends, fixed dividends or minimum dividends.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

There are no special requirements for shareholders duly invested in their capacity to participate in general meetings of shareholders or to vote. However, there is a procedure for calling that must be followed at the shareholders' meeting. The call must be made by a published notice in at least three different places containing, in addition to the place, date, and time of the general meeting, the agenda and, in the case of an amendment to the by-laws, an indication of the subject matter and, for listed corporations, a copy of the by-laws highlighting the proposed amendments along with a report informing the purpose of the proposed amendment and its legal and economic effects.

A shareholder can nominate by proxy another shareholder, a director of the company or a lawyer to represent him or her in the general meeting.

Closely held corporations usually act by written consent when shareholders representing 100 per cent of the shares sign the relevant meeting minutes, even though acting by written consent without a meeting is not expressly authorised by the Corporations Law.

Virtual shareholders' general meetings are permitted for both closely held companies and listed corporations. Companies may choose between in-person meetings, virtual meetings and a hybrid of these options. Virtual meetings are those in which the shareholders may only attend and vote through electronic systems, whereas hybrid meetings are those in which the shareholders may attend and vote either in person or through electronic systems. Specific provisions for listed corporations' remote meetings are set by CVM through Resolution 81/22.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Under Brazilian law, there is a clear distinction between the powers of each body of the company (eg, shareholders' general meetings, board of directors and officers), and the powers of one specific body, as a general rule, cannot be delegated to another body. Consequently, resolutions adopted by the shareholders against the wishes of the board are not an issue. Nevertheless, the board of directors can make recommendations with respect to resolutions to be adopted by the shareholders, but the shareholders are free to resolve against the recommendations of the board. This same principle applies to the nomination and removal of members of the board as the power to do so resides with the shareholders.

The power to convene shareholders' meetings resides with the board (or, in the case of its absence, with the officers). However, shareholders can require meetings to be convened to approve certain matters when directors fail to do so in a timely manner under the terms required by the corporation's by-laws. However, shareholders requiring meetings to be convened is rare as the rule is that directors shall convene the meetings.

Lastly, the law is silent regarding provisions granting shareholders the right to require the board to circulate statements by dissident shareholders.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Regarding controlling shareholders, Brazilian corporate law expressly states that they are liable for the abuse of their power, which is subject to enforcement action, and damage caused to the corporation. Examples of the abuse of power include: deviating from the company's scope; entering into business combinations that are detrimental to the company; changing the by-laws or taking decisions that deviate from the company's interest; appointing board members who are not suitable for the role; hiring with a company in non-equitable conditions; and approving irregular management's accounts intentionally or failing to investigate a valid complain. A claim for damages against the controlling shareholder may be proposed by shareholders representing 5 percent of the company's stock, or by any shareholder if a guarantee is provided in case the courts dismiss the claim.

Shareholder responsibility

9 | Can shareholders ever be held responsible for the acts or omissions of the company?

The shareholders' responsibility is limited to the issuance price of the subscribed shares held by each shareholder in the corporation. However, in special circumstances, legislation permits the piercing of the corporate veil. These circumstances are restricted to the diversion of the company's purpose through the willful use of the legal entity with the purpose of harming the creditors and for practising illicit acts of any nature; and the lack of clear separation between the assets of the company and the assets of directors, officers and shareholders.

Notwithstanding the above, consumer protection, antitrust law and environmental law, as well as employment case law, adopt a less stringent approach to piercing the corporate veil. For those matters, and depending on the circumstances, the shareholders can be held liable if the company is unable to pay its obligation, or in case of violation to the rules set forth in the by-laws.

Employees

10 | What role do employees have in corporate governance?

Shareholders must use their power to enable the corporation to accomplish its purpose and perform its social role, and they shall have duties and responsibilities towards the other parties, the employees and the community in which it operates. The by-laws may provide for an employee to be a member of the board of directors or member of an advisory body of the corporation, such as the fiscal council or the audit committee. However, for state-controlled corporations in the sphere of the federal government, the board of directors must have at least one representative of the company's employees. To be admitted to the board, the representative of the employees must comply with all requirements of the law and the by-laws of the company.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

In Brazil, hostile takeover bids are not yet as common as they are in more mature markets, such as in the United States of America and the United Kingdom. Nonetheless, in the last decade, Brazil has experienced a boost in its capital markets, with a significant increase in the number of listed corporations with dispersed shareholdings. Owing to this fact, hostile takeovers (and, consequently, anti-takeover devices) have gained more attention.

Brazilian law does not prohibit anti-takeover devices, but they must be clearly stated in the by-laws of the corporation. In this context, currently it is not unusual to find in Brazilian corporations' by-laws provisions triggering mandatory tender offers with the payment of a premium once a shareholder increases its equity participation to a certain level (usually between 10 per cent to 30 per cent).

Lastly, the Corporations Law provides for one specific mechanism that can be interpreted as an anti-takeover device. This mechanism provides that the purchaser, in a takeover bid to gain control of a listed corporation, is required to make a public offer to all other voting shareholders of the company for a purchase price of at least 80 per cent of the takeover bid's price.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Yes; for that purpose, the corporation's by-laws must provide for an authorised capital amount and grant the board powers to issue new shares without shareholder approval. If the by-laws do not have this provision, the board cannot issue new shares without shareholder approval.

In addition, shareholders have pre-emptive rights in the subscription of new shares proportionally to the number of shares they hold. The by-laws or a general meeting must establish which pre-emptive rights may be exercised at least 30 days before the issuance of new shares.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Restrictions on the transfer of shares will mostly depend on the type of company. In listed companies, except for some restrictions resulting from shareholders' agreements, shares must be freely traded to guarantee liquidity to the markets. On the other hand, closely held corporations may limit the transfer of shares through their by-laws, terms and conditions, but they may never entirely forbid the transfer.

Limited liability companies, which are governed by the Civil Code and are considered to be *intuitu personae* entities, may incorporate in their articles of association restrictions on the transfer of shares to third parties. However, if the articles are silent in this regard, shareholders may transfer their shares to third parties if this transfer is not opposed by more than 25 per cent of the company's share capital. The transfer of shares to another shareholder of the company is usually permitted in the absence of a specific rule provided in its articles of association.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

The Corporations Law presents two kinds of share repurchases that can be compulsory if determined so by the by-laws or by the extraordinary general shareholders' meeting: redemption and amortisation.

Redemption share repurchases comprise paying the value of the share to withdraw it permanently from circulation, regardless of whether the share capital is reduced. If the share capital is not reduced, a new par value shall be attributed to the remaining shares, as the case may be.

Amortisation share repurchases comprise the distribution to the shareholders of an advance payment, without reduction of the share capital, in the amount that they would be entitled to in the event of liquidation of the corporation. The amortisation may be in full or in part and may cover only one or all classes of shares of the corporation.

A redemption or an amortisation share repurchase that does not cover all shares of the same class shall be carried out by drawing lots.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Yes, the shareholders have appraisal rights in limited situations, according to the Corporations Law. The approval, by at least half of the voting shares, of the following matters grants the dissenting shareholder the right to withdraw from the corporation by a refund of his or her shares:

- creating preferred shares or increasing an existing class of preferred shares without maintaining the existing ratio with the remaining class of preferred shares, unless this is already set forth in or authorised by the by-laws (this is only applicable to those shareholders that have been affected);
- altering a preference, a privilege or a condition of redemption or amortisation conferred upon one or more classes of preferred shares, or creating a new, more favoured, class (this is only applicable to those shareholders that have been affected);
- reducing the compulsory dividend;
- merging the corporation with another corporation or consolidating it;
- participating in a group of corporations;
- changing the corporate purpose;
- approving the spin-off of the corporation; and
- issuance of shares with disproportionate voting rights.

The corporation's by-laws may establish the terms and conditions under which the shares of the dissenting shareholder will be redeemed. The value of the redemption cannot be lower than the company's net worth, as determined pursuant to the latest balance sheet of the company approved by the general meeting, unless the appraisal takes into account the economic valuation of the company, as determined by experts.

If the by-laws require a valuation to be done, the valuation must be carried out by three experts or by a company specialising in valuation. The experts' appraisal must present the grounds on which the valuation was based and provide all the supporting documentation that underpinned their work.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

Listed corporations shall have a two-tier structure: a board of directors and a board of executive officers. The board of executive officers is accountable to the board of directors and makes decisions related to the operational and tactical direction of the company. Nonetheless, the board of directors makes decisions regarding the long-term strategic direction of the business. The corporation will be legally bound before third parties by officers only, considering that directors do not have powers to bind the company.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The board of directors is a deliberative body that assumes responsibility for the treatment of long-term strategic decisions related to the business management of the corporation.

The following are the board's primary legal responsibilities:

- establishing the general business strategy for the corporation;
- electing and discharging the corporation's officers and prescribing their duties in accordance with relevant provisions in the by-laws;
- supervising the performance of the officers, examining the books and records of the corporation at any time, requesting information on contracts signed or about to be signed, or any other act;
- calling a general meeting whenever it is deemed advisable;
- giving its opinion on the reports of the management and on the accounts of the board of officers;
- giving its opinion in advance on actions or contracts whenever required by the by-laws;
- deciding whether to issue shares or subscription bonuses, when so authorised by the by-laws;
- authorising the transfer of fixed assets, the creation of charges in rem and guarantees for liabilities of third parties; and

- selecting and discharging independent auditors.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board of directors' responsibility is to act in the corporation's best interest; therefore, the directors owe legal duties to the shareholders and to the corporation. When acting in the best interest of the corporation, the directors have the following duties.

Duty of care

The director, in the exercise of his or her duties, must employ the care and diligence that a reasonable and honourable person customarily employs in the administration of his or her own business affairs. In addition, directors must exercise their powers within the limits provided in the laws and by-laws and must always act in the best interest of the company.

Duty of loyalty

Under Brazilian law, the duty of loyalty is understood as the obligation of the director to refrain from pursuing personal interests instead of the company's interests. In this regard, the Corporations Law establishes that it is forbidden for a director to use business opportunities to benefit him or herself, not to act in the company's best interests to benefit him or herself and to purchase assets or rights of the company to benefit him or herself.

Duty of disclosure

A director of a listed corporation must declare the number of shares, subscription bonuses, options to purchase shares and convertible debentures issued by the corporation, by a controlled corporation or by a corporation belonging to the same group that he or she owns and must disclose to the markets any material information.

Conflict of interest

A director must not take part in any corporate transaction in which he or she has an interest that conflicts with an interest of the corporation nor in the decisions made by the other officers on the matter. He or she must disclose his or her conflict of interest to the other officers and must have the nature and extent of his or her interest be recorded in the minutes of the administrative council or the board of directors' meeting.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Yes, enforcement action against directors is possible for damage caused to the corporation. Therefore, the corporation is the legitimate plaintiff in the action, and for filing this action, the approval of the majority of shareholders with voting rights is required. However, if the action is not approved, any shareholder holding at least 5 per cent of the capital stock shall have the right to file the action directly.

Although the business judgment rule in Brazil has no well-settled understanding, in recent years it has been frequently applied by the Securities and Exchange Commission of Brazil (CVM) when judging sanction proceedings against directors of listed corporations. However, most scholars understand that a judge can exempt the directors and officers from responsibility when convinced that they acted in good faith and in the interest of the corporation. The business judgment rule shields directors or officers of a corporation from liability only if, in reaching a business decision, the directors or officers acted on an informed and reflected basis, availing themselves of all material information reasonably available, and acted without conflicts of interest. The main purpose of the rule is the protection of the discretionary power of the company's managers, and it guarantees the existence of a presumption that they make decisions always in good faith.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Yes. According to the Corporations Law, directors have a duty of care, which requires that they always exercise competence, honesty and care in conducting the business of the corporation. 'Care' requires that the director must exercise the care that a reasonable person would in similar circumstances. In addition, directors must exercise their powers within the limits provided in the laws and by-laws and must always act in the best interest of the company.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

Under Brazilian corporate law, all the directors are subject to the duties of diligence and care, loyalty and disclosure, and the duty to avoid conflicts of interest. There is no differentiation between directors based on experience or certain skills.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The responsibilities defined by law for the board of directors cannot be delegated. The attributions and powers conferred by law to the management bodies cannot be granted to another body created by law or by the by-laws. However, at the officers' level, it is possible to appoint proxies to act on behalf of the officers.

As they are responsible for day-to-day business management, the officers play a central role in the functioning of the corporate governance system, being responsible, among other things, for implementing the strategy defined by the board of directors, as well as the mechanisms, processes, programmes, controls and systems aimed at ensuring compliance with risk limits and guidelines previously approved by the board.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Law No. 14,195/2021 sets forth the mandatory inclusion of independent directors on the boards of directors of listed companies, in accordance with terms and deadlines defined by the CVM.

CVM Resolution No. 80/22, in turn, provides that at least 20 per cent of the board shall be composed of independent directors, whereas the rules set forth in the Novo Mercado segment for listing corporations issued by B3 determine that at least two members, or 20 per cent of the board, whichever is higher, must be independent directors. The IBGC also recommends that the board of directors has the relevant participation of independent members in relation to the total number of members.

The board of directors must evaluate and disclose annually who the independent directors are and must indicate and justify any circumstances that could compromise the directors' independence.

Situations that may compromise the independence of a member of the board of directors, among others, are:

- if he or she is a direct or indirect controlling shareholder of the company;
- if his or her votes in the board of directors' meetings are bound by a shareholders' agreement of which the object is matters related to the company;
- if he or she is a spouse, partner or relative, lineal or collateral, to a certain degree, of the controlling shareholder, administrator of the company or administrator of the controlling shareholder; and
- if he or she was, in the past three years, an employee or director of the company or of its controlling shareholder.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

According to the Brazilian Corporations law, the board must be composed of at least three members, elected by a shareholders' general meeting, at any time. The size of the board may vary depending on the company's sector and size and the stage of the company's life-cycle, among other things. There is no maximum number of seats on the board, even though best practice recommends no more than 11 members for large corporations. The by-laws shall provide the number of board members and the appointment process. .

The board members should appoint an alternate to occupy an opening position in the case of a vacancy until the following shareholders' meeting. If vacancies comprise a majority of the board of directors, a shareholders' meeting shall be called for the election of the board.

Both Brazilian residents and foreign individuals can be appointed as directors of corporations. Foreign individuals shall be represented by an attorney resident in Brazil with powers to receive summons, subpoenas, citation and notices on behalf of the grantor.

An individual is disqualified from being elected to the position of director if he or she:

- is disqualified by special law, or has been sentenced for a bankruptcy offence, fraud, bribery or corruption, misappropriation of public funds or embezzlement, crimes against the national economy, decency or public property, or to any criminal sanction that precludes, even temporarily, access to public office;
- has been declared by the CVM to be incapacitated;
- holds a position in a competing company, especially in the management board or on the advisory or finance committees, unless an applicable waiver is granted by the general meeting; or
- has conflicting interests with the company unless an applicable waiver is granted by the general meeting.

As for the disclosure requirements, the composition of the board of directors and of the board of officers are made public once they are registered at the relevant Registry of Commerce. In addition, for listed corporations, the composition of the board of directors, as well as all the board's dismissals and resignations must be disclosed to the CVM as the information is classified as relevant facts of change in the management of the corporation.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

As of Law No. 14,195/2021, the combination of positions of a company's chief executive officer or main executive officer with the chairperson of the board of directors for listed companies is prohibited.

However, Resolution CVM No. 168, of September 20, 2022, allowed the accumulation of the functions of the chief executive officer and the chairman of the board of directors in listed companies that have gross revenue lower than 500 million Brazilian Reais in the past fiscal year.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

The Corporations Law does not have a list of mandatory board committees. However, it is usual for large corporations to implement committees for corporate governance purposes in areas such as auditing, human resources or compensation, governance, finance and risks, among others.

Committees have board advisory functions and no power to make decisions; therefore, their recommendations are not binding. According to IBGC best practices, it is recommended that the committees shall: be formed by board members; have at least three members; have at least one member who is an expert in the applicable area; have an exclusive chair; and not contain the corporations' executives, although they may be invited to some meetings.

Notwithstanding the above, for listed companies in the Novo Mercado segment of B3, it is mandatory to have an audit committee, until the date of the shareholders' general meeting, responsible for evaluating and monitoring internal audit activities and compliance. In addition, audit committees are also mandatory for financial institutions and insurance companies.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no minimum number of board meetings per year required by law. If there is a need for the board to evaluate specific topics requiring an immediate decision, a meeting shall be called at any time. In addition, if the corporation has a committee already established, the board shall meet with the committee according to its regulation. For instance, the audit committee, which is a mandatory committee for corporations listed in the Novo Mercado segment, requires meetings of the board of directors every three months.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

Yes, disclosure is required. Most of the practices of the board are outlined in the by-laws of the corporations, which are registered in the relevant Registry of Commerce and are, therefore, made public, (eg, the number of members, term of office, appointment of the chair, procedures in the case of a vacancy and meeting procedures).

In addition, the summary of the resolution taken in some of the board meetings shall be published in local newspapers in accordance with Corporations Law. Nonetheless, privately held corporations with an annual turnover of up to 78 million Brazilian Reais, can publish their corporate acts at the Balance Sheet Platform of the Digital Bookkeeping Public System (SPED), free of charge, and on their website.

For listed corporations, the minutes, prospectuses and statements of additional information are also required to be disclosed.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

According to the Corporations Law, there is no mandatory evaluation. However, according to the Code of Corporate Governance – Listed Companies, it is recommended that corporations carry out formal performance evaluations of the board of directors on an annual basis to identify the main deficiencies that must be improved by the board, including the implementation of corrective measures. The scope of the evaluation shall include a process for assessing the performance of the board of directors, the committees, the chair and the directors individually considered, with the purpose of giving the shareholders a proper understanding of its evaluation results.

For listed companies in the Novo Mercado segment, the board must perform the evaluation at least once during its mandate.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

The shareholders' general meeting shall determine the amount of the remuneration of all of the individual directors, considering their responsibilities, the time dedicated to their functions, their competence, their professional reputation and the value of their services. The remuneration of the members of the board of directors must be aligned to the company's strategic objectives with a focus on its longevity and the creation of long-term value.

The term of a member of the board cannot exceed three years, although re-election is permitted. Listed corporations must disclose more detailed information on the director's remuneration in the prospectus and the statement of additional information annually filed to the Brazilian Securities Commission, and their directors are subject to a stricter two-year term of office, although re-election is admitted.

According to Brazilian law, directors are not allowed to contract loans or any other type of financial arrangement with the corporation without the prior approval of the shareholders.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

The remuneration of the officers is established by the shareholders in the general meeting, which must be aligned with the company's strategic objectives, with a focus on its longevity and the creation of long-term value. The officers are normally responsible for establishing the remuneration of the senior management in line with the company's remuneration policies and also in compliance with the power limitations set forth in the company's by-laws, if any.

Although there is nothing expressly prohibiting the company from granting loans to its officers, according to the Code of Corporate Governance – Listed Companies, this practice is not recommended. The Code suggests that companies implement policies concerning related parties that prohibit granting loans to their officers.

For granting loans or other compensatory arrangements to senior managers, the law is silent. However, the performance of any financial transaction with senior management must comply with the internal codes and policies of the company (eg, the code of conduct and risk and compliance), always preserving the position of the company.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Shareholders shall have the right to vote on the directors' remuneration through the annual general shareholders' meeting, whereas the remuneration of the senior management is typically defined by the officers of the company in line with the company's remuneration policies.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted and is a common practice as part of the benefits package in large corporations. Normally, corporations are responsible for paying the insurance premiums to directors and officers.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

As a general rule, there are no constraints. The director's responsibility shall be excluded as long as he or she acted in the ordinary course of business. While acting in the ordinary course of business and in due compliance with the law and the by-laws, the corporation shall be responsible for the acts of its directors and officers and will, generally, assume responsibility for payments in claims against them.

However, in 2018, the Securities and Exchange Commission of Brazil (CVM) enacted a new (non-binding) guideline (No. 38, dated 25 September 2018) applicable to indemnity agreements executed between publicly listed companies and their directors with the aim of avoiding conflicts of interest, thereby creating new duties to the directors of public companies.

Under indemnity agreements, public companies undertake to compensate directors for damages or losses arising out of arbitration proceedings, court claims or administrative proceedings in general that involve acts, facts or omissions by the directors in the exercise of their duties or powers. Although, in general, the parties are free to negotiate the terms and conditions of the agreement, pursuant to the CVM's interpretation, the compensation is not due if the director breached his or her duty of care or loyalty. As such, the CVM recommends expressly providing the hypothesis of exclusion of liability in the indemnity agreement. In addition, the CVM recommends that before making any disbursements, the company must ensure whether the compensation to the director is due or if it falls into a hypothesis of exclusion of liability.

The CVM's guidelines provide that the directors must implement governance rules to prevent conflicts of interest in the execution of indemnity agreements. To be discharged of this duty, the directors must ensure that the indemnity agreements provide which body of the company will be responsible for assessing whether an exclusion of liability applies, as well as the applicable rules to avoid conflicts of interest. In specific circumstances, such as ones that could result in a material loss for the company, the CVM understands that additional governance rules must be adopted, without specifying them. Lastly, the directors are required to disclose the terms and conditions of the indemnity agreements to allow the shareholders to properly assess the liabilities that the company may be exposed to.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

There is no legal provision regarding this subject in Brazil. Therefore, it shall depend on the litigation or other proceedings and the contractual relationship between the directors or officers and the corporation in negotiating the extent of the advancement of expenses.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

In accordance with Brazilian law, a director or officer is not personally liable for the actions that he or she takes on behalf of a corporation in the ordinary course of business. However, the director or officer shall be liable for losses caused to the corporation if he or she acted with negligence or willful misconduct or in violation of the law or the by-laws. In this case, indemnity or other hold harmless or comfort letters that limit the liability of directors and officers are normally not applicable.

A director or officer shall not be liable for unlawful acts of the other directors or officers, except when acting in collusion with them, when the director or officer neglects to investigate these acts or even when, despite having knowledge of the facts, the director or officer fails to take actions to prevent the act.

In addition, a director or officer shall be exempted from any liability when he or she expressly registers his or her disagreement in the minutes of the board of directors' or the management board's meeting in relation to a specific decision taken that caused the liability.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

Yes; for the terms and conditions of the corporation's by-laws and minutes of shareholders' meetings to be enforceable against third parties, they must be registered at the relevant Registry of Commerce, thereby becoming publicly available.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

In addition to the by-laws and the minutes of shareholders' meetings that are required to be registered at the Registry of Commerce, public corporations must also disclose, among other things:

- the audited financial statements, which must be disclosed in the first months of the following year;
- the quarterly accounting information, which must be submitted within 45 days as of the end of each quarter;
- the prospectus and statement of additional information to be filed in the case of changes (eg, a change in the administration and in the policies of the company, among other things) within five months as of the end of the fiscal year; and

- board meetings and corporate acts that may be relevant to third parties,(eg, providing for the reduction of corporate capital).

In addition, listed corporations must disclose to the market any information that is deemed to be material information. Pursuant to the Securities and Exchange Commission of Brazil (CVM) regulations, material information is any decision of the shareholders or board of directors of listed companies, or any other relevant technical, economic or financial facts or transactions related to the company's business and activities, that may influence the price of any shares or securities issued by the company, the decisions of the investors to buy or sell shares and securities of the company or the decisions of the investors regarding the exercise of any of their rights as shareholders. The CVM regulations also provide examples of what would be material information; the acquisition of control of a company and the execution of shareholders' agreements involving the corporations' securities, mergers, demergers and absorptions are among the material information that must also be disclosed. The list of examples provided by the CVM is not exhaustive, so any information that may fall within the definition of material information will be subject to the disclosure requirements.

As a regular procedure, the disclosure of corporate documents occurs through newspaper publications. However, closely held corporations with annual gross revenues of up to 78 million Brazilian Reais are exempted from publishing in newspapers and may only publish them electronically at the SPED Balance Sheet Center. In their turn, listed companies with annual gross revenues of less than 500 million Brazilian Reais can disclose their corporate information through Empresas.NET or Fundos.NET systems.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Yes; shareholders have the ability to nominate directors by proxy and have them included in the shareholder meeting materials.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

Yes, according to Brazilian law, the engagement of companies with shareholders is possible at arm's length. The company is represented by an officer with the power to act on its behalf. However, the Corporations Law restricts engagement in situations of abuse of the voting or controlling power or conflict of interest of the shareholder.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

Yes, listed corporations must comply with the rules established by the Securities and Exchange Commission of Brazil (CVM) that require listed companies to disclose and report on their corporate social responsibility policies, according to the Code of Corporate Governance – Listed Corporations.

The Code establishes the duty of listed corporations to demonstrate which corporate governance practices have been adopted, making it clear to their current or future investors the degree of adherence that they have with the corporate governance mechanisms. Therefore, the prospectus and statement of additional information of listed corporations must disclose matters related to the environment, human rights, diversity, human capital matters and political spending, as they are set forth in the Code of Corporate Governance – Listed Corporations.

Listed companies are also required to submit a document (Reference Form) that brings together a range of information about the company, such as its main activities, risk factors and capital structure, among other details. Recently, CVM issued Resolution 59 amending the rules for disclosure of information by listed companies on the Reference Form. Such resolution added to the Reference Form information requirements on environmental, social and governance (ESG) practices.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

Although, under the CVM rules, listed companies are required to disclose policies, aggregate amounts, bonuses and other information related to the remuneration of officers and directors, there are no specific requirements to disclose the pay ratio between the CEO's annual total compensation and the annual total compensation of other workers.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

This disclosure is not required according to Brazilian legislation.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

The last few years have seen important changes on the Brazilian corporate governance framework. Due to the conversion of the Provisional Measure (MP) No. 1,040/2021 into Law No. 14,195/2021 with the purpose of, among other things, reducing administrative formalities, increasing the competitiveness and modernisation of business in Brazil, the Securities and Exchange Commission of Brazil (CVM) and the Brazilian Department of Business Registration (DREI) provided relevant changes on their resolutions to be in compliance with the recent federal legislation.

CVM Resolution No. 80, issued on 29 March 2022, revokes 10 prior instructions and consolidates some relevant provisions from the regulatory framework of listed companies. This resolution provides for the registration of securities issuers and periodic information that must be disclosed by officers of listed companies, among other relevant information. Notwithstanding, the new resolution did not promote significant changes to the existing obligations, except a new obligation to listed companies registered in category 'A' to disclose information on corporate lawsuits or arbitral proceedings involving the company itself, their shareholders, officers, and directors as parties. The resolution contains several annexes that list the minimum requirements to be fulfilled when disclosing the information to the shareholders, including the mandatory information to be disclosed on the reference form, which was reviewed and simplified through this new resolution.

In line with these corporate governance framework updates, CVM Resolution No. 81, also dated 29 March 2022, consolidates the rules for shareholders' meetings, debenture holders, and holders of credit notes, also voiding former regulations, such as Instructions CVM No. 372, 481, and 625. This resolution also regulates the remote participation and voting in shareholders' meetings remote and hybrid meetings.

CVM Resolution No. 166, dated 1 September 2022, provides that listed companies that have a consolidated gross revenue lower than 500 million Brazilian Reais are exempted from disclosing the company information in newspapers. Instead, these companies are allowed to carry out their disclosure of corporate information on Empresas.NET and Fundos.NET, both made available by CVM free of charge.

CVM Resolution No. 168, dated 20 September 2022, sets out mandatory provisions related to the election of independent officers and directors in listed companies and brings in new rules allowing the cumulation of the positions of chairman of the board of directors and chief executive officer for listed entities that have a consolidated gross revenue lower than 500 million Brazilian Reais. This resolution also sets out that plural vote shall not apply to votes deliberating on transactions with related parties whose value exceeds 1 per cent of the company's total assets or 50 million Brazilian Reais, whichever is lower.

Law No. 14.451/22, issued on 21 September 2022, reduced the quorums for approval of corporate matters in limited liability companies. As of the entry into force of the new law, limited liability companies whose by-laws do not set forth quorums for the shareholders' resolutions will be subject to the new rule, being required half of the corporate capital to approve (1) amendments on the corporate capital, (2) takeovers and mergers; (3) dissolution or liquidation; and (4) appointment of non-shareholder officer or director, if the corporate capital is fully paid in. However, in case the corporate capital is not fully paid in, the shareholders can only appoint a non-shareholder officer or director with the approval of 2/3 of the corporate capital.

Lastly, Resolution CVM No. 175, issued on 23 December 2022, established a new regulatory framework for investment funds, consolidating several rulings into a single rule, with a general section that applies to all types of funds, and annexes with specific rules applied for FIF and FIDCs.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The main pieces of legislation that regulate corporate governance in China are as follows:

- the Company Law and the judicial interpretations of the Company Law made by the Supreme People's Court of China, which are applicable to both private and public companies;
- the Minutes of the National Courts' Civil and Commercial Trial Work Conference which is, though not cited as law, still often referred to by the courts of all levels;
- the Foreign Investment Law (effective since 1 January 2020), applicable to foreign-invested companies, which has replaced and superseded the Wholly Foreign-Owned Enterprise Law, the Sino-foreign Equity Joint Venture Law and the Sino-foreign Cooperative Joint Venture Law and their respective implementation rules;
- the Securities Law, specific to the corporate governance of public companies;
- the Code of Corporate Governance for Listed Companies and related administrative measures, guidelines, rules and explanatory notes issued by the China Securities Regulatory Commission (CSRC),
- the Chinese stock exchanges (i.e, Shanghai Stock Exchange and Shenzhen Stock Exchange) and other designated trading venues; and
- the rules and guidelines respectively issued by the China Banking and Insurance Regulatory Commission (to be incorporated into the State Administration for Finance Regulation in the reform of state institution in 2023) and CSRC, which apply to companies in the sectors of banking, insurance and securities.

China adopts a 'comply or explain' approach to enforcing corporate governance norms for listed companies.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The National People's Congress and its Standing Committee are the main legislatures for the Company Law, the Foreign Investment Law and the Security Law, which are mainly enforced by the State Administration for Market Regulation, the Ministry of Commerce and the CSRC. For rules applicable to public companies, the CSRC, the Shanghai Stock Exchange and the Shenzhen Stock Exchange act as both legislators and enforcers. Other relevant rules applicable to the sectors of banking, insurance and securities are enacted and enforced by the China Banking and Insurance Regulatory Commission (to be incorporated into the State Administration for Finance Regulation in the reform of state institution in 2023) and CSRC respectively. Currently, there are no well-known shareholder groups or proxy advisory firms that exert material influence on corporate governance-related issues of companies.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

There are two types of companies with limited liability in China:

- limited liability companies (LLC), which only include private companies; and
- companies limited by shares (CLS), which include both private and public companies.

For LLCs, the shareholders are entitled to appoint and remove directors by law in accordance with the method as stipulated in the articles of association. However, an employee representative who serves as a director on the board of directors of an LLC established by two or more state-owned enterprises or some other LLCs, is elected by the employees. As for CLSs, resolutions to appoint or remove directors shall be passed by a shareholders' general meeting by a simple majority of votes cast by shareholders present at the meeting. Under the Company Law, the shareholders' meeting is the highest decision-making body. A board of directors answers to shareholders at these meetings and must enforce resolutions carried at shareholders' meetings.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The Company Law reserves decisions to the shareholders in both LLCs and CLSs on:

- the business direction and investment plans of the company;
- the appointment and dismissal of directors and supervisors and their remuneration;
- resolution on the increase or reduction of the registered capital of the company;
- the issuance of corporate bonds;
- the merger, division, dissolution, liquidation or change of company form;
- the amendment of the articles of association of the company;
- the review and approval of reports of the board of directors or supervisors, annual financial budget, accounting plan, profit distribution plan and loss recovery plan; and
- other matters as provided in the articles of association.

The following additional rights are given to the shareholders:

- the approval, by a resolution of the shareholders' meeting, of security provisions by the company for a shareholder or the de facto controller of the company;
- the approval of director or senior manager entering a contract or trading with the company;
- the approval of director or senior manager seeking business opportunities that belong to the company for themselves or any other person, or operating similar business themselves or for any other person to that of the company they work for; and
- the approval, in a listed company, of transactions by a two-thirds majority of the voting rights of the shareholders present in the meeting, if, within one year, the company purchases or sells major assets, or provides guarantees to third parties, and the transactional value exceeds 30 per cent of the company's total assets.

At present, there is no legal concept or practice about non-binding shareholding votes in China.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

An LLC does not issue shares that shall be substituted for equity interests measured in terms of percentages. In an LLC, the voting rights exercisable by a shareholder at a shareholders' meeting shall be based on the ratio of its capital contribution, unless otherwise provided in the articles of association of the company.

In a CLS, the fundamental principle of 'one share, one vote' is adopted: one share of a shareholder represents one voting right in the shareholders' meeting. The company has no voting right for the shares it holds. However, if a division of ordinary shares and preference shares is adopted in a CLS, preference shareholders are generally not entitled to attend a shareholders' general meeting, unlike ordinary shareholders, and therefore have no right to vote on matters raised during these meetings. However, preference shareholders are entitled to vote during a separate class of meetings on a few limited matters (eg, issuing new preference shares, the amendment of articles of association related to the preference shares, a single or accumulative reduction of the registered capital of the company exceeding 10 per cent, and the merger, division, liquidation or change of corporate form). In addition to preference shares, after considering the market demand the Chinese government has introduced a special voting rights mechanism in the Shanghai Sci-Tech Innovation Board (STAR) called 'Weighted Voting Rights'. This change was revealed in Announcement No. 2 [2019] of the China Securities Regulatory Commission Implementation Opinions on Setting up the Science and Technology Innovation Board and Launching the Pilot Program of the Registration System on the Shanghai Stock Exchange, which formally put forward a policy to allow 'enterprises with special equity structure and red-chip enterprises to be publicly traded'. In 2023, the newly amended listing rules of Shanghai Stock Exchange and Shenzhen Stock Exchange both reaffirmed the arrangement of 'Weighted Voting Rights'. To be specific, this mechanism allows a company's shares to be split into two groups with different voting rights, usually termed 'A shares' and 'B shares'. 'A shares' provide the holder with equally up to 10 votes per share; however, they cannot be transferred at will (therefore cannot be traded on open markets), and the shares' voting privileges must be waived if they are converted to ordinary voting shares. These are usually held by the founding team of a company. 'B shares' offer a single vote per share and can be circulated as normal in the market.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Shareholders legally registered in the shareholders' register are generally allowed to participate in general meetings of shareholders. However, for a general meeting to decide on the matter regarding providing securities to a shareholder or the actual controlling party of the company, these shareholders or the shareholders controlled by the actual controlling party shall not participate in the general meeting of shareholders. Besides, where there are preference shareholders in a CLS, only under limited circumstances can preference shareholders participate in the general shareholders' meeting and vote.

Besides physical meetings, for both LLCs and CLSs, shareholders are permitted to pass a resolution in writing without convening a physical shareholders' meeting as long as this resolution is approved unanimously and is signed and sealed by all the shareholders. If the company's articles of association permit, the shareholders' meeting can be held by telecommunication means. The Company Law is silent on the general requirements applicable to conducting a shareholders' meeting via telecommunication. It can be safely presumed that holding the shareholders' meeting by telecommunication is legal provided that the statutory requirement relating to running the meeting and the adoption of resolutions are adhered to and relevant rules specified in the articles of association are followed.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

To convene a meeting of shareholders, the following must be done.

- In a CLS, shareholders who alone or jointly hold 10 per cent or more of the company's shares for 90 consecutive days or more can convene and preside over a general meeting on their own initiative, if the board of directors and the board of supervisors have failed to fulfil their obligations to convene a general meeting.
- In an LLC, if the shareholders' meeting is not called by directors or supervisors, shareholders who represent 10 per cent or more of the voting rights can convene and preside over the meeting on their own initiative.
- A shareholder may also petition a court to revoke or nullify a general meeting if the procedure or content of the meeting violates any law, administrative regulation or the company's articles of association.

The Company Law does not provide specific rules on the nomination of directors. Pursuant to the Guidelines on Governance of Listed Companies, listed companies shall stipulate in their articles of association standardised and transparent procedures for the nomination and election of directors, and ensure that the election of directors is transparent, fair and equitable.

In practice, if a meeting of shareholders convenes, shareholders are able to make shareholder proposals, such as nominating a person to be a director, before the notice of invitation, which includes the programme and agenda of the meeting, is circulated to the shareholders. However, in a CLS, any shareholder that holds 3 per cent or more of the shares of the company can submit a written proposal to the board of directors at least 10 days in advance of a general meeting. The shareholders' meeting is the decision-making body in the company, while the board of directors executes the decision of the shareholders' meeting. There is no provision in Company Law that prohibits the shareholders from requiring the board to circulate statements by dissident shareholders, nor any provision supporting such practices.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Under Chinese law, a company's controlling shareholder cannot abuse their controlling position, rights and pre-existing relationship with the company (including through manipulation of related-party transactions) to the detriment of the interests of the company and other non-controlling shareholders. Otherwise, this controlling shareholder shall be liable for the damages caused. As for the listed company, additional rules are regulated in the Code of Corporate Governance for Listed Companies in China. In accordance with article

63 of the Code, the controlling shareholders owe a duty of good faith towards the listed company and other shareholders thereof. In addition, the controlling shareholders should exercise their rights in strict compliance with laws and regulations. Any act that could infringe the company's interests or other shareholders' legal rights should be prohibited. The controlling shareholders are also forbidden to acquire additional profits by virtue of their controlling positions.

If the controlling shareholder infringes the lawful rights and interests of the company, causing the company to incur a loss, any shareholder of an LLC or CLS who alone or jointly hold at least 1 per cent of the company's shares for at least 180 days in succession have the right to request the supervisory board (or the supervisors, for an LLC without a supervisory board) to start legal proceedings in court regarding the infringement. If the supervisory board or the supervisors reject this request, fail to start legal proceedings within 30 days upon receipt of this request or in urgent circumstances where failure to promptly start legal proceedings could cause irreparable harm to the company's interests, the shareholders have the right, in the interests of the company, to directly start proceedings in a court in their own name against these controlling shareholders.

In addition, according to article 95 of the Securities Law, when the interests of investors in a listed company are damaged due to actions of the company (eg, misrepresentation), the investors can file a securities civil compensation lawsuit or entrust an investor protection organisation to do so. However, the latter requires at least 50 investors to join in the request. If the issuer engages in fraudulent issuance, misrepresentation or other illegal acts committed at the direction of a controlling shareholder or the actual controller, the controlling shareholder or the actual controller will be directly civilly liable to the investors, in accordance with the law. Besides, if a resolution of the shareholders' meeting violates any law, administrative regulations or the company's articles of association, this resolution will be null and void. Non-controlling shareholders can request a court to confirm that the resolution is void. Moreover, non-controlling shareholders are entitled to directly initiate a lawsuit against the controlling shareholders before a court if his or her own interests be infringed by this controlling shareholder.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Pursuant to article 20 of the Company Law, shareholders shall not abuse their shareholders' rights to cause damage to the company or the interest of other shareholders or abuse independent legal person status of the company and limited liability of the shareholders to cause damage to the interests of the creditors of the company.

Shareholders shall be held responsible for the acts or omissions of the company if the acts or omissions are considered the result of being abused by shareholders' rights and they cause the company or other shareholders to suffer damage.

Shareholders of a company who abuse the independent legal person status of the company and limited liability of shareholders to evade debts and cause damage to the interests of the creditors of the company shall bear joint and several liability for the company's debt.

Employees

10 | What role do employees have in corporate governance?

Employees can participate in corporate governance through a unique system, namely the Employee's Representative Congress (ERC). It is stipulated under the Company Law that companies should adopt democratic management through the ERC or other forms. When considering important operational issues, such as restructuring, employees are encouraged to give their opinions.

Employees' rights and benefits could also be protected by a company labour union organised under the Labour Union Law and the Company Law. It is through this built-in organisation that union activities may be carried out for employees, and under certain circumstances, collective contracts with the company may be arranged and signed.

In an LLC jointly set up by two or more state-owned enterprises or other state-owned investors, the board of director should include representatives of employees. However, for other companies (without the involvement of state-owned investors), employees' participation in the board is not mandatory. The representatives should be elected democratically through the ERC or other forms of a similar nature. Likewise, a representative of employees could also serve as a supervisor on the board of supervisors. The ratio of employee supervisors to all supervisors should be no less than 1:3. In listed companies, core employees may be offered equity incentives through which the core employees can be potential non-controlling shareholders.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

Under Chinese law, there is no regulation restricting the use of any specific anti-takeover devices; however, the Measures for the Administration of Takeover of Listed Companies set out the basic anti-takeover rule, which is that controlling shareholders or actual controlling parties of a target company should not abuse the shareholders' rights to damage the legal rights and interests of the target company or any other shareholders. The directors, supervisors and senior managers of a target company have the duty of fidelity and diligence and shall treat equally all the buyers that intend to take over the company. The decision made and the measures taken by the board of directors of a target company for the takeover shall benefit the company and its shareholders, and it shall not erect any improper obstacles to the takeover by abusing its power, nor may it provide any means of financial aid to the purchaser by making use of the sources of the target company or damage the legal rights and interests of the target company or its shareholders.

In practice, since the attempted Baoneng Group-Vanke hostile takeover in 2015, many listed companies (especially those with relatively scattered ownership structures) have revised articles of association and added special anti-takeover clauses.

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Among other details, these clauses define:

- what a 'hostile takeover' is;
- what process the enterprise is to follow when facing a hostile takeover;
- what golden parachutes exist (lucrative benefits employees receive if they are terminated), which aim to make it more difficult for an acquirer to replace the company's management);
- what restrictions on directors' nomination rights exist, which aim to make it harder for an acquirer to reorganise a company's board of directors; and
- what the acquirer's disclosure obligations are.

Issuance of new shares

12 May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Under the Company Law, only the shareholders' meeting in a limited liability company (LLC) or the shareholders' general meeting in a company limited by shares (CLS) may adopt resolutions on the increase of registered capital or issuing new shares. In addition, a listed company shall submit an application and documents including the resolution of a shareholders' general meeting to the China Securities Regulatory Commission to issue new shares. For shareholders in an LLC, the Company Law explicitly stipulates that they have the pre-emptive right to subscribe to new capital in accordance with the ratio of capital contribution or another ratio as determined by all the shareholders. As for a CLS, the Company Law is silent on the pre-emptive rights of existing shareholders regarding the new shares. In practice, the shareholders in a CLS may create these pre-emptive rights for themselves by agreement. In judicial practice, for a CLS that has not listed or been classified as public company, the shareholders may create these pre-emptive rights for themselves in the articles of association by agreement, due to respecting the autonomy of the company.

Restrictions on the transfer of fully paid shares

13 Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Restrictions on the transfer of fully paid shares in an LLC and CLS are both permitted.

In an LLC, the transfer of equity interest to an external third party is usually subject to the prior approval of more than half of the other shareholders, and the other shareholders have a pre-emptive right to acquire this equity interest on similar terms. The articles of association of a company may include certain additional restrictive provisions on the transfer of equity interest, provided that these restrictions do not violate any mandatory rules of Chinese law.

In a CLS, shares held by incorporators shall not be transferred within one year from the date of incorporation of the company. Shares issued by the company before the share offering shall not be transferred within one year from the date on which the shares of the company are listed on a stock exchange.

Furthermore, the directors, supervisors and senior management personnel of a CLS shall not transfer more than 25 per cent of their shareholding in the company each year during their term of appointment or transfer their shares within one year from the date on which the shares of the company are listed on a stock exchange. The aforesaid persons shall not transfer their shares in the company within half a year after leaving their post.

In addition, the articles of association of a CLS may make restrictive provisions on the transfer of shares held by its directors, supervisors and senior management personnel.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

The Company Law explicitly stipulates a few exceptional circumstances only under which a CLS can make a share buy-back, which include the following:

- a reduction of its registered capital;
- a merger with another company that holds its shares;
- the use of its shares for carrying out an employee stock ownership plan or share incentive plan;
- a request from shareholders who object to a resolution of a shareholders' general meeting on a merger or division of the company to acquire their shares by the company;
- the use of its shares for conversion of convertible corporate bonds issued by a listed company; and
- the necessity that the share repurchase for a listed company maintains its company value and protects its shareholders' equity.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Appraisal rights for dissident shareholders in an LLC are set out in article 74 of the Company Law, which provides a non-exhaustive list of circumstances under which shareholders who cast an opposing vote to a resolution passed at the shareholders' meeting may request the company to buy back the equity interest held by them based on a reasonable price, where:

- the company has not made a profit distribution to the shareholders for five consecutive years even though the company has been profitable for those five consecutive years and satisfies profit distribution requirements stipulated by law;
- there has been a merger, division and transfer of main assets of the company; or
- the business terms of the company have expired or the company has been dissolved for reasons stipulated in the articles of association, and a resolution is passed by a share-holders' meeting to amend the articles of association for the subsistence of the company.

Where the shareholders fail to conclude an agreement for the acquisition of equity interests within 60 days from the date of the resolution at the shareholders' meeting, the share-holders may file a lawsuit with a people's court within 90 days from the date of the resolution of the shareholders' meeting. As for the dissident shareholders in a CLS, the Company Law is silent on their appraisal rights. Except that the resolution of a shareholders' general meeting on a merger or division is objected to by the shareholders, dissident shareholders may also request the company to acquire their shares at a fair value.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The Company Law requires listed companies to adopt a two-tier board system structure, consisting of a board of directors managing the company and a supervisory board supervising the management.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The board of directors are responsible to the shareholders' general meeting for carrying out the following duties:

- to convene shareholders' meetings and report to the board of shareholders;
- to execute the resolutions passed by the board of shareholders;
- to decide on the business plans and investment schemes of the company;
- to formulate the annual financial budget and financial accounting plan of the company;
- to formulate the profit distribution plan and loss recovery plan of the company;
- to formulate the plan for the increase or reduction of registered capital and issuing corporate bonds;
- to formulate the plan for a merger, division, dissolution or change of company structure;
- to decide on the set-up of internal management organisation of the company;
- to decide on the appointment or dismissal of company managers and their remuneration, and decide on the appointment or dismissal of deputy managers and the finance controller of the company based on the nomination by the managers; and
- to formulate the basic management system of the company.

Duties of a board of supervisors include the following:

- to inspect the company finances;
- to supervise the performance of duties by directors and senior management personnel and propose to remove a director or a member of the senior management who violates the provision of the laws and administrative regulations and the articles of association of the company or the resolutions of the board of shareholders;
- to require a director or a member of the senior management who acts against the interests of the company to make corrections;
- to propose to convene an ad hoc shareholders' meeting, and convene and chair a shareholders' meeting when the board of directors fails to convene and chair a shareholders' meeting in accordance with the provisions of the Company Law;

- to make proposals at shareholders' meetings; and
- to file a lawsuit against a director or a member of the senior management in accordance with the provisions of article 151 of the Company Law.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

A board of directors has the executive rights of the company and a board of supervisors has the right to inspect the company finances and supervise the performance of duties by directors and senior management personnel. The board of directors and the board of supervisors are independent of each other, but both boards owe legal duties to the shareholders and the company. Directors and senior managers must not be members of the board of supervisors.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Pursuant to the Company Law, if a director or a member of the senior management violates his or her fiduciary duties owed to the company, violates the provisions of laws and administrative regulations or the articles of association of the company or manipulates a related-party transaction causing losses to the company, any shareholder of a limited liability company (LLC) or a company limited by shares (CLS) who alone or jointly hold at least 1 per cent of the company's shares for at least 180 days in succession have the right to request the supervisory board (or the supervisors, for an LLC without a supervisory board) to start legal proceedings in court in respect of the infringement. If the supervisory board or the supervisors fail to start legal proceedings within 30 days of the date of receiving the request or, in urgent circumstances, where failure to promptly start legal proceedings could cause irreparable harm to the company's interests, the shareholders have the right, in the interests of the company, to directly start proceedings in a court in their own name. According to article 94 of the Securities Law, if an issuer's directors, supervisors or senior management personnel violate laws, administrative regulations or provisions in a company's articles of association during the performance of their corporate duties, causing the company to suffer losses, an investor protection organisation holding shares in the company may file a lawsuit with a People's Court in its own name in the interest of the company. In these cases, the shareholding ratio and shareholding period are not subject to the restrictions stipulated in the Company Law of the People's Republic of China. Article 95 of the Securities Law further stipulates that an investor protection organisation that is entrusted by more than 50 investors may participate in the lawsuit and register with a People's Court as a representative for the rights holders who are confirmed by a securities registration and settlement organisation, unless the investors state they do not want to participate in the lawsuit. The Company Law has not introduced the business judgment rule explicitly from common law.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

As stipulated by article 147 of the Company Law, the board of directors and supervisors owe a duty of loyalty and diligence to the company. In addition, pursuant to the Guidelines on Governance of Listed Companies, directors in listed companies shall perform their duties loyally, diligently and prudently, and perform the undertakings.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

Generally, in Chinese practice the duties of individual members of the board do not differ from each other irrespective of the difference in skill or experience. In most companies in China, directors have the same duties following the provisions of the Company Law and the articles of association. If the board members also serve as officers in charge of a specific aspect of the management of the company, the duties of these board members in this sense will differ. However, for listed companies, the Guidelines on Governance of Listed Companies stipulate that the professional structure of the board of directors must be reasonable. Members of the board of directors must possess the requisite knowledge, skills and quality for the performance of their duties. Furthermore, diversity in the members of the board of directors is encouraged. Pursuant to the Guidelines on Governance of Listed Companies, the board of directors of a listed company must set up an audit committee and may establish the relevant specialised committees, such as a strategic committee, nomination committee, remuneration and appraisal committee, based on the company's needs. All members of a specialised committee must be directors. The convener of the audit committee must be an accounting professional.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

Pursuant to the Company Law, the board of directors may delegate management responsibilities to managers on the following matters:

- the management of the production and business operations of the company and organising and implementing resolutions passed by the board of directors;
- the organisation and implementation the annual business plan and investment scheme of the company;
- the draft of plans for setting up the internal management organisation of the company;
- the draft of the basic management system of the company;
- the formulation of company rules and policies;
- the recommendation, appointment or dismissal of management staff other than those positions that are to be decided by the board of directors; and
- other duties and rights granted by the board of directors.

In addition, the board of directors in a listed company may authorise certain matters to the specialised committees. Meanwhile, it is stipulated by the Guidelines on Governance of Listed Companies that major matters of a listed company shall be decided collectively by the board of directors, and the board of directors shall not authorise the chairman or the general manager to exercise powers vested statutorily in the board of directors.

Non-executive and independent directors

23 | Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Under Chinese law, there is no legal concept of the non-executive director. As for independent directors, Chinese law requires that a listed company must establish an independent director system and at least a third of board members must be independent directors, including at least one accounting professional.

The term 'independent director of a listed company' under Chinese law is defined as a director who does not hold any position in the company other than director and who has no relationship with the listed company engaging him or her or its principal shareholders that could hinder his or her making independent and objective judgements.

In addition to the functions and powers granted directors under the Company Law and other relevant laws and regulations, listed companies should grant independent directors the following special functions and powers:

- to approve major related-party transactions (referring to transactions that the listed company intends to conclude with the related party and whose total value exceeds 3 million yuan or 5 per cent of the company's net assets audited recently) before being submitted to the board of directors for discussion. Before the independent director makes his or her judgement, an intermediary agency can be employed to produce an independent financial advisory report, which will serve as the basis for his or her judgement;
- to put forward the proposal to the board of directors relating to the appointment or removal of the accounting firm;
- to propose to the board of directors the calling of an interim shareholders' meeting;
- to propose to call a meeting of the board of directors;
- to appoint the external auditing or consulting organisation independently; and
- to solicit the proxies before the convening of the shareholders' meeting.

Apart from the above duties, the independent director shall provide an independent opinion on the following matters to the board of directors or to the shareholders' meeting:

- the nomination, appointment or replacement of directors;
- the appointment or dismissal of senior managers;
- the remuneration for directors and senior managers;
- the existing or new loans borrowed from the listed company by, or other funds transfer made by, the company's shareholders, actual controllers or affiliated enterprises that

exceeds 3 million yuan or 5 per cent of the company's net assets audited recently, and whether the company has taken effective measures to collect the amount due;
- the events that the independent director considers to be detrimental to the interests of minority shareholders; and
- other matters stipulated by the articles of association.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

Under the Company Law, an LLC must have a board of directors with between three and thirteen members. An LLC with relatively few shareholders or of a relatively small size can have one executive director instead of a board of directors. For an LLC established with investment from two or more state-owned enterprises or two or more other types of state-owned investors, the members of its board of directors must include employee representatives of the company. Article 51 of the Company Law stipulates that a supervisory board of an LLC must be comprised of at least three members. LLCs with relatively fewer shareholders, or of a relatively smaller scale, may appoint one or two supervisors instead of establishing a supervisory board. A CLS must have a board of directors that is to be composed of five to 19 members. Article 117 of the Company Law stipulates that an LLC's supervisory board must comprise no less than three members.

The composition of directors or supervisors is regulated in the articles of association. Filling vacancies on the board or among newly created directors or supervisors shall be decided at the shareholders' meeting and will entail the amendment to the articles of association of the company.

The Company Law does not set out the criteria a director or a supervisor should meet; however, it provides a negative list and any person that falls under this list cannot be a director or a supervisor:

- a person who has no civil capacity (under the age of 18 or unable to account for his or her own conduct) or limited civil capacity (under the age of 18 or unable to fully account for his or her own conduct);
- a person who has been convicted for corruption, bribery, conversion of property or disruption to the order of socialist market economy and a five-year period has not elapsed since the expiry of the execution period, or a person who has been stripped of political rights for being convicted of a crime and a five-year period has not elapsed since the expiry of the execution period;
- a person who acted as a director, factory manager, manager in a company that has been declared bankrupt or liquidated and who is personally accountable for the bankruptcy or liquidation of the company, and a three-year period has not elapsed since the completion of bankruptcy or liquidation of this company;
- a person who has acted as a legal representative of a company that has had its business licence revoked or has been ordered to close down for a breach of law and who is

personally accountable, and a three-year period has not elapsed since the revocation of the business licence of such company; and
- a person who is unable to repay a relatively large amount of personal debts.

At the incorporation of a company, the information of the identities of each member of the board of directors and supervisors must be registered with the commercial registry and any changes regarding the board members must also be registered with the commercial registry. The names of board members of a company can be found in the nationwide company registration search system, the National Enterprise Credit Information Publicity System.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

The Company Law does not require the separation of functions between a board's chair and the chief executive or president. For LLCs, especially relatively small ones, it is not uncommon that a person performs the dual roles of the board chair and CEO. For a CLS, the separation of the board chair and CEO roles is widely deemed as a more reasonable approach to avoid conflicts of interest.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Pursuant to the Guidelines on Governance of Listed Companies, the board of directors of a listed company must set up an audit committee and may establish the relevant specialised committees, such as a strategic committee, nomination committee and a remuneration and appraisal committee, as required. The audit committee should supervise and evaluate external and internal audit work and internal control, propose the appointment or replacement of external audit firms, examine the company's financial information and disclosure this information. The key duties of the strategic committee are to study the company's long-term development strategies and major investment decisions and make recommendations thereto. The key duties of the nomination committee should include studying the selection standards and procedures for directors and senior management personnel and making recommendation thereto, shortlisting qualified candidates and reviewing candidates for the aforesaid positions. The remuneration and appraisal committee should study the appraisal standards for directors and senior management personnel, conduct appraisal and make recommendations thereto, and study and examine remuneration policies and schemes for directors and senior management personnel. Members of the special committees should be composed of directors. Moreover, independent directors should constitute the majority of the members of the audit committee, the nomination committee and the remuneration and appraisal committee and act as the convener. The convener of the audit committee must be an accounting professional.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no minimum requirement on the number of meetings an LLC's board of directors must hold each year, but its board of supervisors must convene at least one meeting per year. The Company Law requires a CLS to convene at least two meetings of its board of directors every year, and at least one meeting of its board of supervisors every six months. The Guidelines on Governance of Listed Companies, which apply to listed companies, only states that a board of directors must convene meetings on a regular basis, while the Guidelines for Articles of Association of Listed Companies states that the board of directors shall hold meetings no less than twice a year, which is consistent with the Company Law.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

The board practices of an LLC and a CLS are mainly set out in the Company Law and the articles of association. Companies are only allowed to set up their own rules of board practices in the articles of association when the Company Law does not stipulate otherwise. Article 48 of the Company Law states that board minutes should be made for each board meeting, which shall be signed by all the directors present at the meeting. Resolutions should be passed through voting by all the directors present, with each director having one vote. Nevertheless, disclosing the articles of association to the public is not obligatory. Authorised natural persons or qualified lawyers may retrieve companies' files from local counterparts of the State Administration for Market Regulation from which the articles of association could be acquired.

Listed companies, however, are subject to more rigorous regulations. Listed companies should disclose regularly through publishing their regular reports (ie, annual reports, semi-annual reports and quarterly reports). An annual report should include, among other things, the reports of the board of directors, the committee structures and the number of board meetings where resolutions and attendance would be covered. In addition, listed companies should also formulate a system to manage information disclosure. The Measures of Disclosure provide a wide range of the items that this system should embrace. These include, inter alia, the duties of reporting, deliberating and disclosing for the directors, the board of directors, the supervisors, the board of supervisors and senior managers. With regard to the board of directors' procedural rules, article 29 of the Guidelines on Governance of Listed Companies specifies that the rules of procedure for the board should be formulated and be incorporated into a company's articles of association. Board meetings should be conducted strictly according to the rules of procedure.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

There is no mandatory requirement or practice that requires the evaluation of the board in LLCs or CLSs. They may implement their own evaluation mechanism in the articles of association. In listed companies, the Guidelines on Governance of Listed Companies require fair and transparent standards and procedures to be implemented in assessing the performance and fulfilment of the duties of the directors, supervisors and senior executives. Performance assessment should be organised by the board of directors or the remuneration and appraisal committee or, alternatively, other independent (external) firms. Self-assessment, mutual assessment or other methods are introduced in the Guidelines to assess the fulfilment of duties. Each assessment result and remuneration should be reported to the shareholders' general meeting and be disclosed.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

It is specifically stated under article 37 of the Company Law that the shareholders' meeting should exercise a number of powers. These powers are inherent and, therefore, cannot be derogated or circumvented by the articles of association or other shareholders' agreements. One of these powers is to appoint and remove directors, as well as to decide their salaries and compensation. Article 45 of the Company Law provides certain autonomy to companies when it comes to the tenure of directors, requiring the tenure to be set forth in the articles of association, but subject to a three-year maximum. Upon re-election or reappointment, they may continue to serve as directors in the company. For listed companies, a contract should be formed between the company and the director specifying their rights and obligations, the tenure of the director, the liabilities when the statutory or contractual obligations are breached and the compensation when the contract is terminated prematurely. The principle of fairness should be applied when considering the amount of compensation, while keeping the company's lawful interests unharmed and any behaviour amounting to the transmission of interests barred. As in limited liability companies (LLCs) and companies limited by shares (CLSs), according to the Guidelines on Governance of Listed Companies, the remuneration of directors should be decided by shareholders' meetings. Board committees, such as remuneration and appraisal committees, may also be set up to study and review directors' remuneration schemes. It is, however, not mandatory under the Guidelines to have such a committee in place. The board of directors should report the directors' performance, the assessment results and remuneration to shareholders' meetings, which should eventually be disclosed by the company. It is expressly prohibited under the Company Law to provide loans to directors, either directly or indirectly through subsidiaries.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

In LLCs or CLSs, the board of directors should hire or dismiss the manager, the vice-manager and the finance manager, as well as decide their salaries and compensation. Usually, the articles of association will provide further details regarding the factors that may affect the remuneration of senior managers.

It is expressly prohibited under the Company Law to provide loans to senior managers either directly or indirectly through subsidiaries.

The picture is very different where listed companies are involved. A few regulations on managers' remuneration echo those for directors:

- the remuneration and appraisal committee, if set up, would be responsible for studying and reviewing senior managers' remuneration;
- the principle of fairness to be applied when considering the amount of compensation, without prejudice to the company's lawful interests; and
- a comprehensive evaluation mechanism for performance and remuneration must be in place, based on which performance appraisal could be conducted when determining senior managers' remuneration and other bonuses.

Upon being approved by the board of directors, the remuneration distribution plan for senior managers must then be explained in a shareholders' general meeting and be disclosed sufficiently.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

One of the statutory powers of the shareholders' meetings is to elect and change the directors and supervisors, as well as to decide their salaries and compensation. The shareholders' meeting could be a regular or an interim one. Regular meetings should be held in a timely fashion according to the articles of association. Where an interim meeting is proposed by shareholders representing 10 per cent of the voting rights or more, by directors representing a third of the voting rights or more or by the board of supervisors or supervisors (when no board of supervisors is in place), an interim meeting should be held. In a listed company, the remuneration of directors and supervisors would be decided at the general meeting of shareholders.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance was first brought to China in 2002 following the promulgation of the Guidelines on Governance of Listed Companies. Article 24 of the Guidelines on Governance of Listed Companies allows listed companies to purchase liability insurance for directors on the premise that the shareholders' general meeting gives prior approval. The coverage of this liability insurance should be set out in the contract of employment or services, expressly excluding the liabilities arising out of a breach of laws, regulations or the articles of association.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Under the current legal framework in China, no specific law or regulation has directly touched upon these indemnities and constraints on them. Nonetheless, according to the Company Law, the director, executive director or general manager of a company may also be the legal representative of the company. When a company's legal representative engages in civil activities in conformity with the law and the articles of association for and on behalf of the company, all the legal consequences arising therefrom should be borne by the company. If, while performing his or her duties, the legal representative causes harm or damage to third parties, the company should assume the liability. After the company indemnifies the third parties, it may seek to recoup from the legal representative who has caused or contributed to this harm or damage.

In short, if the company's director or executive director is also the legal representative, or if this officer is the general manager who also holds the position of a legal representative, then the aforementioned provisions apply.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

This is not applicable.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

The Company Law greatly limits the circumstances in which directors' and officers' obligations might be precluded or limited. In non-listed companies, the director should be responsible for resolutions of the board of directors. When any of these resolutions is in violation of laws, regulations, the articles of association or resolutions made by shareholders' general meetings, causing serious damage to the company, the directors taking part in the resolutions should be held liable for the company's damages. The liability may only be exempted if the directors raised objections to these resolutions at the board meeting, and these objections were recorded in the minutes. The same provision is laid down in article 23 of the Guidelines on Governance of Listed Companies, governing directors' liabilities and exculpation in listed companies.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

In China, the articles of association embody the functions and features of the corporate charter and by-laws in combination. Parts of the company information that have been registered with a local branch of the State Administration for Market Regulation (SAMR) are publicly available. However, the articles of association, in their entirety, are generally not available to the public. Qualified Chinese lawyers may acquire the articles of association through a local branch of the SAMR if certain conditions are met (eg, when they are authorised by the company itself, or in the course of a civil proceeding, by exercising their statutory power of inquiry to retrieve all the company's files, including articles of association, from the local branch of the SAMR).

Investors are able to check articles of association through the websites of the China Securities Regulatory Commission, Shanghai Stock Exchange and the Juchao Information Network.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

The following information must be disclosed constantly by SAMR and other government departments to the public regarding non-listed companies according to the administrative regulations:

- the company's registered general information;
- the registered movable assets;
- the pledges on equity;

- the administrative punishments;
- the information on granting, altering or renewing administrative permits; and
- other information that must be disclosed in accordance with the law.

In addition, companies must submit their annual reports for the previous year to the online credit disclosure system which will be disclosed to the public. This submitted information must include:

- the company's postal address, postcode, telephone number and email;
- the company's commencement, discontinuation or liquidation;
- the company's investments in other enterprises;
- the amounts, time and forms of capital contributions, subscribed and paid-up, where the enterprise is a limited liability company or a company limited by shares;
- the shareholders' equity transfer;
- the company's website and the name, website and other information on online shops engaging in online business; and
- the number of employees, total assets, total liabilities, guarantees provided externally, total owners' equities, gross operating income, prime operating income, total profits, net margin and total tax payment.

All of the above items shall be disclosed to the public with the exception of the last item, which companies may opt to disclose to the public. For listed companies, the Measures of Disclosure set forth the main documents that should be disclosed: stock prospectuses, bond prospectuses, the listing memorandum, periodic reports (annual reports, half-yearly reports and quarterly reports) and interim reports. In summary, any information that would affect investors' decisions must be disclosed. Effective from 2019, the Securities Law expanded the scope of significant events that should be disclosed in the reports. For stock listed companies, major events now include significant changes in a company's assets, significant guarantees or related transactions and the inability of the chairperson or manager to perform his or her duties. Article 81 stipulates that a bond-listed company should make interim reports on significant matters affecting the trading price of bonds. In particular, the second paragraph lists 10 specific matters, including significant changes in the company's shareholding structure or production and operation status and changes in the bonds' credit ratings.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

This is not applicable.

Shareholder engagement

40 | Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

There are a significant number of small and medium-sized private investors in China, making up a large proportion of total investors. Listed companies' engagement with these private investors and shareholders is mainly led by companies' investor relations teams. On 7 January 2022, the Shanghai Stock Exchange revised the No.1 Self-regulatory Guidelines for Listed Companies, comprehensively obliging the companies to appoint the secretary of the board of directors as the person in charge of relations with the investors, building all kinds of platforms to inform the investors and use the interactive platform designed by Shanghai Stock Exchange, etc. In summary, listed companies should develop companies' investors relations management mechanisms through which the investors can engage with the company effectively and be well informed. The secretary of the board of directors shall be held responsible for detailed work.

China Securities Regulatory Commission (CSRC) also posted new guidance in 2022, expanding contents disclosed to the investors and setting up all kinds of channels to facilitate communication. Generally, the obligations of the listed companies with respect to engagement with the investors involve not only the company and its senior management (directors, supervisors and senior managers), but also the secretary of the board. The guidance does not stipulate specifically when to engage with the investors, leaving it to the discretion of both parties, but the company should actively engage with the investors in accordance with the principles set in the guidance.

Sustainability disclosure

41 | Are companies required to provide disclosure with respect to corporate social responsibility matters?

Generally, the methodology towards disclosing environment-related information is to combine mandatory disclosure with voluntary disclosure. The Company Law stipulates expressly that companies shall bear social responsibility, but it does not mention requirement of disclosure. According to the Environment Protection Law and other environmentally related laws, companies that discharge pollutants must disclose to the public the names of their major pollutants, discharge methods, discharge concentration and total volume of discharged pollutants and any discharge beyond the approved quota, as well as information relating to construction and operation of pollution-preventing facilities. Listed companies are subject to more demands of the disclosure of performing environmental protection duties. Apart from the environmental information (including the information of serious pollution in the course of major asset transactions), a listed company should also disclose information pertaining to poverty alleviation and other social responsibilities in accordance with the Guidelines on Governance of Listed Companies, which since its implementation in 2018, has established the basic framework for information disclosure of ESG (Environment, Social, Governance). Further requirements are established in documents released by China Securities Regulatory Commission (CSRC) and listing rules of Shanghai Stock Exchange and Shenzhen Stock Exchange.

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In addition to compulsory disclosures, the voluntary disclosure includes but is not limited to:

- the purpose and philosophy of the company in fulfilling its social responsibility;
- the protection of the rights and interests of shareholders and creditors
- the protection of the rights and interests of employees
- the protection of the rights and interests of suppliers, customers and consumers
- the environmental protection and sustainable development the company is involved in; and
- the public relations and social public welfare the company is engaged in.

What is distinct under Chinese law is that the efforts to revive the rural areas and reduce poverty is encouraged to be disclosed.

CEO pay ratio disclosure

42 | Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

This is not applicable.

Gender pay gap disclosure

43 | Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

This is not applicable.

UPDATE AND TRENDS

Recent developments

44 | Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Second draft version of the Company Law

The second draft version of the Company Law was submitted to National Peoples' Congress for review on 27 December 2022, which makes amendments in many respects including corporate governance to the Company Law and the first draft version of the Company Law.

On the shareholders' side, classified shares are allowed in accordance with the articles of association. The second draft version of the Company Law further stipulates what shall be recorded in the articles of association related to classified shares. Authorised capital system is also introduced in, empowering the company to be provided with more flexibility about shares issuance. Shareholders in a company limited by shares enjoy pre-emptive rights in accordance with the articles of association or the resolution of the shareholders' meeting as explicitly stipulated in the second draft.

On the directors' side, the role of the board of directors has been clarified and attached with more importance when the board of directors is defined as an executive body and shareholders are entitled to determine the powers of the board of directors in the articles of association. Besides, the maximum limitation of the directors is cancelled. One-tier board structure in which supervisors are not to be set up mandatorily is also permitted. The organisation structure of some companies is simplified because it is feasible for smaller companies not to set the board of directors or supervisors. Employee directors are expected to be more common when the position no longer relates to whether the company is state-owned or not. Liability insurance for directors is conspicuously mentioned for the first time in the second draft.

The second draft version of the Company Law continues to strengthens the liabilities of the controlling shareholders, the directors, the supervisors and the senior managers. The duty of loyalty and the duty of diligence are given more precise and extensive definition in its provisions. By expanding the scope of connected persons, obliging the parties to report and avoid voting, the regulation of connected transactions is thus enhanced. Social responsibilities of the company and the disclosure reports related are now given more encouragement, which conforms to the trend of company law development.

Currently, the second draft version of the Company Law is still under scrutiny. It remains to be seen when the draft version of the Company Law will be officially adopted by the National People's Congress and how the final version present itself.

Implementation of registration-based IPO System

On 17 February 2023, the China Securities Regulatory Commission (CSRC) issued corresponding rules regarding the comprehensive implementation of a registration-based IPO system, replacing the previous approval-based system. The stock exchanges, the National Equities Exchange and Quotations and the Securities Association of China and other related institutions have all issued corresponding rules synchronically.

The reform aims firstly at simplifying the conditions for IPO. The conditions for issuance is now turning into requirements during information disclosure. More diversified and inclusive conditions for IPO are set up in different boards. The reform also improves the registration procedures for vetting. The stock exchange is responsible for vetting while the CSRC takes charge of registration. The responsibility between them will be divided clearly. Besides, there will be no administrative restrictions on the issuing price and size of new shares. The mechanism of quotation, pricing and placement with institutional investors as the main participants will be improved. To improve the system regulating major assets restructure of listed companies, a unified registration system will be implemented in all boards.

Meanwhile, the regulation and law enforcement will be enhanced as well as protection for investors.

To sum up, it is a milestone moment in the course of development of China stock market. And it is expected that the reform will boost the capital market and revive the economy.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The main sources of law relating to corporate governance in France are:

- the Commercial Code;
- concerning listed companies, the general regulations, which are binding, and recommendations of the French stock exchange authority (AMF), which may be binding on a case-by-case basis; and
- specific laws that organise the governance of corporate vehicles designed for certain business sectors (financial institutions) or professions (such as auditors or pharmaceutical businesses).

The relevant European regulations have been incorporated into these sources.

The Commercial Code encourages companies listed on a regulated market to refer to a corporate governance code and requires companies that do not intentionally refer to these codes to explain their reasons for not doing so and to clarify their own corporate governance rules.

There are two established corporate governance codes currently available: the Afep-Medef Code, designed for large listed companies, and the MiddleNext Code, which was initially dedicated to small and medium-sized listed companies but now also addresses large listed firms controlled by one shareholder or a group of shareholders and non-listed companies with a dispersed shareholding. Listed companies that apply a corporate governance code must justify any deviation therefrom in accordance with the 'comply or explain' principle.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

There is no specific agency with exclusive competence in the elaboration and enforcement of corporate governance rules.

However, the AMF, as guarantor of sound market information, closely reviews and monitors the corporate governance practices of listed companies and publishes an annual report on this matter.

The Afep and Medef associations have set up a high-level committee on corporate governance to review the practices of the listed companies applying the Afep-Medef Code and to ensure the effective implementation of the 'comply or explain' principle. This committee works closely with the AMF.

Several shareholders' associations are active in promoting and defending shareholders' rights. They are often consulted by authorities in the development of new regulations and are sometimes involved in legal actions to defend their position.

Recommendations of international (Institutional Shareholder Services and Glass Lewis) or domestic (Proxinvest) proxy adviser firms active in France are also carefully considered by the market.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

In France, the 'limited liability company' concept covers different corporate forms of vehicles.

- Public limited company (SA): most functioning rules are provided for by the Commercial Code and are compulsory. The SA is the only type of vehicle (apart from the limited partnership) that may be listed.
- Joint-stock company (SAS): functioning rules are predominantly decided by the shareholders in the articles of association.
- Limited company (SARL): functioning rules are provided for by the Commercial Code and are compulsory. The SARL structure is generally reserved for small businesses.

- Limited partnership (SCA), organised by the Commercial Code and, to a certain extent, by the articles of association: a sort of limited partnership with share capital, where two types of members coexist, namely general partners, who are liable on their personal assets for the SCA's debts, and limited partners, who basically are shareholders. The SCA form is chosen by listed companies as a poison pill against hostile takeover bids.

In an SA with either a one-tier structure (a board of directors) or a two-tier structure (an executive board and a supervisory board), the shareholders always have the power to remove members of the (supervisory) board with a simple majority vote in a meeting, even if this matter has not been included in the agenda.

SCAs are managed either by a general partner or a third person whose rules of appointment and removal are freely set in the articles of association. SCAs also have a supervisory board whose role is to control management and that may exercise a veto right on the appointment of managers. The power of shareholders in these companies is limited: every decision must be confirmed by the general partners, with the exception of the appointment of the members of the supervisory board.

Shareholders of an SAS benefit from large flexibility to draft the articles of association, especially as regards governance rules, which is why investors who need to address specific governance issues and tailor peculiar corporate functioning rules generally choose this legal form. Appointment and removal rules of executives and directors are provided for in the articles of association.

SARLs do not have a board of directors per se, as management and executive functions are combined in a single type of duty. The appointment and removal of managers are decided by the shareholders at a simple majority unless the articles of association provide for a qualified majority. Shareholders may also request the removal of the managers with cause to the courts.

When consulted on a specific question, a shareholders' vote is binding (with a few exceptions). However, apart from their removal right regarding the board or legal action, shareholders have no direct way to require the board to pursue a particular course of action.

The right of a director to be indemnified in the event of a dismissal depends on the types of corporate form and duties, bearing in mind that dismissal in vexatious circumstances or where the director cannot defend him or herself may give rise to specific damages.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

Shareholders' approval is required for the following decisions:

- approval of the company's (and consolidated) annual accounts;
- dividends allocation;

- appointment of the (supervisory) board members and allocation of the global amount of their attendance fees, the (supervisory) board having the exclusive power to split the fees between members;
- appointment of the statutory auditors;
- approval of the report of the statutory auditors on transactions between the company and its related parties;
- amendments to articles of association (eg, increase or reduction of the share capital, mergers and change of corporate form or nationality); and
- dissolution.

Listed companies' shareholders' meetings also vote each year on all components of the compensation packages of the executive officers and board members for both the current year and the past year.

The articles of association may also provide that certain other decisions require the shareholders' prior approval, but these restrictions cannot be opposed to third parties, and agreements concluded without such a prior approval remain binding. The company's representatives can, however, be held liable for the loss suffered by the company as a result of these agreements. The same solution applies regarding transactions with related parties when the shareholders have refused to approve the statutory auditor's report.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

The 'one share, one vote' principle generally applies subject to several exceptions.

In listed SAs and SCAs, a double voting right is automatically granted to registered shares after a two-year period of uninterrupted holding (unless otherwise provided for by the articles of association).

In non-listed SAs and SCAs, as well as in SASs, preference shares with multiple voting rights may be issued.

Companies may also issue preference shares deprived of voting rights, usually in consideration of the entitlement to preferred dividends. These preference shares are limited to a quarter of the total amount of shares in listed companies (half in non-listed companies). On the contrary, some preference shares benefit from double voting rights or a veto right for certain decisions.

A cap on the votes may also be implemented for each shareholder, it being specified that the articles of association of listed companies may suspend this limit in the event of a takeover bid.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Shareholders must justify ownership of their shares two business days prior to the meeting for listed companies (record date), and either this date or the date of the meeting for non-listed companies (as provided for in the articles of association of such companies).

Shareholders who cannot attend the meeting may vote beforehand (by mail or using an electronic platform if the articles of association authorise this option) or give a proxy. This proxy is either given to a specific person, who may be a shareholder, or sent to the company with no specific proxy holder's name, which corresponds to a vote in the way recommended by the board. In companies that have adapted their articles of association accordingly, shareholders may also vote electronically.

Although French law allows shareholders to participate virtually in meetings if the articles of association so provide, professional associations and law professionals do not, at present, recommend using such an option. To date, only one listed company (with a limited number of participating shareholders) has experienced the format of a digitalised shareholding meeting with online voting.

Shareholders of an SA are not allowed to act by written consent without a meeting. Shareholders in companies of another form may do so if this is expressly permitted in the articles of association.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Shareholders' meetings are generally convened by the board.

All shareholders may request the court to force a board to convene the annual shareholders' meeting in the event of the board's failure to do so as and when legally required. All shareholders may also request the court to appoint an agent who will convene a shareholders' meeting in the event of an emergency. Shareholders holding at least 5 per cent of the share capital have the right to request the court to appoint an agent, who will convene a shareholders' meeting on a given agenda. (They do not need to provide evidence of an emergency, but the judge will assess whether the request is consistent with the company's interests.)

After a public takeover or a change of control of a company, majority shareholders may also convene a shareholders' meeting.

Before a meeting, minority shareholders (holding at least 5 per cent of the voting rights in companies with a share capital not exceeding €750,000, less if it does) may force the board to put a matter on the agenda, including director nomination, which will be discussed during the shareholders' meeting. They may justify their action in a statement, which will be transmitted to the shareholders. Otherwise, shareholders cannot force the board to circulate any statement.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

French law does not provide for any duties owed by controlling shareholders to the benefit of the company or to minority shareholders. However, case law prevents majority shareholders from voting in favour of resolutions taken against the company's interests with the sole purpose of favouring their own interests to the detriment of other shareholders. When this is characterised by the judge, the disputed vote may be declared null and void, and the majority shareholders may be sentenced to pay damages.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

The responsibility of shareholders is normally limited to the price paid for their shares.

However, the corporate veil may be pierced when a shareholder has de facto replaced a chief executive and committed mismanagement (eg, commingling its own assets with those of the company or causing the company's insolvency by obvious misconduct).

In addition, parent companies may be held liable for damage caused by their subsidiaries: as regards environmental losses, if a mismanagement action can be assessed against the parent company; and if they belong to a large group (employing 5,000 persons in France or 10,000 worldwide), as regards human rights abuses, physical injuries or environmental losses, if the parent company has failed in the setting-up of a specific prevention plan and if a loss directly arises out of this failure.

Employees

10 What role do employees have in corporate governance?

All companies employing at least 50 individuals must set up a social and economic committee (composed of employees' representatives), which must be periodically consulted and informed on various matters that include, in some instances, contemplated corporate governance changes. Representatives of the committee may attend all meetings of the corporate bodies and must be provided with the same level of information.

Two non-cumulative schemes exist to appoint one or several genuine directors representing the employees in companies listed on a regulated market according to a process provided for in the articles of association: when they have employees owning more than 3 per cent of the share capital; or when they employ, with their subsidiaries, more than 1,000 individuals (5,000 worldwide) and must set up a social and economic committee.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

Anti-takeover devices are allowed under French law insofar as they abide by the corporate interest. Although France has implemented the Takeover Directive, it has often chosen not to adopt some options of the Directive.

Before a takeover bid is made public, various measures may be implemented to thwart any offer, including:

- double voting rights, which increases the number of shares that a bidder must acquire to gain the target's control;
- prior disclosure of shareholders' agreements provisions relating to share transfer;
- share repurchase programmes (up to 10 per cent of the share capital); and
- delegations to the board to issue new shares or specific 'bid warrants'. These warrants are designed to be attributed, if a takeover bid takes place, to existing shareholders for no consideration to maintain the share ownership (if the bid fails, the company can finally decide not to activate the warrants and new shares will not be issued).

During the takeover bid, unless the articles of association provide otherwise, the board is no longer (as it formerly was) required to remain neutral and to submit any anti-takeover action to shareholders' approval. The board may also sell (or buy) a strategic asset, seek an alternative and friendly bid (the white knight), use delegation previously granted by the shareholders, etc. However, approval is still necessary to perform a repurchase programme if it may harm the success of the bid.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Shareholders' approval is necessary for the issuance of new shares but can be delegated to the board (which, in a listed company, may then subdelegate this power to the executive officers). Rights of issuance can be granted to the board with or without a preferential subscription right to shareholders. In this latter case, a priority right may be implemented in listed companies by the board, depending on the shareholder delegation's terms.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Restrictions on share transfers are compulsory in limited companies (requiring prior approval of any transfer to a third party) and optional in other non-listed limited liability companies. If some or all shareholders agree to be bound by these restrictions, they are provided for in the articles of association or in shareholders' agreements (in which case they may remain confidential).

Shareholders of listed companies may include share transfer restrictions in shareholders' agreements only, and these restrictions must be disclosed to the public when they relate to at least 0.5 per cent of the shares or voting rights, failing which the undisclosed agreement will have no effect during a takeover bid.

Common restrictions include pre-emption rights, prior approval (by the shareholders' meeting, the board or a specific corporate body), tag-along and drag-along rights, and standstill. Apart from standstill restrictions, of which the effect must be time-limited, these restrictions may not harm the ability of a shareholder to exit the company if it has found a buyer (the transfer being made to this buyer, the company or the other shareholders).

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

A shareholder of a non-listed company may force the company or other shareholders to buy its shares if the implementation of a prior approval clause contained in the company's articles of association has given rise to the refusal of the contemplated share transfer.

The articles of association of a joint-stock company and non-listed public limited company (SA) may contain drag-along rights or exclusion clauses (with objective exclusion causes and price determination rules) whereby a shareholder may be forced to sell its shares.

In listed companies, compulsory repurchase may only occur when 90 per cent of the shares and voting rights are held by a shareholder or shareholders acting in concert. This bid may be triggered either by minority shareholders or by majority shareholders or may follow a takeover bid at the successful bidder's initiative.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Minority shareholders do not have the right to sell their shares if they disagree with a decision of the company unless it is so provided in the articles of association or in a share-holders' agreement.

Certain restructuring transactions (such as a merger, a disposal of all or most of the company's assets, reorientation of the company's purpose and substantial changes to the articles of association) involving listed companies may lead to the French stock exchange authority imposing on the majority shareholders to launch a takeover bid at fair market value (this is compulsory in the event of the conversion of an SA into a limited partnership).

Finally, in a merger involving (listed or non-listed) entities with the same parent (owning at least 90 per cent of the voting rights of all involved entities) or an absorbing entity owning at least 90 per cent of the voting rights of all absorbed entities, minority shareholders have the right for their shares to be acquired at a fair market value if the entities involved in the merger decide not to submit the transaction to an independent auditor.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

One-tier structured public limited companies (SA) are largely predominant, representing about 80 per cent of large issuers. About two-thirds of them are led by a chief executive who is also the chair of the board. Two-tier structured SAs represent about 15 per cent and limited partnerships about 5 per cent.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The board of directors is the corporate body in charge of setting the main lines of the company's business activity and strategy and of ensuring their implementation, in accordance with the powers reserved by law to the shareholders and the company's executives. If the board is legally entitled to deal with any issue it considers relevant, by law it has exclusive competence in the following matters:

- drawing up of the annual (consolidated) accounts and management report;
- suggesting dividends allocation;
- the convening of shareholders' meetings and fixing their agenda;
- appointment and removal of the company's executives;
- authorisation of guarantees granted by the company and of transactions with related parties; and
- bonds' issuance (unless reserved to the shareholders' meeting by the articles of association).

In two-tier structures, the supervisory board's role is mainly to appoint (and remove if permitted by the articles of association), control and supervise the executive board (eg, review of the accounts, management reports and strategy, and prior approval of transactions with related parties) and refer matters to the shareholders' meeting. The executive board and the supervisory board may each convene shareholders' meetings.

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Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board has no legal personality and is only a corporate body that promotes and defends the company's interests.

Ultimately, the board is responsible to the shareholders, who can decide, at each meeting, to remove any of its members (including all of them). However, civil and criminal liability of directors may be sought where applicable either by the company itself or by shareholders (or third parties in limited cases and the public prosecutor as regards criminal liability).

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Legal actions may be brought against directors individually or collectively. The 'corporate' derivative action aims at indemnifying against losses suffered by the company itself as a result of faults of its directors. It can be initiated for the account of the company either by the company's legal representatives or by a shareholder acting on behalf of the company. Shareholders may also bring an action to be indemnified for losses that they have directly suffered.

These actions may only be brought if directors have committed a breach of law or of the company's articles of association, or mismanagement acts. As regards mismanagement, there is no business judgment rule as such in France, but as the claimant must evidence that a fault has been committed, this is a similar conclusion as to the directors' liability regime in common law countries. When the fault is committed collectively, the enforcement action is led against all directors taken individually, but each member of the board may elude its liability if it can prove that it opposed the disputed decision.

Criminal liability may be sought in specific cases, mainly in the event of misuse of corporate assets, abuse of powers, distribution of fictitious dividends and publications of untrue accounts. It may be initiated by any purported victim, but the legal action is controlled by criminal judges.

No distinction is made by law between the directors depending on whether they are interested or disinterested, executive or independent. They are all under the same liability regime, and the difference only resides on the grounds of evidence and the ability of the claimant to establish the facts that give rise to liability of any such directors.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Directors owe a duty of care to the company at all times. Case law has promoted a specific duty of loyalty by board members if these directors hold sensitive information and are involved in share transactions with other shareholders.

Internal rules of the board often describe more precisely the scope of this duty (eg, attendance of members and conflict of interests).

Board member duties

21 | To what extent do the duties of individual members of the board differ?

The duties of the various board members are the same and considered on an equal basis.

Directors may be members of specific board committees (audit (which is compulsory in listed companies), appointment, compensation, strategic, ethical, etc) and their work (and exposure) may so differ in practice. Usually, members of specific committees are chosen among directors with skills and experience corresponding to their field of expertise.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The board may delegate to the management some of its specific powers, such as the authorisation of guarantees (by law) or the issuance of new shares (upon shareholders' approval).

The board may create committees in charge of monitoring specific matters. It can also appoint any person to perform specific tasks. However, the aim of these committees or appointments is only to facilitate or improve the work of the board and its decision-making process. Directors cannot ignore any of the matters discussed in board meetings; committees or individuals that the board has appointed always act under its authority.

Non-executive and independent directors

23 | Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Companies listed on a regulated market must appoint at least one independent director to their audit committee. This is a minimum, and the law implicitly leaves it to the soft law corporate governance codes to determine the appropriate proportion of independent board members and the criteria of independence. For example, the Afep-Medef Code requires that at least half of the directors are independent in an uncontrolled company, or one-third in the case of a company controlled by a majority shareholder or a group of shareholders, and those independent directors should represent two-thirds of the audit committee and the majority of the appointment and compensation committee if applicable.

The Afep-Medef Code sets out that to be considered as independent, directors must not have any particular relationship (majority shareholder, employee, family or other) with the company or the company's executives. According to these criteria, an independent director is someone who:

- has not been an employee or an executive officer for the past five years in the company or a related company;
- is not a significant client, supplier, adviser or banker; and
- has not been an independent director for longer than 12 years (renewal included).

While they are expected to be particularly cautious of the company's interests, their liability does not differ by law from that of the other directors.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The board size of between three and 18 members is ultimately determined by the shareholders. If they do not provide otherwise, no more than one-third of the directors may be over 70 years old. The same threshold applies to employees of the company.

In listed companies and large companies (ie, companies that had, for three consecutive financial years, over 250 permanent employees and a total turnover or balance sheet of more than €50 million), the proportion of board members of a specific gender must represent at least 40 per cent of the total. As an exception to the 40 per cent requirement, boards can be made of eight members or fewer, when the gender gap cannot exceed two directors.

Before their appointment, shareholders may request information on the candidates' curricula vitae during the last five years; in listed companies, a brief summary of their expertise should always be available. Apart from the specific requirement regarding the independent member of the audit committee, expertise is not required by law.

Criminal records are only provided to the French stock exchange authority (AMF) for listed companies during initial public offerings, but directors or supervisory board members in all companies must demonstrate that they have not been restricted from running a business owing to criminal proceedings.

The (supervisory) board may appoint temporary new members in the event of a vacancy, subject to confirmation by the next shareholders' meeting, while only the shareholders may create new directorships.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

Laws and governance codes do not require the separation or joining of these functions but organise decision-making processes (including in terms of transparency) in this respect.

Historically, these functions were joint, and this structure still prevails today (about two-thirds of SAs with a one-tier structure are managed by a CEO who is also the chair of the board).

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

The audit committee is mandatory in companies listed on a regulated market, but the board of directors may decide to take over its functions directly. In these cases, when the agenda of the board meeting handles relevant matters of the audit committee, executive members of the board must temporarily leave. Only board members may be part of the audit committee, of which at least one independent director must have specific financial expertise.

Further, the board may set up whatever committees it considers appropriate and has complete flexibility to organise them. However, the Afep-Medef Code recommends the creation of committees on the nomination and compensation of senior management and a corporate responsibility committee regarding environnement, social and governance topics.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Legally, in one-tier structures, the board must meet at least once per year to draw up annual accounts and convene the annual shareholders' meeting (twice in listed companies, which have to publish half-year accounts).

In two-tier structures, the supervisory board must meet at least four times a year to review the executive board's report.

However, in listed companies, corporate governance codes require more frequent meetings: the MiddleNext Code recommends a minimum of four meetings a year, whereas the Afep-Medef Code does not set a minimum requirement but provides that the number of meetings must be sufficient to enable the board to perform an in-depth review of all topics that are put on its agenda and that one meeting per year must be held without the presence of the executive officers.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

The board of a listed company is required by law to disclose specific information on its operations and on the company's governance in general. This information includes the structure of the board, the number, the overall attendance of the meetings during the last year and individual attendance of each member, which governance code it applies and a review of the company's compliance with that code. Explanations of the items it has chosen not to enforce must be disclosed under the 'comply or explain' principle.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

The board of directors, or the executive board in a two-tier structure, of a listed company must issue each year a report on the corporate governance in place within the company. The supervisory board, in a two-tier structure, must approve the terms of this report. The statutory auditors must also give their views on it.

The content of this report addresses most corporate governance issues: the frequency of the board meetings, options that were chosen when the comply or explain principle applies, description of the board and the committees' work, description of the compensation policies for executives and directors, review of the independence criteria applicable to the directors, etc. The Afep-Medef Code issued a recommendation on a board evaluation process including an evaluation of the effective contribution of each director to the work of the board.

Every year, the AMF reviews a sample of these reports and delivers a study, which is a major source of sound practices in corporate governance.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

In consideration of their duties in this capacity, directors can only receive attendance fees, the global amount of which is decided by the shareholders' meeting. The division of this amount is, however, reserved to the (supervisory) board itself; governance codes recommend allocating the fees in consideration of the attendance of each relevant member at the meetings, a criterion that is predominant in the Afep-Medef Code. Directors are also reimbursed for the expenses incurred while carrying out their duties, but no other compensation is allowed.

The director's appointment term is legally capped at six years (but is renewable), but the shareholders may retain a shorter term of duties.

Loans to directors are prohibited, and transactions between the company and directors (or their relatives) must be submitted for prior approval by the board, and are subject to subsequent reviews by the statutory auditors and votes by shareholders. Transactions that exceed one year must be reviewed by the board each year and mentioned in the auditors' report to the shareholders' meeting.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

The remuneration of senior management is determined by the (supervisory) board and must, in listed companies, be disclosed to shareholders and to the public and is submitted to a compulsory say-on-pay vote.

Governance codes intend to set effective criteria to give general and consistent frameworks to the executive officers' compensation. These criteria include benchmark, balance, intelligibility, consistency and social and environmental targets of the company.

When variable compensation is provided, the French stock exchange authority requires that it is calculated with respect to objective criteria fixed in advance.

Executive officers are in the same position as directors regarding loans or transactions with the company (requiring prior approval by the board, review by the statutory auditors and a vote by the shareholders' meeting).

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Shareholders of listed companies have a binding say-on-pay vote as follows:

- to approve general compensation schemes regarding corporate officers (eg, chief executive, deputy CEO, board chairs and directors), it being specified that in the event of a negative vote, the existing scheme would continue; and
- to approve the fixed, variable and exceptional remuneration for each individual corporate officer (excluding directors in that capacity) for the past financial year, it being specified that variable and exceptional remuneration will not be paid until a positive vote is held.

Golden parachutes must be authorised as transactions with related parties, as the vote is not purely advisory.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted and very common in companies with significant business exposures. Usually, companies pay the corresponding premiums.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

As opposed to market practices in other jurisdictions, a French company never indemnifies managers acting in their professional capacity, as any fault committed by them would likely give rise to a claim by the company itself against these managers; or a directors' and officers' liability insurance scheme, which are authorised by French law, will cover relevant situations where managers might incur personal liability (unless the acts that gave rise to liability cannot legally be covered by an insurance policy).

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

A company may advance expenses to directors or executive officers in connection with litigation or other proceedings only to the extent that these proceedings are not reasonably expected to give rise to these directors' or officers' personal liability. Otherwise, advance payments would qualify as misuse of corporate assets.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

Executive officers may delegate part of their powers in specific matters to employees and, consequently, preclude their personal, including criminal, liability (eg, in labour law or tax matters). To be effective, the delegation must be precisely determined, and the assignee must be granted all resources and powers needed to perform the relevant tasks (including in the articles of association or otherwise).

There is no other way to preclude or limit the liability of directors and officers.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

All companies' articles of association are available at the companies' registry and can be accessed electronically. Corporate governance codes recommend that listed companies publish their board and the internal rules of their committees on their websites.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

All companies must file specific corporate documents with the companies' registry, these documents being publicly available (eg, articles of association, and shareholder resolutions amending the articles of association or appointing corporate bodies, merger agreements, statutory auditors and specific auditors' reports).

Listed companies have periodic disclosure obligations. In particular, they must make the following publicly available:

- annual financial reports (containing annual accounts and notes thereto, the management report and the statutory auditors' report);
- half-year information (half-year accounts, the interim management report and the statutory auditors' limited review report); and
- certain other information (eg, statutory auditors' fees and missions, and data regarding repurchase programmes).

Quarterly results are no longer subject to a disclosure obligation, but listed companies usually continue to disclose them. The annual financial report may be included in the universal registration document mentioned by Regulation (EU) 2017/1129 relating to prospectuses, which is to be filed in France with the French stock exchange authority (AMF).

Listed companies also have an ongoing disclosure obligation, where they must disclose without delay any non-public information that, if known to the public, would likely have a significant effect on the price of securities (privileged information). The AMF regulations authorise the relevant issuer to postpone this disclosure to protect its legitimate interests, provided that the public is unlikely to be misled and the issuer ensures the confidentiality of this information.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Before a meeting, shareholders holding a certain number of shares (5 per cent if the share capital does not exceed €750,000, less if it does) may force the board to put the appointment of a director on the agenda. All meeting materials (including those at the shareholders' request or initiative) are prepared and distributed at the company's expense.

During shareholders' meetings, if a director nomination is on the agenda or upon the dismissal and appointment of a director, every shareholder may apply for the board position.

Regarding proxy solicitation, shareholders may freely consult the list of registered shareholders to contact and convince them to vote in a certain way. However, they have no right of access to the list of holders of bearer shares (except those who are also registered shareholders and have expressed their intention to vote at the meeting with their bearer shares). The cost of proxy solicitation is assumed by the initiator of this solicitation. Anyone can actively solicit proxies if they disclose their voting policy.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

French listed companies are increasingly engaging with shareholders beyond the mandatory legal interactions at the time of the annual shareholders' meeting through written or oral questions, resolution proposals, etc. The engagement efforts mainly depend on the size of the company: the larger it is, the more specific and dedicated the staff it involves. The types of initiatives are also diversified (shareholders' clubs, social events, periodical information meetings, newsletters, etc).

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

Large listed companies (ie, companies that have more than 500 permanent employees and either a total turnover of €40 million or a balance sheet of €20 million at the end of the financial year) and large non-listed public limited companies (ie, companies that have over 500 permanent employees and a total turnover or balance sheet of €100 million at the end of the financial year) must disclose corporate social responsibility information.

This information includes details on the impact of the company's activity on climate change; actions being taken towards sustainable development and recycling and waste management;

the relations and state of negotiations with the social and economic committee, diversity programmes, etc, to the extent that these details help understand the position of the disclosing company, the evolution of its business, its results and any impacts of its activities.

Additionally, listed companies must disclose information on the effects of their activities on human rights and the fight against corruption.

This information is disclosed in the annual report. Companies that have over 500 permanent employees and a total turnover or balance sheet of €100 million at the end of a financial year must have the information verified by an independent body prior to annual shareholders' meetings.

CEO pay ratio disclosure

42 | Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

Listed companies must now disclose all components of the compensation of the chief executive and other top officers, and indicate the pay ratio between the compensation of each of these executives and the average compensation of other workers and the median compensation of all workers (including the executives), as well as the evolution of this ratio over the five preceding financial years.

In other companies, shareholders are entitled to receive information on the compensation of the five or 10 (depending on whether the company has over 200 employees) best-paid people.

Gender pay gap disclosure

43 | Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

Companies are required to disclose gender pay gaps as part of the annual consultation of the social and economic committee. For companies employing fewer than 300 persons, a general comparison is made by taking into account differences in pay, qualifications, experience, age and promotion rates per occupation category. Companies employing more than 300 persons must provide a breakdown of this data by specifying, for each gender, the average period between two promotions and the average experience level per occupation, within each occupation, per level and hierarchy within the company. The average age must be presented by occupation, level and hierarchy within the company.

Information on pay is therefore broken down by average monthly pay per occupation, level and hierarchy within the company and age group. The information on the 10 best-paid women in the company must also be provided.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Last year, again, non-financial considerations received most attention from corporate governance institutions and practitioners in France. In line with European initiatives (adoption on 14 December 2022 of the Corporate Sustainability Reporting Directive (EU) 2022/2464, European Commission works on the proposal for a directive on corporate sustainability due diligence), the new version of the soft law code jointly issued by the Afep and Medef organisations in 2022 includes a full section on social and environmental corporate responsibility (which is mainly set on boards of directors). Clearly, boards' obligations are to be increased, in terms of control of social and environmental information to be provided to all stakeholders, as well as a result of the guideline given to boards to draw up and monitor a climate change related plan, which is to be submitted to the non-binding vote of shareholders' meetings every three years or following a significant amendment to such plan. Even though 'say-on-climate' shareholder resolutions were not considered market practice in 2022 (only 11 blue chip companies submitted this resolution to their annual shareholders' meetings), they will be soon, and shareholders' voting will become more educated and crucial due to increased disclosure of qualified information, open positions of proxyholders, and proposals made by professionals to facilitate shareholders' voting initiatives at shareholders' meetings.

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Summary

SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The primary sources of law and regulation that must be complied with by both listed and non-listed capital companies in Germany are:

- the German Limited Liability Companies Act;
- the German Stock Corporation Act;
- the European and German acts on European stock corporations;
- the German Commercial Code;
- the Reorganisation of Companies Act;
- the Takeover Act (implementing the EU Takeover Directive (Directive 2004/25/EC));
- the Securities Trade Act; and
- the Anti-Money Laundering Act.

Listed companies must also comply with the applicable listing rules and the German Corporate Governance Code (DCGK). The DCGK differentiates between recommendations, which must be complied with or otherwise the company must explain why it chose not to comply and disclose such an explanation on its website and as part of its corporate governance reporting ('comply or explain' policy), and suggestions, from which deviations are allowed without disclosure, excluding new general principles, which must be adhered to.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The primary government agencies are the federal parliament and, to an increasing extent, the European Union's legislators. The DCGK and its amendments are prepared and issued by the Government Commission for the German Corporate Governance Code. The listing rules are usually set by the stock exchanges or other listing entities. Capital markets laws and regulations are enforced by the Federal Financial Supervisory Authority.

Shareholders' associations, most notably the German Association for the Protection of Capital Investors and the German Society for the Protection of Securities Holders, are usually present in general meetings to voice their members' questions and concerns. Statements by 'proxy advisers' have become increasingly noticeable in the market.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Under German law, one must differentiate between the two most popular legal company forms: the stock corporation (AG) and the company with limited liability (GmbH).

The members of an AG's supervisory board (ie, non-executive directors) are elected by the shareholders during a general meeting. The members of the management board (executive directors) are appointed by the supervisory board – not by shareholders. This basic structure cannot be altered. Unless the articles of association provide otherwise, members of the supervisory board are elected by a simple majority of votes and can be removed with a 75 per cent majority. Unless the AG has entered into a control agreement with its parent company, the supervisory board and the management board act independently and cannot be required by the shareholders to pursue a particular course of action.

Unless its articles of association stipulate otherwise, a GmbH only has managing directors and no supervisory board. The managing directors can be appointed and removed by shareholders with a simple majority vote. The shareholders' meeting can instruct the managing directors to pursue a particular course of action.

The legal forms of a European stock corporation (SE) and a partnership limited by shares (KGaA) are, to a large extent, comparable to an AG.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The following selected decisions are reserved by law for the shareholders of an AG:

- election and removal of the supervisory board members;
- appointment of an auditor;
- appropriation of profits;
- formal approval of action for members of both the management board and the supervisory board;
- in listed companies, approval of the remuneration policy and the annual remuneration report; and
- fundamental decisions, in particular:
  - amendments to the articles of association;
  - liquidation of the corporation;
  - mergers and demergers;
  - changes of legal form;
  - sale of substantially all the corporation's assets; and
  - conclusion of corporate agreements (eg, control agreements, and profit and loss transfer agreements).

The following decisions are reserved by law for the shareholders of a GmbH:

- election and removal of the managing directors and conclusion of their service agreements;
- approval of annual accounts;
- appointment of an auditor;
- appropriation of profits;
- formal approval of action for managing directors;
- fundamental decisions; in particular, amendments to the articles of association, liquidation of the corporation, mergers, demergers, changes of legal form, sale of substantially all of the corporation's assets and conclusion of corporate agreements (control agreements, profit and loss transfer agreements); and
- instructions to the managing directors.

Matters that are subject to a non-binding shareholder vote are uncommon in German law, except for resolutions on the remuneration policy.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

In an AG, one share cannot carry more than one vote (in the case of shares without nominal value) or one vote per euro of nominal value (in the case of shares with a nominal value). The articles of association of a non-listed AG can provide for limits on exercising voting rights.

In a GmbH, disproportionate voting rights or limits on exercising voting rights are allowed.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

In an AG, an SE and a KGaA, shareholders cannot act by way of written consent without a meeting. Meetings of shareholders in which attendees are present both physically and by using electronic means as well as virtual shareholder meetings are permitted if provided for in the company's articles of association. The articles of association can provide for a requirement to register within a time frame of at least six days prior to the general meeting. In the case of listed companies, this registration must be made by way of a specific depositary statement referring to the shareholding on the 21st day prior to the general meeting.

In a GmbH, shareholders can act by way of written consent without a meeting or conduct a virtual meeting, provided that all shareholders agree in text form.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

In an AG, an SE and a KGaA:

- shareholders holding at least 5 per cent of the registered share capital can require meetings of shareholders to be convened; and
- shareholders holding at least 5 per cent of the registered share capital or shares with a nominal value of at least €500,000 can require resolutions to be put to a shareholder vote against the wishes of the management board or the supervisory board, if this request is received by the company 24 days prior to the general meeting or, in the case of a listed company, 30 days prior to the meeting.

Shareholders' requests to add items to a general meeting's agenda must be published, typically together with a statement from the management and supervisory board.

Counterproposals made by shareholders to resolution proposals made by the management and supervisory boards must be submitted to the shareholders, potentially together with a statement of the management and supervisory board. In the case of listed companies, counterproposals and the company's statements regarding them must be published on the company's website.

In a GmbH, shareholders holding at least 10 per cent of the registered share capital can require shareholders' meetings to be convened or resolutions to be put to a shareholder vote against the wishes of the company's managing directors.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

All shareholders have a fiduciary duty towards the company and other shareholders. The fiduciary duty of controlling shareholders is more intense than that of non-controlling shareholders.

In an AG with a controlling shareholder, the controlling shareholder and its boards are subject to certain additional statutory duties. Enforcement actions can be brought against controlling shareholders and, under certain circumstances, their representatives for breach of these duties.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Based on corporate law, shareholders can only be held responsible for acts by or omissions of the company under exceptional circumstances. This may happen where the company acts through its shareholders. For example, if the GmbH has no managing directors, the shareholders are obliged to file for insolvency if the company is insolvent. Failure to do so will result in liability of the shareholders.

There are certain other areas of law that provide for the responsibility of shareholders for acts or omissions of their company, including antitrust law, data protection law and criminal law.

Employees

10 What role do employees have in corporate governance?

The management board is obliged to implement proper corporate governance and to continually supervise its functions. Employees have a role in the following areas. The management board is allowed to deploy employees by way of vertical instruction and is therefore at the same time dependent on its employees fulfilling their tasks and duties. This fulfilment is itself subject to supervision by the management board. In addition, recommendation A.4 of the German Corporate Governance Code recommends giving employees the ability to report legal violations in the company in a protected manner (most commonly through a whistle-blower system). This should enable employees to give anonymous reports of legal violations by or within the company. The EU Whistle-Blower-Directive (2019/1937/EU) is also due to be implemented in national law.

If an AG, a KGaA or a GmbH exceeds the threshold of generally 500 employees within German territories, one-third of the company's supervisory board members must be employee representatives (the One-Third Participation Act). If it exceeds 2,000 employees within

German territories, 50 per cent of the supervisory board must be comprised of employee representatives (the Co-Determination Act).

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

In public takeover bids, the management board is allowed to take pre-bid and certain post-bid defensive measures in accordance with the Takeover Act.

Pre-bid defences

The target's shareholders' meeting can authorise the management board to take action to prevent the success of any takeover bid, subject to the approval of a defensive action (if and when it is taken) by the supervisory board. This authorisation is valid for 18 months and requires a qualified majority (75 per cent of the share capital represented at the general meeting). Furthermore, a shareholders' meeting can decide on capital measures, or authorise the management board to acquire the company's own shares or to issue convertible bonds. The fact that payments for the early termination of contracts of management board members should not exceed twice members' annual remuneration limits the defensive effect of compensation claims (the 'golden parachute' defence).

Post-bid defences

After a takeover announcement, the management board must refrain from taking any frustrating action. However, it can seek alternative bids (a 'white knight' defence) or take actions that a prudent and conscientious director of a company not subject to a public takeover bid would have taken. Moreover, it can take defensive actions approved by the target's supervisory board or shareholders' meeting, or call a shareholders' meeting following a takeover announcement where a vote on defensive action can be held. The notice periods of these meetings are significantly shorter than ordinary shareholders' meetings. If such a meeting is convened, the offer period is extended to 10 weeks to allow the shareholders' meeting to take place before the offer expires. Finally, the boards can advise the shareholders to refuse a hostile takeover bid when giving their joint reasoned opinions. In this respect, the management board and the supervisory board must consider the transparency principle and avoid misleading statements.

European opt-in

A German listed company can opt out of the German rules for defensive actions and opt in to the rules set out in the EU Takeover Directive (Directive 2004/25/EC), which was implemented in the Takeover Act, by amending the company's articles of association. A target that does not opt in is automatically subject to the rules of the Takeover Act on defensive actions.

Breakthrough

The articles of association of a German listed company may apply the 'breakthrough clause' of the EU Takeover Directive, as implemented in the Takeover Act, under which certain transfer restrictions and restrictions on exercising voting rights in certain contracts do not apply in certain circumstances.

Publication of defence measures

All companies listed in Germany must give detailed information on all existing defence mechanics in the management report that forms part of the company's annual financial statements. The supervisory board must comment on this information in its own report to the annual general meeting.

Issuance of new shares

12 May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

The general meeting of a stock corporation (AG), a European stock corporation (SE) and a partnership limited by shares (KGaA) can authorise its management board, subject to the approval of the supervisory board, to issue new shares (authorised capital). Authorised capital may not exceed 50 per cent of the registered share capital.

Statutorily, shareholders have pre-emptive rights. With a 75 per cent majority of the share capital represented at the general meeting, pre-emptive rights can be excluded, even under a management board's authorisation to issue new shares. Yet, proxy voters only approve these authorisations for exclusions of pre-emptive rights under certain requirements and to a certain percentage of the authorised capital (usually 20 per cent). Often, the authorisation will provide that the management board may, with the approval of the supervisory board, exclude pre-emptive rights without cause if the shares to be issued amount to less than 10 per cent of the registered share capital and are not issued significantly below the current stock market price.

Similarly, the shareholders' meeting of a company with limited liability (GmbH) can authorise its managing directors to issue new shares (authorised capital). This authorised capital may not exceed 50 per cent of the registered share capital. Under applicable case law, shareholders of a GmbH have pre-emptive rights to acquire newly issued shares, subject to certain exceptions and exclusion mechanisms.

Restrictions on the transfer of fully paid shares

13 Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

In principle, restrictions on the transfer of fully paid shares of stock corporations (ie, AG, SE or KGaA structures), in particular of listed ones, are not permitted. As an exception to this, the transfer of registered shares may be subject to approval by the company, the supervisory board or the general meeting, if provided for in the articles of association.

In closed companies, including GmbHs, restrictions on the transfer of shares are permitted and customary. The transfer of shares is usually subject to the prior approval of the supervisory board, a shareholders' meeting or a general meeting. Other customary restrictions include contractual rights of first refusal or tag-along rights.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Compulsory share repurchases are not common in German law and practice. They may be allowed in certain exceptional cases.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Shareholders have the right to sell their shares to the company at a fair value (in which case a valuation based on the Institute of Auditors in Germany's IDW S1 standard on the principles for the performance of business valuations is required) in the case of certain types of mergers or similar transactions (eg, entering into a domination or profit-and-loss transfer agreement, a change of legal form or a squeeze-out).

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The predominant board structure of stock corporations (AG), European stock corporations (SE) and partnerships limited by shares (KGaA) follows the two-tier system, with a management board that manages and represents the company and a supervisory board that supervises the management board. In Germany, only SEs are allowed a one-tier system with one board (an administrative board) that consists of executive and non-executive board members.

Most companies with limited liability (GmbH) only have managing directors, who are all executive directors, but they are allowed to implement a supervisory or advisory board in its articles of association, resulting in a two-tier structure. However, a supervisory board is compulsory in a GmbH in cases of co-determination. A GmbH cannot have a one-tier board.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The supervisory board of an AG and SE has the power to appoint and dismiss members of the management board and is responsible for supervising the management board's activities. A supervisory board is entitled to regularly or irregularly request reports from the management board and define certain transactions and measures in the management board's rules of procedure or in individual cases that are subject to the supervisory board's approval (eg, regarding significant transactions and measures exceeding a certain threshold). This definition may also be made by the shareholders in the company's articles of association. However, this approval does not have any effect on the transactions or measures with regard to third parties, but only on the internal relationship between the two bodies and the liability of members of the company's management board.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The supervisory board does not represent anybody in fulfilling its own legal duties; rather, the supervisory board is independent to a large extent. Supervisory board members, who may be delegated or elected from a certain shareholder majority, are not allowed to pass on any information received in their function as members of the supervisory board to the respective shareholder. Consequently, supervisory board members must always act in the best interest of the company, which itself is defined by the 'stakeholder model' (the opposite of the Anglo-Saxon shareholder model, in which board members must act in the best interest of the shareholders). The members of the management board and managing directors of a GmbH also owe their legal duties to the company and must, therefore, only act in the best interest of the company (ie, its stakeholders).

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Managing directors of a GmbH may be instructed to take or refrain from taking certain measures by way of shareholder resolutions. Management board members of an AG and an SE are, conversely, entitled to manage the company at their own discretion. Consequently, neither the general meeting nor the supervisory board is allowed to adopt management decisions or bring forward enforcement action against members of the management board. However, the supervisory board is entitled and, according to case law, obliged to assert liability claims against the management board if the company suffered damage owing to a breach of tasks and duties by the management board. Members of both the supervisory and management board, as well as managing directors of a GmbH, may be exempt from liability if at the time of their action they could have reasonably been assumed, based on adequate information, to have acted in the company's best interest (the business judgment rule). The scope and application of the business judgment rule have been refined by numerous court decisions.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Managing directors of a GmbH and management board members of an AG, an SE and a KGaA do have to apply the care of a prudent and diligent business person. In addition, in supervising the management board of an AG or SE, the supervisory board must follow this principle.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

Generally, supervisory board members have the same rights and duties. However, applicable law and German Corporate Governance Code (DCGK) provide for the requirement of appointing individual members with certain skills (eg, finance, reporting and auditing expertise). Thus, these members' duties differ from the other members' duties. The differences in duties do however not reflect higher liability exposure.

The tasks and duties of the management board of an AG, SE or KGaA are usually allocated to several functional or operational departments for which individual members of the management board are responsible. However, all members of the management board remain jointly responsible for the management of the company. Therefore, members of the management board also have a duty to reasonably be aware and oversee the operation of departments for which they are not directly responsible.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The supervisory board is not allowed to assume management responsibilities, nor is it allowed to delegate supervisory functions to the management board or to other persons. The supervisory board is, however, entitled to implement committees from its midst. In some instances, such as regarding the management board members' service agreements, the committees are statutorily not entitled to resolve on these matters in place of the supervisory board, but only to prepare the respective resolutions for the supervisory board and to supervise their execution. In addition, the board may ask a board member to prepare a certain topic. However, the responsibility to decide upon this topic remains in any instance with the supervisory board.

The tasks and duties of the management board of an AG, an SE or a KGaA are usually allocated to several functional or operational departments for which individual members of the management board are responsible. Decisions within each department are made by the responsible member of the management board unless a material decision requires a resolution of the entire board. Similar structures may be implemented among managing directors of a GmbH; however, a designation of a chairman spokesperson is less common.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

In the case of a one-tier system within an SE, applicable law requires that the majority of the board's members be non-executives. Members are non-executive if they are not registered as managing directors of the SE in the commercial register. If they are registered as managing directors, they have the power to manage and represent the company. Non-executive members are not allowed to do so and are only entitled to supervise the executive directors (ie, the managing directors) within the company's internal relationship. Additionally, according to the DCGK, in the case of listed companies, the supervisory board shall, in its opinion, propose a reasonable number of independent members. When proposing individuals for election to the supervisory board, the individuals' independence from controlling shareholders, the management board and other groups (eg, competitors) are factors that the supervisory board must consider.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The supervisory board of an AG, an SE and a KGaA must have at least three members. Unless the stock corporation is co-determined (meaning that one-third or half of the board members are elected by the employees), the supervisory board's members may number a statutorily higher amount of up to nine, 15 or 21 members – depending on the registered share capital of the corporation. In the case of statutory co-determination, the number of members must be divisible by three. In the case of equal co-determination, the total number of supervisory board members is dependent on the total number of German employees.

Shareholder representatives on the supervisory board are generally appointed by the general meeting and in cases of co-determination employee representatives are appointed by employee elections. In the case of vacancies, under certain circumstances, members can, upon filing, also be appointed by a court.

In AGs, SEs and KGaAs that are equally co-determined and listed on a stock exchange, the supervisory board (or, in the case of a one-tier system SE, the administrative board) must comprise at least 30 per cent women and at least 30 per cent men. The minimum percentage must be complied with by the supervisory board in its entirety. Furthermore, corporations that need to fulfil the aforementioned gender criteria for their boards must include a declaration on corporate governance in their management report. This declaration must include information on whether the company has complied with the requirements for appointing male and female supervisory board members.

There is no minimum number of members required for a management board, unless the company's articles of association provide otherwise. Members of the management board must fulfil basic statutory requirements regarding personal reliability (eg, no criminal record). In companies that are both listed and equally co-determined, there needs to be at least one woman and one man on the management boards in case of three or more members. In companies that are either listed or co-determined by one third, the supervisory board must determine and annually report on a target percentage for women on the management board and the supervisory board and deadlines by which this percentage is to be reached. The DCKG makes several recommendations regarding the diversity of the management board and the tenure of its members. 'Diversity' is not defined, but does include criteria such as nationality and expertise.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

In the German two-tier system, the chief executive (and other members of the management board), who manages and represents the company, is strictly separated from the functions of the supervisory board. Neither body is allowed to assume the functions of the respective other body. In the case of a one-tier system, within an SE, the CEO and chair of the board may be the same person as there is no separation requirement.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

A supervisory board is entitled to establish committees from its members. In some instances, the committees are statutorily not entitled to resolve on matters instead of the supervisory board, but only to prepare resolutions of the supervisory board and supervise their execution. Listed AGs, SEs and KGaAs are statutorily required to implement an audit committee with at least two financial experts. The DCGK recommends that listed companies also implement a nomination committee for nominating the candidates for election to the supervisory board. Committees of the management board or of a GmbH's managing directors are less common.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Supervisory boards of listed companies are statutorily required to hold at least four meetings a year. Supervisory boards of non-listed companies are entitled to resolve on holding only two meetings per year. In any case, the supervisory board must report on the number and main topics of its meetings in its annual report to the general meeting. There is no minimum number of meetings to be held by the management board, but it will usually meet on a regular basis (eg, monthly).

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

A supervisory board is statutorily obliged to report on its constitution, its meetings, the attendance of its meetings and its supervisory activities in an annual report to the general meeting. The same applies to the work of its committees. There is no obligation for a management board to report on its practices, but some information will likely be included in the annual management report.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

No such evaluations are provided for, either statutorily or according to regulation or listing requirements. This applies to both the management and supervisory board. However, the DCGK recommends that the supervisory board self-evaluates its own effectiveness regularly and reports on the self-evaluation in the corporate governance declaration. In compliance practice, self-evaluations are also often implemented for the management board.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

The German Stock Corporation Act (AktG) and the German Corporate Governance Code (DCGK) provide for specific rules to which the supervisory board must adhere when resolving upon the remuneration policy to be proposed to a general meeting for its approval, and when resolving upon the fixed and variable remuneration of management board members (the variable remuneration is differentiated between short-term and long-term incentives) as well as on loans or other compensatory arrangements (eg, stock options). For example, the DCGK recommends that the majority of variable remuneration is connected to long-term incentives and is granted in either shares or share-based instruments.

The supervisory board of listed stock corporations must determine the remuneration of the management board in a remuneration policy. The AktG requires only a few elements (eg, a determination of the maximum total remuneration of the management board) to be included in every remuneration policy, but provides for extensive 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. The DCGK makes several recommendations with respect to aspects to be regulated in the remuneration policy, such as the ratio between the fixed and variable remuneration based on short- and long-term incentives and the performance and non-performance indicators to determine the payment of variable remuneration.

The general meeting is entitled to resolve on the approval of the remuneration policy and on any material changes thereto at least every four years. The management and supervisory boards must prepare an annual remuneration report that is also subject to a resolution by the general meeting. However, the resolution on the approval of both the remuneration policy and report are of a declaratory nature only (ie, thereby, the supervisory board's responsibility to decide upon the remuneration remains unaffected).

Service contracts may be entered into for five years (in AGs) and six years (in SEs) at the most, with a right of renewal. According to the DCGK, the service contracts of management board members shall provide that payments, including fringe benefits, made to a management board member in the case of an early termination of the contract do not exceed twice their annual remuneration (the severance cap) and do not constitute remuneration for more than the remaining term of their employment contract. The DCGK further recommends that service contracts of management board members do not include clauses granting these members benefits in the event of a termination of their contract because of a change of control. Remuneration of the members of the supervisory board is either determined in the articles of association or by resolution of the general meeting and is usually comprised of fixed remuneration.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

The law gives the responsibility for deciding upon senior management's remuneration to the management board. The supervisory board can, however, foresee own approval requirements with respect to cash compensation and other advantages, such as granting company cars. According to applicable law, granting stock options to senior management requires a resolution of a general meeting, which must fulfil certain statutory requirements, and a supervisory board's approval.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

A general meeting of a listed stock corporation (AG), European stock corporation (SE) and partnership limited by shares (KGaA) must vote on the remuneration policy and on any material change thereto at least every four years. If the general meeting dismisses a resolution proposal on the remuneration policy, the next annual general meeting must resolve on a reviewed remuneration policy. The resolution must be published online for the period of the application of the remuneration system – at least 10 years.

The annual general meeting must also resolve on the approval of the remuneration report for the management and supervisory board referring to the previous financial year, with the exception of small and medium-sized corporations within the meaning of sections 267(1) and (2) of the German Commercial Code, if the remuneration report is presented as a separate item on the agenda of the annual general meeting. Neither the vote nor resolution on the remuneration policy or on a remuneration report can be objected to by means of a contesting action or an action for annulment. The remuneration policy does not affect the remuneration of senior management, which remains in the capacity of the management board.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted and is common practice for management and supervisory board members in listed companies. However, it is also becoming more popular in non-listed companies. Premiums are generally paid by the company, whereas members of the management board of a stock corporation are obliged to bear a deduction of between 10 per cent of the damage and one-and-a-half times their fixed salary.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Besides granting directors' and officers' insurance coverage, indemnifications by a stock corporation (AG), European stock corporation (SE) and partnership limited by shares (KGaA) are in essence not permitted as the company is only allowed to waive or settle on liability claims against management board members three years following their accrual and only subject to a general meeting's approval without an objection of a shareholder minority jointly representing 10 per cent of the registered share capital.

In a company with limited liability (GmbH), as German law follows the stakeholder model, according to which managing directors must act in the best interest of the company (and not the shareholder or the majority of shareholders), indemnification agreements are subject to constraints on fiduciary duties. In addition, a GmbH may not indemnify any managing director breaching capital protection rules.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Members of the management board or managing directors may be entitled to request that the company advances expenses in connection with litigation or other proceedings initiated by a third party against the respective member based on his or her service contract and under general law. However, this claim only exists where the action that is subject to the litigation or other proceeding with a third party does not also constitute a breach of duty. If it is found that the action did indeed constitute a breach of duty, the supervisory board must reclaim all expenses from the respective member of the management board. Naturally, where the company (represented by the supervisory board) initiates litigation against a member of the management board, there is no claim for an advance or reimbursement of expenses. Similar principles apply with respect to members of the supervisory board. However, because its members are not involved in the day-to-day management of the company, litigation against the members of the supervisory board is less common.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

A preclusion is not allowed within an AG, an SE or a KGaA. The supervisory board is responsible and, according to case law, obliged to assert liability claims against management board members. Shareholders of a GmbH are more flexible in that regard and may, with certain statutory exceptions, waive claims against managing directors for a breach of duty.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The deed of incorporation and the articles of association of German companies are publicly available. They are available through the commercial register, which is administered and managed by the local courts. The online commercial register includes and allows the downloading of all commercial register documents submitted since 2007. The articles of association of listed companies are generally also available through their websites.

The by-laws of a company (meaning the rules of procedure for its supervisory board, supervisory board committees, management board or managing directors) are generally not publicly available. However, rules of procedure of supervisory boards of listed companies are recommended to be published on the company`s website by the German Corporate Governance Code (DCGK).

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

Companies must publicly disclose their annual accounts. Listed companies may be required to disclose more financial documents, such as half-year or quarterly reports.

Companies must publicly disclose certain information regarding changes to their shareholder structure and certain other information (eg, capital increases).

Companies must file certain information and documents in the commercial register, which can be accessed by the public. In addition, companies whose shares are listed in an organised market must disclose:

- insider information through ad hoc notification;
- subject to receiving information from shareholders regarding:
  - increases and decreases of their shareholdings by 3, 5, 10, 15, 20, 25, 30, 50 and 75 per cent; and
  - increases and decreases of positions in their financial instruments by 5, 10, 15, 20, 25, 30, 50 and 75 per cent;
- subject to receiving notification of a manager`s transaction, information on these;
- an annual statement on compliance with the DCGK (comply or explain) as part of the report on corporate governance to be included in the management report; and
- changes in the company`s share capital.

Under the German Money Laundering Act, legal persons organised under private law and registered partnerships must collect, retain and keep up-to-date information on its beneficial owners and supply this information electronically to the German transparency register.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

As the members of the management board of a stock corporation (AG), a European stock corporation (SE) and a partnership limited by shares (KGaA) are not elected by the shareholders' meeting, shareholders of these entities do not have the ability to nominate members of the management board. Candidates for membership of the supervisory board may be proposed to a general meeting by the supervisory board; however, shareholders are entitled to make counterproposals. A stock corporation's articles of association may also confer shareholders with the right to designate a supervisory board member. However, this right is restricted to designating up to one-third of a supervisory board's members and is very uncommon, at least in listed companies. Apart from this, the model of a shareholder-nominated director is not provided for in German law and regulations.

Shareholders of a company with limited liability (GmbH) have the ability to nominate managing directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense.

Shareholder engagement

40 | Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

Listed companies generally do not engage with their shareholders, in particular, not outside ordinary or extraordinary general meetings. In preparing these meetings, the chief executive holds calls with shareholder representatives and potential proxy voters but abstains from providing them with any information that he or she has not already disclosed in the invitation to or does not intend to disclose in the general meeting to all other shareholders.

However, the German Corporate Governance Code (DCGK) suggests that the chair of the supervisory board should, to an appropriate extent, be available for conversations with investors on supervisory board issues. If a listed company chooses not to follow this proposal, it does not have to explain its choice or its reasons.

Closed companies typically engage with their shareholders, as is the case in the majority of jurisdictions. Shareholders of a GmbH may at any time demand information on company matters and access to the company records from the managing directors.

Sustainability disclosure

41 | Are companies required to provide disclosure with respect to corporate social responsibility matters?

Under the German Commercial Code, companies that meet certain criteria concerning their size are under a duty to issue non-financial statements that expand on their management report. This statement must briefly describe the business model of the company. Moreover, it must refer to certain aspects of corporate social responsibility, at least to environment-related matters, employee-related matters, social matters, respect for human rights and the fight against corruption and bribery.

Disclosure regarding corporate social responsibility matters has also become an increasing focus on EU level in the past years. As part of the EU Action Plan for Financing Sustainable Growth, the EU Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088) has applied in Germany since 10 March 2021 to financial market participants and financial advisors, establishing extensive transparency obligations with respect to their investment strategy, processes and financial products. Under the EU taxonomy for sustainable activities (Regulation (EU) 2020/825), certain companies are obliged to disclose the proportion of sales, capital expenditure and operational expenditures in taxonomy-compliant activities. The new EU Corporate Sustainability Reporting Directive (Directive (EU) 2022/2464), which entered into force on 5 January 2023, modernizes and strengthens the requirements for corporate sustainability reporting. It extends the scope of companies subject to sustainability reporting and aims to set more comprehensive and unified European standards.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

There is no general requirement to disclose this pay ratio. Nevertheless, companies must add a note to their profit and loss statement stating the total remuneration granted to each of the following bodies: a management board, a supervisory board, an advisory board or similar bodies.

For listed companies, it is mandatory for pay ratios of full-time employees to be included in remuneration reports.

The DCGK recommends that the supervisory board considers these pay ratios in the context of the company's remuneration policy. If the recommendation is followed, and as the remuneration policy is available on the company's website, it provides a further degree of disclosure with respect to certain aspects of pay ratios.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

There is no requirement to disclose information concerning gender pay gaps. However, companies with generally more than 200 employees are obliged, upon an employee's request, to supply information on the average payment for comparable work, and if comparable work is predominantly done by female or male staff. Furthermore, companies with more than 500 employees that are under a duty to publish a management report are, according to the Payment Transparency Act, obliged to publish a report that states their measures concerning the promotion of gender equality and equal pay.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

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 came into force in January 2023, aiming to expand the reporting requirements. It must be implemented into national law within 18 months. Further, the supply chain law came into force in January 2023 (and will further on as of January 2024), intending to implement the UN Guiding Principles on Business and Human Rights throughout the global supply chain. Also, the revised version of the German Corporate Governance Code (DCGK), which became effective in June 2022, extends the coporate duties in connection with environmental and social sustainability-related issues.

Virtual shareholders' meetings

Following the expiry of the covid-19 legislation 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 statutes 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. In order to give stock corporations sufficient time to implement such provision, the legislator has granted a transitional period until 31 August 2023, during which virtual meetings may be held without such provision.

Digitalisation

The laws implementing the Directive (EU) 2019/1151 regarding the use of digital tools and processes in company law have become applicable in August 2022. The provisions of this act offer the possibility, for example, to found GmbHs online via virtual notarial certification and to make trade register excerpts free of charge.

Dual class shares

In contrast to the current legal situation in Germany, there are plans to permit dual class shares under certain circumstances in the future. However, it remains to be seen how and to what extent this will be implemented.

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Summary

SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The corporate governance regime in India gains its powers from the Companies Act, 2013 (the Companies Act) along with the rules and regulations, notifications, circulars, orders and forms issued by the Ministry of Corporate Affairs (MCA), secretarial standards issued by the Institute of Company Secretaries of India, and the Securities and Exchange Board of India Act, 1992 (the SEBI Act) read with the rules and regulations, circulars and notifications issued by the Securities and Exchange Board of India (SEBI).

Unlisted Indian companies are subject to the corporate governance norms contained in the Companies Act. Listed companies are also required to comply with applicable corporate governance principles in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2020 (LODR Regulations). Additionally, reports of the board of directors must include a section confirming compliance with the corporate governance provisions.

In case of non-compliance, the company and its management may be subject to penalties in the form of monetary fines, imprisonment or both. In the case of non-compliant listed entities, companies may face the imposition of fines, suspension of trading, freezing of promoter or promoter group holding of equity shares, and other actions by the market regulator SEBI.

The laws and regulations pertaining to corporate governance in India are still primarily based on the 'mandatory' approach, rather than the 'comply or explain' approach.

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Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The primary government agencies for implementation of corporate governance for all types of companies are:

- the Ministry of Corporate Affairs;
- the National Company Law Tribunal;
- the National Company Law Appellate Tribunal;
- the Regional Director; and
- the Registrar of Companies.

In addition, for listed companies, corporate governance is also implemented by SEBI.

There are also sector-specific regulators, such as:

- the Insurance Regulatory and Development Authority of India (insurance sector);
- the Telecom Regulatory Authority of India (telecom sector);
- the Reserve Bank of India (banking and non-banking finance sector); and
- the Department of Pharmaceuticals (pharmaceuticals sector).

The National Foundation for Corporate Governance was set up in 2003 by the MCA in partnership with the Confederation of Indian Industry, the Institute of Company Secretaries of India and the Institute of Chartered Accountants of India to promote good corporate governance practices at the level of both individual corporates and industry as a whole. Their views are sought for various policy-level decisions. Generally, the government of India sets up committees of eminent people from various industries to deliberate and make recommendations on various issues, including existing laws and proposed laws; however, their recommendations are not binding.

InGovern is India's first independent proxy adviser firm in the field of independent corporate governance research. SES Governance and Institutional Investor Advisory Services India Limited are other proxy adviser firms in India providing assistance to investors and shareholders in making informed decisions. Proxy adviser firms are subject to registration with SEBI.

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THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

The shareholders of a company have the power to appoint and remove directors, subject to compliance with the provisions of the Companies Act, 2013 (the Companies Act). If the articles of association of a company provide for the same, the board can also appoint any person as an additional director, alternate director or nominee director. An additional director holds office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier, and their reappointment is considered by the shareholders in the general meeting.

The shareholders have the power to remove a director by a simple majority vote, after giving the director concerned an opportunity of being heard. However, shareholders cannot remove a director appointed by the National Company Law Tribunal or the directors appointed by the minority shareholders under the proportional representation mechanism as per the provisions of the Companies Act.

Typically, shareholders do not interfere in the decision making of the board. However, under the Companies Act, the board is required to refer certain important matters to the shareholders for their approval. If the directors' acts were done in bad faith, or their actions are not in the interest of the company, the shareholders have the power to remove them by following the procedure prescribed under the Companies Act.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The Companies Act provides that certain important decisions must be approved by the shareholders of the company. Some of the decisions that are required to be approved by the shareholders include:

- the appointment and removal of directors and auditors;
- mergers and amalgamations;
- sales of undertakings;
- variations of shareholder rights;
- alterations in memoranda of association or articles of association;
- approval of audited financials and boards reports;
- declarations of dividends;
- reduction in capital; and
- liquidation of the company.

There are no provisions under the Companies Act for non-binding shareholder votes.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

The provisions of the Companies Act and regulations of the Securities and Exchange Board of India (SEBI) permit the issuance of equity shares with disproportionate rights as to voting, dividends etc, subject to an enabling provision for the same in the articles of association.

Private limited and unlisted public companies are permitted to issue equity shares with disproportionate rights as to voting, dividends or otherwise, subject to certain specified conditions, including the following:

- the voting power in respect of shares with differential rights cannot exceed 74 per cent of total voting power, including voting power in respect of equity shares with differential rights issued at any point in time;
- the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- the company has no subsisting default in the payment of a declared dividend to its shareholders; and
- the issue of shares is authorised by an ordinary resolution passed at a general meeting of the shareholders of the company.

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 prohibit a listed company from issuance of shares which may confer on any person superior rights as to voting or dividend vis-à-vis the rights of equity shares that are already listed. However, a listed entity with equity shares having superior voting rights issued to its promoters or founders is permitted to issue such further equity shares to its shareholders through a bonus, split or rights issue in accordance with the provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 and the Companies Act.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

No meeting of shareholders can be validly held unless the minimum quorum prescribed under the Companies Act, or any higher number prescribed under the articles of association of the company, is present. The minimum quorum requirement for private companies is for two members to be present, irrespective of the number of members in the company.

For public companies, the minimum quorum requirements are:

- five members present, if the number of members in the company is up to 1,000;
- 15 members present, if the number of members in the company is more than 1,000 but up to 5,000; and
- 30 members present, if the number of members in the company exceeds 5,000.

Individual shareholders can attend the general meetings themselves or through a proxy appointed by them (who should be a natural person) to attend and vote at the general meetings. The proxy is not allowed to speak at any such meetings and only has the right to vote by poll. Unless the articles of association of the company permit, a proxy does not have the right to vote if voting is done by a show of hands.

If the shareholder is a body corporate, it can appoint any natural person as its authorised representative to attend and vote at a meeting of the shareholders. Such an authorised representative shall have all the rights of the shareholder, including speaking at the meeting and casting his or her vote on all matters, irrespective of the manner of voting.

For listed companies and companies with more than 200 shareholders, approval of shareholders on certain matters requires the adoption of a postal ballot mechanism or voting through e-voting.

It is mandatory for a listed company or other companies with more than 1,000 shareholders to provide an electronic voting facility to their members for general meetings. A virtual meeting of the shareholders is not permitted under the Companies Act.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Shareholders' meetings are typically convened by the board. However, shareholders holding 10 per cent or more of the shares can make a requisition to the board to convene an extraordinary general meeting (EGM) and provide the details of the resolutions that they intend to move at such meeting. If, within 21 days of the receipt of such requisition, the board fails to proceed to call an EGM to be held within 45 days from the date of the requisition received from the shareholders, the shareholders may proceed themselves to convene the EGM within a period of three months from the date of the requisition by following the prescribed procedure.

There is no specific provision in the Companies Act that mandates a board to circulate the statements of dissident shareholders to all the shareholders. However, the statements of the dissident shareholders made during the meeting may be recorded in the minutes of that meeting, subject to the consent of the chairperson of that meeting.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Decisions that require approval of the shareholders are taken with the consent of the majority shareholders. It is expected that all decisions must be taken in the interest of the company and its stakeholders, and not to benefit only a section of the shareholders at the expense of other shareholders. If the majority shareholders benefit themselves at the expense of the minority shareholders or take such actions that are oppressive to them, the minority shareholders have the right to act against the majority shareholders to protect their interest.

As per the Companies Act, action for oppression and mismanagement can be initiated against the controlling majority by at least 100 shareholders or one-tenth of the total number of shareholders of a company, whichever is less, or shareholders holding at least 10 per cent of the issued share capital of a company.

The Companies Act provides for class actions by the minority shareholders for seeking restraining orders against the company, its directors, auditors or any expert, adviser or consultant for any action taken by them that is ultra vires to the memorandum or articles of the company, or other actions that are prejudicial to the interest of the company and its stakeholders and claim damages or compensation from them.

Shareholder responsibility

9 | Can shareholders ever be held responsible for the acts or omissions of the company?

The liability of the shareholders is limited to the extent of their shareholding in the company. Such shareholders will not be held responsible beyond the amount, if any, unpaid on the shares held by them. The shareholders cannot be held personally liable for the acts or omissions of the company. In the case of a company with unlimited liability, the shareholders can be made responsible to the extent of the amount agreed that they would contribute to the assets of the company in the event of its winding up.

However, if the shareholders have given any personal guarantees for a loan or any other obligations of the company, they can be held personally liable. Further, in cases where the corporate veil is lifted and the shareholders are found guilty, they can be held personally liable.

Employees

10 | What role do employees have in corporate governance?

Typically, the responsibility to implement and enforce proper corporate governance in a company is placed upon the company's board and senior management. The role of the employees is limited to specific duties assigned to them with respect to undertaking certain actions and reporting to the management.

The Companies Act and SEBI regulations, as applicable, require all listed companies, companies that accept deposits from the public and companies with borrowings of more than 500 million rupees from banks or public financial institutions to establish a whistle-blowing mechanism that provides adequate safeguards against the victimisation of employees and directors who report issues pertaining to the governance of the company, unethical behaviour, actual or suspected fraud or violation of the company's code of conduct, etc to the management of the company. In addition, corporate governance practice must include provisions for reports of any escalation of existing victimisation to be directly supplied to the company's management.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

There are no specific statutory barriers to prevent takeovers in India. The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (the Takeover Code) mandates acquirers to make certain specific disclosures when a certain threshold of shares is acquired by them. Such disclosures alert the management and promoters of the target company, who may take necessary steps to either prevent such takeovers or to make the transaction more beneficial for the target company and its shareholders. Any acquirer, together with the persons acting in concert with them, is required to make certain disclosures related to their shareholding in the target company beyond the certain specified thresholds.

Companies use various anti-takeover devices to prevent and protect themselves from any unwarranted or hostile takeover bids or to make an unwanted takeover bid more difficult or expensive for the acquirer. These measures include greenmailing (ie, the target purchases its own shares back at a premium), acquisition by a 'white knight' (ie, permitting a takeover by a friendly company), 'poison pill' policies (ie, allowing existing shareholders to purchase additional shares at a discount, diluting the share pool), and the high-risk 'Pac-Man' defence, in which the target attempts to take over the acquirer.

Further, in India, takeovers meeting certain thresholds are under the surveillance of the Competition Commission of India (CCI) and can be stopped where, in CCI's view, such a takeover can have an appreciable adverse effect on competition in the relevant market.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Shareholders' approval is required to be taken by a company in a general meeting for issuing new shares and securities convertible into shares, except when the shares are being offered through a rights issue. Under a rights issue, shareholders are offered further shares to subscribe in the same proportion to their shareholding in the company. The articles of association of a company generally provide for the pre-emptive rights of shareholders.

In a listed company whose shares are listed, or are intended to be listed, on any recognised stock exchange in India, any offer to the public must comply with the relevant Securities and Exchange Board of India (SEBI) regulations.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

The transfer of shares (including fully paid-up shares) of private companies is restricted by having specific provisions in their articles of association. However, fully paid-up shares of public companies are freely transferable unless restricted in terms of any agreement. The restrictions typically include rights of first refusal, restrictions on transfer to a competitor, lock-in period, etc.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

The Companies Act, 2013 (the Companies Act) does not provide for the compulsory repurchasing of a company's shares by itself, except when a reduction of capital is approved by the National Company Law Tribunal, and once implemented, the same shall be binding on all shareholders. Further, in cases where the company has issued redeemable preference shares, it is under an obligation to redeem the same in terms of their issuance. Such redemptions of preference shares are not considered to be a reduction in share capital.

The Companies Act enables the buy-back of equity shares by a company, but the company cannot force any shareholder to tender their shares under a buy-back scheme – this is down to the shareholders' discretion.

Dissenters' rights

15 | Do shareholders have appraisal rights?

The Companies Act provides that in the event of an acquirer, or a person acting in concert with such acquirer, becoming the registered holder of 90 per cent or more of the issued equity share capital of a company, or in the event of any person or group of persons becoming a 90 per cent majority or holding 90 per cent of the issued equity share capital of a company by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, such acquirer, person or group of persons, as the case may be, is required to notify the company of their intention to buy the remaining equity shares and is required to make an offer to minority shareholders to purchase their shares at a price determined on the basis of valuation by a registered valuer in accordance with the prescribed rules to provide minority shareholders with an exit.

Further, in the case of a scheme or contract involving the transfer of shares approved by shareholders holding at least 90 per cent of the value of the transferable shares, the acquirer has the right to purchase the shares of minority shareholders and dissenting shareholders on the same terms as agreed with the approving shareholders. However, if dissenting shareholders make an application to the National Company Law Tribunal against such an acquisition and the Tribunal does not pass an order in their favour, the acquirer can purchase the dissenting shareholders' shares as per the prescribed procedure.

SEBI regulations also provide certain exit routes to the dissenting shareholders, including the process of valuation of their shares.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The predominant board structure of listed companies is one-tier. A company's board is responsible for its entire operations and management, subject to certain conditions that require the approval of the shareholders.

Indian companies do not have supervisory boards.

A company's board is obligated to establish certain mandatory committees to look after specific functions in the company, such as an audit committee, a nomination and remuneration committee, a corporate social responsibility committee and a stakeholders' relationship committee.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

A company's board is responsible for managing the operations and management of the company in a legally compliant manner to achieve the company's objectives and to enhance and protect the interests of its shareholders, employees and all stakeholders. In case of non-compliance, a director can be held personally liable as being the 'officer-in-default'.

The Companies Act provides for specific duties for directors, including the duty to act in good faith, to exercise due and reasonable care, skill and diligence, to avoid conflicts between the company's interests and their personal interests, and not to achieve any undue gain or benefit. Directors also have a fiduciary duty towards the company and are expected to act in the best interest of the company and its stakeholders. The Companies Act also prescribes a binding code with respect to professional conduct for independent directors.

In addition to holding meetings of the board, committees and shareholders, and to comply with all applicable laws, the board is also responsible for preparing books of accounts of the company, having the books audited and presenting the books of account before the shareholders in annual general meetings for their approval.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The company, being an artificial person, is represented by its board. The board is expected to manage the affairs of the company in a legally compliant manner and is required to act within the authority entrusted to it. Any action taken by the board on behalf of the company within their powers will be binding on the company.

The directors act within the overall supervision of the board and are expected to act in good faith. They can be held liable for non-compliance by the company. They are not agents of the shareholders and cannot bind shareholders to follow certain actions.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

A director of a company can be held to be personally liable. Enforcement actions can be taken up against them by the company, its shareholders or third parties adversely affected in the event a director:

- defaults in his or her duties;
- is found guilty of fraud or misrepresentation;
- commits fraud, negligence, conspiracy, breach of trust and duties, false representation etc; or
- has personally assured, indemnified, or guaranteed the payment obligations of the company.

The business judgment rule is neither mentioned in the Companies Act nor is prevalent otherwise as a market practice. However, the Companies Act states that in any proceeding for negligence, default, breach of duty, misfeasance, or breach of trust, if the court is of the opinion that the director has done his or her duty honestly and in good faith and considering the circumstances of the matter ought to be excused, then the court may relieve them, either wholly or partly, from any such liability without taking any enforcement actions.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

The Companies Act specifically provides that the director of a company must exercise his or her duties with reasonable care, skill and diligence in decision making. Directors are required to act honestly and diligently while discharging their duties as a person of prudence of his or her ability and knowledge.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

The duties of directors depend on their position in the company and the terms of their appointment. A director can be an executive director, non-executive director, managing director, independent director, etc. The basic duty of directors is to act in a good faith to promote and protect the interest of all its shareholders.

A managing director is typically entrusted with substantial powers of management to manage the affairs of the company. Executive directors are responsible for the overall management and day-to-day operations of the company and are generally appointed to manage specific business areas such as finance, operation, technical, human resources, etc, depending on their individual qualifications and skills. Independent and non-executive directors are part of the overall decision-making process of the board. Each director is responsible for the duties and functions assigned to them.

Delegation of board responsibilities

22 To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

It is common practice for a board to delegate certain powers and functions either to a board committee or to individual persons to efficiently manage the affairs of the company. However, as per the provisions of the Companies Act, there are certain matters and powers that the board cannot delegate and must make decisions on (eg, issuance of securities, approving financial statements and the board's report, diversifications of the company's business, amalgamations, mergers, reconstruction, etc). In addition, a board cannot delegate powers if they are restricted from doing so by the company's articles of association or the shareholders' wishes.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

As per the provisions of the Companies Act, at least one-third of listed public companies' boards must be made of independent directors. Further, public companies that have paid-up share capital of 100 million rupees or more, a turnover of 1,000 million rupees or more, or aggregate outstanding loans, debentures and deposits exceeding 500 million rupees, are required to have at least two independent directors.

As per the Securities and Exchange Board of India (SEBI) regulations, if the chair of a listed company's board is a non-executive director, at least one-third of the total number of directors are required to be independent directors. However, if the listed company does not have a non-executive director as its chair, then at least half of its board must be made of independent directors. A chair held by a non-executive promoter or a person related to the promoters, or a person holding a managerial position at the board level or a level below that, will not be considered a non-executive chair.

'Promoter' refers to a person who has been named as such in a prospectus or is identified as such by the company in its annual return filed with the Registrar of Companies, or a person who has direct or indirect control over the affairs of the company, whether as a shareholder, a director or otherwise, whose advice, directions or instructions the board of directors is accustomed to act in accordance with; except for those who act merely in professional capacities.

A non-executive director can be anyone except for a whole-time director and is only appointed as a member of the board. Executive directors are whole-time directors. Independent directors are directors who are not the managing director, whole-time director or a non-executive director, who is not a promoter or related to any promoter of the company or its holding, subsidiary or associate company and fulfils the independence criteria as prescribed under the Companies Act.

Unlike executive directors, non-executive directors and independent directors are not responsible for the day-to-day management of the company. Independent directors are responsible for improving the company's corporate credibility and governance standards, and play a vital role in risk management, including taking an active part in the various committees set up by the company to ensure good governance.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

Board composition and disclosures

The size of the board is determined by the shareholders and mentioned in the company's articles of association.

As per the Companies Act, a private company must have at least two directors, whereas a public company must have at least three directors. A company may have a maximum of 15 directors unless a higher number is approved by the shareholders through a special resolution.

The right to appoint directors is held by the shareholders. However, if the articles of association of a company permit, the board can appoint additional directors, alternate directors and nominee directors. The board can fill any casual vacancy on the board that may arise if the office of a director is vacated before the expiry of his or her term, subject to the articles of association and subsequent approval by the shareholders in the next general meeting.

Every company must have a resident director (ie, a person who stays in India for a period of 182 days during the financial year).

SEBI regulations require that 50 per cent of the board of directors of all listed companies must comprise non-executive directors, and all listed and certain specified unlisted public companies are required to also have one female director. The board of the top 1,000 listed companies by market capitalisation in the previous financial year must have at least one female independent director.

The Companies Act makes it mandatory for all directors, during the first board meeting of each financial year, to disclose their interest in other entities (whether as shareholder, director, partner, proprietor, etc) and make a declaration that they are not disqualified to be a director of the company, and submit the same to all companies in which they are a director. If there is any change in their interests, this must be disclosed in the first meeting of the board held after such a change.

Eligibility criterion

The Companies Act provides that only an individual can be a director. No person can be appointed as a director below the age of 18 years. A company cannot appoint a person as its managing director, manager or whole-time director who is below 21 years or above 70 years in age, except with the approval of the shareholders through a special resolution.

The Companies Act and SEBI regulations also provide for additional qualifications for independent directors, managing directors, whole-time directors, etc.

Further, among other things, the Companies Act provides that a person shall not be eligible for appointment as a director of a company if he or she:

- is declared not of sound mind by a competent court;
- is an undischarged insolvent;
- has been convicted by a court and sentenced to imprisonment for not less than six months; and
- has been convicted for dealing with related party transactions at any time during the preceding five years.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

The Companies Act provides that every listed company and every other public company having a paid-up share capital of 100 million rupees should not appoint the same individual as its board chair and managing director or chief executive at the same time, except where the company's articles of association provide otherwise or the company does not carry out multiple businesses.

However, the aforementioned restriction does not apply to large public companies with paid-up capital of 1 billion rupees or more and annual turnovers of 10 billion rupees or more, that are engaged in multiple businesses, and have appointed a CEO for each such business.

Currently, the chairs of many listed companies in India also act as the company's managing director and CEO. Previously, such companies were required to make the appropriate changes and comply with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 by 1 April 2022. Recently, considering the rather unsatisfactory level of compliance achieved so far, constraints arising from the covid-19 pandemic, and with a view to enabling companies to plan for a smoother transition, SEBI has made this provision applicable to listed entities on a voluntary basis and not as a mandatory condition.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

The Companies Act and SEBI regulations require the mandatory constitution of the following board committees for better compliance and corporate governance purposes.

Audit committee and nomination and remuneration committee

The Companies Act provides that all listed public companies and public companies with paid-up share capital exceeding 100 million rupees, turnovers exceeding 1 billion rupees, or aggregate outstanding loans, borrowings, debentures or deposits exceeding 500 million rupees, must have an audit committee and a nomination and remuneration committee.

The audit committee should have a minimum of three directors, and a majority of them should be independent directors. In the case of listed companies, a minimum of two-thirds of the audit committee's members should be independent directors.

The members of the audit committee should have the ability to read and understand financial statements, and at least one member should have accounting or related financial management expertise.

The audit committee is required to review and provide suggestions to the board for financial reporting processes, internal financial control, audit processes, recommend the remuneration and appointment of auditors, approve related party transactions, supervise the vigil mechanism established by a company to address the genuine concerns of directors and employees, etc.

The nomination and remuneration committee should have at least three or more non-executive directors, of which not less than one-half should be independent directors.

Stakeholders' relationship committee

A company having more than 1,000 shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year is required to constitute a stakeholders' relationship committee, which shall consider and resolve the grievances of security holders of the company. It should consist of a chairperson who should be a non-executive director of the company, and any other members as decided by the board.

Corporate social responsibility committee

Every company having a net worth exceeding 5 billion rupees, turnover exceeding 10 billion rupees or net profit exceeding 50 million rupees during the immediately preceding financial year, and a corporate social responsibility obligation exceeding 5 million rupees, is mandatorily required to constitute a corporate social responsibility committee.

This committee should consist of at least three directors, of which at least one must be an independent director. A company that is not required to appoint an independent director should have at least two directors in the corporate social responsibility committee. Additionally, a private company having two directors must constitute a corporate social responsibility committee with those directors. In the case of a foreign company, the corporate social responsibility committee should have at least two directors, one of which should be a resident of India and the other a person nominated by the foreign company.

The corporate social responsibility committee is required to formulate a corporate social responsibility policy, including the activities to be undertaken under the said policy, expenditure to be incurred on such identified activities, and to monitor the implementation of the same.

Other committees

In addition, the top 500 listed companies in India, and some other companies, are required to constitute risk management committees. The risk management committee formulates policies for the identification of risks primarily in finance, operations, cyber operations, governance and the mitigation of such risks.

The board may also constitute and discharge certain powers to other committees made of directors or experts from various fields as is deemed necessary to assist the board in discharging its functions.

Board meetings

27 | Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Every company is required to hold its first board meeting within 30 days of its incorporation. Thereafter, every company, including listed companies, is required to conduct a minimum of four board meetings in each calendar year. The gap between two consecutive meetings should not be more than 120 days. In the case of a non-profit company incorporated under section 8 of the Companies Act, small companies, dormant companies and private companies registered as a start-up company, only two board meetings are required to be held, once in each half of the calendar year, and the gap between two meetings shall not be less than 90 days.

Board practices

28 | Is disclosure of board practices required by law, regulation or listing requirement?

As per the Companies Act, the company must disclose committee structure, the number of meetings held, meetings attended by each director, directors' responsibility statements, etc in the board's report, which it must submit to shareholders in a general meeting and thereafter filed with the Registrar of Companies.

As per SEBI regulations, a listed company is required to submit quarterly, half-yearly and annual compliance reports to the stock exchange, containing such particulars as may be prescribed by SEBI from time to time.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

A listed company is required to undertake evaluations of its board and various committees. As per the Companies Act and SEBI regulations, a listed company is required to constitute a nomination and remuneration committee which will be responsible for formulating the criteria for evaluation of the board and independent directors.

Independent directors will be evaluated by the board, and independent directors are required to evaluate the company's non-independent directors. The boards of listed companies are required to provide a statement in the corporate governance section of the company's annual report, stating the way the formal annual evaluation of the board, committees and independent directors have been conducted.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

As per the Companies Act, 2013 (the Companies Act), there are no provisions specifically dealing with the limit and restriction on remuneration to be paid to directors of a private limited company, and such a company is free to determine the remuneration at the time of their appointment as per the company's policies.

As per the Companies Act, a public company (whether listed or unlisted) cannot pay remuneration beyond 11 per cent of the net profit of the company to its directors, including whole-time directors and managing directors. If a public company only has one managing director or whole-time director or manager, the remuneration paid to that person must not exceed 5 per cent of the net profit of the company and the total remuneration paid to all such directors and managers should not exceed 10 per cent of the company's net profit.

Non-executive directors of a public company can receive remuneration which should not exceed 1 per cent of the net profit of the company if the company has only one managing director or whole-time director or manager, and 3 per cent of the net profit in all other cases.

Any fee paid to directors for attending board meetings is excluded when calculating their remuneration.

If a company has no or inadequate profits, the remuneration paid to directors can be based on the effective share capital of the company.

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As per the Securities and Exchange Board of India (SEBI) regulations, in the case of listed entities, in addition to the threshold limits prescribed under the Companies Act, they must adhere to the ceiling laid down under the applicable SEBI regulations. Unless otherwise approved by the shareholders by passing a special resolution, a company that only has one managing director or whole-time director or manager, remuneration should not exceed 50 million rupees (an absolute limit) or 2.5 per cent of the net profits of the company, whichever is higher; in case of more than one such director or manager, 5 per cent of the company's net profit.

Length of director's service contract or appointment

A managing director, whole-time director or manager can only be appointed for a maximum term of five years at a time. The reappointment can be considered not earlier than one year before the expiry of his or her term. This limit does not apply to private limited companies unless a company's articles of association provide otherwise.

For public companies, two-thirds of the total number of directors (except independent directors) must retire by rotation, unless the company's articles of association provide a higher number. Of those directors, at least one-third are required to retire at every AGM. Retiring directors, if eligible, can offer themselves for reappointment.

Loans

A company registered under the Companies Act can provide a loan, guarantee or security in connection with any loan to any person or entity in whom any of the directors have an interest, only if such a transaction is approved by the company's shareholders by way of a special resolution.

There are certain conditions in which a loan can be given, namely:

- loans to a managing director or whole-time director may be given if it is a part of the company's policy approved by the shareholders by way of a special resolution; and
- the loans may be given by companies in the ordinary course of business if the rate of interest charged on such loans is no less than the prevailing yields of one, three, five or 10-year government securities closest to the tenor of the loan.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

There is no specific law that prescribes any limit on the remuneration that can be paid to the members of senior management, except directors, managing directors and managers. A company's nomination and remuneration committee is responsible for determining and recommending the remuneration that can be paid to directors, key managerial personnel (eg, managing directors, chief executives, chief financial officers, whole-time directors or company secretaries) and other members of senior management. The remuneration is typically bifurcated into fixed and variable components including incentives and is paid based on the combined performance of the individual and the overall achievement of the company's financial and other goals. The agreed remuneration and other perquisites (including loans and advances), and the way such remuneration and perquisites shall be paid forms part of the terms of the employment contract.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

In the case of a private limited company, no approval from the shareholders is required for payment of remuneration to directors irrespective of the amount. However, in the case of a public company, the remuneration must be paid within the limits prescribed under the Companies Act and approved by the shareholders in a general meeting. The shareholders can approve the remuneration to be paid to directors, managing director or managers for a maximum period of three years at a time.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance has been recognised by the Companies Act, 2013 (the Companies Act), and obtaining it is becoming an increasingly common and prudent business practice in India. Due to the changes in the legal and economic paradigms, including the substantial compliance burden on directors and officers, companies have started opting to take D&O liability insurance to safeguard their interests from any liability, such as any negligence, default, misfeasance, breach of duty or breach of trust, for which directors or officers of the company may be guilty in relation to the company.

As per the Companies Act, if the company buys and pays premiums for D&O liability insurance, the amount so paid shall not form part of the director or officers' remuneration. However, if the director or the officer is found guilty, then such premium paid by the company will form part of their remuneration.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

There is no specific restriction under the Companies Act with respect to indemnification of directors and officers by the company for the liabilities that they may incur for negligence, default, misfeasance, or breach of trust or duty. Further, it is also not mandatory for a company to provide such indemnifications. However, due to the increasing obligations and risks associated with business, more and more companies are procuring D&O liability insurance for directors and officers to protect them from any such liability. In practice, even if no D&O policy is obtained or no specific policy is made for such indemnification, many companies indemnify their directors and officers against liabilities incurred by them while discharging their duties in good faith.

Companies can make specific provisions with respect to indemnification of their directors and officers in their articles of association and can make policies for the same accordingly.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

The law does not impose any monetary limit on the expenses that a company may advance to its directors and officers to litigate any matter, and the same may be given as per the internal policies of the company.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

It is not possible for a company or its shareholders to preclude or limit the liability of the directors and officers under the Companies Act. However, when a director or officer is specifically made responsible for certain acts, then only such director or officer shall be responsible in case any offence is committed while performing their obligations, unless any other director or officer was in connivance with them, or any such offence was committed with their consent. Therefore, a company can make specific persons responsible for different roles and activities to minimise the risk for other directors and officers.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The charter documents (ie, memorandum of association and articles of association of a company) are available for public inspection and download on the online portal of the Ministry of Corporate Affairs. Charter documents may be inspected and downloaded by paying a nominal fee of 100 rupees. It is also possible to obtain certified true copies of the charter documents from the concerned Registrar of Companies by payment of a specified fee.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

As per the Companies Act, a company is required to disclose and submit certain documents and information in the prescribed electronic forms to the Registrar of Companies from time to time. Such filings include audited financials, annual reports, the appointment and resignation of auditors, changes in directors, issuance and allotment of shares, the creation or satisfaction of charges on the company's assets, declaration of deposits, etc.

Additionally, companies that get supplies of goods or services from micro and small enterprises and whose payments to micro and small enterprise suppliers exceed 45 days from the date of acceptance or the date of deemed acceptance of the goods or services are required to file a return with the Registrar of Companies every half year in the prescribed form.

Listed companies, in addition to the filings that must be made to the Registrar of Companies, are also required to provide additional information to stock exchanges in a time-bound manner as per various Securities and Exchange Board of India regulations.

The timelines for each disclosure and filing differ.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

As per the Companies Act, 2013 (the Companies Act), shareholders have the right to propose the appointment of any person as a director of the company by serving a notice of at least 14 days before any general meeting.

In the case of a listed or public company, the proposal must be accompanied by a deposit of 100,000 rupees or such other amount as may be prescribed from time to time, as a nomination fee. After receiving such a proposal, the company is required to serve a notice to all members informing them of the candidate, and if the nominated person is appointed as a director, the nomination fee is refunded to the shareholder who proposed the nomination.

In the case of an appointment of an independent director, or a director recommended by the nomination and remuneration committee or the board, the deposit of a nomination fee is not required.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

A company engages with shareholders when it conducts an annual general meeting or an extraordinary general meeting of shareholders. To increase the participation of the shareholders in such meetings, in the case of listed companies and certain other companies, attendance of shareholders through video conferencing is permitted. In the case of a private limited company, shareholders must meet physically, unless exempted in some extraordinary situations, like the covid-19 pandemic.

An annual general meeting must be conducted once a year, within six months of the end of a financial year. It is mandatory for all directors to attend such a meeting. The chair of the meeting is required to notify the meeting of absences and provide reasons. The company's statutory auditor is also required to be present in the meeting.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

As per the Companies Act, every company on which provisions pertaining to corporate social responsibilities (CSR) are applicable is required to furnish certain details regarding these activities it undertakes in the directors' report. The details must include the amount required to be spent on them in the previous financial year, activities undertaken and the actual amount spent. The reasons for not spending the full amount must be furnished if any of the required amount was not spent.

Companies are also required to prepare and publish CSR policies on their website.

Further, all unspent amounts of the CSR budget must be deposited in a special account opened by the company in any scheduled bank or deposited in a fund specified by the Ministry of Corporate Affairs in the Schedule VII of the Companies Act, under the terms of the amendments brought under the Companies (Corporate Social Responsibility) Amendment Act, 2021.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

There is no mandatory requirement for a private or unlisted public company to disclose the 'pay ratio' between its CEO's annual total compensation and the annual total compensation of other workers.

However, a listed company is required to declare the ratio of the remuneration of each director to the other employees' remuneration in its board report, along with additional details prescribed under the Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2016.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

It is not mandatory for a company to disclose gender pay gap information. However, the Equal Remuneration Act, 1976 mandates that a company must pay the 'same pay for same work', irrespective of gender.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

There have been few developments during the last year to enhance corporate governance.

With the amendment in the Companies (Corporate Social Responsibility (CSR) Policy) Rules, 2014 under the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2022, now if a company has any unspent amount left from previous financial year, in its unspent corporate social responsibility bank account as per sub-section (6) of section 135, this company shall be required to constitute a CSR Committee and comply with the provisions contained in sub-sections (2) to (6) of section 135 of Companies Act, 2013. Having said that, as per the FAQs issued by the Ministry of Corporate Affairs dated 25 August 2021, any company is spending less than I5 million rupees on CSR activity, will not be mandatorily required to form a CSR committee but the functions of the CSR committee shall be discharged by the board of directors of the company.

Due to the covid-19 pandemic in India, the Ministry of Corporate Affairs (MCA) allowed companies to undertake their AGM and EGMs through video conferencing or other audio-visual means. The MCA, has recently (see its General Circular No. 10/2022 and 11/2022 for AGM and EGMs respectively, dated 28 December 2022) allowed the companies until 30 September 2023 to undertake their AGM through video conferencing or other audio-visual means.

Further, environmental and social govenance (ESG) compliances and disclosures by the companies are becoming a new norm. All companies are required to disclose certain information related to ESG in their annual report.

The Securities and Exchange Board of India (SEBI) has made it mandatory for the top 1000 listed companies by market capitalisation to submit their Business Responsibility and Sustainability Report (BRSR) as part of their annual report detailing their ESG initiatives.

Filing a BRSR is now mandatory (since 2022-23) and replaces the earlier report, namely, a business responsibility report.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The Companies Act (www.japaneselawtranslation.go.jp/ja/laws/view/4135, www.japaneselawtranslation.go.jp/ja/laws/view/4136), its subordinate rules and the rules of stock exchanges govern issues relating to the incorporation, organisation, operation and administration of corporations. In addition, the Financial Instruments and Exchange Act (www.japaneselawtranslation.go.jp/ja/laws/view/3986) and the rules of stock exchanges (www.jpx.co.jp/english/rules-participants/rules/regulations/tvdivq0000001vyt-att/listing_regs_1-842_20220404.pdf) regulate the disclosure of information by listed corporations. Further, the Japan Corporate Auditors Association has published a Code of Audit and Supervisory Board Member Auditing Standards (www.kansa.or.jp/wp-content/uploads/support/cf76c3571c904a7d02a39867a68b6b351a4d90c9.pdf), a Code of Audit Committee Auditing Standards (www.kansa.or.jp/wp-content/uploads/2022/10/el001_20221025_03.pdf) and a Code of Audit and Supervisory Committee Auditing and Super vision Standrds (www.kansa.or.jp/wp-content/uploads/2022/10/el001_20221025_05.pdf). The Corporate Governance Code (www.jpx.co.jp/english/news/1020/b5b4pj0000046kxj-att/b5b4pj0000046l07.pdf) has been published jointly by the Financial Supervisory Agency and the Tokyo Stock Exchange through amendment of the rules of the stock exchanges. Most of the rules of stock exchanges are mandatory rules but the provisions in the rules relating to the Corporate Governance Code apply on a comply or explain basis.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

There are no specific government agencies or other bodies responsible for enforcing the statutes except for the courts; however, commentaries authored by officials of the Department of Justice are sometimes relied upon. The rules of stock exchanges are enforced by the exchanges through a listing agreement between the exchange and the listed company. There are no well-known shareholder rights protection groups whose views are considered.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Directors of a stock corporation are elected at the general meeting of shareholders by a simple majority of votes (where shareholders hold at least a majority (or a lesser number set forth in its articles of incorporation but at least one-third) of voting rights present) unless otherwise provided for in its articles of incorporation. A director of a stock corporation can be removed at the general meeting of shareholders by a simple majority of votes unless also otherwise provided for. Shareholders of a stock corporation do not have the direct power to decide the course of action of the corporation except for certain material actions, such as mergers and corporate splits. They can do so only through the appointment of directors and proposals at general meetings of shareholders. A stock corporation can issue special shares that have voting rights only in respect of items specified in the articles of incorporation. Thus, shareholders with limited voting rights cannot appoint or remove directors if the items listed in the articles of incorporation do not include such an appointment or removal. Further, the articles of incorporation can specify items that require the approval of a meeting of holders of a specific type of share. Therefore, if the articles of incorporation provide that the appointment or removal of directors requires the approval of a specific type of shareholder, these shareholders have the right of veto in respect of the appointment or removal of directors.

Non-public stock corporations can issue a class of shares that carries exclusive power to appoint a certain number of directors, but this type of share is not permitted for public corporations.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The scope of decisions reserved to the shareholders differs depending on the type of governance structure adopted by corporations. The following shows the scope for corporations that have adopted the corporate auditor-type governance structure:

- appointment and dismissal of directors, statutory accounting advisers, corporate auditors (corporate auditors do not exist in corporations that adopted the committee-type governance structure) and accounting auditors;
- payment of dividends and disposition of loss (with certain exceptions);
- payment of dividends in kind;
- determination of remuneration for directors (except for committee-type governance corporations), statutory accounting advisers and corporate auditors;
- discharge of liabilities of directors, statutory accounting advisers, corporate auditors, executive officers and accounting auditors (unless the articles of incorporation give this authority to the board of directors);
- amendments of the articles of incorporation;
- issuance of shares at especially favourable prices;
- issuance of stock options at especially favourable prices;
- changes of types of corporations;
- mergers;
- corporate splits;
- statutory share transfers (a procedure to create a wholly owning parent above an existing corporation by operation of law);
- statutory share exchanges (a procedure under which one corporation becomes a wholly-owned subsidiary of another corporation by operation of law);
- statutory share delivery (a procedure to acquire shares of another corporation as a subsidiary);
- transfers of all or a material part of the business;
- leases of all the business;
- entrustment of all the business to another party;
- agreements to share all the profit with another party;
- acceptance of the entire business of another corporation;
- acquisition of material assets within two years of its incorporation;
- authorisations to purchase its own shares for counter value with certain exceptions;
- acquisition of special shares that are specified as shares that may be acquired by the issuing corporation in their entirety by a resolution of shareholders;
- consolidation of shares;
- capital reductions;
- reductions of legal reserves; and
- dissolution of the corporation.

While non-binding shareholders' votes are not required, the management of companies sometimes try to obtain shareholder resolutions to support their actions.

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Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Under the Companies Act, a stock corporation may adopt the unit system for its shares where one voting right is granted to one unit of shares. For example, if a corporation's articles of incorporation provide that 1,000 shares of common stock constitute one unit, a shareholder that owns 2,000 common shares has two votes for his or her shares. The number of shares constituting one unit for one class of shares can be different from that for another class of shares. So, if the corporation sets different numbers for different classes of shares, it can effectively give disproportionate voting rights. In addition, a corporation can issue shares with limited voting rights (namely, shares that do not have voting rights in respect of the items specified in the articles of incorporation of the corporation). Lastly, the articles of incorporation of the company may provide that certain matters that are subject to the approval of a general meeting of shareholders or approval of the board of directors also require the approval of the meeting of a certain class of shareholders.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

To attend and vote at a general meeting of shareholders, a shareholder must have his or her name registered in the register of shareholders of the corporation. Once his or her name is registered, it will remain on the register until the shareholder transfers the relevant shares to a third party, and this transfer is logged in the register. A shareholder may delegate authority to another person to act as a proxy. However, under their articles of incorporation, many corporations require that this other person also be a shareholder. A shareholders' resolution can be passed if all the shareholders agree in writing. As such a written resolution requires unanimous agreement, in practice, a listed corporation cannot pass a written resolution. A stock corporation can designate more than one place to have a shareholders' meeting, but audio (or chat) and visual connections must be established in all places. Virtual meetings (without physical meeting) of shareholders are permitted if a listed corporation acquires confirmation from the Minister of Economy, Trade and Industry and its articles of incorporation have a provision for such virtual-only meetings.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

A shareholder that has held 3 per cent or more of the entire voting rights for the previous six months may require that directors of the corporation convene a general meeting of shareholders (the scope of qualified shareholders can be expanded by the articles of incorporation). If directors fail to convene a general meeting of shareholders without delay, the requesting shareholder may convene a meeting after obtaining the approval of the court. A shareholder who has held 1 per cent or more of the entire voting rights or 300 or more voting rights for the previous six months has the right to require the corporation to include its proposals (including a list of director candidates) in the agenda of the general meeting of shareholders by sending written notice to that effect to the corporation eight weeks prior to the date of the meeting (the scope of qualified shareholders can be expanded by the articles of incorporation). Shareholders do not have the right to require the board to circulate their dissenting statements.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

There are no specific provisions in the Companies Act or established court precedents that establish the duties of controlling shareholders. However, a resolution of a general meeting of shareholders can be nullified through a resolution nullification suit if the resolution is unduly tainted as a result of the exercise of voting rights by one or more shareholders with a special interest in the resolution. A resolution nullification suit must be filed with the court within three months of the date of the relevant shareholders' meeting.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Theoretically, a shareholder could be held responsible for the acts or omissions of the company if a director representing the company commits a tort when he or she is an employee of the shareholder and acts under the control of that shareholder, or a director representing the company and the relevant shareholder jointly commit a tort. However, a shareholder will not be held responsible solely for the exercise of (or the failure to exercise) his or her voting rights, even if the voting is a decisive factor in the general meeting of shareholders.

Employees

10 What role do employees have in corporate governance?

Legally, employees do not have any role in corporate governance in Japan. As a minimum matter of course, in many instances, the management of a corporation consults the union or the representative of employees when it wishes to conduct major corporate restructuring.

CORPORATE CONTROL

Anti-takeover devices

11 Are anti-takeover devices permitted?

Many listed Japanese corporations have adopted various types of anti-takeover devices. Most of them are structured to enable the board of directors to issue stock acquisition rights that cannot be exercised by a hostile acquirer. The validity of these devices has, however, not been fully tested by the courts. Recently, there has been a trend to abolish this type of anti-takeover device in response to demands from institutional investors. At the same time, there have also been some recent cases where listed companies have introduced an anti-takeover device only after actual hostile acquirers had emerged.

Issuance of new shares

12 May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

In the case of listed corporations, as long as the issue price is nearly equal to the market price, the board can issue new shares without shareholder approval under the Companies Act. However, the rules of the Tokyo Stock Exchange require:

- an independent party opinion confirming the necessity and appropriateness of the issuance; or
- shareholder approval if:
    - the number of the new shares is 25 per cent or more of the outstanding shares; or
    - the issuance results in a change of controlling shareholder.

Restrictions on the transfer of fully paid shares

13 Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

No share transfer restrictions enforceable by the corporation itself are allowed in the case of listed corporations. Agreements among large shareholders sometimes contain this type of provision. In the case of non-listed corporations, the Companies Act allows a corporation to have a provision in its articles of incorporation where the transfer of shares requires the approval of the board of directors. If a shareholder of such a corporation wishes to sell his or her shares, but the board of directors does not approve such a transfer, the shareholder may require the board of directors to appoint a purchaser who is acceptable to them.

If a listed corporation amends its articles of incorporation to include such a provision, its shares are delisted in accordance with stock exchange listing rules.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

A corporation may not directly force its shareholders to sell their shares to it unless such a compulsory repurchase is specifically provided for in its articles of incorporation as a characteristic of the relevant shares. A corporation can effectively force its shareholders to sell their shares by attaching this repurchase provision by the resolution of a shareholders' meeting in which a large shareholder has a controlling stake. Further, a shareholder holding 90 per cent or more may force the other shareholders to sell their shares to him or her under the special provisions in the Companies Act.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Yes. Shareholders have appraisal rights in cases of mergers, corporate splits, statutory share exchanges, statutory share transfers and certain changes of the terms of shares.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The conventional Japanese governance structure is one-tier. The board of directors consists of all the directors of the corporation, including directors who can represent the company (namely, representative directors). In addition, a listed corporation has a board of corporate auditors consisting of at least three corporate auditors (in the case of a corporation with a stated capital of ¥500 million or more or with total debts of ¥20 billion) or at least one corporate auditor (in the case of other corporations) whose duty, in both cases, is to audit the directors' conduct. The Companies Act also allows two types of two-tier governance structures. One is a committee-type structure consisting of the board of directors (appointed by the shareholders), its three committees (audit, nomination and compensation) and executive officers appointed by the board. The other is an audit committee-type structure consisting of the board of directors and an audit committee. Members of the audit committee are directors separately elected as such at the shareholders' meeting.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

In the case of corporations that have adopted the conventional corporate auditor-type governance structure, the board of directors determines all management matters unless they are specifically reserved for a general meeting of shareholders under the Companies Act (such as a merger) or they are delegated by the board to a representative director (a director with the power to represent and bind the corporation, who is also a member of the board). The Companies Act specifically requires a board resolution if a corporation wishes to conduct any material actions, including, but not limited to, the following actions:

- disposition or acceptance of important assets;
- borrowing of substantial amounts of money;
- appointment and dismissal of managers and other important employees;
- establishment, change and abolition of branches and material organisations;
- determination of material items relating to the issuance of bonds;
- determination of a corporate governance system; and
- discharge of liabilities of directors, statutory accounting advisers, corporate auditors, statutory executive officers and accounting auditors authorised by the articles of incorporation.

The board may not delegate these items to a director. In the case of corporations that adopt the committee-type governance structure, the board may, and normally does, commission most of the powers to executive officers appointed and supervised by the board. In the case of corporations that adopt the audit committee-type governance structure, the board may delegate most of the decision-making powers to individual directors if the majority of its directors are outside directors or the articles of incorporation contain provisions to allow this delegation.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board of directors is the decision-making body of a corporation. Each director owes fiduciary duties to the corporation. Therefore, he or she may not act for the benefit of a major shareholder if such an action is against the interests of the shareholders as a whole. Further, directors are required by the Companies Act to exercise the duty of care of a prudent manager in performing their duties.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

A corporate auditor (a person elected at the general meeting of shareholders) of a corporation that has adopted the conventional corporate auditor-type governance structure may apply to the court seeking injunctive relief if the conduct of a director goes beyond the objectives of the corporation or violates the law or the articles of incorporation, or the conduct is threatening and it would cause material damage to the corporation. Members of the audit committee of a corporation that has adopted the committee-type governance structure and members of the audit committee of a corporation that has adopted the audit committee-type governance structure also have the same power. A shareholder who has held shares in the corporation for the preceding six-month period may also apply for injunctive relief if there is a possibility that the conduct by a director would cause 'substantially material' damage to the corporation. The courts apply a business judgment rule when evaluating the legality of directors' conduct.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Each director owes fiduciary duties to the corporation. A director is also required to exercise the duty of care of a prudent manager in performing his or her duties. A director may not engage in business that competes with the business of the corporation unless he or she first obtains the board's approval. Further, a director may not enter into a transaction with the corporation unless he or she first obtains board approval. Even if a director obtains board approval in connection with a transaction with the corporation, he or she is still liable for any damages incurred by the corporation as the result of such a transaction.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

As a general rule, the duties of individual members of the board do not differ from each other, irrespective of the difference in skill or experience. In the case of a corporation that has adopted a conventional corporate auditor-type governance structure, however, there is no separation of the functions of directors and those of officers in charge of the day-to-day management of the corporation. So, in most corporations, each director also serves as an officer in charge of a specific aspect of management of the corporation. In this sense, the duties of individual members of the board may differ. In the case of a corporation that has adopted a committee-type governance structure, the members of each committee perform additional duties. The same applies to members of the audit committee in a corporation that has adopted the audit committee-type governance structure.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

In the case of a corporation that has adopted the conventional corporate auditor-type governance structure, in principle, the board acts as a management body as well as a supervising body. But the board may delegate its responsibilities to each director except for material matters regarding the business of the corporation (including but not limited to those specifically identified in the Companies Act) and the following matters:

- disposition or acceptance of important assets;
- borrowing of a substantial amount of money;
- appointment and dismissal of managers and other important employees;
- establishment, change and abolition of branches and material organisations;
- determination of material items relating to the issuance of bonds;
- determination of the corporate governance system; and
- discharge of the liabilities of directors, statutory accounting advisers, corporate auditors, statutory executive officers and accounting auditors authorised by the articles of incorporation.

In the case of a corporation that has adopted the committee-type governance structure, the board is expected to act mainly as supervising body and can delegate management decisions to statutory executive officers except for the limited number of items specified in the Companies Act. The board is also required to determine the following items:

- the management policy;
- items necessary for the operation of the audit committee;
- the allocation of duties among statutory executive officers and matters relating to the relationships between statutory executive officers;
- identification of the director to whom statutory executive officers should request the convocation of a meeting of the board of directors; and
- a framework to ensure appropriate management of the corporation.

In the case of a corporation that has adopted the audit committee-type governance structure, the board can delegate management decisions to individual directors except for the limited number of items specified in the Companies Act if the majority of its directors are outside directors or the articles of incorporation contain provisions to allow this delegation. The board is also required to determine the following items: the management policy; items necessary for the operation of the audit committee; and a framework to ensure appropriate management of the corporation.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

If a listed corporation that has adopted the conventional corporate auditor-type governance structure does not have an outside director, it must explain, at the annual general meeting of shareholders, why it is appropriate not to have an outside director. In other words, the Companies Act strongly recommends that listed corporations have at least one outside director. An 'outside director' is defined as a director who:

- is not an executive director, statutory executive officer, manager or other employee of the corporation or any of its subsidiaries;
- has not served as executive director, statutory executive director, manager or other employee of the corporation or any of its subsidiaries for the 10-year period immediately preceding the appointment as a director;
- is not a director, statutory executive officer, manager or other employee of its parent corporation;
- is not an executive director, statutory executive officer, manager or other employee of any of the subsidiaries of its parent corporation; and
- is not related to any of the directors, statutory executive officers, managers or other important employees of the corporation.

There are some additional rules relating to the qualification of 'outside' directors. In the case of a corporation that has adopted the committee-type governance structure, it must establish three committees (audit, nomination and compensation committees) and appoint one or more executive officers. Each committee must consist of at least three directors (a majority of whom must be outside directors). None of the members of the audit committee may hold the position of statutory executive officer, executive director, manager or employee of the corporation or any of its subsidiaries or statutory accounting adviser of any of the subsidiaries. In the case of a corporation that adopted the audit committee-type governance structure, it must establish an audit committee. The audit committee must consist of at least three directors (a majority of whom must be outside directors). Each member of the audit committee of this type of corporation is a director elected as such at the general meeting of shareholders. None of the members of the audit committee of this type of corporation may hold the position of executive director, manager or other employee of the corporation, or statutory accounting adviser or statutory executive officer of any of the subsidiaries of the corporation.

Legally, the responsibility of the outside directors is the same as those not classified as outside directors, provided, however, that a corporation can adopt articles of incorporation authorising it to enter into an agreement with each of the outside directors and non-executive directors to limit the maximum amount of monetary liability of these directors.

Stock exchange rules require a listed corporation to have at least one independent officer. An 'independent officer' is defined as an outside director or corporate auditor whose interests do not conflict with that of general shareholders. Further, under the Corporate Governance Code, listed companies are urged to have at least two independent outside directors.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

Articles of incorporation of a Japanese stock corporation provide the minimum or maximum number of directors. Further, under the Companies Act, a corporation with a board of directors (a listed corporation always has a board) must have at least three directors. Vacancies must be filled with the resolution of the general meeting of shareholders.

The Corporate Governance Code requires that a listed corporation should have directors that can effectively perform their roles and responsibilities (from knowledge, experience and capacity perspectives). Listed companies are required to disclose their responses to this requirement in their corporate governance reports.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

The Companies Act does not require the separation of the functions of board chair and chief executive or president. In a corporation that has adopted the corporate auditor-type governance structure or audit committee-type governance structure, the board of directors appoints one or more representative directors from among themselves. A representative director represents, and may legally bind, the corporation. Customarily, one of the representative directors is the president and another is the chair. If there is a chair, he or she customarily serves as chair at board meetings. If there is no chair, the president customarily serves as chair at these meetings. The position of chair at meetings is customarily provided for in the articles of incorporation or the regulations of the board of directors of the corporation. In a corporation that has adopted the committee-type governance structure, the board appoints statutory executive officers, who run the day-to-day business of the corporation, and the representative statutory executive officer or officers, who represent the corporation and can legally bind it. Statutory executive officers may be elected from among the directors. One of the representative statutory executive officers customarily uses the title of CEO.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

In the case of a corporation that has adopted the corporate auditor-type governance structure, board committees are not mandatory. Although the corporation may have internal board committees, these are not legally recognised bodies under the Companies Act.

In the case of a corporation that has adopted the committee-type governance structure, the corporation must set up the nomination, audit and compensation committees and appoint one or more executive officers. Each committee must consist of at least three directors (a majority of whom must be external directors not also serving as executive officers). None of the members of the audit committee may be a statutory executive officer, executive director, manager or employee of the corporation or any of its subsidiaries or statutory accounting adviser of any of the subsidiaries. The nomination committee has the power to determine proposals to be submitted to the general meeting of shareholders as to the appointment and removal of directors. The audit committee has the power to audit the performance of directors and statutory executive officers and to determine proposals to be submitted to the general meeting of shareholders as to the appointment, removal or non-renewal of outside accounting auditors. The compensation committee has the power to determine the compensation payable to directors, statutory executive officers and statutory accounting advisers.

In the case of a corporation that has adopted the audit committee-type governance structure, it must establish an audit committee. The audit committee must consist of at least three directors (a majority of whom must be outside directors). Each member of the audit committee of this type of corporation is a director elected as such at the general meeting of shareholders. None of the members of the audit committee of this type of corporation may hold the position of executive director, manager or other employee of the corporation, or statutory accounting adviser or statutory executive officer of any of the subsidiaries of the corporation.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

The Companies Act requires that each representative director and executive director of a corporation that has adopted the corporate auditor-type governance structure or the audit committee-type governance structure reports on how he or she has been carrying out the business to the board of directors at least once every three months. Therefore, the meeting of the board of directors must be held at least once every three months. In the case of a corporation that has adopted the committee-type governance structure, similar obligations are imposed on executive officers. Therefore, the meeting of the board of directors must be held at least once every three months.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

The governance structure of the corporation is registered in the commercial register. The corporation's commercial register is a public record. If it is necessary for a shareholder of a corporation or a shareholder of the parent of a corporation to exercise his or her rights, he or she can access and make copies of the minutes of the board meetings after obtaining court permission. A creditor of a corporation can also apply for court permission if this access is necessary to claim compensation for damages incurred against a director, statutory accounting adviser, corporate auditor or statutory executive officer of the corporation.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

Under the Corporate Governance Code, which is enforced only on a 'comply or explain' basis, the board of directors is required to analyse and evaluate the effectiveness of the board management every year and disclose the outline of the result of this analysis and valuation to the public. While the valuation must be made through self-evaluations of each director, the purpose of this is to evaluate the entire board.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

In a corporation that has adopted the corporate auditor-type governance structure, the remuneration of directors must be approved at a general meeting of shareholders unless there are relevant provisions in its articles of incorporation. Most stock corporations approve the maximum aggregate amount of remuneration payable to the entire group of directors and give the board of directors the power to decide how it is allocated among the directors. The board of directors generally delegates this power to the president and representative director. In a corporation that has adopted the audit committee-type governance structure, the remuneration of directors who are to serve as members of the audit committee must be approved at a general meeting of shareholders separately from that payable to directors who are not to serve as members of the audit committee. The directors who are also members of the audit committee have the right to express their opinion on the remuneration payable to audit committee members at the general meeting of shareholders. The audit committee director elected by the audit committee may express opinions on the remuneration payable to directors who are not audit committee members. In a corporation that has adopted the committee-type governance structure, the remuneration of the directors must be approved by the compensation committee. The Corporate Governance Code requires that a listed corporation should have a compensation structure that will enhance its sustainable growth by combining compensation linked to its mid-term and long-term performance or combining cash compensation and stock plans.

In a corporate auditor-type governance corporation, the length of directors' service shall be two years or less. In an audit committee-type governance corporation, it shall be two years for audit committee member directors and one year or less for other directors. It shall be one year in a committee-type governance corporation. Even if the service contract provides for a longer term, this provision will not limit the power of the general meeting of shareholders to replace the directors upon expiry of the two-year period. For the corporation to advance a loan to its director or to enter into a transaction with its director, the relevant director is required to obtain a board resolution in respect of such a loan or transaction.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

No law, regulation, listing requirement or practice exists that affects the remuneration of directors. Loans to directors and other transactions between the company and directors must be approved by the board of directors (or general meeting of shareholders if the company has not adopted a board system). Board approval is also required for loans to, and transactions with, statutory executive officers in cases where corporations have adopted a committee-type governance system.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

In the case of the corporate auditor-type governance structure, a resolution of the general meeting of shareholders is required for a Japanese listed corporation to pay remuneration to its directors or corporate auditors unless it is already provided for in its articles of incorporation. Once the maximum amount of the aggregate amount of remuneration payable to directors and to corporate auditors has been approved, no further resolution is required unless this maximum amount needs to be amended. In the case of the audit committee-type governance structure, the amount payable to audit committee directors and to other directors must be separately determined. In the case of the committee-type governance structure, the remuneration of the directors and executive officers is determined by the remuneration committee. So, in this case, shareholders do not have any direct power to determine the remuneration of directors and executive officers. In respect of senior management, shareholders do not have any control over their remuneration.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' (D&O) insurance is permitted and has recently become common practice. The company can pay the premiums if so resolved at the board meeting.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

The company may enter into an indemnity agreement with directors in respect of their liabilities incurred against a third party in their capacity as directors if the execution of such indemnity agreement and the contents thereof is authorised by the board meeting. If the company's articles of incorporation contain a specific provision, the board may discharge a certain portion of the directors' liabilities against the company itself, which exceeds the amount calculated based upon the formula specified in the Companies Act. The corporation can enter into a contract with its outside directors or non-executive directors, limiting their liabilities against the company to a certain amount if it is so authorised in its articles of incorporation.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Companies can and will be required (if so required by directors) to pay expenses to their directors to the extent that these expenses were expected to be paid by the directors as part of their performance of their role. However, the company cannot and will not be required to pay expenses that relate to the directors' wrongdoings, so expenses for defence can be reimbursed only when the directors succeed in defending the case. However, companies can pay the entire D&O insurance premium if this payment is approved by a board resolution.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

A two-thirds vote at the shareholder meeting can limit the liability of directors and officers to certain statutorily calculated amounts (except in the case of certain types of liability) unless the relevant damages incurred by the company are caused by gross negligence of the relevant director or officer. This power can be delegated to the board of directors by amending the articles of incorporation of the company. Liabilities of outside directors, non-executive directors and auditors can be limited by a liability-limiting agreement if the articles of incorporation contain a provision permitting such an agreement.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The articles of incorporation are the only constitutional document of a stock corporation. There are no by-laws or corporate charters. Under the Companies Act, the articles of incorporation are only available to shareholders and creditors. In the case of a listed corporation, its articles of incorporation are publicly available on the website of the stock exchange as well as at the head office and major branches of the corporation and the office of the stock exchange.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

A listed corporation is required to file an annual securities report setting forth the business results of the corporation with the appropriate local finance bureau within three months of the end of its fiscal year via the electronic corporate disclosure system, EDINET. It must also file a quarterly report within three months of the end of each quarter. These reports are available to the public via EDINET. Further, stock exchange rules require timely disclosure by listed corporations of major events or decisions of the listed corporation.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

A shareholder or a group of shareholders who have held 1 per cent or more of the outstanding voting rights for the previous six months can ask the directors to present a proposed agenda, including the appointment of directors to the general meeting of shareholders, by giving eight weeks' notice.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

In Japan, listed companies' engagement with their shareholders is relatively limited. But when there is a proposed resolution that is not very popular among the shareholders, the company sometimes contacts shareholders to urge them to cast positive votes at its shareholders' meeting. These actions are often conducted by persons within the company's general affairs bureau under the supervision of directors.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

The Corporate Governance Code requires that a listed corporation must cultivate a corporate culture that respects the rights of various stakeholders, such as employees, customers, counterparties, creditors and the surrounding society, and establish management policies that respect these stakeholders' rights. The code requires that listed corporations publicly disclose these management policies.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

No such pay ratio disclosure is required. But if the total compensation value payable to one director is ¥100 million or more, then his or her name, the amount of the compensation and other information must be disclosed in its Annual Securities Report.

Read this article on Lexology

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

No such disclosure is required.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

The section classification of the Tokyo Stock Exchange changed on 4 April 2022. The old sections (First, Second, Mothers, JASDAQ Standard and JASDAQ Growth) were reclassified into three new sections (Prime, Standard and Growth). All the principles of the Corporate Governance Code apply to the corporations listed in the Prime and Standard Sections, while special rules enhancing higher governance requirements apply to corporations listed in the Prime Section. Only basic principles will apply to corporations listed in the Growth Section.

Separately from the above, an amendment to the Companies Act that enabled corporations to distribute materials for shareholders' meetings to shareholders electronically without consent from each shareholder became effective from 1 September 2022.

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Summary

SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The primary sources of law relating to corporate governance may be determined by the type of entity. The primary source of corporate governance law for limited liability companies is the Companies Act, No. 17 of 2015 (Companies Act). For listed companies, the Capital Markets Act, No 17 of 1989; Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 (CMA Code). Market intermediaries (eg stockbroker, derivatives broker, REIT manager, trustee, dealer, investment adviser, fund manager, investment bank, central depository, authorised securities dealer, authorised depository, online forex broker, commodity dealer, commodity broker) are guided by the Capital Markets (Corporate Governance) (Market Intermediaries) Regulations, 2011.

State-owned entities draw governance principles and practices from the State Corporations Act, No 11 of 1986 and Code of Corporate Governance for State Corporations 2015 (Mwongozo).

Entities with conduct banking business (banks and microfinance institutions) are guided by the Banking Act, Cap 488 or the Microfinance Act, No 19 of 2006 together with the Prudential Guideline on Corporate Governance (Prudential Guidelines) issued by the Central Bank of Kenya.

Entities in the insurance industry is regulated by the Insurance Act, Cap 487 and the Corporate Governance Guidelines for Insurance and Reinsurance Companies, 2011 issued by the Insurance Regulatory Authority.

In the pensions sector, corporate governance principles and guidelines are provided for under the Retirement Benefits Act, No 3 of 1997 and Retirement Benefits (Good Governance, practices in the Management of retirement benefits schemes) guidelines, 2018.

Last, the Sacco societies sector governance practices are governed by the Sacco Societies Act, No 14 of 2008, Sacco Societies (Non-Deposit-Taking Business) Regulations, 2020 and Sacco Societies (Deposit-Taking Sacco Business) Regulations, 2010. The Sacco Societies Regulatory Authority has also issued Guidelines on Governance of Deposit Taking Sacco Societies, 2022.

Listed companies are required to strictly comply with listing rules. Separately the Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 adopts an 'Apply or Explain' standard, which requires full compliance. Where the listed entity has not complied, a satisfactory explanation will be acceptable. Nevertheless, the board is required to fully disclose any non-compliance to relevant stakeholders including the Capital Markets Authority and to demonstrate how it will achieve full compliance.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

Many government agencies are empowered to make rules relating to corporate governance. In respect of limited liability companies, the Attorney General is empowered by the Companies Act, No. 17 of 2022 to make regulations on issues including governance of companies.

The Capital Markets Authority (CMA) regulates the capital markets sector and is empowered by section 11 of the Captial Markes Act, No. 17 of 1989 to prescribe notices or guidelines on corporate governance of companies which have issued their shares or securities to the public or a section of the public.

In the banking sector the Central Bank of Kenya (CBK) is empowered by section 33 of the Banking Act, Cap 488 to issue guidelines to be followed by institutions for the maintenance of a stable and efficient banking and financial system.

The Insurance Regulatory Authority (IRA) regulates the insurance sector. It is empowered by the Insurance Act, Cap 487 to formulate and enforce standards for conducting insurance and reinsurance business in Kenya. Further, it is mandated to issue supervisory guidelines and prudential standards for the better administration of insurance business.

The pensions sector is regulated by the Retirement Benefits Authority (RBA), which has the authority to issue guidelines, practice notes or codes of conduct for better administration of the retirement benefits schemes. These powers are provided for under section 55 of the Retirement Benefits Act, No. 3 of 1997.

The Sacco Societies Regulatory Authority (SASRA) regulates Sacco Societies and is empowered under the Sacco Societies Act, No. 14 of 2008 to exercise such incidental powers as may be necessary to carry out its functions. This, therefore, includes the publishing of guidelines on corporate governance in the Sacco societies sector.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Power to appoint or remove directors

Upon incorporation, shareholders can appoint directors by ordinary resolution at a general meeting or through written resolutions. This is subject to the articles of association (articles) of a company, which may provide for a higher or lower threshold for appointment of directors.

Shareholders have power to remove directors prior to the end of their term at a meeting by passing an ordinary resolution. A special notice is required for a resolution to remove a director or to appoint another director to replace the removed director. A director has a right to protest against removal in writing and to be heard at the meeting discussing the removal of the director.

An ordinary resolution is one which is passed by a simple majority of the shareholders.

Power to require the board to pursue a course of action

Shareholders can direct the company's course of action by passing a resolution in that regard at a general meeting of shareholders. In addition to this, shareholders may require directors to convene a general meeting if the thresholds stipulated in the Companies Act are met. The directors must convene the general meeting within 21 days from the date of the request.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The Board of Directors is tasked with the management and operations of the Company. However, Shareholders have the power to reserve decisions under the articles of association of a company. In addition, the Companies Act, has provided for some shareholder reserved matters. These include, but not limited to, the following.

Appointment of directors

Save for an appointment to fill a casual vacancy, the appointment of directors is reserved for shareholders at a general meeting.

Removal of directors

The directors may remove directors prior to the expiry of their term at a general meeting.

Alteration of capital and allotment of shares

A company's capital may be altered by allotting new shares or reducing its share capital. Any form of alteration of the share capital can only be valid if the shareholders have passed an ordinary resolution authorising the alteration.

Amendment of articles of association

An amendment of a company's articles can be done only by way of special resolution of the shareholders of the company. A special resolution is one which is passed by a majority of at least 75 per cent.

Change of name

Subject to the articles, change of name of a company is reserved to the shareholders by passing a special resolution. The directors may however resolve to change the name of the company if so directed by the Registrar of Companies.

Conversion of company

A private company may convert itself to a public company. This action requires a special resolution by the shareholders of the company. Likewise, by a special resolution of the shareholders a public company can be converted to a private company.

Liquidation of companies

A voluntary liquidation of a company requires a resolution by the shareholders. If a company is a fixed-term company an ordinary resolution of the shareholders will be required to liquidate it. In any other circumstance, a special resolution will be required to liquidate the company voluntarily or by the court.

Variation of class rights

Variation of class rights requires the consent of the holders of a particular class of shares. This may be given in writing by at least three quarters in nominal value of the issued shares of that class or a special resolution of the holders of that class of shares.

Payment for loss of office

There are instances where a director is compensated for loss of office as a director or as consideration for retirement as a director. The Companies Act provides that no payment as compensation for loss of office may be made unless such payment has been approved by a resolution of the shareholders.

Substantial property transactions

As a general rule companies require the approval of the shareholders to enter into substantial property transactions. Such arrangements are defined as:

- acquisition from the company of a substantial non-cash asset by a director of the company or its holding company or a person connected to the director; or
- acquisition by the company of a substantial non-cash asset from a director of the company or its holding company or a person connected to the director.

A substantial non-cash asset is one that exceeds 10 per cent of the company's asset value and is more than 5 million Kenyan shillings or any non-cash asset of a value greater than ten million Kenyan shillings.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Voting rights

The general rule is that each shareholder has one vote for each share held by the member in the company. However, companies may have different classes of shares with different rights, including voting rights.

Limits to exercise of voting rights

There are limitations on who is entitled to vote on a written resolution. If a resolution is proposed as a written resolution, the shareholders entitled will be those who were entitled to vote on the resolution on the date of circulation of the resolution.

There is also a limit on the voting rights relating to ratification of acts of a director where the director is a shareholder. The limitation extends to shareholders who are connected to the director.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Requirements for meetings

Directors have an obligation to convene an annual general meeting of the company each year. They also have power to convene a general meeting that is not an annual general meeting. To convene a general meeting, private companies are required to issue at least 21 days' notice while public companies require 21 days' notice for the annual general meeting and 14 days' notice for any other meeting.

The notices should be given to each shareholder and director in hard copy, electronic, on the company's website or a mixture of the foregoing.

Shareholders may appoint a proxy to attend the general meeting on their behalf and to exercise their rights of voting and to speak during the meeting.

Shareholders of a private company may make a written resolution save for purposes of removing a director or auditor before the end of their term in officer.

Virtual meetings

The Companies Act does not have provisions for holding of virtual or hybrid meetings. However, the Business Registration Service (BRS) has issued guidelines for holding of hybrid and virtual meetings. The Capital Markets Act, No 17 of 1989 (CMA) issued guidelines on conducting virtual and hybrid annual general meetings of issuers of securities to the public on 27 May 2020.

The Institute of Certified Secretaries (ICS) has also issued a Governance Guideline for Virtual Meetings to provide guidance for the convening and conduct of virtual meetings for boards, shareholders or other stakeholders of an organisation. The guideline provides that virtual meetings must be permitted by the constitutive documents or applicable law.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Shareholders can require directors to convene a general meeting if members representing 10 per cent of the paid-up capital of the company request so. For private companies, where the directors have not convened a general meeting of shareholders within 12 months, shareholders representing 5 per cent of the paid-up capital of the company may direct the directors to convene a general meeting. The directors must convene the general meeting within 21 days from the date of the request.

A request to the directors to convene a general meeting should state the agenda of the meeting.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Minority shareholders are protected by having the right to apply to court for relief if the company's affairs are being conducted in a manner that is oppressive or unfairly prejudicial to the interests of shareholders.

The law also provides safeguards against variation of class rights. The consent of the holders of a particular class of shares may be given in writing by at least three quarters in nominal value of the issued shares of that class or a special resolution of the holders of that class of shares.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

The liability of shareholders in a limited liability company is limited by the company's articles to the amount unpaid on the shares held by the member. However, if an unlawful distribution is made to a shareholder, and the shareholder knew or had reasonable grounds to believe that the distribution was not a proper distribution, the shareholder will be liable to pay the company the amount of the distribution.

Employees

10 What role do employees have in corporate governance?

Corporate governance includes elements of board composition and structure, transparency and disclosure, risk management, internal control, corporate citizenship and stakeholder engagement. This means that the chief executive officer, company secretary, internal auditor, chief risk officer and chief financial officer play a key role in promoting and implementing good corporate governance practices within a company.

CORPORATE CONTROL

Anti-takeover devices

11 Are anti-takeover devices permitted?

A company may opt-in for purposes of the company takeover provisions in the Companies Act if it is traded on a regulated market. The company also has the option of opting out by passing an opting-out resolution.

In private companies, there is a restriction on transfer of shares typically buttressed by inclusion of pre-emption rights in the articles of association.

Issuance of new shares

12 May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

A company is allowed to increase its share capital by allotting new shares. An ordinary resolution of shareholders is required for an allotment of shares to be valid.

Restrictions on the transfer of fully paid shares

13 Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Private companies have a restriction on transfer of shares in the company.

In public companies, there are no restrictions on transfer of shares and invitations to the public to subscribe to the company's shares.

Compulsory repurchase rules

14 Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

A company with share capital may purchase its own shares subject to restrictions or prohibitions within its articles. In the purchase of own shares, companies require the authority of the shareholders. Purchase of one's own shares can be an off-market or market purchase. An off-market purchase requires the approval of the terms of the contract by a special resolution of the company while a market purchase requires the approval of a simple resolution.

Dissenters' rights

15 Do shareholders have appraisal rights?

Offerors in company takeovers have a right to buy out minority shareholders if they meet the thresholds of a squeeze in. Minority shareholder also have the right to force an offeror to buy their shares of the offer meets the threshold of a sell-out. A minority shareholder may apply to court for relief for the court to impose a higher consideration if the current consideration is unfair.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The board structure adopted by most companies is a one-tier structure comprised of both executive and non-executive directors.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The responsibility of the board is to approve and oversee the implementation of a company's strategy. This is achieved by overseeing the activities of management. The Companies Act provides that the directors owe a fiduciary duty to the company. Directors have a duty to act within the powers conferred upon them by the company's constitution. Directors also have a duty to promote the success of the company, exercise independent judgement, exercise reasonable care, skill and diligence and avoid conflicts of interest.

For issuers of securities to the public, the Capital Markets Act, No 17 of 1989; Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 (CMA Code) requires each board member to:

1 act in the best interests of the company;
2 devote sufficient time to carry out their responsibilities and enhance their skills;
3 promote and protect the image of the company;
4 owe their duty to the company and not to the nominating authority; and
5 owe the company a duty to hold in confidence all information available to them by virtue of their position as a board member.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

Fiduciary duties of directors of a company are owed to the company and not to the nominating shareholders or authority.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Directors are the agents of the company appointed by the shareholders to manage the company. The shareholders are entitled to exercise their rights by passing resolutions at general meetings. In addition, a derivative action can be brought in respect of an action or inaction or planned action or inaction involving negligence, default, breach of duty or breach of trust by a director of the company.

It was determined in paragraph 44 of the ruling in Ghelani Metals Limited & three others v Elesh Ghelani Natwarlal & another [2017] eKLR that the procedure set out under the Companies Act is the exclusive method of pursuing derivative claims.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Directors are expected to exercise the care, skill and diligence that may reasonably be expected of a person performing the functions performed by the director in relation to the company and the general knowledge, skill and experience that the director has.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

The Companies Act does not provide for the differentiation of the duties of directors with different skills and experience.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The board of directors has the authority to delegate its functions to a board committee, the managing director and management. This may be achieved through an instrument of delegation of authority that outlines functions reserved to the board and its committees and those delegated to management. Generally, the board should not delegate matters to the extent that the delegation will prejudice its functions. For example, the board cannot delegate responsibilities imposed by statute such as convening general meetings.

Non-executive and independent directors

23 | Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Private companies are required to have at least one director while public companies are required to have at least two directors. In both cases, companies are required to have at least one director being a natural person. The minimum and maximum number of directors can be set in the articles of association. For listed companies, the CMA Code requires companies to have a balance of both executive and non-executive directors with a majority of non-executive directors. It further requires the companies to have independent non-executive directors constituting at least one third of the total board members. An independent director is one who does not have a material or pecuniary relationship with the company or related persons, is compensated through sitting fees or allowances and does not own shares in the company. A continuing independent director's term of service is nine years.

Under the Prudential Guidelines an independent non-executive director must not have been employed by the company within the preceding five years, must not have had a business relationship with the company for the preceding five years and does not have any interest in the company that exceeds 5 per cent of its equity interest.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

At incorporation, the size of the company is determined by the promoters of the company. The ideal size of a board is premised upon consideration to the industry, regulatory environment, business model, risks to be managed and the composition of the committees.

The CMA Code recommends that the size should not be so small that it excludes wider expertise and skills to improve the effectiveness of the board and the formation of its committees is compromised or so big that it undermines interactive discussions.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

For listed companies the functions of the board should be separate from those of management with the CEO being different from the board chairman. As best practice, the board chairman should be an independent non-executive director. Separation of the chairman and CEO positions is a key component of board independence because of the fundamental differences and potential conflicts between these roles. A non-executive chairman can serve as a valuable sounding board, mentor, and advocate to the CEO.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Listed companies are required to establish board committees to cover functions such as audit, board nominations, risk management, remuneration, finance, investment and governance. The committee tasked with audit should be composed of at least three independent and non-executive directors and should be chaired by an independent and non-executive director. Furthermore, at least one of the committee members should hold a professional qualification in audit or accounting and be in good standing with his or her respective professional body.

For companies licensed to conduct banking business, the Board Audit Committee, Board Risk Management Committee and Board Credit Committee are mandatory committees.

In state corporations, the board must establish not more than four committees. However, the board may establish ad-hoc committees to deal with ad-hoc matters as and when they arise such as recruitment of the Chief Executive Officer and other disruptive matters. Additionally, the board is required to establish an audit committee and another three committees to discharge the functions including: governance, risk, compliance, finance, technical matters, strategy and human resource.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Most organisations internally prescribe the number of meetings to be held by the board in the board charter as well as the articles. Governance Standard 002: Meetings of the Board and Committees issued by ICS under guide 5.3 recommends that the authority to convene a board meeting should either be as prescribed by the law or the constitutive documents of the organisation.

Prudential Guidelines prescribe that the Board should meet regularly, preferably at least once each quarter for purposes of being informed on the business condition of the financial institution. In addition to this, the board audit committee is required to meet at least once every quarter and should report to the board regularly.

Listed companies must oversee the corporate management operations, management accounts, major capital expenditures and review corporate performance and strategies at least on a quarterly basis. This means the board should meet at least once quarterly.

For state corporations, board members must dedicate adequate time and effort for meetings and meet at least once quarterly to effectively lead the organisation.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

Disclosures of board practices including the board composition and structure, attendance of meetings and board evaluation results are contained in the annual reports of the company. Listed companies must disclose in their annual reports a statement of policy on good governance, status of application of the code of governance, board structure including qualifications and skills mix, board remuneration policies and procedures, highlights of the financial performance and board evaluation.

Boards of state corporations must include in the annual report information including:

- the governance structure including the composition and size of the board, the committees of the board and the management;

- details of the board members including the names, qualifications, date of appointments, terms served, other board memberships and any other relevant information; and
- a summary of the board evaluation results.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

Listed companies must conduct a board evaluation annually. Annually, the directors agree on the parameters of their evaluation.

Banks and financial institutions must regularly review the required mix of skills and experience and other qualities to assess the effectiveness of the board. The review is a peer and self-evaluation of the board as a whole, its committees and the contribution of each and every director, including the chairman and should be conducted annually.

Boards of state corporations must determine their performance criteria and undertake an annual evaluation of performance that results in a report with recommendations for implementation and should be shared with the relevant stakeholders. It is the responsibility of the State Corporation Advisory Committee to facilitate the annual evaluation that covers the board as a whole, its committees, individual members, the chairperson, the CEO and the corporation secretary.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

Listed companies must remunerate board members fairly and responsibly. It is recommended that the board of a listed company should establish and approve formal and transparent remuneration policies and procedures that attract and retain board members. The remuneration policy for board members should stipulate the elements of such remuneration including directors' fees, attendance allowances and bonuses. The board remuneration policies and procedures should be disclosed in the annual report.

In state corporations, the remuneration of board members must comply with the provisions and guidelines under the State Corporations Act Cap 446 and in accordance with the prevailing relevant legislative provisions and guidance from the relevant authorities such as the Salaries & Remuneration Commission, State Corporation Advisory Committee and as approved by the relevant Ministry.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

Boards of listed companies and banks must put in place remuneration policies for employees. While the specific range of remuneration is not provided, the level of remuneration should be sufficient to attract and retain high calibre talent balanced against ensuring that the company's funds are not used to subsidise excessive remuneration packages.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Subject to the articles of association, the shareholders' powers regarding remuneration of directors are limited to the approval of the directors' remuneration report at a general meeting.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted under the Companies Act.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Section 194(3) of the Companies Act voids any arrangement that seeks to provide, whether directly or indirectly, an indemnity for a director of the company, or associated company, against a loss to the director for reasons of negligence, default, breach of duty or breach of trust. Directors may, however, be indemnified for liability incurred by the director to a party other than the company or associated company to the extent that the director is not liable to pay a fine imposed in criminal proceedings or a penalty to a regulator for non-compliance with a regulatory requirement.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

As a general rule, the shareholders' approval is required for advancement of funds to directors. The Companies Act however, has an exception for expenditure on defending proceedings. A company may therefore advance expenses to directors in connection with litigation to provide the director with funds to meet expenditure incurred or to be incurred by the director in defending any criminal or civil proceedings in connection with any alleged negligence, default, breach of duty or breach of trust by the director in relation to the company and in connection with an application for relief.

The financing may be done on the terms that:

- the loan is to be repaid, or any liability of the company incurred under any transaction connected with the thing done is to be discharged, if:
  - the director is convicted in the proceedings
  - judgment is given against the director in the proceedings; and
  - the Court refuses to grant the director relief on the application; and
- that it is to be so repaid or discharged not later than:
  - the date on which the conviction becomes final;
  - the date on which the judgment becomes final; or
  - the date on which the refusal of relief becomes final.

A director may also be financed to meet the expenses incurred or to be incurred by the director defending him or herself in an investigation by a regulatory authority and against action proposed to be taken by a regulatory authority, in connection with any alleged negligence, default, breach of duty or breach of trust by the director in relation to the company or an associated company.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

As a general rule, a provision of a company's constitution, contract, scheme or arrangement that purports to exempt a director from any liability of a director in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The memorandum of association and articles of association of a company are available at the Registry of Companies at a fee.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

Public disclosure requirements for private companies and unlisted companies are not prominent. The main disclosures required are disclosures of changes in the company (such as changes in directorship, shareholding, articles of association and share capital) being made to the Registrar of Companies. Annually, all companies must file a return with the Registrar of Companies.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Shareholders may nominate directors and have them included in shareholder meeting material.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

Shareholder engagement is primarily limited to engagements in the annual general meeting and general meetings. At the general meetings both shareholders, executive directors and non-executive directors participate. Independent auditors also present their report at the general meeting.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

The Companies Act requires quoted companies to have a business review in their annual reports with information about: environmental matters and the impact of the business of the company on the environment, the employees of the company and information on any policies of the company in relation to social and community issues and the effectiveness of those policies. Further, the Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 requires boards to continually work towards introduction of integrated reporting, which includes reporting on sustainability.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

The remuneration of directors, including the CEO, who is typically the managing director, is disclosed in the annual financial statements. However, in reporting executive compensation there is no obligation to disclose the CEO's pay ratio.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

The principle of equal pay is enshrined in the Constitution of Kenya. However, there is no legislation requiring disclosure on the gender pay gap.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Governance audits

The Code of Corporate Governance Practices for Issuers of Securities to the Public 2015 recommends that a Governance Audit should be carried out to confirm the company is operating on sound governance practices. the Capital Markets Act, No 17 of 1989 has issued further guidelines on the frequency of governance audits. Similarly, Mwongozo requires boards of state corporations to ensure that they subject the state corporation to a governance audit. We have noted that there is a steady increase in the number of listed companies and state corporations undertaking independent governance audits.

ESG

The Nairobi Securities Exchange (NSE) in November 2021 published the NSE ESG Disclosures Guidelines to guide on the reporting of ESG information by companies listed on the NSE. Under the guidelines, listed companies are expected to report at least once annually on their ESG performance. The guidelines aim to promote consistent, transparent and principle-based approach to ESG reporting with the ultimate objective of meeting stakeholder expectations.

The NSE ESG Disclosures Guidelines are currently operational. Listed companies are therefore expected to include a sustainability/ESG report in their annual integrated reports.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

Good corporate governance practices apply to all entities, with the main source of corporate governance being the Companies Act (Chapter 386 of the Laws of Malta), which regulates the division of authority between the board of directors and general meetings of shareholders. The memorandum and articles of association also act as an important source of corporate governance practices, since this document regulates the internal management and administration practices of companies. Public listed entities are subject to the Code of Principles of Good Corporate Governance set out in the Capital Market Rules issued by the Malta Financial Services Authority (the Code). The Capital Market Rules list 12 principles of good corporate governance that public listed companies should endeavour to adopt. If a company chooses not to comply with one or more of the provisions of the Code, it must give a careful and clear explanation with respect to the reason for such non-compliance. Specifically, issuers shall include in a specific section of their Annual Financial Report a corporate governance statement, which, to the extent to which an issuer departs from the Code, shall include an explanation as to which parts of the Code it has departed from and the reasons for doing so. Furthermore, while it is expected that listed companies will comply with the Code's provisions, it is recognised that departure from the provisions of the Code may be justified in particular circumstances.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The primary government agencies in the corporate space are the Malta Financial Services Authority, which, inter alia, publishes and enforces the Capital Markets Rules, and the Malta Business Registry (MBR), the local company registrar, which ensures compliance with the provisions of the Companies Act.

Apart from these government agencies, there are a variety of well-known business and professional associations in Malta, whose views in the realm of corporate governance are often considered. Some of the more popular business groups include the Malta Chamber of Commerce, Enterprise and Industry; and the Chamber of Advocates.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

The memorandum and articles of association typically require directors to be appointed by a defined majority of the shareholders. In cases where the share capital of a company is composed of different classes of shares, in practice it is common for each class of shareholders to be given the right to appoint one or more directors based on a percentage of shareholding.

Article 140 of the Companies Act provides that a company may remove a director before the expiration of his period of office by a resolution taken at a general meeting of the company and passed by a member or members having the right to attend and vote, holding in the aggregate shares entitling the holder or holders thereof to more than 50 per cent of the voting rights attached to the shares represented and entitled to vote at the meeting. On receipt of a notice of an intended resolution to remove a director, the company shall forthwith send a copy thereof to the director concerned and the director shall be entitled to be heard on the resolution at the meeting. The removal of a director shall create a vacancy which, if not filled at the meeting at which the director is removed, may be filled as a casual vacancy. This procedure for removal may not be derogated from in the company's memorandum and articles of association.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

There is no obligation in terms of law for the board to engage actively with the company's shareholders. In general, the holding of an annual general meeting shall be sufficient for this purpose. Shareholders may, in addition to the annual general meeting, request an extraordinary general meeting to be convened. The Board shall be required to engage with shareholders if the articles of association or a separate shareholders' agreement provide for shareholders' reserved matters, in which case shareholder approval may be required.

The general governance of a company as well as its proper administration and management and the general supervision of its affairs is vested in the board of directors, and hence, shareholder activism is not common practice in Malta. The only exception to this is where the articles of association of the company provide for shareholders' reserved matters, in which case the board of directors must obtain approval from the shareholders before proceeding to take certain decisions. Aside from shareholders' reserved matters, shareholders may exert influence on a corporate entity's management either during the annual general meeting of the company or by calling an extraordinary general meeting by requisition.

As regards the conduct of business at general meetings, all business shall be deemed special (ie, requiring extraordinary resolution) that is transacted at an extraordinary general meeting, and also all that is transacted at an annual general meeting, with the exception of (ie, the following require ordinary resolution):

- declaring a dividend;
- the consideration of the annual accounts and the reports of the directors and auditors;
- the election of directors in the place of those retiring; and
- the appointment of, and the fixing of the remuneration of, the auditor

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

The Companies Act does not prohibit the granting of disproportionate voting rights to shareholders or the limiting of the exercise of voting rights. Voting rights are to be provided for in the memorandum and articles of association of the company. Typically, different voting rights would be achieved by the issuance of different classes of shares.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

In terms of Maltese law, an annual general meeting is to be held once in every year. The annual general meeting shall be held at such time and place as the directors shall appoint.

The annual general meeting is an opportunity for company shareholders to discuss the affairs of the company as well an opportunity to hold the directors of the company accountable to the shareholders. During the annual general meeting, the board of directors are to present the company's annual accounts to the shareholders, who shall proceed to vote on the annual report and audited accounts for the year ended.

Shareholders with voting rights in terms of the memorandum and articles of association of a company shall be entitled to participate and vote at annual general meetings of the company. Furthermore, in terms of article 210 of the Companies Act, in the case of a private company, a resolution signed by all the members for the time being entitled to receive notice of and to attend and vote at general meetings shall be as valid and effective as if the same had been passed at the general meeting of the company duly convened and held.

In July 2020, the legislator introduced new regulations for remote and virtual AGMs for public companies. The regulations provide that AGMs and EGMs may be held remotely, this notwithstanding anything contained in the memorandum and articles of association of a company, subject to a number of conditions. For remotely held meetings, the notice calling such a meeting must include the means used for the virtual meeting and the procedure of how members are entitled to attend and vote, how they can participate in the discussion, and how they can vote.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Apart from general meetings of the company, which are to take place annually, shareholders may propose matters for a vote or call a special meeting by requisition (ie, by asking the directors to convene an extraordinary general meeting). The procedure is regulated in the Act and requires the directors of the company to duly convene an extraordinary general meeting if the requisition is made by a member or members of the company holding not less than one-tenth of the paid-up share capital of the company.

In terms of Maltese law, directors are expected to act in the best interests of the company and for the benefit of its members as a whole. The right to appoint directors vests in shareholders, and it is possible for the memorandum and articles of association of a company to provide for different classes of shareholders to be able to each appoint their own directors to the board. Subject to the terms of the memorandum and articles of association of the company, shareholders shall have the right to nominate directors by means of a shareholders' vote, even if such nomination goes against the wishes of the board.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Shareholders generally do not have specific stewardship, disclosure or other responsibilities with respect to the corporate governance of an entity, other than their obligations to pay up any share capital they promised to contribute to the company and to attend and vote at general meetings of the company. Furthermore, controlling shareholders must ensure that their actions are not unfairly prejudicial to the interests of the members generally or to some part of its members.

In terms of the Companies Act, any member of a company who complains that the affairs of the company have been or are being or are likely to be conducted in a manner that is, or that any act or omission of the company have been or are or are likely to be, oppressive, unfairly discriminatory against or unfairly prejudicial, to a member or members or in a manner that is contrary to the interests of the members as a whole, may make an application to the court. If the court is satisfied that the complaint is well-founded, it may, inter alia, regulate the conduct of the company's affairs in the future; restrict or forbid the carrying out of the proposed act; or require the company to do an act which the applicant complained that the company has omitted to do.

Other enforcement actions that may be taken in the case of breach of duties include the right to requisition an extraordinary general meeting, the right to demand a poll that a particular resolution be put to vote at a general meeting and the right to apply for an investigation into the affairs of the company in terms of the Companies Act.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

A Maltese company acquires formal legal existence or 'legal personality' on the day the Malta Business Registry issues a certificate of incorporation. This legal personality continues until the company is struck off the company register. Once a company has acquired separate personality, it may sue and be sued in its own name, and it acquires rights, obligations and liabilities that are separate from those of its shareholders and officers. By default, therefore, shareholders are not to be held responsible for any acts or omissions of the company.

Employees

10 What role do employees have in corporate governance?

The management of Maltese limited liability companies and public listed companies is typically vested solely in the board of directors. In terms of law, directors are responsible for the general governance of the company and its proper administration and management, as well as for the general supervision of its affairs.

Maltese law does not provide for two-tier board structures under which employees are given a forum to exercise control over the management of the company, nor are employees given an automatic right to representation at board level.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

The Companies Act does not regulate takeover bids. Takeover bids of public limited liability companies whose securities are admitted to trading on a regulated market are primarily regulated by Chapter 11 of the Capital Markets Rules as published by the Malta Financial Services Authority (MFSA). Chapter 11 of the Capital Markets Rules provides that the board of directors of a company must not take or permit any action in relation to the affairs of the target company that could effectively result in an offer being frustrated; or the holders of securities of the target company being denied an opportunity to decide on the merits of the matter.

Exceptions to the above rule are the following:

- if an ordinary resolution has been passed by the target company;
- if the action is taken or permitted under a contractual obligation entered into by the target company; and
- if the action has been permitted with the prior approval of the MFSA.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

The Companies Act provides that any increase in the issued share capital of a company is to be decided upon by an ordinary resolution of the company, unless the memorandum and articles require a higher threshold.

By way of exception, it shall be possible for the shareholders to permit the board of directors (either in the memorandum and articles of the company or by means of an extraordinary resolution) to issue shares up to a maximum amount as may be specified in the same memorandum or articles or extraordinary resolution, which permission shall however be for a maximum period of five years, renewable by ordinary resolution for further maximum periods of five years each.

Any rights of pre-emption are to be granted to existing shareholders in terms of the memorandum and articles of association.

Restrictions on the transfer of fully paid shares

13 Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Restrictions on the transfer of fully paid shares are permitted. Such restrictions would typically include pre-emption rights of existing shareholders and the requirement of the transferring member to inform the board of directors by a notice in writing of his or her intention to sell the shares. It is also possible for the articles of association of a company to provide for a lock-up period (ie, prohibiting a shareholder from transferring his or her shares for a specific period of time).

Compulsory repurchase rules

14 Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Compulsory share repurchases are permitted in terms of Maltese law, and such repurchases can also be made mandatory if expressly catered for in the memorandum and articles of association of the company. Typically, the memorandum and articles of the company would include the purchase price to be paid by the company, as well as the formula for calculation of such purchase price.

Dissenters' rights

15 Do shareholders have appraisal rights?

Chapter 5 of the Capital Markets Rules applicable solely to public listed companies requires that acquisitions and realisations be classified in accordance with the following tests:

- gross asset test: calculated by dividing the gross assets the subject of the transaction by the gross assets of the issuer;
- profits test: calculated by dividing the profits attributable to the assets the subject of the transaction by the profits of the issuer; and
- consideration test: calculated by taking the consideration as a percentage of the aggregate market value of all the ordinary shares of the issuer.

Further to the above, the purchase price for securities that are the object of a mandatory bid must be equitable. If a bid is announced, but before it closes for acceptance, the offeror or any person acting in concert with him or her purchases securities at a higher price than the offer price, the offeror must increase his or her offer to match the highest price paid. The fair price is to be established by an independent expert appointed by the offeror.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

Predominantly, the board structure of a listed company is single-tiered. The Capital Market Rules, however, stipulate that companies having debt or equity securities listed on the Malta Stock Exchange should also have an audit committee, a remuneration committee and a nomination committee.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The duties of directors include, among others, the following:

- the duty to act honestly and in good faith in the best interests of the company;
- the duty to remain within their powers and not to act ultra vires;
- the duty to have no conflict of duty and interest;
- the 'no-profit' rule and use of corporate property opportunity or information;
- the duty not to misuse information;
- the duty not to engage in insider dealing;
- the duty not to compete with the company; and
- the duty to not obtain benefits from third parties.

Where a director of the company knew, or ought to have known, that there was no reasonable prospect that the company would avoid being dissolved due to insolvency, such director may be found liable of wrongful trading. A director may also be held liable for fraudulent trading if it appears that any business of the company had been carried on with the intent to defraud creditors of the company or any other creditors. Directors may, inter alia, also be held personally liable if they fail to keep proper accounting records.

In addition to the foregoing, in the case of public companies the Capital Markets Rules provide that directors are stewards of a company's assets and their behaviour should be focused on, inter alia, adding value to those assets by working with management to build a successful company and enhance shareholder value.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

In terms of Maltese law, directors have a stewardship role, in that they are responsible for managing a company on behalf of its shareholders. Directors, therefore, owe their legal duties to the company and the shareholders of the company whom they represent. Shareholders themselves do not have specific stewardship, disclosure or other responsibilities regarding the corporate governance of an entity, other than their obligations to pay up any share capital they promised to contribute to the company and to attend and vote at general meetings of the company.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Company shareholders have various rights of enforcement action against the company and the members of its board. These include:

- the right to requisition an extraordinary general meeting;
- the right to demand a poll that a particular resolution be put to vote at a general meeting;
- the right to apply for an investigation into the affairs of the company in terms of the Act;
- the right to remove directors before the expiration of their period of office by a resolution taken at a general meeting of the company in terms of the Companies Act; and
- the statutory right to be treated fairly (unfair prejudice) – if the affairs of the company have been or are being or are likely to be conducted in a manner that is or is likely to be, oppressive, unfairly discriminatory against or unfairly prejudicial, to a member or members or in a manner that is contrary to the interest of the members as a whole or if any act or omission of the company has been, or is or is likely to be, oppressive to a member or members or to the interests of the members as a whole, shareholders may seek relief under article 402 of the Companies Act.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

The Companies Act provides that directors of a company shall be obliged to exercise the degree of care, diligence and skill that would be exercised by a reasonably diligent person having both:

- the knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by or entrusted to that director in relation to the company; and
- the knowledge, skill and experience that the director has.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

The duties of individual board members will generally be determined based on the knowledge, judgment, skills, experience and expertise of the individual board members. The duties of directors of public companies will further differ based on whether such directors are executive or non-executive directors. A non-executive director shall be one who is not engaged in the daily management of the company, whereas an executive director shall be engaged in the day-to-day running of the company.

Delegation of board responsibilities

22 To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The model articles of association outlined in the Companies Act provide that a director may from time to time appoint a managing director or a director or directors holding any other executive office from among themselves, delegating to such individual any of the powers exercisable by them upon such terms and conditions and with such restrictions as they may think fit, and either collaterally with or to the exclusion of their own powers and may from time to time revoke, withdraw or vary any such powers. Such appointment shall be for such period and on such terms as the directors think fit, and, subject to the terms of any agreement entered into in any particular case, the directors may revoke such appointment.

The Capital Markets Rules provide that any delegation should be clear and unequivocal, and that directors shall nonetheless remain responsible for all actions or non-actions arising from discussion and actions taken by them or their delegates.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

In terms of Maltese law, every public company shall have at least two directors, and every private company shall have at least one director.

The Capital Markets Rules provide that the board of a public listed company should be composed of executive and non-executive directors, including independent non-executives. A non-executive director is a director who is not engaged in the daily management of the company. A non-executive director has an important role in overseeing executive or managing directors and dealing with situations involving conflicts of interests. Non-executive directors and executive directors have as board members the same responsibilities in terms of law. However, as the non-executive directors are not involved in the day-to-day running of the business, they can bring fresh perspectives and contribute more objectively to supporting as well as constructively challenging and monitoring the management team.

A director is considered to be independent when he or she is free from any business, family or other relationship with the company, its controlling shareholder or the management of either, that creates a conflict of interests such as to the jeopardise the exercise of his or her free judgment.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The Companies Act provides that a minimum of one director is to be appointed to the board of a private company, and a minimum of two directors are to be appointed to the board of a public company. The model articles of association contained in the First Schedule to the Act provide that directors are to retire from office at the annual general meeting of the company; however, they may be eligible for re-election. Shareholders of a company may exclude the provisions of this section by expressly providing for such exclusion in the articles of association of the company.

In the case of public listed companies, the Capital Markets Rules provide that the board should be of sufficient size to ensure that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption. The board should be composed of executive and non-executive directors, including independent non-executives. The Capital Markets Rules provide that a minimum number of directors must be independent. Appointments to the board of directors of a public company should be made on merit and against objective criteria, and directors to be appointed are to be proposed by the Nomination Committee, where such a committee is duly constituted.

There are no restrictions on the nationality and residence of directors sitting on a board of directors in Malta. While diversity requirements including the right balance of knowledge, experience and gender have been proposed in a consultation paper issued by the Malta Financial Services Authority (MFSA) in 2020, the MFSA has stated in a consultation paper issued in 2021 that it does not intend to introduce prescriptive blanket requirements and will instead focus more on the promotion of social diversity (such as gender, race and ethnicity, and age), as well as professional diversity.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

The Companies Act does not provide for the appointment of a chief executive officer. While, in practice, a CEO may be appointed to manage the business of a limited liability company, the Act does not provide for the separation or joining of the functions of the board chairman and CEO.

In public listed companies, the chairman has a pivotal role to play in helping the board achieve its full potential. The chairman should allow every director to play a full and constructive role in the affairs of the company. Hence, there should be separation in the roles of the chairman and the CEO, to avoid concentration of authority and power in one individual and to differentiate leadership of the board from the running of the business. The chairman should also facilitate the effective contribution of non-executive directors in particular and ensure constructive relations between executive and non-executive directors.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

The Code of Principles of Good Corporate Governance annexed to the Capital Markets Rules applicable to listed companies recommends the establishment of the following committees:

- Audit Committee: this committee assists the board in its oversight responsibilities for the internal governance, internal controls, financial statements, risk management and internal audit functions of the MFSA.
- Remuneration Committee: the main duties of the remuneration committee shall be to make proposals to the board on the remuneration policy for directors and senior executives, to make proposals to the board on the individual remuneration to be attributed to executive directors, ensuring that they are consistent with the remuneration policy adopted by the company, and to monitor the level and structure of remuneration of the non-executive directors.
- Nomination Committee: the main functions of this committee shall be to propose to the board candidates for the position of director, to periodically assess the structure, size, composition and performance of the board, to consider issues related to succession planning, and to review the policy of the board for selection and appointment of senior management.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no minimum requirement when it comes to convening board meetings in the case of non-listed entities. Board meetings may be adjourned by directors as they think fit. The model articles of association also provide that a resolution in writing, signed by all the directors for the time being entitled to receive notice of a meeting of the directors, shall be as valid and effectual as if it had been passed at a meeting of the directors duly convened and held.

The Capital Markets Rules provide that the board of a listed company should meet regularly to discharge its duties effectively and, further, that the Audit Committee shall meet at least four times a year.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

The Companies Act does not set out disclosure requirements with respect to the number of board meetings held or the attendance thereat.

For public listed companies, however, as part of the disclosure requirements in the annual report, the board should provide adequate information about its internal organisation and including an indication of the extent to which the self-evaluation of the board has led to any material changes in the company's governance structures and organisation. Furthermore, the annual report should contain a remuneration statement which should disclose information on performance (highlighting any significant changes in the company's remuneration policy as compared to the previous financial year) as well as any changes that the company intends to effect in its remuneration policy for the following financial year.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

While there are no evaluation requirements with respect to limited liability companies, when it comes to public listed companies, the Capital Markets Rules provide that the board should undertake an annual evaluation of its own performance and that of its committees. The Rules further provide that the board should appoint a committee chaired by a non-executive director to carry out a performance evaluation of its role, whose role will be to report directly to the chair, who should act on the results of the performance evaluation process to ascertain the strengths and to address the weaknesses of the board and to report to the board, and where appropriate, to report to the annual general meeting.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

Directors on the board are typically compensated by means of a directors' fee, which is to be determined by a contractual agreement to be entered into between directors and the company. The model articles of association provide that the remuneration of directors shall be determined from time to time by the company in general meeting. Other than the above, Maltese law does not regulate directors' remuneration.

Maltese law prohibits companies from making a loan to any person who is its director or a director of its parent company, or to enter into any guarantee, unless such a loan has been granted with the approval of the company given at a general meeting, or if the ordinary business of the company includes the lending of money or the giving of guarantees in connection with loans made by other persons.

The Capital Markets Rules provide that the remuneration policy for directors and senior executives shall be established by the Remuneration Committee. The Code of Principles of Good Corporate Governance provides that the Committee should devise appropriate packages needed to attract, retain and motivate directors (both executive and non-executive). It should, however, avoid paying more than is necessary to secure the people with the appropriate skills and qualities. In carrying out this function the Remuneration Committee should judge where to position its company relative to other companies in the marketplace.

Remuneration of senior management

31 | How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

Maltese law is silent on how the senior management of limited liability companies is to be remunerated.

In the case of public listed companies, the Capital Markets Rules provide that the remuneration policy for senior executives shall be established by the Remuneration Committee. The Code of Principles of Good Corporate Governance provides that the Committee should devise appropriate packages needed to attract, retain and motivate directors (both executive and non-executive).

Say-on-pay

32 | Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

A managing director or director holding any other executive office shall receive such remuneration as the directors, subject to the approval of the company in general meeting, may from time to time determine.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Professional indemnity insurance is permitted to cover board members' potential personal liability. While not an obligation imposed by law, such indemnities and insurance covers are becoming increasingly common practice within the Maltese jurisdiction. Premiums may be paid by the company.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

The model articles of association state that every managing director, director holding any other executive office or other director, and every agent, auditor or company secretary and in general any officer for the time being of the company shall be indemnified out of the assets of the company against any liability incurred by him or her in defending any proceedings in which judgment is given in his or her favour or in which he or she is acquitted. Such indemnities are becoming increasingly common practice within the Maltese jurisdiction.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Subject to the articles of association of the company, Maltese law generally does not prohibit companies from indemnifying directors and officers in connection with litigation or other proceedings against them.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

Other than by including an indemnity provision in the articles of association of a company, it is not possible for companies or shareholders to preclude or limit the liability of directors and other officers.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

Memorandum and articles of association of limited liability companies are available from the local company registrar, and may be downloaded online from the Malta Business Registry (MBR) website: mbr.mt

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

Private limited liability companies and public limited companies must submit their accounts to the MBR, which then makes them public by uploading them to the MBR website. Prior to delivering a copy of the accounts to the Registrar for publication, the accounts must be approved by the company in a general meeting. For private companies, such period for approval shall be 10 months after the end of the relevant accounting period. For a public company, such period for approval shall be seven months after the end of the relevant accounting period. Company directors shall have 42 days from the end of the relevant approval period to deliver a copy of the company's annual accounts to the Registrar for registration.

Publicly listed companies must, in terms of the Capital Markets Rules, publish their unaudited half-yearly financial report as soon as it has been approved by the directors, and in any case, not later than two months after the end of the relevant period. Furthermore, a public listed company must make its audited annual financial report available to the public no later than four months after the end of each financial year. The Capital Markets Rules provide that the annual financial report must include a corporate governance statement outlining the principles of the corporate governance code from which the company departed and the reasons for doing so. Public listed companies are to publish their half-yearly and annual financial reports by means of a company announcement to be issued through the Malta Stock Exchange.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Any member entitled to attend and vote at a meeting of the company shall be entitled to appoint another person, whether a member or not, as a proxy to attend and vote instead of him or her. A proxy shall have the same rights as the member to speak at the meeting and to demand a poll. All appointments of a proxy are to be made in writing.

In the case of public companies, the Companies Act (Public Companies – Annual General Meetings) Regulations 2020 state that shareholders shall only be able to appoint the chairman of the meeting as their proxy and they are to indicate on the form of proxy the manner in which such proxy is to vote on each resolution put to the meeting.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

The general governance of a company as well as its proper administration and management and general supervision of its affairs shall be vested in the board of directors, and hence, shareholder involvement is not common practice in Malta. Shareholders may influence the board of directors in the following scenarios:

- if the articles of association provide for shareholder reserved matters;
- during the annual general meeting of the company; and
- by requisitioning an extraordinary general meeting.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

Maltese companies (both limited and public companies) are to date not subject to specific corporate social responsibility requirements. However, directors of public listed companies are required to adhere to accepted principles of corporate social responsibility in their day-to-day management practices of their company. The Code of Corporate Governance in the Capital Markets Rules encourages public listed companies to take up initiatives aimed at augmenting investment in human capital, health and safety issues, and managing change, while adopting environmentally responsible practices related to the management of natural resources used in production processes. Public listed companies are furthermore expected to act as corporate citizens in the local community. Public listed companies are also expected to go through material relating to the theme of corporate social responsibility, and to generally keep abreast with initiatives being taken in the local and international scenario.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

There is no obligation on Malta registered companies to disclose pay ratios.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

Maltese law does not require the disclosure by companies of gender pay gap information.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

A significant trend and talking point that has been focused on in the past year has been environmental, social and governance requirements (ESG). Maltese limited liability companies are to date not subject to specific ESG requirements, although, in practice, many entities voluntarily allocate resources to ESG and corporate social responsibility in general.

The Malta Financial Services Authority (MFSA), which grants licences to entities that seek to provide financial services, has recognised that the European Commission has placed sustainable finance among its main priorities. In this regard, the MFSA has made sustainable finance a key priority of its Strategic Plan.

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Summary

SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

All mercantile entities are regulated by the General Law of Business Organisations, which establishes the different types of commercial entities that can be formed in Mexico, as well as the general provisions to be included in their by-laws, including governance matters. Although said law regulates several forms of business organisations, in practice, some have become obsolete, whereas the most common forms are stock corporations and limited liability companies.

The Securities Market Law sets forth the legal framework and rules applicable to investment promotion stock corporations and listed companies in the form of publicly traded corporations, including regulation with respect to the formation and responsibilities of the boards and committees, minority rights and voting agreements, among others.

Publicly traded corporations, which are those with shares registered before the National Securities Registry and listed on an authorised stock exchange, are primarily regulated by the Securities Market Law as mentioned above, the Mexican General Regulations Applicable to Securities Issuers, the Mexican General Regulations Applicable to Entities and Issuers Supervised by the National Banking and Securities Commission that hire auditing services with respect to financial statements and the General Law of Business Organisations, with respect to corporate governance, transparency and disclosure and other maintenance requirements for publicly traded corporations.

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There are specific corporate governance provisions applicable to certain regulated entities, such as banks, financial corporations, insurance companies and other financial institutions, which are set forth in the relevant laws and regulations governing those entities.

The Best Corporate Practices Code provides a compilation of the best corporate governance practices for Mexican companies, prepared under the corporate governance framework of the Organization for Economic Cooperation and Development; the provisions set forth therein are voluntary for non-listed companies and publicly traded corporations are required to inform the corresponding stock exchange and the public of the extent or degree to which their corporate governance practices adheres to such code.

Finally, the by-laws may contain additional governance practices to the extent that they do not contravene the laws.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

There is no governmental agency responsible for enforcing corporate governance rules for non-listed companies; however, compliance with this regulatory framework is monitored by shareholders, the board of directors, statutory or external auditors, and third parties such as lenders. In the event of conflicts or disputes, the enforcing authority would be the competent judicial court (whether federal or local). The entity responsible for amending the General Law of Business Organisations or the Securities Market Law is the federal legislative power known as the Congress of the Union, composed of the Chamber of Deputies and the Senate.

Regarding publicly traded corporations, the National Banking and Securities Commission is the entity in charge of surveillance and shall issue and amend any secondary regulations. Other regulated entities may be subject to the supervision of the relevant agency and the Ministry of Finance.

In Mexico there are no shareholder groups or specific proxy advisory firms whose views are often considered. Shareholders follow the advice of their boards of directors and legal advisors.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

The shareholders' meeting appoints and removes the members of the board of directors. Unless otherwise provided in the by-laws of a company, the shareholders may appoint and remove them by a majority vote. The General Law of Business Organisations sets forth that if there are three or more members of the board of directors, the by-laws shall provide the rights corresponding to the minority shareholders to appoint members of the board, but in any case, minority shareholders representing 25 per cent of the capital stock shall have the right to appoint at least one member. For investment promotion stock corporations and publicly traded corporations, the shareholders representing 10 per cent of the capital stock shall have the right to appoint at least one member, and the removal of such member by the remaining shareholders (ie, the non-appointing shareholders) may only take place if the shareholders intend to remove all of the members of the board of directors.

The General Law of Business Organisations also establishes that the shareholders' meeting shall appoint, remove or ratify the members of the board of directors or sole directors, at least on a yearly basis; in practice, however, such a change is made whenever the business needs it.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

Pursuant to the General Law of Business Organisations, the shareholders' meeting is the supreme body of any commercial entity. Therefore, such body has full power and authority to approve any matter concerning the company's affairs. Whereas some matters may be resolved by either the shareholders' meeting or the management body, among others, the following decisions are reserved to the shareholders:

- approval of financial statements and the annual report prepared by the management body;
- appointment and removal of the board of directors and the statutory auditor(s);
- early dissolution;
- increase or decrease of the capital stock;
- change of the corporate purpose or nationality;
- transformation or merger;
- issuance of preferred shares;
- amendments to the by-laws; and
- any other decision reserved to the shareholders pursuant to the by-laws of the company.

Matters involving the organisational structure of the company and matters for which the law requires a special quorum are reserved to extraordinary shareholders' meetings.

Under Mexican law, there are no specific matters that shall be submitted to a non-binding shareholder vote; however, the by-laws of any company may include provisions regarding voting restrictions applicable to certain types of shares.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Generally, at meetings, shareholders shall be entitled to one vote per each share they hold; however, the by-laws may provide for classes or series of shares that may grant different rights (ie, limited voting, non-voting, preferred shares). Furthermore, pursuant to the General Law of Business Organisations, companies may include in their by-laws provisions regarding the issuance of shares that:

- do not confer or confer limited voting rights;
- grant non-economic rights other than the right to vote or exclusively the right to vote; or
- grant veto rights or require the favourable vote of one or more shareholders.

Whereas some restrictions for excluding shareholders from profit sharing apply for stock corporations and limited liability companies, there is no such restriction for investment promotion stock corporations.

As a general rule, publicly traded corporations may only issue ordinary shares where the rights of their respective holders are not limited or restricted; however, they may issue different series of shares with the authorisation of the National Banking and Securities Commission, provided that non-voting shares, restricted voting shares and limited voting shares may not exceed 25 per cent of the shares held by the general public (or float).

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Meetings must be held at the company's corporate domicile to be valid, except in the case of acts of God or *force majeure*. In Mexico, corporate domiciles are set forth by each company in its by-laws and often it is expressed as a city and not a particular address (ie, Mexico City). Prior notice must be sent to all shareholders of the agenda, time and date of the meeting. Notice must be given at least 15 days before the meeting for stock corporations and eight days for limited liability companies unless otherwise stated in the by-laws. However, the shareholders' meeting shall be deemed legally installed and prior notice is not required if 100 per cent of the company's share capital is represented at the meeting, although publicly traded corporations must always give at least a 15-day notice using the electronic system for publications.

Nevertheless, the General Law of Business Organisations sets forth that the by-laws may provide unanimous resolutions in lieu of a shareholders' meeting, which shall have the same validity as a shareholders' meeting, to the extent that they are confirmed in writing.

Shareholders may be represented at the meetings by a proxy, who may be or may not be part of the company, but in any case, a proxy cannot be a member of the board of directors or a statutory auditor.

In connection with virtual meetings, regarding commercial entities, since 2022 legislators are discussing the amendment of certain relevant laws to recognise shareholders' and partners' meetings held via videoconference as valid, allowing shareholders and partners to hold meetings by electronic means. In the event that such a proposal is approved, the commercial entities must regulate in greater detail in their bylaws the processes and specific rules on how to conduct such meetings.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

The authority to call a shareholders' meeting lies with the board of directors or sole director, as applicable, or to the statutory auditors. In stock corporations, shareholders representing at least 33 per cent of the company's share capital can, at any time, request the sole director, board of directors or the statutory auditors to call a shareholders' meeting to discuss matters stated in the request. If the meeting is not called within 15 days of receipt of the request, the meeting can be called by a court resolution at the shareholder's request.

In investment promotion stock corporations and publicly traded corporations, shareholders owning at least 10 per cent of the voting shares (including limited or restricted voting rights) can, at any time, request the president of the board of directors, the statutory auditor, the company's external auditors or a board committee to call a meeting to discuss relevant issues.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Under Mexican law, there are no specific provisions regarding special duties, such as fiduciary duty, owed by the controlling shareholders in favour of the company or the non-controlling shareholders. However, shareholders shall abstain from voting in such matters where the corresponding shareholder has a conflict of interest. A shareholder failing to comply with such provision can be subject to damages and losses that affect the company.

Furthermore, shareholders representing 25 per cent of the capital stock of stock corporations or 20 per cent of the capital stock of investment promotion stock corporations may oppose the resolutions approved by the shareholders' meeting through a judicial procedure, provided they have voting rights with respect to the matters approved in such disputed resolutions.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Shareholders are only liable for the amount of their capital contributions. If a company is not duly registered with the Public Registry of Commerce, shareholders or partners may be held jointly liable for certain acts and omissions of the company in violation of tax and criminal laws.

Furthermore, partners or shareholders shall be jointly liable with respect to tax claims in the part that cannot be covered by the assets of the company, without exceeding the amount of their capital contributions, among others, in the event that the company does not comply with certain tax obligations.

The tax liability will only be applicable to the partners or shareholders who have or had effective control of the company, with respect to the tax claims when they had such capacity as partners or shareholders. Effective control is defined in the Federal Tax Code as the authority to:

- impose decisions in shareholders' meetings, or appoint or remove the majority of the board of directors or equivalents;
- have the right to exercise the vote with respect to more than 50 per cent of the capital stock of the company; and
- direct the administration, strategy or main policies of the company, whether through the ownership of shares, by contract or otherwise.

Employees

10 What role do employees have in corporate governance?

Under the General Law of Business Organisations or the Securities Market Law, there are no specific provisions regarding the role or obligations of employees in connection with corporate governance. Moreover, there are no requirements under Mexican law for employee or union representation on boards of directors or committees. Nevertheless, on a case-by-case basis, companies may adopt policies or guidelines imposing specific obligations for its employees with respect to corporate governance activities.

CORPORATE CONTROL

Anti-takeover devices

11 Are anti-takeover devices permitted?

There are no specific provisions that prohibit anti-takeover devices. Regarding publicly traded corporations, their by-laws may contain anti-takeover provisions (the poison pill being the most common mechanism) to the extent that such provisions:

- are approved by an extraordinary shareholders' meeting where no more than 5 per cent of the shares vote against such provisions;
- do not exclude one or more shareholders different from the person that intends to obtain control, from the economic benefits that derive from such provisions;
- do not restrict in its entirety the control of the company; and
- do not contravene the relevant mandatory tender offer provisions of the Securities Market Law or nullify the exercise of economic rights by the corresponding acquiror.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Pursuant to the General Law of Business Organisations, any issuance of new shares shall be approved by the shareholders' meeting. Regarding the pre-emptive rights to acquire shares, the General Law of Business Organisations sets forth that shareholders shall have a pre-emptive right to subscribe the newly issued shares in the event of an increase in the capital stock of the company, in proportion to the number of their shares. With respect to investment promotion stock corporations, the by-laws may contain provisions that amplify, restrict or deny the pre-emptive rights set forth in the General Law of Business Organisations. Regarding publicly traded corporations, the above-mentioned pre-emptive right will not apply to capital increases by means of a public offering.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Yes, companies are allowed to include in their by-laws restrictions for the sale or transfer of shares, such as requiring the prior approval of a shareholders' meeting or the board of directors. Additionally, by-laws may include further share transfer rules, such as tag-along, drag-along, put and call options and other similar rights and obligations.

Furthermore, limited liability companies require the approval of the partners' meeting for the transfer of equity quotas to a person alien to the company.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Put and call options are valid; however, under Mexican law, there are no provisions regarding compulsory share repurchase. Investment promotion stock corporations and publicly traded corporations may repurchase their shares in compliance with the provisions set forth in the Securities Market Law; notwithstanding the foregoing, by-laws may include specific cases in which to require the repurchase of shares as long as the provisions set forth in said law are complied with.

Dissenters' rights

15 | Do shareholders have appraisal rights?

The General Law of Business Organisations provides that the by-laws of a company shall include the scenarios for shareholders to exercise their retirement right and provisions regarding the mechanisms to be followed in case of a deadlock where the shareholders fail to reach an agreement with respect to certain specific matters, inter alia.

Also, the General Law of Business Organisations sets forth that any opposing shareholder with respect to resolutions adopted by a shareholders' meeting in connection with a change of corporate purpose, change of nationality, the transformation of the company, or spin-off, shall have the right to sell their stock and obtain reimbursement for their shares, in proportion to the company's assets.

In limited liability companies, partners have the right to retire from the company when a person alien to the company is appointed as a member of the board or sole manager, to the extent that the retiring partner has voted against such appointment.

With respect to publicly traded corporations, shareholders that own stock of the variable portion of the capital stock do not have the right to separate from the company as provided for stock corporations by the General Law of Business Organisations.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

Under Mexican law, the board of directors of a publicly traded corporation is assisted by one or more special committees responsible for audit and corporate practice matters, which are entitled to carry out various activities regarding, among others, the supervision of corporate governance and the assistance provided to the board of directors in connection with corporate matters and surveillance.

The Best Corporate Practices Code issued by the Mexican Business Coordinating Council recommends that companies set up committees for audit, evaluation and compensation, finance and strategic planning, and risk assessment and compliance. It also recommends that these committees are formed mostly of independent directors, with a minimum of three and a maximum of seven directors.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The board of directors oversees all matters concerning the management of the company. In accordance with the General Law of Business Organisations, directors shall have the responsibilities inherent to their mandate and those arising from their obligations pursuant to law and the by-laws. The shareholders may limit the board of directors' authority in the by-laws, and such restrictions are enforceable against third parties.

In publicly traded corporations, the board of directors is expressly released from handling day-to-day activities. The general director or chief executive officer is in charge of:

- day-to-day activities;
- the existence of accounting, internal audit and control systems;
- surveying compliance; and
- disclosure of material information.

Furthermore, the board of directors will carry out its activities with the assistance and support of the corporate practices committee, the audit committee and other special-purpose committees created to focus on specific tasks (such as compensation and risk management), and the external auditor.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board of directors represents and manages the company and owes legal duties to it.

The directors are jointly and severally liable with the company with respect to, among others:

- maintaining the capital contributions made by the shareholders;
- any non-compliance with the General Law of Business Organisations and the by-laws relating to declaring and paying dividends (including liability for dividends paid exceeding those legally available);
- the existence and maintenance of the company's accounts and other books and records; and
- due compliance with shareholder resolutions.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

The Securities Market Law sets forth a civil liability legal action against directors and relevant officers of publicly traded corporations, which can be exercised either by the company or its shareholders who own at least 5 per cent of the capital stock. The Securities Market Law further establishes that, under certain circumstances and when acting in good faith, directors will be excluded from such liability. In stock corporations, shareholders representing 25 per cent of the capital stock may initiate a civil liability legal action against directors, when:

- the claim includes the total amount of liabilities incurred by the directors in favour of the company, and not only the amount corresponding to the plaintiffs' personal interest; and
- the plaintiffs voted against the shareholders meeting's resolution whereby it was agreed to release directors from their liabilities.

In investment promotion stock corporations, such action may be enforced by shareholders representing at least 15 per cent of the capital stock.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Generally, members have a fiduciary duty towards the shareholders and the company. They have the responsibilities and duties that are inherent to their position towards the company, shareholders and third parties (which includes, in a broader sense, care and prudence elements). In terms of applicable laws and the corresponding by-laws of the company, board members shall protect and look out for the company's interests and refrain from participating in decisions in which they have a conflict of interest.

The Securities Market Law sets forth the following fiduciary duties upon members of the board of directors and committees, the general director or chief executive officer and relevant officers of publicly traded corporations: duty of care and duty of loyalty. Furthermore, they shall abstain from participating and being present in the discussion and voting of any item where they have a conflict of interest.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

There are certain positions within the board of directors that may have additional duties or responsibilities. For example, the General Law of Business Organisations provides that the chair of the board of directors, unless otherwise provided in the by-laws, has a tie-breaking vote in resolutions adopted by the board of directors and shall be in charge of the formalisation and execution of the resolutions adopted by the board of directors.

The by-laws of companies may set forth certain skills, experience or any other characteristics that the board members or certain officers shall comply with to be able to be appointed in such a position.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

Under the General Law of Business Organisations, the director and member of the board positions are personal and shall not be performed through representatives. However, the board of directors can appoint a board member as a special delegate to carry out specific tasks. Nevertheless, the foregoing does not limit the board's legal and statutory liability. Furthermore, the board or sole director may confer powers of attorney to other persons to be exercised on behalf of the company for the performance of diverse responsibilities (within the scope of the board's respective authority), which may be revoked at any time.

Also, the company can grant powers of attorney to directors to act individually, as an attorney-in-fact and not as a director. Powers of attorney granted to a director can be limited.

The board of directors of publicly traded corporations is assisted by one or more special committees responsible for audit and corporate practice matters.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Stock corporations and limited liability companies are not required to appoint independent directors but can do so in their by-laws. Under the Securities Market Law, at least 25 per cent of the board members of a publicly traded corporation must be independent.

An independent director is a person who has no considerable influence in the company, nor any power of command, and is not part of the management team of the listed company. Therefore, the independent director is impartial towards the company, not having any conflict of interest or personal interest and is appointed as an independent expert based on his or her expertise, capacity and professional reputation.

The Best Corporate Practices Code and the Securities Market Law provide a list of persons who are not considered independent directors.

For publicly traded corporations and investment promotion stock corporations, the Securities Market Law also provides that a shareholder who is part of a controlling group of shareholders is not an independent director.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

In the case of stock corporations and limited liability companies, management may be entrusted to a sole director or manager or to a board of directors or managers. The board shall be composed of at least two members. If the board has three or more members, the by-laws shall determine the rights that minority shareholders shall have for the appointment of such members, but, in any case, the minority representing at least 25 per cent of the capital stock shall appoint at least one member. For publicly traded corporations, this percentage shall be 10 per cent; for investment promotion stock corporations, shareholders that jointly or individually hold 10 per cent of the shares with voting rights (even if limited or restricted) may appoint or remove a member of the board.

Only the shareholders' meeting is entitled to make appointments to fill vacancies on the board, and, exceptionally, in the event of vacancies resulting in the lack of a quorum for adopting resolutions, the statutory auditor of the company may appoint provisional members. There are no specific provisions or differences in connection with newly created directorships.

Pursuant to the Securities Market Law, the board of directors of publicly traded corporations shall be integrated by a maximum of 21 members, of which 25 per cent must be independent. As provided in the Securities Market Law, the board of directors may appoint provisional members in exceptional vacancy cases, whenever a member is not replaced by the shareholders within a 30-day period or if such a vacancy results in the lack of a quorum for adopting resolutions.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

There is no law or regulation in this regard. However, separating the function of board chair and chief executive officer is generally recognised as best practice. The rationale behind this practice is that the chief executive officer is supposed to be supervised by the board.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

The General Law of Business Organisations does not provide a requirement for mandatory board committees; however, companies may create board committees as permitted by their by-laws.

The Securities Market Law establishes that the board of directors of publicly traded corporations may be assisted by one or more committees created for that purpose. The committee or committees that carry out activities in connection with corporate practices and auditing shall be exclusively integrated by independent directors and by a minimum of three members appointed by the board of directors. In the event that the company is controlled by a person or group of persons that hold 50 per cent or more of the capital stock, the corporate practices committee shall be formed by, at least, a majority of independent directors.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no minimum number of board meetings required by law. However, in accordance with the General Law of Business Organisations and the Securities Market Law, the shareholders must hold at least one annual shareholders' meeting, within the first four months of each year, approving, among other matters, the report submitted by the board or management body of the company, with respect to the company's performance in a calendar year, as well as the policies adopted by directors and, as applicable, the main existing projects of the company. Thus, although there is no specific requirement for a formal board meeting, it is customary that the board gathers at least once a year to discuss and prepare the foregoing report to be submitted for the shareholders' approval in their annual meeting.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

No disclosure of board practices is required. However, regarding publicly traded corporations, because they are obliged to disclose certain documents and resolutions that contain the appointment, structure, functions and duties of the board (ie, an annual report and shareholders' resolutions), such information is thereby disclosed. Additionally, there are some specific resolutions that publicly traded corporations are required to disclose in certain circumstances (ie, authorisation for launching a tender offer).

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

In stock corporations, the shareholders can appoint one or more statutory auditors to oversee the performance of the board of directors and must file a report to the shareholders' meeting, including their opinion regarding management's performance.

Statutory auditors must be appointed in stock corporations, but this is not mandatory for limited liability companies. In publicly traded corporations, this role is performed through the audit and corporate practices committees and the external auditors. Investment promotion stock corporations can be managed as a stock corporation or a publicly traded corporation.

In most entities, board evaluation is an annual exercise by choice. The evaluation methodology and the process have some degree of flexibility. The process is usually tailored to the needs of the entity, the specific situation it is in, the corporate structure, the board culture and the internal set processes. However, there is no common format applicable to all entities.

Unless otherwise prescribed by internal regulations, annual evaluation is the most commonly followed cycle for board evaluation. Most commercial entities make the evaluation cycle consistent with the annual shareholders' or partners' meeting in which the financial report prepared by the board and, if applicable, the statutory auditor's report on management's performance are approved. As a result of such approval, and evaluation, the shareholders' or partners' could modify the board's composition or ratify its members and, as required, take action against members for failure to comply with their mandate as set forth above.

Although the laws do not expressly require it, the best practice would be to carry out a periodic performance evaluation of the board and its members' fiduciary duties.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

Other than the obligation for the shareholders' meeting to review or determine the remuneration for the members of the board of directors annually, there are no specific rules or provisions. Publicly traded corporations must disclose in their annual reports the total benefits (including a description of their nature) and remuneration paid to board members and high-level officers and related persons, although disclosure is usually made on an aggregate basis.

The Best Corporate Practices Code recommends internal policies to define the directors' responsibilities, key performance indicators, selection process and remuneration. It is also recommended to disclose the remuneration policy in the annual report.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

There is no law or regulation governing the remuneration of senior management of stock corporations and limited liability companies.

Pursuant to the Securities Market Law, the board of directors of publicly traded corporations shall approve, among others, the appointment and remuneration policies with respect to high-level managers, as well as the policies for granting loans, credits or guarantees in favour of such managers; however, there is no regulation or guideline regarding how such policies shall be determined.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Although it is not common that shareholders have an advisory or other vote regarding executive remuneration, the shareholders' meeting is the supreme body of a commercial company; thus, it is entitled to vote on those matters. Normally, executive remuneration is part of the business plans prepared and approved by the board of directors; those plans may be filed before the shareholders' meeting for approval.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted. Some companies take out directors' and officers' insurance to cover actions and liability incurred by directors and officers against the company. It is common practice for publicly traded corporations to take out this type of insurance as permitted by the Securities Market Law, provided that the damages caused by their actions to the company do not derive from fraud, wilful misconduct, bad faith or unlawful acts under Mexican law.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Publicly traded corporations may agree on indemnities and directors' and officers' insurance, bonds or sureties covering the amount of the indemnity for damages caused by directors' and officers' actions to the company, except in the case of fraud, wilful misconduct, bad faith or unlawful acts under the Securities Market Law or other laws and regulations.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

There are no requirements in this regard. However, the shareholders may agree to include the related provisions in the by-laws of the company.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

A director's liability can be limited to a specific amount of incurred damages if provided by the company's by-laws or approved by the shareholders' meeting. The shareholders' meeting can pardon or indemnify a director against liability due to malpractice and not exercising due diligence if the director acted in good faith and the incurred damages have been covered or recovered by the director. The company or its shareholders cannot indemnify a director against liability for any action taken in connection with fraud, wilful misconduct, bad faith or unlawful acts under the Securities Market Law or other laws and regulations.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

Once incorporated, companies shall file and register their articles of incorporation and by-laws before the Public Registry of Commerce corresponding to their corporate domicile. In practice, such registry only discloses excerpts of the main clauses of the by-laws of the companies to the public upon request.

Publicly traded corporations' articles of incorporation and by-laws are available in the electronic public registry of the stock exchanges and on their websites.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

Pursuant to the Code of Commerce, it is mandatory for companies to file and register their articles of incorporation and by-laws before the Public Registry of Commerce. Additionally, stock corporations and limited liability companies must disclose the registry of shareholders or partners, respectively, and the transfer of shares or equity quotas that are recorded in the company's shareholders' or partners' registry book. In such publications, the Ministry of Economy must keep the shareholder's name, nationality and domicile confidential, except for those cases in which the judiciary or administrative authorities request the disclosure of the information.

Public companies are required to furnish periodically certain information to the National Banking and Securities Commission and to the stock exchange, including an annual report, quarterly and annual financial reports, press releases and other corporate governance and compliance matters.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Shareholders may nominate directors in accordance with the process or requirements set forth in the by-laws. Under Mexican law, there are no specific proxy access provisions.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

Generally, engagement occurs during shareholders' meetings. The relationship between the company and its shareholders is carried out through the board of directors, the chair of the board and the secretary of the board and is usually during the annual meeting season.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

There are no obligations in connection with the disclosure of corporate social responsibility (CSR) matters set forth in the Mexican law. Therefore, CSR is not mandatory, but it is common for companies to launch CSR projects and engage outside interests voluntarily.

Under specific requirements arising from environmental laws, companies are required to report, among other items, their issuance of contaminating pollutant emissions and greenhouse gas emissions to record and implement the corresponding measures to mitigate the adverse effects of such emissions. Additionally, the Mexican stock exchanges have implemented sustainability evaluations whereby companies must produce and submit sustainability reports to be rated in sustainability indexes and reports.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

There are no mandatory requirements.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

There are no mandatory requirements.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Taking international and European trends as an example, financial agents and institutional investors are paying more attention to entities that focus their growth strategies and actions around sustainable practices. To standardise the way in which organisations manage environmental, social and corporate governance (ESG) issues, Latin American countries have followed the European Union's lead and have begun to issue ESG regulations applicable to entities. Although Mexico does not yet have ESG regulation at the national level, several states in the country have approved tax requirements that are subject to ESG issues. In this sense, entities that make excessive use of water or generate large polluting emissions will have to pay 'green taxes' at a local level.

While entities that are subsidiaries of large multinational corporations already take ESG issues into account to comply with regulations established in their parent countries, this trend has led Mexican entities to focus on these issues since customers, suppliers, creditors, investors and shareholders demand increasingly detailed, measurable and verifiable information about organisational performance to make entities report ESG policies, making companies within each industry 100 per cent comparable.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The primary sources are the Dutch Civil Code, the Dutch Financial Supervision Act, the Dutch Corporate Governance Code, the Euronext Listing Rules, EU regulations and Dutch case law. It is mandatory for listed companies to comply with the Euronext Listing Rules. The Dutch Corporate Governance Code, which contains best practice provisions for listed companies, applies on a 'comply or explain' basis. As of 1 January 2018, the Dutch Corporate Governance Code has been enshrined in Dutch law. Listed companies are required to account for compliance with the Dutch Corporate Governance Code in their directors' report.

As of 1 January 2023, an updated version of the Dutch Corporate Governance Code has entered into force. Where principles or best practice provisions in this code, compared with the previous version of the code, require changes to rules, regulations, procedures or other written records, a company will be deemed to be compliant with this code if such changes have been implemented no later than 31 December 2023.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

Laws are made through the joint effort of the Dutch government, together with the Upper House and the Lower House. Usually, the government submits a bill, which was originally the initiative of a specific ministry; however, any member of the Lower House (but not the Upper House) may also submit a bill. The government often presents draft bills to the public for consultation, enabling anyone to comment on the draft bill. These comments, usually including comments from interest groups and prominent law firms, may influence the ultimate bill, but it is up to the Lower House and the Upper House to adopt the bill.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

In principle, an individual shareholder does not have the power to appoint or remove directors as this requires a resolution by the general meeting (unless a separate class of shares is introduced for such shareholder). However, a shareholder who meets certain criteria can request that the management board add an item to replace managing and supervisory directors on the agenda of the general meeting. The power of the general meeting to appoint and remove managing and supervisory directors can be restricted. In addition, if the item that the shareholder wants to be put on the agenda may result in a change in the company's strategy (eg, as a result of the dismissal of managing or supervisory directors) the management board should be given the opportunity to stipulate a reasonable period in which to respond (the response time). This follows from the Dutch Corporate Governance Code.

The Dutch Supreme Court has consistently ruled that the adoption of policies and strategy is, in principle, a matter for the management board. By extension, the Dutch Supreme Court has ruled that a shareholder cannot force the management board to bring an agenda item that falls within the competence of the management board to a vote in a general meeting. Therefore, it will be difficult for shareholders to require the board to pursue a particular course of action by requesting the change in strategy to be put to a vote in a general meeting.

Most listed companies have limited the rights of the general meeting to appoint and dismiss managing and supervisory directors in such a way that the resolution requires a (non-binding) nomination to be prepared by the supervisory board or, in some cases, by the meeting of holders of priority shares. A resolution to appoint a managing director or supervisory director nominated by the supervisory board must be adopted by an absolute majority of the votes cast.

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The general meeting of shareholders of a company not having statutory two-tier status (*structuurregime*) may adopt a resolution to cancel the binding nature of a nomination for the appointment of a member of the management board or of the supervisory board and/or a resolution to dismiss a member of the management board or of the supervisory board by an absolute majority of the votes cast. It may be provided that this majority should represent a given proportion of the issued capital, which proportion must not be set higher than one-third. If this proportion of the capital is not represented at the meeting, but an absolute majority of the votes cast is in favour of a resolution to cancel the binding nature of a nomination, or to dismiss a board member, a new meeting may be convened at which the resolution may be adopted by an absolute majority of the votes cast, regardless of the proportion of the capital represented at the meeting.

A different appointment and removal system applies to structure regime companies. The Dutch structure regime applies to companies (irrespective whether these are listed or not) that meet the following criteria: total equity of at least €16 million; the presence of a works council; and at least 100 employees working in the Netherlands with the company and its group companies. In these companies, the involvement of the supervisory board and the works council in the appointment of supervisory directors is greater than in other companies.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The following matters, among other things, are, in principle, reserved for general meetings:

- the appointment, suspension and dismissal of managing directors and supervisory directors;
- the determination of the general remuneration policy of the management board;
- the adoption of the annual accounts;
- the amendment of the articles of association;
- the issuing of shares and granting of rights to subscribe for shares, unless this authority has been delegated to another corporate body for a maximum period of five years;
- the restriction or exclusion of pre-emptive rights in relation to a share issuance, unless this authority has been delegated to another corporate body for a maximum period of five years;
- the delegation to another corporate body of the authority to issue shares, grant rights to subscribe for shares and restrict or exclude pre-emptive rights;
- the authorisation of the management board to repurchase shares (only for NVs);
- the reduction of the issued share capital;
- the approval for resolutions of the management board that result in changes of the identity or the character of the company or its enterprise;
- the distribution of dividends or distributable reserves;
- the dissolution of the company;
- the merger or demerger of the company;
- the appointment of auditors; and

- only applicable to an NV, resolutions of the management board regarding an important change in the identity or character of the company or the enterprise conducted by it, in any case:
  - the transfer of the entire business or almost the entire business to a third party;
  - starting or breaking up an important cooperation arrangement of the company itself or any of its subsidiaries insofar as this is of significant importance; and
  - invest or dispose of an interest with a value of at least one-third of the assets as shown on the balance sheet (or, insofar as applicable, the consolidated balance sheet) of the company.

Dutch law does not require matters to be subject to a non-binding shareholder vote, but the company's articles of association may stipulate otherwise.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

The starting point is that each shareholder may cast as many votes as he or she holds shares. If the authorised share capital was divided into shares of an unequal nominal amount, the number of votes that may be cast by each shareholder is equal to the total nominal amount of his or her shares divided by the nominal amount of the smallest share. Thus, disproportionate voting rights can be created by issuing two types of shares with different nominal values (eg, class A shares with a nominal value of 1 cent carrying one vote each for all matters, and class B shares with a nominal value of 10 cents each carrying 10 votes). The class B shares would be held by the founding shareholders, enabling them to maintain a controlling interest in the company while acquisitions are financed by the issuance of class A shares.

Disproportionate voting rights may undermine the interests of the minority shareholders, and some institutional investors prefer to limit this construction as far as possible.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

For each general meeting of a listed company, the statutory record date will be applied to determine the shareholders in which voting rights and meeting rights are vested. The record date is 28 days before the date of the meeting. A shareholder who wants to attend the general meeting and who wants to vote must be a shareholder on this record date. To exercise the meeting and voting rights, a shareholder should submit at the meeting a deposit receipt that has been issued by his or her bank. Shareholders of listed companies cannot act by written consent without holding a formal meeting as this would require the unanimous vote of all shareholders. However, shareholders of private companies can, in principle, act with written consent, provided all shareholders have consented; the articles of association may contain additional provisions for such procedure.

Under Dutch law, the management board is authorised to determine that the meeting rights can be exercised by using electronic means of communication. If so decided, it will be required that each person holding meeting rights, or his or her proxy, can be identified through electronic means of communication, directly follow the discussions in the meeting and, to the extent applicable, exercise his or her voting right. The management board may determine further conditions to the use of electronic means of communication, provided that these conditions are reasonable and necessary for the identification of shareholders holding meeting rights and the reliability and safety of the communication. Pursuant to the Dutch Corporate Governance Code the company should, as far as possible, give shareholders the opportunity to vote by proxy and to communicate with all other shareholders. Pursuant to the Temporary Act governing the Covid-19 Measures, a general meeting could be held through livestream or audio, but this act is no longer in force. The Dutch legislator, however, has proposed a new digital general meetings for private companies act that will allow general meetings to be held fully digitally. This new act was open for consultation until 6 February 2023. It is currently unknown when this act will enter into force.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Shareholders who jointly represent at least 10 per cent (NVs) (unless the NV's articles of association contain a lower percentage) or 1 per cent (BVs) of the company's issued capital may request the management board to convene a general meeting, stating specifically the business to be discussed. In addition, shareholders who jointly represent at least 10 per cent (NV) or 1 per cent (BV) of the issued share capital may be authorised by the provisional relief judge of a district court, upon their application, to convene a general meeting. This request will be rejected if the shareholder has not already requested the management board in writing to convene a general meeting, with a precise description of the matters to be discussed at this meeting, and the management board has not taken the necessary measures to ensure that the general meeting could be held within six weeks after the request was made to one of them.

Further, if a general meeting is convened by the company, shareholders who, alone or jointly, represent at least 3 per cent (for NVs) or at least 1 per cent (BVs) of the company's issued share capital will have the right to request the management board to place items on the agenda of this general meeting, provided that the reasons for the request are stated therein and the request is received by the company in writing at least 60 days before the date of the general meeting.

The convocation right and the right to place items on the agenda are limited by the response time and the statutory reflection period.

Shareholders will be able to put resolutions and director nominations to a shareholder vote if the general meeting is authorised to resolve upon these resolutions. If the company's articles of association state that certain resolutions by the general meeting require approval or nomination by the supervisory board, it is doubtful whether without this approval the item could be put to a vote in the general meeting.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Shareholders may, in principle, be primarily guided by their own interests. However, this does not release them from the obligation to act reasonably and fairly, which could mean that they should take into account the interests of minority shareholders and the interests of other stakeholders, such as employees and creditors. As a general rule, one could argue that the bigger the stake the shareholder holds in the company, the bigger his or her responsiveness towards other shareholders will be. Enforcement actions can be brought against controlling shareholders for the breach of these duties on the basis of a breach of reasonableness and fairness. In addition, the company or minority shareholders who meet certain thresholds may request the Enterprise Chamber of the Amsterdam Court of Appeal to start an inquiry into the company affairs, and the Enterprise Chamber may order immediate relief.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Under Dutch law, shareholders can, in principle, not be held responsible for acts or omissions of the company. This may be different if a shareholder was acting as a policymaker of the company (ie, acting as if he or she was a managing director). In this case, a shareholder can be held liable as if he or she was a managing director. Further, it is conceivable that a shareholder could be held responsible if he or she violates a statutory duty or does not act reasonably and fairly towards those who, pursuant to the law and the articles of association, are involved in the company's organisation.

Employees

10 What role do employees have in corporate governance?

A company is obliged to establish a works council if a company has 50 employees or more. The management board is obliged to provide the works council with certain information and meet with the council at least once a year.

The works council should be consulted by the management board prior to taking certain decisions, which include, among other things, appointing or dismissing a managing or supervisory director, transferring control of or terminating all or part of the (activities of the) company, important investments, major organisational changes in the company and the remuneration policy of the managing directors. Dependent on the topic, the works council has the right to render advice or has the right to consent.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

Anti-takeover devices are permitted in the Netherlands, provided, however, that the triggering of the device is justified if the measure is necessary, among other things, with a view to the continuity of (the policy of) the company and the interests of those involved. Anti-takeover devices will enable the management board under the supervision of the supervisory board to take care of all involved stakeholders, including the shareholders. Anti-takeover devices may be used in the case of a hostile takeover bid or in situations of shareholders' activism. The possibility to have preference shares issued to an independent foundation is the most commonly used protective measure in the Netherlands. In respect of listed companies, the management board may invoke a response time of 250 days in the case of a public take-over bid or in the case of one or more shareholders lodging a proposal for suspension or dismissal of one or more managing directors or supervisory directors or a proposal for an amendment of the articles of association regarding the procedure for appointment, suspension or dismissal of managing directors or supervisory directors. Shareholders may request the Enterprise Chamber of the Amsterdam Court of Appeal to end the reflection period, which request will be awarded if certain criteria have been met.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Shares may be issued pursuant to a resolution of the management board, if and insofar as that board is authorised to issue shares by the general meeting. This authorisation can be granted for a maximum period of five years at a time and can be extended by the general meeting each time for a maximum period of five years. General practice (for listed companies) is an authorisation for 18 months, which is limited to a maximum of 10 per cent or 20 per cent of the total issued share capital.

Upon the issuance of shares, each shareholder will have pre-emptive rights in proportion to the aggregate nominal value of his or her shares. A shareholder does not have pre-emptive rights in respect of shares issued against a non-cash contribution or shares issued to employees of the company. Holders of preference shares shall not have pre-emptive rights upon the issuance of ordinary shares (and vice versa) unless the articles stipulate otherwise. The pre-emptive rights can be excluded or restricted by the general meeting or by the corporate body that has been authorised to do so by the general meeting.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

No, listed shares should be freely transferable. The transfer of non-listed shares may be subject to a (non-mandatory) share transfer restriction clause in the articles of association, pursuant to which the approval from a corporate body, such as the management board or the supervisory board, will be required. The transfer of non-listed shares may also be subject to a right of first refusal. The transfer of shares in private companies is usually restricted by share transfer restriction clauses.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Repurchases for NVs will be difficult as they require authorisation of the general meeting, whose authorisation may only last 18 months (in case of a listed NV) and five years (in case of a non-listed NV), and the purchase price must be paid out of the company's distributable reserves. For BVs, the management board resolves on share repurchases, which must meet certain criteria. The managing directors of a BV will be jointly and severally liable to make up any deficit insofar as they knew or ought to know that, after the share repurchase, the BV would not be in the position to continue payment of its due and payable debts.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Shareholders do not have these statutory rights. There may be contractual agreements in place pursuant to which the company should buy shares from a shareholder if a specific circumstance arises, but this may be limited by financial assistance rules. If a shareholder disagrees with a merger, he or she should vote against the proposal to merge in the general meeting. If the result of the vote is that the motion to merge is passed, the shareholder may sell his or her shares on the stock exchange against the price listed there.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

Historically, Dutch law only provided for two-tier boards with a management board and separate supervisory board. Since 2013, Dutch law also provides for one-tier boards for private limited liability companies and public limited companies (including listed companies). Although several listed companies have adopted the one-tier board, the predominant board structure remains the two-tier board.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

Under Dutch law, the main rule is that the management board manages the company. Several duties have been specified as falling within the scope of the management board, including:

- the day-to-day management of the company;
- adopting the company's policies and the strategy;
- monitoring the liquidity position of the company and the financial policy and fulfilling tax obligations (including tax planning);
- overseeing risk management;
- reporting to the (annual) general meeting;
- preparing, publishing and filing the annual accounts; and
- representing the company to third parties.

The management board must carry out its duties in line with the objectives of the company, which are included in the company's articles of association. Dutch law provides that managing directors when carrying out their duties, must be primarily guided by the interests of the company and the enterprise connected with it. This means that the management board should also take into account the interests of not only the shareholders but also the employees, creditors and other stakeholders, or even (local) society.

Pursuant to the Dutch Corporate Governance Code, The management board should develop a view on sustainable long-term value creation by the company and its affiliated enterprise and formulate a strategy in line with this. The management board should formulate specifc objectives in this regard. Depending on market dynamics, it may be necessary to make short-term adjustments to the strategy.

In addition, pursuant to the Dutch Corporate Governance Code, The management board and the supervisory board should ensure that decisions are made in a balanced and effective manner while taking account of the interests of stakeholders. The management board should ensure that information is provided in a timely and sound manner. The management board and the supervisory board should keep their knowledge and skills up to date and devote sufficient time to their duties and responsibilities. They should ensure that, in performing their duties, they have the information that is required for effective decision-making.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The primary concern of the management board is to be guided by their company's interests and enterprises connected with it. As such, the management board is largely autonomous when performing its duties, even if the managing directors risk being dismissed by the general meeting, for example, because some shareholders are of the opinion that their interests are being subordinated.

The management board's autonomy can be restricted to a certain extent. For example, certain resolutions by the management board can and will mostly be subject to approval by the general meeting or the supervisory board, or both. Management board resolutions pertaining to important changes to the identity of a listed company require the general meeting's approval in any case. Further, to a certain extent, the general meeting can have the right to issue instructions to the management board. The management board and the supervisory board must provide the general meeting with all requested information unless a substantial interest of the company opposes this.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

The corporate body that originally appointed a managing director – usually the general meeting – is authorised to suspend and dismiss a managing director. A managing director should be consulted before he or she is suspended or dismissed. Other managing directors must also be given the opportunity to express their views regarding the proposal to suspend or dismiss a managing director. In addition, minority shareholders who meet certain criteria may request the Enterprise Chamber of the Amsterdam Court of Appeal to start an inquiry into the company's affairs, and the Enterprise Chamber may order immediate relief, for example, by suspending or temporarily replacing a managing director. There is no business judgment rule.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Under Dutch law, a managing director must fulfil his or her duties with due care and attention. Should he or she fail this duty of care, then the managing director may be held personally liable for any damage caused to the company as a result. Based on Supreme Court case law, it is established that a managing director is personally liable only if he or she could be blamed for seriously culpable conduct. Actions by the managing directors are most likely to constitute seriously culpable conduct if these actions would not have been taken by any other reasonably acting and fully experienced managing director.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

A multi-member management board may divide duties among its various managing directors. This division is typically included in management board regulations. Dividing duties does not mean that responsibility for the actions of each of the managing directors is limited to the duties conferred to them. Managing directors have joint responsibility for the company's day-to-day business, general policy and financial affairs. The management board shall be joint and several liable for shortcomings in the performance of management board duties.

If an individual director can prove that he or she has not been negligent in taking measures to prevent improper management by demonstrating that he or she took all measures in his or her power to prevent improper management, this director may exculpate him or her from directors' liability.

Delegation of board responsibilities

22 To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

Listed companies often establish an executive committee. These executive committees usually consist of both statutory managing directors and members of the senior management. An executive committee can be defined as a management layer responsible for preparing and adopting resolutions of the company. It usually has an advisory and supportive function, but it can also have a more managerial function. In addition, the management board may grant (continuing) power of attorney. This type of power of attorney is also referred to as a power of procuration. Holders of powers of attorney will carry out their duties on the basis and within the limits of this power. It is often granted to officers in certain positions who are not a part of the statutory management board.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

A two-tier board structure does not have non-executive directors but a separate supervising body being the supervisory board. For structure regime companies, the supervisory board consists of at least three members. The supervisory board is responsible for supervising the policy pursued by the management board and the general course of affairs in the company and its business. The supervisory board also advises the management board. Pursuant to the Dutch Corporate Governance Code, the composition of the supervisory board should be such that the members are able to operate independently and critically in relation to one another, the management board and any particular interests involved. The Corporate Governance Code includes detailed independence criteria.

A one-tier board consists of executive and non-executive directors. The non-executive directors are charged with the general management of the company. To a certain extent, the role of non-executive directors can be compared to the role of supervisory directors; however, they are more actively involved than supervisory directors in the general policy of the company and decision-making of the board. Pursuant to the Dutch Corporate Governance Code, the majority of the board should be made up of non-executive directors. The Corporate Governance Code includes detailed independence criteria for non-executive directors.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

Regarding the management board, the minimum number of directors is one (in a one-tier board, the minimum number of executives is one and non-executive directors are two). Maximum numbers are not provided. The number of directors is usually set by the general meeting.

An individual shareholder does not have the power to appoint or remove directors as this requires a resolution by the general meeting. However, a shareholder who meets certain criteria can request that the management board put an item to replace managing and supervisory directors on the agenda of the general meeting. The power of the general meeting to appoint and remove managing and supervisory directors can be restricted.

Most listed companies have limited the rights of the general meeting to appoint and dismiss managing and supervisory directors in such a way that the resolution requires a (non-binding) nomination to be prepared by the supervisory board or, in some cases, by the meeting of holders of priority shares. A resolution to appoint a managing director or supervisory director nominated by the supervisory board must be adopted by an absolute majority of the votes cast.

The general meeting of shareholders of a company not having statutory two-tier status (*structuurregime*) may adopt a resolution to cancel the binding nature of a nomination for the appointment of a member of the management board or of the supervisory board and/or a resolution to dismiss a member of the management board or of the supervisory board by an absolute majority of the votes cast. It may be provided that this majority should represent a given proportion of the issued capital, which proportion must not be set higher than one-third. If this proportion of the capital is not represented at the meeting, but an absolute majority of the votes cast is in favour of a resolution to cancel the binding nature of a nomination, or to dismiss a board member, a new meeting may be convened at which the resolution may be adopted by an absolute majority of the votes cast, regardless of the proportion of the capital represented at the meeting.

A different appointment and removal system applies to structure regime companies. The Dutch structure regime applies to (listed) companies of which the majority of the employees are employed in the Netherlands. In these companies, the involvement of the supervisory board and the works council in the appointment of supervisory directors is greater than in other companies.

Shareholders will be able to put resolutions and director nominations to a shareholder vote if the general meeting is authorised to resolve upon these resolutions. If the company's articles of association state that certain resolutions by the general meeting require approval or nomination by the supervisory board, it is doubtful whether without this approval the item could be put to a vote in the general meeting

Read this article on Lexology

Directors of insolvent companies may be banned for five years from taking director positions.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

In the two-tier board structure, this issue does not apply as a managing director cannot be a member of the supervisory board at the same time.

In the one-tier board structure, only natural persons can be a non-executive director and only a non-executive director can become chair. The functions of the board chair and chief executive (the latter being an executive director) cannot be fulfilled by one person.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Public interest companies (ie, listed companies) must, pursuant to the terms of the law, establish an audit committee. The management board may establish an executive committee.

Pursuant to the Dutch Corporate Governance Code, if the supervisory board consists of more than four members, it should appoint from among its members an audit committee, a remuneration committee and a selection and appointment 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. If the supervisory board decides not to establish an audit committee, a remuneration committee or a selection and appointment committee, the best practice provisions applicable to these committees apply to the entire supervisory board. The committees of a one-tier board should be comprised exclusively of non-executive directors. Neither the audit committee nor the remuneration committee can be chaired by the chair of the board or by a former executive director of the company.

The Dutch Corporate Governance Code further elaborates on the duties and responsibilities of audit committees. In some cases, especially in companies operating in the financial sector, a risk committee is established in addition to the audit committee. Article 39(4) of the EU Statutory Audits Directive (Directive 2006/43/EC) stipulates that, if another body has been designated to perform the functions of the audit committee, the management report must state which body carries out those functions and how that body is composed. Various companies have set up a committee in addition to the audit committee to deal with sustainability issues relating to the company. Such a committee is often referred to as a sustainability committee or corporate responsibility committee. If a company has established such a committee, the preparation of the decision-making for the supervision of the integrity and quality of the sustainability reporting can also be carried out by such a committee instead of the audit committee.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There is no statutory requirement regarding the minimum number of meetings of the management board or of the supervisory board. Usually, the minimum number is included in the articles of association or in the respective board regulations.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

Relationships between a company's corporate bodies (ie, the management board, the general meeting and, possibly, the supervisory board) and relationships within these corporate bodies can be included in the articles of association or in the board's regulations. As the articles of association of companies are publicly available through registration in the Trade Register of the Chamber of Commerce and usually also through publication on the company's website, this information is disclosed to the public. With regard to supervisory board regulations and management board regulations, the Dutch Corporate Governance Code prescribes that these should be posted on the company's website. The regulations usually contain detailed provisions on the board's practices.

In addition, pursuant to the Dutch Corporate Governance Code, the division of duties within the supervisory board and the procedures of the supervisory board should be laid down in terms of reference. The supervisory board's terms of reference should include a paragraph dealing with its relations with the management board, the general meeting, the employee participation body (if any) and the executive committee (if any). The terms of reference should also be posted on the company's website.

The Dutch Corporate Governance Code furthermore provides that the supervisory board should draw up terms of reference for the audit committee, the remuneration committee and the selection and appointment committee. The terms of reference should indicate the role and responsibility of the committee concerned, its composition and the manner in which it discharges its duties. The terms of reference should be posted on the company's website.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

Pursuant to the Dutch Corporate Governance Code, at least once per year, outside the presence of the management board, the supervisory board should evaluate the functioning of the management board as a whole and of the individual managing directors. The management board, in addition, should evaluate its own functioning as a whole and the functioning of the individual managing directors at least once a year.

At least once per year, outside the presence of the management board, the supervisory board should evaluate its own functioning, the functioning of the various committees of the supervisory board and that of the individual supervisory directors.

The supervisory board's report should state in what manner the evaluations have been carried out and what has been or will be done with the conclusions from the evaluations.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

The general meeting adopts the remuneration policy of the management board. The works council (mandatory in companies with more than 50 employees) has the right to determine a position in advance on the remuneration policy and then explain this position at the general meeting. The remuneration itself is usually adopted by the supervisory board. Proposals for remunerations that are to be paid in the form of shares or rights to subscribe for shares require the approval of the general meeting. The remuneration for the supervisory directors is adopted by the general meeting.

Pursuant to the Dutch Corporate Governance Code, the remuneration policy applicable to management board members should be clear and easy to understand, focus on sustainable long-term value creation for the company and its affiliated enterprise and take into account the internal pay ratios within the enterprise. The remuneration policy should not encourage management board members to act in their own interest nor to take risks that are not in keeping with the strategy formulated and the risk appetite that has been established. The supervisory board is responsible for formulating the remuneration policy and its implementation.

Specific remuneration rules apply in respect of the financial sector. The Netherlands have chosen a wider scope of the remuneration rules and a lower bonus ceiling than those indicated in the European regulations for financial institutions (banks, investment firms, insurers and managers of collective investment schemes). The Dutch Remuneration Policy (Financial Enterprises) Act includes additional requirements for variable remuneration. These rules include those relating to the bonus ceiling, retention payments, welcome and severance packages, and publication obligations.

In recent years, the remuneration paid to managing directors has become the subject of increasing scrutiny. This has manifested itself in a number of ways, including various pieces of (sectoral) legislation that impose limits on the remuneration paid to managing directors.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

In principle, the remuneration of senior management falls within the scope of the management board. The Dutch Corporate Governance Code prescribes that if the management board has an executive committee, the management board should inform the supervisory board about the remuneration of the members of the executive committee who are not management board members. The management board should discuss this remuneration with the supervisory board annually.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

The general meeting has the authority to adopt the remuneration policy of the managing directors and can also adopt the remuneration of the supervisory directors.

Pursuant to Dutch law, the remuneration policy for directors of companies whose shares or depositary receipts have been are admitted to trading on a regulated market should at least every four years after being established be presented to the general meeting for adoption. In addition, the company must prepare a remuneration report annually, which includes an overview of all remunerations that, over the past financial year, have been awarded or are owed to the individual directors. Pursuant to the Dutch Corporate Governance Code, the remuneration report should also be made available on the company's website (though companies are not expected to disclose the scenario analyses included in such report).

Pursuant to the Dutch Corporate Governance Code, the remuneration policy should focus on long-term value creation for the company and its affiliated enterprise and take into account the internal pay ratios within the enterprise. The remuneration of the managing directors is usually determined by the supervisory board within the limits of the remuneration policy adopted by the general meeting. Proposals for remuneration that is to be paid in the form of shares or rights to subscribe for shares must be approved by the general meeting. The remuneration policy of the managing directors should be presented to the shareholders every four years. In addition, the remuneration report must be submitted to the general meeting each year. The remuneration of the senior management (not being a member of the management board) is usually determined by the management board.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability is common practice in the Netherlands. Typically, the company is the policyholder and pays the insurance premiums, while managing directors and supervisory directors are the insured parties. Usually, all acts on the part of managing directors and supervisory directors are covered with the (usual) exception of wilful misconduct and fraud.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Managing directors and supervisory directors may be offered protection by the company by way of contractual indemnification or indemnification under the company's articles of association, provided that a company does not indemnify a director for his or her liability against the company itself. A director shall, however, have no right to be indemnified against any liability in any matter if it is finally determined that this liability resulted from the intent, wilful recklessness or serious culpability of the director.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Expenses in connection with the preparation and presentation of a defence to any claim, action, suit or legal proceeding may be advanced to the directors and officers by the company. However, any director and officer must repay these expenses if it is ultimately determined that any directors' or officers' liability resulted from the intent, wilful recklessness or serious culpability of this director or officer.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

The liability of directors cannot be limited, but the consequences of a director's liability can be mitigated. Members of the management board and the supervisory board may be granted discharge by the general meeting. This discharge releases the directors to a certain extent from (potential) liability towards the company. The general meeting is not obliged to discharge the directors, and shareholders may vote against or abstain from voting for this discharge. Once granted, the director, in principle, will no longer be able to be held liable by the company. Further, the directors can be indemnified, and it is common practice to have directors' and officers' liability insurance.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The publicly available Trade Register of the Chamber of Commerce includes the corporate data of companies, including the registered seat and address, details of the directors, the articles of association and certain limited financial information. Further, listed companies usually publish their articles of association and the board regulations on their websites.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

The publicly available Trade Register of the Chamber of Commerce includes the corporate data of companies, including the registered seat and address, details of the directors, the articles of association and certain limited financial information. Further, listed companies usually publish their articles of association and the board regulations on their websites.

In addition, the annual accounts must be filed with the Trade Register of the Chamber of Commerce annually, and listed companies should publish their half-year results also with the Dutch regulatory authority, the Authority for the Financial Markets (AFM). Further, each capital increase must be filed at the Trade Register. Listed companies are required to publish price-sensitive information directly related to the company via press release as quickly as possible and file (if the listing is in the Netherlands) the press release with the AFM. In addition, the yearly and half-yearly results of listed companies must be made publicly available.

As of 27 September 2020, the following information regarding an ultimate beneficial owner (UBO) of an entity must be registered in the UBO register: name, month and year of birth, country of residence, nationality and the nature and extent of the UBO's economic interest. The UBO register was initially publicly available, but as of 22 November 2022 this is no longer the case due to a decision by the European Court of Justice. The requirement to register UBOs in the UBO register has remained in force.

In relation to the nature and extent of the UBO's economic interest, only a range (25 to 50 per cent (exclusive); 50 to 75 per cent (exclusive); or 75 to 100 per cent (inclusive)) needs to be registered. In other words, no absolute numbers are registered. The registration of the UBOs in the register is a requirement for companies and other (legal) entities registered with the trade registry of the Dutch Chamber of Commerce. Dutch listed companies incorporated in the Netherlands are exempt from the obligation to register their UBOs in the UBO register. All Dutch subsidiaries of listed companies regulated within the European Union or

European Economic Area are also exempt under certain circumstances from registering their UBOs in the UBO register.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Directors are appointed by a resolution of a general meeting. Dutch law does not contain any provisions that give individual shareholders the right to nominate directors for appointment. However, a company's articles of association can provide for this. Further, a shareholder holding at least 10 per cent or 1 per cent of the issued share capital can request the board to include the appointment of a director on the agenda of the general meeting.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

The management board and the supervisory board ensure proper engagement between the company and its shareholders. The management board and the supervisory board must provide the general meeting with all requested information unless a substantial interest of the company opposes this. However, the Dutch Supreme Court ruled that this right to information does not apply to individual shareholders or to shareholders outside of the general meeting. Bilateral contracts between the company and major shareholders are not uncommon. Pursuant to the Dutch Corporate Governance Code, companies should formulate a policy on bilateral contacts with the shareholders and should post this policy on its website.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

Listed companies that have at least an average of 500 employees must include a declaration in their annual report setting out how the company is dealing with, at least, environmental, social and staff matters; respecting human rights; and tackling corruption and bribery. Sustainability is more often put as a separate discussion item on the agenda of the general meeting. In addition, large listed companies must provide information on their diversity policy in relation to the composition of the management and supervisory board. The company should state the objectives of the policy, as well as the ways in which the policy is implemented and the results in the past financial year. If the company does not have a diversity policy, it must explain why this is the case.

CEO pay ratio disclosure

42 | Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

Pursuant to the Dutch Corporate Governance Code, the supervisory board should render the account of the implementation of the remuneration policy in a transparent manner in its remuneration report. This report must include whether the changes in the remuneration of managing and supervisory directors is in proportion to the salary of the average employee. The report should be posted on the company's website.

The remuneration report should explain, among other things, how the total remuneration of management board members is in line with the remuneration policy, how sustainability objectives have been taken into account in the implementation of the remuneration policy and how this contributes to the creation of long-term value. It should also be explained whether there have been any changes in the pay ratios in comparison with at least five previous financial years. In addition to the minimum information that can be expected in relation to pay ratios, additional information may be provided. Examples include the pay ratios for other management board members (besides the CEO), the pay ratios broken down by the main regions in which the company operates and/or the pay ratios for specific reference groups of employees.

Gender pay gap disclosure

43 | Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

The European Parliament has published a proposal for a directive to strengthen the application of the principle of equal pay for equal work or work of equal value between men and women through pay transparency and enforcement mechanisms. This directive will have to be implemented into Dutch law once it has entered into force. At present, however, there is no statutory regulation that requires disclosure of gender pay gap information in the Netherlands.

For the sake of completeness, in general with respect to gender equality, pursuant to the Dutch civil code, listed corporate entities are required to set targets for the ratio of men to women in management boards, supervisory boards and top management positions. In addition, the Dutch civil code includes a diversity quota of at least one-third male and one-third female for supervisory boards of listed companies. The diversity quota for supervisory boards applies to Dutch listed companies. Furthermore, pursuant to the Dutch Corporate Governance Code, the management board, the supervisory board and the executive committee (if any) should be composed in such a way 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

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

The new Corporate Sustainability Reporting Directive (CSRD) requires all large companies to publish regular reports on their environmental and social impact activities. From 2024/2025, companies will be required to report on their sustainability policy and performance. In April 2022, the European Commission presented the proposal for the CSRD. The proposed directive revises and strengthens the rules introduced by the Non-Financial Reporting Directive (Directive 2014/95/EU). These regulations oblige companies to report on environmental and social impact of their business activities. Information about this must be verified by an accountant.

The CSRD aims to increase the quality of information and transparency about the environmental and social impact of companies, and supports the transition to a sustainable economy in line with the Paris climate agreement.

On 23 February 2022, the European Commission adopted a proposal for the Corporate Sustainability Due Diligence Directive (CSDDD). This Directive address the negative impacts on human rights and the environment in value chains and aims to link the variable remuneration of directors to the sustainability objectives of companies.

Adjustments of Chapter One of the Dutch Corporate Governance Code put emphasis on environmental, social and governance (ESG) factors. Many of the ESG provisions in the Dutch Corporate Governance Code can be seen as a bridge until the implementation of the CSRD into Dutch legislation.

Reference should also be made to a bill on unwanted control in the telecoms sector that was recently adopted by the Upper House. Pursuant to this act, parties wishing to take over Dutch telecoms facilities (eg, telephone, internet or data centre providers) must notify the Ministry of Economic Affairs and Climate in advance. The Minister of Economic Affairs and Climate has the power to prohibit the acquisition or retention of dominant control in a telecommunications party if, in its opinion, obtaining or retaining this control would result in a threat to the public interest.

In the first half of 2023, it is expected that the Dutch Investments, mergers and acquisitions security screening act (Security Screening Act) will enter into force. Once the Security Screening Act has entered into force, parties involved in a transaction must notify the transaction to the Dutch Investment Screening Bureau (ISB) if the transaction involves a target company that is (1) a vital (service) provider (as described in the act), (2) a corporate campus manager, and/or (3) active in the field of sensitive technology.

Subsequently, the ISB will review the transaction and the transaction may not be consummated prior to either (1) has indicated that a 'review decision' is not required; or (2) that a review decision has been taken, which can prohibit the transaction or impose requirements or provisions (concerning the transaction) that must be complied with. In addition, the Security Screening Act contains a mechanism pursuant to which the Dutch government may (within the first eight months after entering into force) retroactively direct parties involved in a transaction that occurred after 8 September 2020 (but before the entering into force) to file a notification, if on reasonable grounds the conjecture has arisen that the transaction could pose a risk to national security. The Dutch government may subsequently conduct a security screening and take a review decision.

A proposal for a directive amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting was adopted by the European Commission in April 2021 that imposes requirements on in-scope companies to report under a double materiality perspective in compliance with European Sustainability Reporting Standards (ESRS).

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Summary

SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The main sources of law relating to corporate governance are the:

- Companies and Allied Matters Act 2020 (CAMA);
- Investment and Securities Act;
- Financial Reporting Council of Nigeria Act (FRCA);
- Banks and Other Financial Institutions Act;
- Central Bank of Nigeria Code of Corporate Governance for Banks and Discount Houses in Nigeria (the CBN Code);
- Insurance Act;
- National Insurance Commission Act (the NAICOM Act);
- Nigerian Code of Corporate Governance issued by the Financial Reporting Council of Nigeria;
- CBN Code of Corporate Governance for Microfinance Banks in Nigeria;
- CBN Code of Corporate Governance for Development Finance Institutions in Nigeria;
- CBN Code of Corporate Governance for Finance Companies in Nigeria;
- NAICOM Code of Corporate Governance for the Insurance Industry in Nigeria (NAICOM Code);
- Code of Corporate Governance for Licensed Pension Operators (PENCOM Code);
- Rule book of the Nigerian Exchange Limited;
- Securities and Exchange Commission Code of Corporate Governance in Nigeria (the SEC Code);
- SEC Rules and Regulations;

- SEC Code of Conduct for Shareholders' Associations (SCCSA);
- Nigerian Communications Commission Code of Corporate Governance for telecommunication companies (NCC Code);
- Nigerian Exchange Limited Guidance on Companies' Virtual Board, Committee and Management Meetings (NGX Guidance); and
- Business Facilitation (Miscellaneous Provision) Act, 2023 (BFA).

The Rule book of the Nigerian Exchange Limited requires mandatory compliance with listing rules.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The primary government entities responsible for making these rules are:

- the Corporate Affairs Commission (CAC), created under CAMA, which oversees the registration of companies and compliance by corporate bodies with the provisions of CAMA;
- the Securities and Exchange Commission (SEC), created under the Investment and Securities Act, which regulates the capital market;
- the Central Bank of Nigeria, which regulates banks and other financial institutions in Nigeria;
- the National Insurance Commission, established under the NAICOM Act, which ensures compliance by insurance companies with the provisions of the NAICOM Act and the Insurance Act;
- the National Pension Commission established under the Pension Reform Act, which regulates pension fund administrators and pension fund custodians;
- the Nigerian Communications Commission, established under the Nigerian Communications Act (NCA), which regulates the communications industry in Nigeria and ensures compliance with the NCA;
- The Financial Reporting Council of Nigeria (FRCN), created under the Financial Reporting Council of Nigeria Act, is empowered to enforce and approve compliance with accounting, auditing, corporate governance and financial reporting standards in Nigeria and is charged with ensuring good corporate governance practices in the public and private sector; and
- the Directorate of Corporate Governance, which was created under the Financial Reporting Council of Nigeria Act, is responsible for issuing a code of corporate governance and guidelines and developing a mechanism for periodic assessments of the code and guidelines
- the Nigerian Exchange Group (NGX). The NGX is the primary stock exchange in Nigeria, and it plays a significant role in corporate governance. The NGX has established rules and guidelines for listed companies to ensure strict adherence to best practices in corporate governance.

There are several shareholder activist groups in Nigeria and these groups are more active in participating in annual general meetings, influencing decision-making at these meetings and protecting shareholders' rights.

Regulatory authorities, such as the SEC, NGX and the FRCN, adopt a consultative process in making regulations to obtain the views of various stakeholders, including shareholder groups. The SCCSA is one of the means through which the SEC seeks to ensure the highest standard of conduct among association members and the companies with which they interact as shareholders and to ensure that association members make positive contributions to the affairs of public companies. The SCCSA prescribes that shareholders' associations be registered with the CAC for their views to be considered by the SEC during consultations on corporate governance issues.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Shareholders in a general meeting have the power to appoint or remove directors by a resolution passed by a simple majority of votes cast in person or by proxy. Though the board of directors of a company is empowered to appoint new directors to fill casual vacancies created by death, resignation, retirement or removal, these appointments are, however, subject to ratification by the shareholders in a general meeting. Generally, unless the articles of association provide otherwise, the directors, when acting within the powers conferred upon them by the Companies and Allied Matters Act 2020 (CAMA) or the articles, are not bound to obey the directions or instructions of the shareholders in general meetings provided that the directors act in good faith and with due diligence. This notwithstanding, the shareholders may make recommendations to the board regarding actions to be taken by it and may ratify or confirm any action taken. The Securities and Exchange Commission Code of Corporate Governance in Nigeria (the SEC Code) provides that the board is to ensure that all shareholders are given equal treatment and minority shareholders are adequately protected from the abusive actions of controlling shareholders. In addition, there should be adequate shareholder representation on the board proportionate to the size of shareholding.

A shareholder can bring a court action to restrain the directors from entering into an illegal or ultra vires transaction or perpetuating a fraud. Members holding 5 per cent of the total voting rights in the company could circulate a resolution to be voted upon at a general meeting, indicating a course of action that should be adopted by the directors of the company. Also, members holding one-tenth of the class of shares issued may also apply to the Corporate Affairs Commission (CAC) to investigate the affairs of the company.

Under CAMA, a company may remove a director before the expiry of his or her tenure of office, notwithstanding anything in its articles or in any agreement between the company and the director. However, CAMA requires that a special notice be given to those entitled to attend and vote, as well as the director sought to be removed, to move and pass this resolution. The company shall also give its members notice of this resolution a minimum of 21 days before the meeting where the removal of the director is to be considered.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

The shareholders in a general meeting are empowered to:

- appoint and remove directors of the company;
- determine directors' remuneration;
- appoint auditors and approve their remuneration;
- alter the company's share capital;
- alter the memorandum and articles of association of the company;
- approve the conversion of the company from a private to a public company and vice versa, and from a limited company to an unlimited company and vice versa;
- change the company's name;
- make the liability of directors unlimited;
- appoint a person over 70 years of age as the director in a public company;
- sale or other transfer of the company's major asset, which is 50 per cent or more of the book value of the company's assets;
- winding up of the company;
- Striking off the company's name from the register of the Commission; and
- declare a dividend on the recommendation of the board.

CAMA provides that, subject to the provisions of the articles of association of a company, there are certain powers of the board that cannot be restricted by the shareholders in a general meeting. These include powers over the day-to-day running of the company and the powers of the directors to institute actions on behalf of the company. Where the board fails to institute or defend an action on behalf of the company when it ought to do so because the board is itself in the wrong or there is a deadlock on the board, then the shareholders may apply to a court to bring the action on behalf of the company.

Where the articles of association of a company expressly vest the board with certain powers, it is not bound to obey the instructions of the shareholders, especially when it acts in good faith and with diligence. In these situations, the shareholders may only amend the articles of association of the company such that those powers are now made exercisable by the shareholders in a general meeting and not by the board of directors.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

CAMA expressly prohibits disproportionate voting rights and the limitation of voting rights. The basic rule is 'one share, one vote' and no company may, by its articles or otherwise, authorise the issue of shares that carry more than one vote in respect of each share or that do not carry any rights to vote. There are, however, a few exceptions. Preference shareholders, if the articles of the company so provide, can have more than one vote per share upon consideration of any resolution:

- where a dividend on the preference share remains unpaid after the due date of the dividend;
- that seeks to vary the rights attached to the preference shares;
- to appoint or remove an auditor; and
- for winding up the company.

Furthermore, any special resolution of a company increasing the number of any class may validly resolve that any existing class of preference shares carry the right to the votes in addition to the one vote per share necessary to preserve the existing ratio that the votes exercisable by the holders of these preference shares bear to the total votes exercisable at the meeting. The rights of members to vote upon their shares may also be limited by the company's articles until all calls or other sums payable to the company by them in respect of the shares have been paid.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

All shareholders are entitled to attend and vote at the company's general meeting. However, until the name of a person with shares in a company has been entered as a member in the register of members, which companies are statutorily required to maintain, that person will not be deemed a member of the company and, therefore, may not attend meetings of the company or be allowed to vote at these meetings.

The articles of a company may also provide that members who have not made payments on all calls on their shares shall not be entitled to attend meetings.

Shareholders of a private company can act by way of written resolution. CAMA provides that a resolution of the shareholders of a company would be effective only if it is passed at a general meeting. However, the shareholders of a private company may act by a written resolution signed by all the shareholders entitled to attend and vote at the general meeting of the company where the resolution would have been passed.

Generally, CAMA provides that (with the exception of small companies and companies having a single shareholder) all statutory and annual general meetings shall be held in Nigeria. However, a private company may hold its general meetings electronically, provided that such meetings are conducted in accordance with its articles of association. Although CAMA makes no provisions for the conduct of virtual meetings by public companies, the NGX Guidance recommends that the articles of association of a company or its Board, Committee, and Management Charters or Terms of Reference should provide or be altered to provide for and authorise virtual meetings. In practice, a company may provide for the holding of virtual meetings in its articles of association.

Additionally, the Business Facilitation Act 2023 amended some of the provisions of the CAMA and permits public limited companies (PLCs) to hold their meetings electronically. It also expanded the method in which a member can cast a vote at a meeting so that this can be done either by show of hands or electronically.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

The duty to call general meetings of shareholders is one held by the board of directors. However, a shareholder or shareholders representing at least 10 per cent of the shareholding (or voting rights in a company without share capital) of the company may requisition a general meeting at any time. Where the board refuses to convene the requisitioned meeting within 21 days, the requisitionists are authorised to convene the meeting (within three months of the requisition) after issuing the required notices, and any reasonable expenses incurred in relation to the meeting shall be repaid by the company.

The nomination of a person to the board of directors can be put to a vote at a general meeting, provided that prior notice (not less than three days or more than 21 days prior to the meeting) outlining his or her intention to propose this person for election has been given, signed by a shareholder qualified to attend and vote at the meeting and accompanied by a notice in writing signed by the nominated person of his or her willingness to act.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

There are no statutory provisions that expressly provide that controlling shareholders owe legal duties to the company or minority shareholders. However, the following codes provide that it is the responsibility of the board to ensure that minority shareholders are protected from the overbearing influence of controlling shareholders of a company and to ensure the fair treatment of all shareholders:

- the Central Bank of Nigeria Code of Corporate Governance for Banks and Discount Houses in Nigeria (the CBN Code);
- the CBN Code of Corporate Governance for Microfinance Banks (MFBs) in Nigeria;
- the CBN Code of Corporate Governance for Development Finance Institutions (DFIs) in Nigeria;
- the CBN Code of Corporate Governance for Finance Companies (FCs) in Nigeria;
- the Nigerian Code of Corporate Governance (the NCCG);
- the SEC Code; and
- the National Insurance Commission Code of Corporate Governance for the Insurance Industry in Nigeria.

Further, if a controlling shareholder infringes on the rights of a minority shareholder, or commits a fraud on either the company or the minority shareholder, which the directors fail to redress (owing to the wrongdoer being in control of the company or otherwise), the non-controlling shareholder may apply to a court for injunctive relief.

A shareholder may also bring an application to the court for relief on the grounds that the actions of the company are being conducted in an unfairly prejudicial and oppressive or discriminatory manner.

Further, a shareholder may bring a derivative action on behalf of the company where the wrongdoers are effectively in control of the company, the directors refuse to act, the application is brought in good faith, and it is in the best interest of the company. Evidence that the majority shareholders have approved any such wrongdoing will not in itself prevent a shareholder from seeking relief from the courts.

A shareholder who possesses significant control over a company, whether a private company or a public company, must notify the company of the particulars of such control, within seven days of becoming such a person. The company shall not later than one month from the receipt of such information, notify CAC and disclose the same in its annual return.

Also, a shareholder who possesses, either directly or through a nominee, shares in a public company that entitles the shareholder to exercise 5 per cent 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 or she is a substantial shareholder. The company shall within 14 days of receipt of the notice or of becoming aware that the person is a substantial shareholder give notice in writing to the CAC. The duty also arises where the person ceases to be a substantial shareholder (that is, his or her shareholding falls below 5 per cent).

A 'person with significant control' is defined as a person:

1. directly or indirectly holding at least 5 per cent of shares or interest in a company;
2. directly or indirectly holding at least 5 per cent of the voting rights in a company;
3. directly or indirectly holding the right to appoint or remove a majority of the directors;
4. who has the right to exercise, or who actually exercises, significant influence or control over a company; or
5. who has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or firm whether or not it is a legal entity but would itself satisfy any of the first four conditions if it were an individual.

Definition 5 also applies to legal persons that satisfy any of the conditions 1 to 4.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Shareholders are generally not liable for the acts or omissions or debts of the company as the liability of shareholders is limited to the amounts yet to be paid on their shares. In the case of an unlimited company, the liability of members for the debts of the company is unlimited. The company is a separate legal personality from its members. However, the courts may lift the corporate veil where a company is a mere sham or is being used as a tool to perpetuate illegality.

Employees

10 What role do employees have in corporate governance?

CAMA provides for the protection of employees who are required to make disclosures into the affairs of his or her employer to an inspector appointed to conduct an investigation into that company and makes provision for compensating such employees in the event that they are relieved of their employment without any just cause, other than the disclosure made during the course of the investigation.

The Central Bank of Nigeria (CBN) Code and the SEC Code require every public company to establish whistle-blowing procedures that encourage staff to report unethical activity or breaches of corporate governance to the bank and CBN, under the CBN Code, and the company, under the SEC Code. In addition to the provisions of the CBN Code on whistle-blowing, the CBN Codes for MFBs, DFIs and FCs require that MFBs, DFIs and FCs submit returns to the CBN on compliance with the whistle-blowing policy on a semi-annual basis no later than seven days after the end of the relevant period. The Investment and Securities Act also makes provision for employees of publicly quoted companies to report suspected criminal activities or non-compliance with any legal obligation within the company. The law provides that any such whistle-blower shall be protected from detriment as a result of his or her actions. Where he or she suffers any detriment, the Securities and Exchange Commission may, on his or her complaint, order that the employee be reinstated or compensated, or both. The CBN Guidelines for Whistle-Blowing in the Nigerian Banking Industry 2014 provide similar protection for employees of financial institutions. The Nigerian Code of Corporate Governance is in tandem with the stipulations of the CBN Code and SEC Code.

In addition, the managing director and executive directors, as employees of the company, are responsible for the implementation of corporate governance policies.

The PENCOM Whistle-Blowing Guidelines for Pensions (WBGP) provides that the directors, management, employees and any other persons that have dealings with a pension fund administrator or a pension fund custodian shall have the responsibility to report breaches to PENCOM and requires that all pension fund administrators and custodians undertake not to victimise employees that comply with the WBGP. Where victimisation nonetheless occurs, the WBGP provides that PENCOM shall employ appropriate regulatory tools to offer redress to the employee concerned.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

There are generally no rules prohibiting anti-takeover devices. The directors have a duty to act in the best interests of the company in all situations. Major shareholders of a company may enter into a lock-in arrangement.

The Investment and Securities Act mandates the directors of a target company to send circulars to members of the target company expressing their opinion one way or the other on a takeover bid. A dissenting director can also circulate his or her opinion to the shareholders.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

The power to issue shares is vested in the company. A private company may delegate this power to the directors, subject to any condition or direction that may be imposed in the articles or by the company in a general meeting.

The Companies and Allied Matters Act 2020 (CAMA) provides for the pre-emptive rights of shareholders in a company and makes it mandatory for a company to offer newly issued shares to its existing shareholders first. In practice, the articles of a company usually provide for pre-emptive rights.

However, the Business Facilitation (Miscellaneous Provision) Act, 2023 (BFA) has removed the requirement for public companies to first offer newly created shares to existing shareholders in the proportion of their shareholding. The right of first offer now applies only to private companies.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

The transfer of shares of a private company is subject to restrictions as specified in its articles of association. Restrictions commonly employed include provisions on pre-emptive rights. The right of pre-emption gives the other shareholders the first option to buy any shares a shareholder wishes to sell or transfer. Other restrictions employed are clauses in a company's articles giving the board of directors, and, in some cases, the shareholders, the discretion to refuse to approve or register a transfer of shares to persons or entities of whom they do not approve.

Public companies are expressly precluded from restricting the transfer of fully paid shares.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

A company may only repurchase its shares, including irredeemable shares, upon the fulfilment of certain conditions. These conditions are:

- if this action is permitted by the company's articles;
- a special resolution is passed by the shareholders approving the repurchase of the shares;
- the shares are fully paid up;
- notice of the proposed purchase by the company of its own shares is published in two national newspapers within seven days of passing the special resolution;
- a statutory declaration of solvency is filed with the Corporate Affairs Commission within 15 days after the newspaper publication; and
- the company would still retain some of its issued shares other than redeemable shares or shares held as treasury shares.

A company may only repurchase its shares from certain persons or channels, including:

- existing shareholders or security holders on a proportionate basis;
- from the existing shareholders in a manner permitted by a court sanction in respect of a scheme of arrangement;
- from the open market; or
- by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or any other similar scheme.

CAMA provides that an agreement with a company providing for the acquisition by a company of its shares is specifically enforceable against the company to the extent that the company can perform the agreement without breaching the provisions of CAMA on the repurchasing of shares. Any public company seeking to repurchase its own shares is also required to obtain the approval of the Securities and Exchange Commission (SEC) and comply with the SEC Rules and Regulations.

Where the shares are to be repurchased by the company, payment for the shares may only be made from the distributable profits of the company.

Dissenters' rights

15 | Do shareholders have appraisal rights?

CAMA and the Investment and Securities Act provide that where the approval of 90 per cent of the shareholders has been obtained, the shares of the dissenting shareholders (those who have not approved a scheme of merger, takeover or acquisition) may be acquired, with notice, at the value agreed by the consenting shareholders except where the dissenting shareholders apply to a court to have those terms varied. Aggrieved shareholders may petition the court to make an order compelling the company to buy them out at a price to be determined by the court.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The board structure for listed companies can best be described as one-tier, comprising both executive and non-executive directors.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The board's legal responsibilities include directing and managing the affairs of the company, securing its assets, performing its duties in the interest of the company and furthering the purposes for which the company was formed.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board represents the company and owes its duties primarily to the company. The board is to perform its duties in the interest of the company and all its shareholders as a whole, and not in the interest of a specific shareholder or a section of the shareholders. The board is also to take into consideration the interests of the employees in general in performing its duties. However, the interests of the company must always come first, regardless of whether the actions of the board may adversely affect a shareholder.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

The directors owe their duty to the company. The company can bring an action against a director to enforce any duty imposed by law or contract. A shareholder may bring an action to prevent or redress a breach of duty by the directors.

A shareholder may also, with the leave of court, bring a derivative action on behalf of the company where the wrongdoers are directors who are in control and, thus, will not redress the wrong done to the company. A shareholder may also apply for relief from the court on the grounds that the affairs of the company are being conducted in an unfairly prejudicial and oppressive manner.

Care and prudence

20 Do the duties of directors include a care or prudence element?

The directors of a company owe a duty of care and skill to the company and are to exercise the degree of care and skill that a reasonably prudent director would exercise in comparable circumstances. A director is required to exercise the powers and duties of his or her office honestly, in good faith and in the best interests of the company.

Board member duties

21 To what extent do the duties of individual members of the board differ?

The same standard of care in relation to the duties of a director is expected of all members of the board, including executive and non-executive directors. The relationship is a fiduciary one, and directors are trustees of the company's assets and are bound to exercise their powers in the interest of the company.

However, there may be additional contractual liabilities and benefits for executive directors under the principles of 'master and servant' where there is a contract to that effect.

Delegation of board responsibilities

22 To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The board is empowered, subject to any specific provisions in the articles to the contrary, to delegate any or all of its powers to a managing director or to committees made up of members of the board. The managing director or committee shall, in exercising the responsibilities delegated to them, conform to any directions or regulations of the board. However, this delegation should not be done in such a way that it amounts to an abdication of duty. Even after delegating its powers, the overall responsibility of directing and managing the affairs of the company still ultimately lies with the board.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Non-executive directors are those whose roles are strictly supervisory and who do not participate in the day-to-day running of affairs of the company but are, nevertheless, important members of any board in that they play a key role in the transparency, integrity and credibility of the board. An independent director, on the other hand, serves the function of bringing an objective, unbiased perspective to the board in carrying out its functions.

The Companies and Allied Matters Act 2020 (CAMA) and the various codes that govern specific industries set out different requirements for the numbers and types of directors of companies operating in those sectors, and different definitions of 'independent director'.

CAMA

CAMA makes it mandatory for public companies to have at least three independent directors. This provision has been amended by the Business Facilitation (Miscellaneous Provision) Act, 2022 (the BFA), which provides that the total number of independent directors for a public company should be one-third of the total numbers of directors on the board.

CAMA describes an 'independent director' as a director (or whose relatives either separately or together with the director or each other) during the two years preceding their proposed appointment:

- was not an employee of the company;
- did not:
    - make payments to, or receive payments from, the company of more than 20 million naira;
    - directly or indirectly own more than 30 per cent of shares or other ownership interest in any entity that the company made payments to, or received payments from, of more than 20 million naira; or
    - act as a partner, director or an officer of a partnership or a company that made payments to, or received payments from, of more than 20 million naira;
- did not own directly or indirectly more than 30 per cent of the shares of any type or class in the company; and
- was not engaged, directly or indirectly, as an auditor for the company.

The SEC Code

The Securities and Exchange Commission of Corporate Governance in Nigeria (SEC Code) recommends that there be at least five members of a board, with a mix of both executive and non-executive directors, the latter should outnumber the former, and there should be a minimum of one independent director.

The SEC Code describes an independent director as a non-executive director who:

- is not a substantial shareholder of the company (ie, their shareholding, directly or indirectly, does not exceed 0.1 per cent of the company's paid-up capital);
- is not a representative of a shareholder that has the ability to control or significantly influence management;
- has not been employed by the company or the group of which it currently forms part, or has not served in any executive capacity in the company or the group, for the preceding three financial years;
- is not a member of the immediate family of an individual who is, or has been in any of the past three financial years, employed by the company or the group in an executive capacity;

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- is not a professional adviser to the company or group, other than in the capacity of a director;
- is not a significant supplier to or customer of the company or group;
- has no significant contractual relationship with the company or group and is free from any business or other relationship that could materially interfere with his or her capacity to act in an independent manner; and
- is not a partner or an executive of the company's audit firm, internal audit firm, legal or another consulting firm that has a material association with the company and has not been a partner or an executive of any such firm for the three financial years preceding his or her appointment.

The CBN Code

The Central Bank of Nigeria Code of Corporate Governance for Banks and Discount Houses in Nigeria (the CBN Code) provides that the number of non-executive directors on a bank's board should exceed the number of executive directors, and at least two of the non-executive directors should be independent directors; and that for discount houses at least one non-executive director should be an independent director.

The PENCOM Code

The Code of Corporate Governance for Licensed Pension Operators (the PENCOM Code) provides that the number of non-executive members (excluding the chair) of a board must equal the number of executive directors, and at least one non-executive member should be an independent director. It defines an 'independent director' as one who has no relationship with the company, its related companies or officers that could interfere or be reasonably perceived to interfere with the exercise of his or her independent business judgment.

The NAICOM Code

The National Insurance Commission Code of Corporate Governance for the Insurance Industry in Nigeria (the NAICOM Code) provides that the board of insurance companies should have a minimum of seven and a maximum of 15 members, that the maximum number of executive directors should not exceed 40 per cent of the board, and there should be at least one independent director.

The NCC Code and NCCG

Nigerian Communications Commission Code of Corporate Governance for telecommunication companies (the NCC Code) and the Nigerian Code of Corporate Governance (the NCCG) also provide that the number of non-executive directors should exceed the number of executive directors; however, the NCC Code also requires at least one non-executive director to be an independent director.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

Qualifying for a directorship

Generally, persons of unsound mind, under the age of 18, previously convicted of fraud or breach of duty in connection with the promotion, formation or management of a company, and insolvent persons are statutorily disqualified from being directors.

There is no restriction on the nationality of directors. Non-Nigerian citizens are permitted to be directors. Aside from the NCCG and the NCC Codes, there are no gender requirements for the composition of boards.

A person over 70 years of age, who is or is to be appointed as a director in a public company, is required to disclose his or her age to the members of the company in a general meeting. Failure to do so amounts to an offence under the CAMA. Special notice of the resolution approving or appointing such a director must be given by the company to its members, disclosing the age of the director.

An appointee to the board of a public company is also expected to disclose his or her membership of boards of other companies to enable the shareholders to give full consideration to his or her other obligations and commitments in determining his or her suitability to be a board member.

However, additional criteria are contained in the various Codes that govern specific industries, as can a specific company's by-laws and articles. For example, a company may, by its articles, require that directors hold a specified number of shares. A director who fails to obtain their share qualification within two months of appointment must vacate his or her office until he or she obtains the shareholding qualification.

The PENCOM Code provides that a director of a pension fund administrator must not be a director, an employee, a principal officer or a shareholder in a pension fund custodian with which the pension fund administrator conducts business.

The regulations and guidelines governing certain industries may require managing directors and key management operating in these areas to have specific qualifications.

The SEC Code permits public companies to form governance or remuneration committees, the function of which is to establish the criteria for board and board committee membership and to periodically evaluate the skills, knowledge and experience required to sit on the board.

The CBN Code prescribes that members of the board shall be qualified persons of proven integrity and be knowledgeable in business and financial matters, in accordance with the extant CBN Assessment Criteria for Approved Persons' Regime for Financial Institutions. This is the same position in the CBN Codes for microfinance Banks (MFBs), development finance institutions (DFIs) and finance companies (FCs).

The NAICOM Code also emphasises competence and integrity.

Composition of boards of directors

CAMA requires every company that is not a small company (which can only have one director) to have a minimum of two directors at all times but does not state a maximum number of directors. However, it does provide that the number of directors shall be determined in writing by the subscribers of the company's memorandum of association, or a majority of them with the power of the shareholders at a general meeting to increase or reduce the board.

The laws and regulations governing particular industries also set a minimum and a maximum number of board seats.

- The CBN Code prescribes a minimum and maximum board size of five and 20 directors respectively.
- The SEC Code prescribes a minimum of five directors and directs that the board of a company be of sufficient size relative to the scale and complexity of the operations of the company.
- The NAICOM Code prescribes a minimum of seven and a maximum of 15 board members for insurance companies.
- The PENCOM Code prescribes that the board of a company shall not exceed a size that will allow it to employ simple and effective methods of work to enable each director to feel a personal responsibility and commitment to the company, and the board must take into account the scope and nature of the company's operations.
- The NCC Code requires:

    - that the composition of a board includes a mix of skills, diversity, experience and genders;
    - that the number of directors should reflect the scale, size, complexity and reach of the business of the company;
    - that the skills and resource requirements of the company have to be taken into consideration;
    - a majority of the board to be non-executive directors;
    - at least one independent director must hold, directly or indirectly, no more than 0.1 per cent of a shareholding in the company;
    - one-third of the non-executive directors retire each year by rotation, subject to reappointment; and
    - non-executive directors should not remain on the board of larger companies for a continuous period in excess of 15 years.

- The NCCG does not provide for a minimum or a maximum number of directors, but recommends that a board be of sufficient size to effectively undertake and fulfil its business (ie, overseeing, monitoring, directing and controlling the company's activities) and be relative to the scale and complexity of the company's operations. However, it does require a board to have at least one independent director, who may hold, directly or indirectly, no more than 0.1 per cent of a shareholding in the company.

The CBN Code for MFBs requires the following of MFBs' boards.

- Unit MFB boards:
  - must have a minimum of five and a maximum of seven members;
  - including at least one independent non-executive director (INED); and
  - the managing director or chief executive must be the only executive director.
- State MFB boards:
  - must have a minimum of five and a maximum of nine members, including:
  - at least one INED, if there are five or six members; or
  - at least two INEDs, if there are seven members.
- National MFB boards:
  - must have a minimum of seven and a maximum of 12 members;
  - including at least two INEDs.

The CBN Code for DFIs requires that a board of a DFI:

- has a minimum of seven and a maximum of 11 members; or
- be in accordance with the law establishing the institution; and
- that the board of any FC be limited to a minimum of five and a maximum of nine members.

The CBN Codes for MFBs, DFIs and FCs also provide that:

- no more than two members of a family can be on the board at the same time ('family' includes a director's spouse, parents, children, siblings, cousins, uncles, aunts, nephews, nieces and in-laws); and
- a board must be constituted in such a way that the number of non-executive directors exceeds the number of executive directors.

Filling vacancies

Vacancies on a board may be filled by the shareholders of a company during a general meeting.

A board of directors is also empowered to appoint new directors to fill casual vacancies created by death, resignation, retirement or removal of a director. These appointments are, however, subject to ratification by the shareholders at the next general meeting.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

While the role of the chief executive is to see to the day-to-day running and management of the company, the chair's role is to provide overall leadership, direction and supervision of the board. The separation of the roles of board chair and CEO is considered best practice.

CAMA provides that the chair of a public company must not act as the chief executive of such a company. A similar restriction exists in NCCG.

The SEC Code recommends that the board of a company should not be dominated by any one person, and the positions of chair and CEO should be separate and held by different individuals. In addition, the chair should be a non-executive director to ensure the effective operation of the board.

The CBN Code (including the Codes for MFBs, DFIs and FCs) and the NAICOM Code state that no single person shall hold or combine the office of chair of the board and CEO or managing director. The CBN Code further provides that no executive vice-chair shall be recognised in the board structure.

The PENCOM Code, the NCCG and the NCC Code also require the position of chair of the board and CEO to be occupied by separate individuals.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Audit committees

Every public company is required to set up an audit committee of five members comprising three members and two non-executive directors. Members of an audit committee are not entitled to remuneration and are subject to re-election annually. The functions of an audit committee include:

- ascertaining whether the accounting and reporting policies of the company are in accordance with legal requirements and agreed ethical practices;
- reviewing the scope and planning of audit requirements;
- reviewing the findings on management matters in conjunction with the external auditor and departmental responses thereon;
- keeping under review the effectiveness of the company's system of accounting and control;
- making recommendations to the board regarding the appointment, removal and remuneration of the external auditors of the company; and

- authorising the internal auditor to carry out investigations into any activities of the company that may be of interest or concern to the committee.

The various corporate governance codes require that members of the audit committee should be able to read and understand basic financial statements and be in a position to make valuable contributions to the committee, and the SEC and CBN Codes provide that at least one member of this committee should be financially literate. The SEC Code further provides that, the Committee may seek where necessary, external professional advice.

Risk management and governance or remuneration committees

In addition to an audit committee, the SEC Code permits the board of a public company to establish a risk management committee and a governance or remuneration committee.

The risk management committee assists in overseeing the risk profile and the risk management framework to be determined by the board.

The governance or remuneration committee periodically evaluates the skills and experience required of the individual members of the board and the board as a whole and makes recommendations on the compensation structure for the executive directors of the company.

Committees under the CBN Codes

The CBN Code also directs banks and discount houses in Nigeria to establish committees responsible for overseeing risk management and auditing (it provides that these functions may be carried out by one committee, particularly in small institutions), and a board governance and nominations committee.

The Code proscribes the chair of a board from being a member or chair of any committee, and provides that board committees must be headed by non-executive directors; a board remuneration committee must have at least two non-executive directors; and a board audit committee must have at least three members, consist only of non-executive directors, and be headed by an independent director.

The CBN Codes for MFBs, DFIs and FCs maintain the same positions as the main CBN Code, but make no provisions for the composition of remuneration committees and provide for an additional committee: the board credit committee. The Codes for MFBs and FCs merely state that this committee must be comprised of members knowledgeable in credit analysis.

The Codes for MFBs and FCs require all board committees to have their charters approved and reviewed every three years, or from time to time as determined by the CBN. The CBN Code and the CBN Code for DFIs merely state that each board committee must have a charter that is approved by the CBN.

Finally, the Codes for MFBs and FCs provide that a board may not replace members of the board audit committee and a company's external auditors at the same time.

Committees under the PENCOM Code

The PENCOM Code requires pension fund administrators and pension fund custodians to constitute nominating committees, the duty of which is to make recommendations to the board on all board appointments. This committee must consist of three directors, including the chair of the board and an independent director.

Committees under the NCCG

The NCCG recommends establishing the same committees provided by the CBN Code, and also provides that when appointing members of the board committees, there should be a balanced distribution of power so that no individual has the ability to dominate decision-making and undue reliance is not placed on any individual; that each committee should comprise at least three members; and individual committee charters should indicate if they require INEDs.

It is common practice among quoted companies to have various board committees assist the board in administering the affairs of these companies and strengthening corporate governance. These committees, which may be known by different names in different companies, include nomination committees, general-purpose committees, remuneration or compensation committees, risk assessment committees, strategy committees, and corporate governance and finance committees.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

There are no statutory minimum requirements on the number of board meetings per year. However, directors are required to meet no later than six months after the incorporation of the company. The directors may otherwise regulate their meetings.

The PENCOM, CBN, SEC and NCC Codes, the NCCG, and the CBN Codes for MFBs, DFIs and FCs recommend that board meetings be held at least quarterly in each financial year. The NAICOM Code provides that the board should meet not less than four times a year.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

CAMA

CAMA provides that, where a director presents him or herself for re-election, a record of his or her attendance at meetings of the board during the preceding year must be made available to members at the general meeting where he or she is to be re-elected. Where a person to be appointed or re-elected as a director is 70 years old or older, a notice of his or her election or re-election must disclose his or her age to the shareholders.

The CBN Codes

The CBN Code and the CBN Codes for MFBs, DFIs and FCs require the board to disclose the total number of board meetings held in the financial year and attendance by each director in its annual report.

The CBN Code also provides that members of the board be appraised by an independent consultant annually on all aspects of the board's structure, composition, responsibilities, processes and relationships, and the report of the independent consultant must be presented to the shareholders in the general meeting and to the CBN.

The CBN Codes for MFBs and FCs further provide that a copy of the annual board appraisal conducted by the independent consultant must be forwarded to the CBN no later than 31 March of the following year.

The SEC Code

The SEC Code provides that the board of a public company must include a corporate governance report in its annual reports, to be circulated to members and the regulatory authorities.

The report may contain information on the composition and responsibilities of board committees and records of attendance at board and shareholders' meetings by directors during the period covered by the annual report; The SEC Code provides that the company's annual report ought to make sufficient disclosures on its accounting and risk management issues, indicating the board's responsibility for the process of risk management and its opinion on the effectiveness of the process.

Public companies must also disclose the details of any director's interests in contracts with the company, its subsidiaries or holding companies, and should also disclose any service contracts and any other significant contracts with controlling shareholders.

A company's directors are required to disclose:

- their shareholdings in the company;
- loans made by the company to the director;
- the director's interests in any contract involving the company; and
- any conflicts of interest in relation to the company.

The SEC Code also requires directors to disclose any directorships in other companies, so that the members of the company can take a director's other responsibilities into consideration when assessing his or her suitability as a director.

The NCCG has similar provisions to the SEC Code.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

The NCC Code

Under the NCC Code, the board is required to establish a system for periodic evaluation of its own performance and that of its committees, chair, chairs of its committees, and individual directors. This should be done at least annually.

A statement of evaluation must be included in a company's annual returns, stating whether an evaluation had been conducted during the period under review. The evaluation must be an objective and independent process.

The appraisal of the chief executive is done by the board, or a committee of the board made up of non-executive directors.

The SEC Code

The SEC Code requires the board to establish a system to annually undertake a rigorous evaluation of its own performance and that of its committees, chair and individual directors. The board may engage the services of external consultants to facilitate the evaluation.

The chair oversees the evaluation of the CEO's performance, while the CEO oversees the executive directors' evaluations. The results of the evaluations must be communicated to and discussed by the board as a whole, while the chair must communicate and discuss the evaluation of the independent directors with them. The results are used as a guide for re-election.

The SEC Code recommends providing training for any director whose performance is found to be unsatisfactory or their removal from office if this is not feasible.

The PENCOM Code

The PENCOM Code has similar provisions to the SEC and NCC Codes, but also requires that copies of the evaluations are submitted to the Pension Commission and are included in the company's annual corporate governance report.

Under the PENCOM Code, the evaluation should consider issues such as:

- how well the board performed against any performance objectives that have been set;
- what the board's contribution to the testing and development of the strategy has been;
- whether the composition of the board and its committees is appropriate with the right mix of knowledge and skills to maximise performance in the light of future strategy;
- if the board responded to any problems or crises that have emerged and whether these could have been foreseen;

- how well the board communicates with the management team, company employees and others;
- how effectively the board uses mechanisms such as the annual general meeting;
- whether the board as a whole is up to date with the latest developments in the regulatory environment and the market;
- whether sufficient board and committee meetings of appropriate length are held to enable proper consideration of issues; and
- whether board procedures are conducive to effective performance and flexible enough to deal with all eventualities.

The CBN Codes

The CBN Code requires an annual formal assessment of the effectiveness of the board as a whole, and the contributions of each individual director (including the chair) to the effectiveness of the board.

The nomination committee recommends an evaluation procedure and proposes objective performance criteria, which are then approved by the board. The issues evaluated should include:

- individual directors':
  - attendance at meetings;
  - contributions to discussions at board meetings and board committee meetings;
  - business referrals or other support they provide to the institution;
  - their public standing; and
  - the effects of their standing on the institution's business; and
- the institution's:
  - compliance status;
  - overall performance;
  - regularity of board meetings; and
  - the overall contribution of the board to the institution's performance.

The CBN Codes for MFBs and FCs provide that an independent consultant must annually appraise board members on all aspects of the board's structure, composition, responsibilities, processes and relationships. This report must be presented to shareholders in a general meeting and also forwarded to the CBN no later than 31 March of the following year.

The NCCG

The NCCG provides that a board must establish a system to undertake a formal and rigorous evaluation of its own performance and that of its committees, chair and individual directors, facilitated by an independent external consultant, at least once every three years.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

Remuneration of directors

The Companies and Allied Matters Act 2020 (CAMA) provides that the remuneration of directors should be determined by the company in a general meeting.

The Securities and Exchange Commission Code of Corporate Governance in Nigeria (the SEC Code) provides that the remuneration of executive directors should be set by a remuneration committee consisting wholly of non-executive directors. It also provides that the remuneration for non-executive directors should be fixed by the board and approved by the members in a general meeting and that, where share options are granted as part of the remuneration for directors, the board should ensure that they are not priced at a discount except with the approval of the SEC.

The Central Bank of Nigeria Code of Corporate Governance for Banks and Discount Houses in Nigeria (CBN Code) also requires the remuneration of directors to be fixed by a committee composed of non-executive directors, and the remuneration for non-executive directors should be strictly limited to directors' fees, sitting allowances for board and board committee meetings and reimbursable travel and hotel expenses. Executive directors do not receive sitting allowances and directors' fees.

The CBN Code further provides that stock options offered as part of executive remuneration shall be tied to performance subject to the approval of shareholders in a general meeting, may only be exercisable after one year of the expiry of the director's tenure and may only be priced at a discount on the authorisation of relevant regulatory agencies.

The CBN Code of Corporate Governance for Microfinance Banks (MFBs) in Nigeria, the CBN Code of Corporate Governance for Development Finance Institutions (DFIs) in Nigeria, the CBN Code of Corporate Governance for Finance Companies (FCs) in Nigeria, and the Financial Reporting Council of Nigeria Code of Corporate Governance (NCCG) maintain the same position with the CBN Code in these respects.

The remuneration of each director should be proportionate to his or her skill and experience and should be sufficient to attract, motivate and retain skilled and qualified persons. The remuneration of directors is to be disclosed in the yearly financial statements of the company.

Tenures of directors

The CBN provides that the tenure of executive directors, deputy managing and managing directors (EDs, DMDs and MDs) shall be subject to a maximum tenure of 10 years. However, when an ED or a DMD, becomes the MD or CEO of a bank or any other DMB before the expiration of their maximum tenure, the cumulative term of this director shall not exceed 12 years.

CAMA discourages directors' service contracts beyond a five-year term and provides that a service contract for a term beyond five years is executed must be approved by a resolution of the company before being executed.

The SEC Code, while subjecting the tenure of directors to the provisions of CAMA, recommends that all directors be submitted for re-election at regular intervals of at least once every three years. It also provides that non-executive directors of public companies should serve for reasonable periods on the board, but emphasises the necessity to continually reinforce the board by injecting new energy, fresh ideas and perspective and that the board should ensure the periodic appointment of new directors to replace existing non-executive directors.

Company loans to directors

Companies are prohibited from making loans to directors and are also not allowed to guarantee such loans. However, CAMA provides two exceptions: loans to enhance the performance of the director's duties in the company, and where money lending is one of the company's ordinary businesses and the lending is done in the ordinary course of business.

In addition, substantial property transactions between a company and its directors are prohibited, unless approval is granted by the company by way of an ordinary resolution at a general meeting.

If a director is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company, he or she is required to declare the nature of his or her interest at a meeting of the board.

Banks are also required to disclose details of insider-related credits in their financial statements. These insider-related credits include transactions involving directors, shareholders and employees and their related interests.

Consideration payments

CAMA makes it unlawful for a company to make payment to a director as compensation for loss of office or as consideration for, or in connection with, his or her retirement from office unless particulars of the proposed payment and amount have been disclosed to the members of the company and approved.

Under CAMA, members' approval is also required for compensatory payments to be made where, in connection with the transfer of the whole or part of the undertaking or property of a company, it is proposed to make any payment to a director as compensation for loss of office or as consideration for, or in connection with, his or her retirement from office.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

The remuneration of the managing director is determined by the board.

Companies are prohibited from making loans to directors and are also not allowed to guarantee such loans. However, CAMA provides two exceptions: loans to enhance the performance of the director's duties in the company, and where money lending is one of the company's ordinary businesses and the lending is done in the ordinary course of business.

The Central Bank of Nigeria requires banks to disclose details of insider-related credits, including the aggregate amount of insider-related loans, advances and leases outstanding with non-performing components further analysed, examining the security, maturity, performance, provision, interest-in-suspense and names of borrowers in their financial statements.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Shareholders have a direct say in directors' remuneration. CAMA provides that directors' remuneration should be determined by the shareholders in a general meeting. Such votes take place at the annual general meeting of a company. However, the board fixes the remuneration of executive directors. The NCCG, SEC and CBN Codes stipulate that only the non-executive directors should be involved in decisions regarding the remuneration of executive directors.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted. It is not common practice for companies to take out this insurance, though some companies, in keeping with international best practices, take out liability insurance for their directors and officers.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Companies are permitted to indemnify their directors and officers for liabilities incurred in their capacities as directors and officers of the company, except in cases of negligence, fraud or breach of trust in relation to the company.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

There are no specific provisions or statutory or regulatory restrictions on advancing expenses to directors or officers of a company in connection with litigation or similar proceedings where they are witnesses. The Companies and Allied Matters Act 2020 permits companies to pay directors all expenses incurred in connection with the business of a company. Therefore, arrangements for the payment of these expenses may be made contractually or be part of the policy of a company.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

A company may ratify the act of an officer or director even where such an act or conduct is irregular. The company may also, by its articles (or by the director's contracts of service), limit the liability of a director except in cases of negligence, fraud or breach of trust of which a director or officer may be guilty in relation to the company.

Further, a company may also provide that the liability of a director must be unlimited, regardless of the fact that the company itself is a limited liability company, provided that the director is given notice before he or she takes up the appointment that his or her liability shall be unlimited. The company may also, by special resolution, amend its memorandum make the liability of its directors or managers unlimited.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The memorandum and articles of association and other statutory filings of companies are available to the public at the Corporate Affairs Commission (CAC). Copies can be obtained upon application and are subject to the payment of prescribed fees.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

Annual reports and accounts consisting of the directors' report, auditor's report and financial statements must be filed with the CAC after every annual general meeting of a company. These documents can be accessed by the general public upon payment of the requisite fee.

Other information filed with the CAC, which is available to the public, includes any changes in the composition of the board of directors, return of allotment of shares, change of registered address, charges on the company's assets, the appointment of receivers or liquidators, etc. Outside the statutory requirements, companies are encouraged to also include corporate governance reports laying out the company's governance structure, policies and practices in their annual reports.

Quoted companies are required to make certain disclosures to the Nigerian Exchange Limited and the Securities and Exchange Commission (SEC) from time to time. These disclosures include:

- information on acquisitions of other companies or businesses;
- preliminary results for any year, half-year or quarter and comparative figures in respect of the profits/losses before and after taxation, even if this calls for the qualification that these figures are provisional or subject to auditing;
- information on any proposed changes in the capital structure of the company or redemption of securities;
- financial statements; and
- interim reports, such as first quarter, half-year and nine-month accounts.

In addition, the annual reports must disclose, among other things, the directors' direct and indirect holdings in the issued shares, substantial shareholdings representing 5 per cent or more of issued shares and a five-year financial summary. The CBN Code and the SEC Code also require a board to disclose its risk management policy in its annual report, and the Nigerian Code of Corporate Governance also prescribes including a statement on a company's environmental, social and governance activities in its corporate governance report.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Shareholders can nominate a director to be appointed to the board at the general meeting. The law states that a motion for nomination will be treated as a motion for his or her appointment.

A member may leave a signed notice in writing of his or her intention to propose a person for election to the office of a director in the place of a retiring director at a general meeting at the registered address of a company. The notice must be given no less than three days and no more than 21 days before the date appointed for the meeting and must be accompanied by a notice in writing signed by that person of his or her willingness to be elected.

One or more members representing no less than 5 per cent of the total voting rights of members entitled to vote at a general meeting, or 100 or more members holding shares on which there has been paid up an average sum per member of at least 500 naira, may requisition the company to circulate notice of a resolution they intend to be moved at a general meeting. The proposed resolution can suggest the appointment of a new director.

The company has a duty to give notice of the resolution to members entitled to receive notice of the next annual general meeting when the resolution is intended to be moved. The notice of the resolution shall be given in the same manner and, so far as practicable, at the same time as the notice of the meeting; where not practicable, notice shall be given soon thereafter. The company is, however, not bound to give notice of any requisition unless a duly signed copy is deposited at the registered address of the company, and a sum is deposited or tendered that is reasonably sufficient to meet the company's expenses in giving effect to it. The company may also decide to bear the expenses of circulating notice of the proposed resolution.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

The process of engaging with the shareholders is typically led by the directors and senior management of the company. Generally, companies engage with their shareholders by holding general meetings. It is usual for directors, senior management, external counsel, auditors and other specialists or consultants engaged in relation to matters to be discussed or decided during a general meeting of the company to be involved in these engagements. Some quoted companies also organise pre-annual general meeting forums or dinners for directors, management, investors and major customers, etc, to interact.

The Securities and Exchange Commission Code of Corporate Governance in Nigeria (SEC Code) provides that the general meetings of a company should be the primary avenue for meeting and interaction between the shareholders, management and board of a company. It further requires that general meetings should be conducted in an open manner allowing for free discussions on all issues on the agenda such that sufficient time is allocated to shareholders to participate fully and contribute effectively at the meetings.

The Code of Corporate Governance for the Insurance Industry in Nigeria (NAICOM Code) provides that directors should always communicate information that is understandable and accessible to shareholders in a timely manner and on a regular basis and encourage shareholders to participate in annual general meetings.

Under the Central Bank of Nigeria Code of Corporate Governance for Banks and Discount Houses in Nigeria (CBN Code), banks are encouraged to communicate with their shareholders via their websites. Information to be provided through this means shall include major developments in the bank, risk management practices, executive compensation, local and offshore branch expansions, the establishment of investment in subsidiaries and associates, board and top management appointments, and sustainability initiatives and practices.

The CBN Code of Corporate Governance for Microfinance Banks in Nigeria, the CBN Code of Corporate Governance for Development Finance Institutions in Nigeria and the CBN Code of Corporate Governance for Finance Companies in Nigeria maintain the same position as the CBN Code. However, they add that the operators are encouraged to communicate with shareholders via the website, newsletters, annual general meetings and extraordinary general meetings.

The Nigerian Code of Corporate Governance (NCCG) provides that the board should develop a policy that ensures appropriate engagement with shareholders. The policy should be posted on the company website.

The NCC Code provides that there should be dialogue and engagement between the board and shareholders to align appreciation and attain a mutual understanding of the corporate objectives of telecoms companies.

Sustainability disclosure

41 | Are companies required to provide disclosure with respect to corporate social responsibility matters?

While some of the codes encourage corporate social responsibility, they do not all have specific disclosure requirements.

The SEC Code requires companies to pay attention to the interests of their employees, host communities, consumers and the general public. It further requires that companies demonstrate sensitivity to local social and cultural diversity issues, and mandates that the board report annually on the nature and extent of its social, ethical, safety, health and environmental policies and practices, including the application of options with the most benefit or least damage to the environment, opportunities created for physically challenged persons or disadvantaged individuals, the nature and extent of the company's social investment policy, and the company's policies on corruption and related issues.

The CBN Code requires that banks demonstrate a good sense of corporate social responsibility to their customers, employees, host communities and the general public, and encourages banks to make robust disclosures beyond the statutory requirements of the Companies and Allied Matters Act 2020 and the Banks and Other Financial Institutions Act.

The Nigerian Code of Corporate Governance requires highlights of sustainability policies and programmes covering social issues, such as corruption, community service (including environmental protection, serious diseases and matters of general environmental), social and governance initiatives, to be included in the corporate governance report in the company's annual report.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

There is no direct requirement to disclose the pay ratio between CEOs and other employees of companies. However, various codes of corporate governance require that companies disclose their remuneration policies.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

The various corporate governance codes or regulations have no requirement for disclosure of information on the gender pay gap. The SEC Code requires that companies report annually on the nature and extent of employment equity and gender policies and practices, especially as they relate to executive-level opportunities.

Additionally, the NCCG requires that companies have a clearly defined governance policy with a focus on enhancing gender and diversity on the Board. The policy should be disclosed in the annual report, along with a report on the Board's performance in achieving diversity.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

On 22 November 2022, the National Insurance Commission (the Commission) issued a circular titled – Tenure Limit for Executive Directors of Insurance and Reinsurance Companies (the Circular). By this Circular, the Commission introduced (1) maximum tenure limits of 10 years for executive directors (EDs) and chief executive officers (CEOs) of Insurance and Reinsurance Companies in Nigeria, (2) a cumulative term of 15 years for an ED who is subsequently appointed as a CEO in the same company. In a restructuring arrangement or any other business combination by an insurance company, the service years of the CEO or ED in the company prior to and following the restructuring arrangement or other combination will count towards the 10-year maximum tenure. The Circular also provides for a 12-month transitional period from the effective date regarding existing appointments. All CEOs and EDs who have served for 10 years in the insurance sector have been mandated to cease to continue in such capacity at the expiration of the transition period.

On 9 February 2023, the Honourable Minister for Industry, Trade, and Investment, inaugurated the Technical Working Groups (TWG) for the development of the Nigerian Public Sector Governance Code (NPSGC) and the Nigerian Not-For-Profit Governance Code (NNFPGC). The NPSGC will serve to engender public accountability of government resources and ensure the sustainability of government-owned entities among others. The code is expected to be a set of guidelines that outlines the principles and practices that public sector organisations should follow to ensure they are well managed and accountable to the public they serve. The NNFPGC will enhance public trust in non-profit organisations by promoting transparency, accountability, and ethical behaviour.

On 14 February 2023, the Business Facilitation (Miscellaneous Provision) Act, 2022 (BFA) was passed into law. The enactment of the BFA is part of the government's efforts to deliver an enabling environment for micro, small, and medium-sized enterprises (MSMEs) in Nigeria. The main objectives of the BFA are to promote the ease of doing business in Nigeria and eliminate bottlenecks; and amend relevant business-related legislations. Some of the key highlights of the Act as it relates to the Companies and Allied Matters Act 2020 (CAMA) include the following.

Public companies can now hold their AGMs electronically provided these meetings are held in accordance with the articles of association of the company. The share capital of a company can now be increased by a board resolution however subject to the approval of the general meeting or as provided under the articles of association.

The total number of independent directors for a public company should be one-third of the total number of directors on the board instead of the three provided under CAMA 2020.

Removal of the requirement for public companies to first offer newly created shares to existing shareholders in the proportion of their shareholding. The right of first offer now applies only to private companies and a timeline of 21 days has been imposed for shareholders to make their decision.

Permits the giving of a notice of meeting by electronic means and further amends the voting pattern in a meeting to include electronic voting.

On 24 February 2023, the Central Bank of Nigeria (CBN) with the aim of strengthening governance practices in the banking industry published a circular to all Deposit Money Banks (the Circular), which provides new tenures for bank executives, EDs, deputy managing directors (DMDs) of deposit money banks and financial holding companies. The Circular prescribes a cumulative tenure for EDs, DMDs, Managing Directors (MDs) or CEOs, and Non-Executive Directors (NEDs) of deposit money banks and financial holding companies, among others.

The Circular also introduces a cool-off period of one year for former EDs, DMDs, and MDs of Banks who exit their roles upon or before the expiration of their maximum term before being eligible for appointment as NED to the board of a deposit money bank. However, EDs, DMDs, MDs, and NEDs can only serve as directors in the banking industry for a maximum of 20 years.

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Summary

SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The primary source of law relating to corporate governance is the Korean Commercial Code (KCC), which applies to both listed and unlisted companies. For listed companies, additional regulations relating to public disclosure, the establishment of audit committees and election of outside directors, insider trading and the prohibition of unfair trade practices, among other matters, are contemplated in the Financial Investment Services and Capital Markets Act (the Capital Markets Act).

It is mandatory for listed companies to comply with listing rules, including the Rules on Issuance of Securities and Disclosure, which are derived from the Capital Markets Act, as well as the applicable listing rules of the Korea Exchange, including the KOSPI Market Listing Rules, KOSDAQ Market Listing Rules, KOSPI Market Disclosure Rules and KOSDAQ Market Disclosure Rules.

In this chapter, we focus on the laws, regulations and practices that apply to a Korean joint-stock company, which is the most common form of company in Korea.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The power to enact and amend Korean laws is vested with the legislative body of the National Assembly, wherefrom ministries of the government under the executive branch have the authority to enforce laws that are within their jurisdiction.

The Ministry of Justice and the Financial Services Commission are the primary government agencies responsible for enforcing rules on corporate governance derived from the KCC, the Capital Markets Act and the Act on the Corporate Governance of Financial Companies.

There are no well-known domestic shareholder groups whose views are often considered, albeit there are organisations such as the People's Solidarity for Participatory Democracy whose main objective is to protect the rights and interests of minority shareholders. Likewise, there are no well-known large-scale domestic proxy advisory firms whose views are often considered, but the Korea Corporate Governance Service is a renowned think tank whose views are respected.

The Korea Corporate Governance Service released its Korea Stewardship Code in 2016, in which it recommends that major institutional shareholders should actively participate in matters of corporate governance. As a result, it is foreseeable that the influence and relevance of proxy advisory firms in Korea will increase in the years to come.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Shareholders have the power to appoint or remove directors through the general meeting of shareholders. Under the Korean Commercial Code (KCC), the appointment of directors requires a majority of votes of the shareholders present at the general meeting representing more than a quarter of the total outstanding shares of the company; for the removal of directors, more than two-thirds of the votes are required of those shareholders present at the general meeting representing more than a third of the total outstanding shares of the company.

The board of directors is empowered to execute the business of the company in accordance with the KCC. Accordingly, apart from their ability to appoint or remove directors, shareholders do not otherwise possess any power to require the board to pursue a particular course of action.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

Under the KCC, the following decisions must be reserved to the shareholders, which may be resolved by a majority of votes of the shareholders present at the general meeting of shareholders representing more than a quarter of the total outstanding shares of the company:

- appointment of a director or a statutory auditor;
- approval of annual financial statements;
- approval of remuneration of directors and statutory auditors; and
- declaration of dividends.

For the following decisions that are reserved to the shareholders, the KCC requires a special resolution comprising more than two-thirds of the votes of the shareholders present at the general meeting of shareholders representing more than a third of the total outstanding shares of the company:

- transfer of all or a material portion of the company's business;
- removal of directors and statutory auditors;
- amendments to the articles of incorporation of the company;
- capital reduction;
- mergers and spin-offs of the company;
- dissolution or continuance of the company; and
- granting of stock options.

In addition, when exempting directors or statutory auditors from liability incurred by the company, unanimous approval of shareholders is required.

Under the KCC, there are no matters for which a non-binding shareholder vote is required.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Disproportionate voting rights are not permitted under the KCC. However, there may be limits on the exercise of voting rights in exceptional circumstances, such as the following:

- issuance of different classes of shares with no voting rights or restricted voting rights;
- treasury stocks acquired by the company have no voting rights;
- if the company, its parent or subsidiary holds more than 10 per cent of the total outstanding shares of another company, the shares in the company or its parent company held by the other company have no voting rights;
- voting rights of a shareholder are restricted if that shareholder has a special interest in the resolution to be adopted at a meeting of shareholders; and

- when electing statutory auditors, a shareholder who holds more than 3 per cent of the total outstanding shares of the company, exclusive of non-voting shares, may only vote on up to 3 per cent of his or her shares.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

There are no special requirements for shareholders to participate in general meetings of shareholders, but a shareholder must first be registered as a holder of the company's shares as of the applicable record date designated by the company.

Although the general requirement is for meetings of shareholders to be held in person, a company with capital of less than 1 billion won may, by unanimous agreement of all shareholders, resolve matters by way of written resolution in lieu of a meeting, which will have the same effect as if this written resolution was passed at a meeting of shareholders.

Although virtual meetings of shareholders are not permitted under the KCC, virtual voting is permitted where a company has determined that its shareholders may exercise their votes by electronic means and its shareholders vote electronically on the premise that a general meeting of shareholders is being held in person.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

A shareholder or group of shareholders holding more than 3 per cent of the total outstanding shares of the company (more than 1.5 per cent for listed companies, held for the preceding six-month period) may requisition the board to call an extraordinary general meeting of shareholders. In addition, a shareholder or group of shareholders holding more than 3 per cent of the total outstanding shares of the company, excluding non-voting shares (more than 1 per cent for listed companies and more than 0.5 per cent for listed companies with capital in excess of 100 billion won, held for the preceding six-month period) may make a proposal to directors that certain matters be raised as agenda items for a general meeting of shareholders (eg, the appointment of a director), which is referred to as a 'shareholder proposal'. Apart from the foregoing, shareholders are not otherwise authorised to demand that the board circulate statements by dissident shareholders.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Controlling shareholders do not owe duties to the company or to non-controlling shareholders under the KCC; however, any person, including controlling shareholders, instructing a director to conduct business by using their influence over the company, conducting business under the name of a director or conducting business by using a title that may give the impression that they are authorised to conduct the business of the company, will, in each instance, be seen as a director for the purposes of the KCC, thereby attracting liability and responsibility for compensating losses resulting from these actions.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Under the KCC, a shareholder's liability is limited to the acquisition or subscription price of their shares; however, the Supreme Court of Korea had previously held that there may be exceptions for situations where companies are essentially sole proprietorships or deemed to have no substance, but incorporated merely for the purpose of shielding legal implications that would otherwise apply against the individual proprietor, leading to a ruling that, in such cases, the corporate veil may be pierced, thereby imposing personal liability on the individual proprietor. In addition, under Korean tax law, a shareholder who owns more than 50 per cent of the total outstanding shares of a company may, in certain cases, be liable for the company's secondary tax liability in proportion to their ownership interest.

Employees

10 What role do employees have in corporate governance?

Employees have a limited role in corporate governance, and are generally not entitled to management rights (such as representation on the board of directors) or consultation rights (including on employment issues that affect them); however, a company with 30 or more employees must establish a labour management council (LMC) comprising three to 10 employee representatives and an equal number of management representatives to consult, resolve or report certain managerial and employment-related matters pursuant to the Employee Participation and Cooperation Promotion Act (CPCPA).

Under the CPCPA, the LMC serves three purposes: consultation, resolution and reporting on various matters, including the following.

- Matters for consultation: productivity improvement; hiring, posting, educating and training of employees; handling employee grievance; general principles on coordination and restructuring of employees resulting from managerial or technological reasons, etc.
- Matters for resolution: establishment of a basic plan for employee training and skill development; establishment and management of employee welfare facilities; establishment

of the company welfare fund; matters not resolved by the grievance handling committee; and establishment of various labour management cooperative committees.

- Matters for reporting: management plans and results; quarterly production plans and results; manpower plans and results; and economic and financial conditions of the company.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

Anti-takeover devices such as the following are prohibited under the Korean Commercial Code (KCC):

- any form of poison pills granting shareholders the right to acquire new shares out of treasury at discounted prices;
- any form of golden shares that could veto certain matters, such as mergers, irrespective of the proportion of golden shares issued on a fully diluted basis; and
- any other form of securities with anti-takeover attributes, such as shares with multiple voting rights.

However, there are requirements for disclosure under the Financial Investment Services and Capital Markets Act (the Capital Markets Act) that stipulate that an investor who holds or will hold, pursuant to a share purchase agreement, 5 per cent or more of the total number of the shares of a listed company must disclose the status and purpose of this shareholding (referring to their intention to exert influence over the management of the company) within five days from, to the extent applicable, the execution of the share purchase agreement and the acquisition, respectively. In addition, upon reaching this level of interest, subsequent disclosures must be made for any change of 1 per cent or more in the shareholding of the investor. In light of the foregoing, an investor's stakebuilding and takeover strategy are significantly affected by these disclosure requirements.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Unless provided otherwise in the articles of incorporation, the board is permitted to issue new shares without shareholder approval. Although shareholders possess pre-emptive rights to acquire new shares in proportion to their respective shareholdings, new shares may be allocated to third parties (new shareholders) when deemed necessary by the board of directors to achieve certain business objectives of the company, including the introduction of new technology and the improvement of the financial structure of the company.

Restrictions on the transfer of fully paid shares

13 Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Restrictions, such as the requirement of board approval for the transfer of fully paid shares, may be permitted in the articles of incorporation, in which case a transfer without board approval will be invalid. In addition, restrictions on the transfer of fully paid shares are commonly adopted in shareholders' agreements; however, shares transferred in violation of these agreements alone will not cause the transfer to be invalid but instead result in liability for the transferrer in respect of damages caused by the breach of the agreement.

Compulsory repurchase rules

14 Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Compulsory share repurchases are not allowed under the KCC, nor are there any circumstances in which these repurchases would be allowed.

Dissenters' rights

15 Do shareholders have appraisal rights?

Under the KCC, if there is a resolution of the board of directors in connection with a merger, a spin-off followed by a merger, a business transfer, or a comprehensive exchange or transfer of shares, and this transaction meets certain materiality requirements, a shareholder who opposes this resolution may request that the company purchase the shareholder's shares. Further, under the Capital Markets Act, a vertical split-off and a lateral spin-off of a listed company where shares of the spun-off entity would not be listed may also trigger these appraisal rights of dissenting shareholders.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

Unlike in certain other jurisdictions, where a two-tier board structure consisting of a supervisory board and a management board is permitted or mandated by law, a two-tier board structure is not recognised under Korean law. Thus, the predominant board structure in Korea (including for listed companies) is best categorised as one-tier.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The board's primary legal responsibilities consist of making key decisions on issues of corporate governance and the business of the company, including:

- transactions involving any disposition or transfer of material assets of the company;
- borrowing of significant amounts of money;
- the appointment or dismissal of managers; and
- the establishment, change or closure of branch offices.

In addition, the Korean Commercial Code (KCC) vests certain powers with the board of directors, including:

- calling general meetings of shareholders;
- approving competitions with the company by directors;
- dealing with the wrongful taking of corporate opportunities or self-dealing transactions;
- approving transactions between listed companies and their largest shareholders; and
- issuing bonds and payment of interim dividends.

A board resolution to approve these transactions generally requires the presence of a majority of all directors and affirmative voting of a majority of the directors present at a meeting, unless this voting requirement is enhanced by the company's articles of incorporation. However, for the approval of usurpation of corporate opportunities and self-dealing transactions, a supermajority vote of two-thirds or more of all directors is required.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

Although members of the board are elected by the shareholders of the company, the board, and each of its members, only represents and owes legal duties to the company.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Directors who intentionally or negligently violate the articles of incorporation of the company or applicable laws, or omit to perform their duties, are jointly and severally liable for damages resulting from these acts or omissions.

A shareholder who holds more than 1 per cent of the total outstanding shares of the company (0.01 per cent for listed companies, held for the preceding six-month period) may demand that the company file a lawsuit against the director in respect of the foregoing acts or omissions.

In addition, shareholders who hold more than 1 per cent of the total outstanding shares of a company (0.05 per cent for listed companies, held for the preceding six-month period or, for a company with at least 100 billion won of capital, 0.025 per cent) may, on behalf of the company, file a claim with a court demanding the suspension of activities of a director who violates the articles of incorporation or applicable laws.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

The board's duties are subject to a standard of duty of care of a good manager in similar circumstances, which includes participation in meetings of the board of directors, supervision of other directors of the company, including representative directors, and observance of these duties as are prescribed under law or contemplated in the articles of incorporation.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

The duties of individual members of the board do not differ, regardless of their respective qualifications or experience.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

Subject to the articles of incorporation of the company, the board may delegate certain responsibilities to board committees and to the representative director.

Generally, board committees can exercise the powers of the board of directors on a range of matters, except the following:

- proposal of any matter that requires approval from the general meeting of shareholders;
- appointment or dismissal of the representative director;
- establishment of a board committee, including the appointment or dismissal of its members; and
- any matters that are subject to the articles of incorporation.

In addition, provided that the scope of these activities is defined in advance, the board may delegate to the representative director the authority to implement the day-to-day activities of the company, except the following:

- disposal or transfer of material assets;
- borrowing of large-scale assets;
- appointment or dismissal of managers; and
- management of certain affairs, such as the establishment, transfer or closure of branch offices.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Under the KCC, the members of the board of directors may be divided into three main groups comprising 'inside directors', 'outside directors' and 'non-executive directors' (ie, other directors not directly engaged in the regular business of the company). Although each type of director assumes the duties of a standard director, outside directors are not immediately engaged in the regular business of the company and are seen to be independent of the controlling shareholders and management of the company. 'Non-executive directors' may be defined as directors that do not directly engage in the regular business of the company but are not considered outside directors.

For unlisted companies, it is not a requirement to appoint outside directors, but in the case of listed companies with total assets of less than 2 trillion won as of the end of the immediately preceding fiscal year, at least a quarter of the members of the board of directors must be outside directors. (For listed companies with total assets exceeding 2 trillion won as of the end of the immediately preceding fiscal year, at least three outside directors that comprise a majority of the members of the board are required).

There is no minimum number of non-executive directors required by law.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

Under the KCC, a company with a total capital of less than 1 billion won may have one or two directors; otherwise, the requirement is to appoint at least three directors. The size of the board can also be determined in the articles of incorporation, subject to the foregoing requirements under the KCC.

Although there is no maximum number of seats on the board, the size of the board can be fixed in the articles of incorporation.

Directors are appointed at the general meeting of shareholders, during which vacancies or newly created seats on the board can be filled. In the event of a vacant seat on the board, the director who previously held this vacant seat continues to have the rights and obligations of a director until his or her replacement has been elected to the board.

Although there are no particular criteria required to become a director, a statutory auditor of a company cannot concurrently hold the office of director. Furthermore, a person who falls within any of the following cannot be an outside director of a company:

- directors and employees who are engaged in the regular business of the company, or directors, auditors and employees who have been engaged in the regular business of the company within the previous two years;
- if the largest shareholder is a natural person, the largest shareholder, his or her spouse, lineal ascendants and lineal descendants;
- if the largest shareholder is a company, directors, auditors and employees of the largest shareholder;
- spouses, lineal ascendants and lineal descendants of directors, auditors or executive officers of the company;
- directors, auditors, executive officers and employees of the parent or a subsidiary of the company;
- directors, auditors, executive officers and employees of another company that has a significant interest in the company, such as business relations; and
- directors, auditors, executive officers and employees of another company in which directors or employees of the relevant company work as directors, auditors, executive officers or employees.

In addition, the KCC stipulates reasons for disqualification of an outside director of a listed company, including the following:

- a person who is a minor, or has been found to be incompetent or quasi-incompetent;
- a person for whom two years have not passed since being dismissed or removed from office after he or she violated acts relating to finance separately determined by presidential decree, including but not limited to the Financial Investment Services and Capital Markets Act (the Capital Markets Act), the Banking Act and the Insurance Business Act;
- the largest shareholder, and his or her specially related parties under the meaning of article 542-8 of the KCC;
- a shareholder who:
    - owns more than 10 per cent of the total number of issued shares, other than non-voting shares, by his or her calculation regardless of the name of a shareholder; or
    - exerts de facto influence on important matters related to the management of listed companies; and
    - his or her spouse, lineal ascendants and lineal descendants;
- a person who has served for more than six years as an outside director at the relevant listed company, or over nine years in total as an outside director at the relevant listed company or its affiliates; and
- a person determined by presidential decree to have difficulty in faithfully performing his or her duty as an outside director, or who may have an influence on the management of listed companies.

Information on directors, including their names and dates of birth, and information on the representative director, including the name, date of birth and address, are disclosed to third parties in the commercial registry. In addition, with reference to listed companies and companies prescribed under the Capital Markets Act, information relating to each director's duties, career experience and terms of office, as well as information relating to the composition of committees are made available in the business report submitted to the Financial Services Commission and the Korea Exchange, which will then be disclosed to the public.

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Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

Although the office of the chief executive is not recognised in the KCC, the office of the representative director plays a similar role.

There is no particular requirement that the roles of the representative director and board chair be joint or separate, and each company specifies its own approach to corporate governance in this regard in the articles of incorporation.

Common practice is for the board chair to be appointed by the board of directors (and it is also common for the representative director to be appointed to this role), as contemplated in the articles of incorporation.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

It is mandatory for listed companies whose total assets are more than 2 trillion won, as of the end of the immediately preceding fiscal year, to establish an audit committee led by outside directors accounting for at least two-thirds of the membership of this committee (the audit committee), with at least one member who is an accountant or financial professional, and a committee for recommending candidates for outside directors (the outside director recommendation committee) comprising outside directors representing a majority of the membership of this committee.

The outside director recommendation committee recommends candidates to be appointed as outside directors at the general meeting of shareholders. At these meetings, only those candidates who have been so recommended can be appointed by the shareholders.

The audit committee has a similar function to that of a statutory auditor (ie, supervision of other directors and the accounting of the company).

Apart from the committees discussed above, a company may (but is not obliged to) establish other board committees comprised of at least two directors, varying in terms of their role, authority and function, as may be contemplated by the articles of incorporation or any resolution of the board of directors.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Although there is no minimum or set number of board meetings per year required by law, regulation or listing requirements, the representative director must report the performance of the company to the board of directors once every quarter, which will require the board to convene at least four times a year.

The directors must be physically present at a board meeting. However, it is permitted for a director to participate in the resolution by means of a mode of communication whereby audio signals are simultaneously transmitted (eg, by conference calls), and a director participating through these means is deemed to be physically present at the board meeting unless this method is prohibited under the company's articles of incorporation.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

Under the Capital Markets Act, companies that are required to submit annual reports, such as listed companies, must submit quarterly, semi-annual and annual reports to the Financial Services Commission and to the Korea Exchange, which are then publicly disclosed. These reports contain information regarding the composition of the board, major items resolved by the board, including whether each outside director voted in favour of or against these items and, if applicable, the composition and activities of the subcommittees of the board. In addition, KOSPI Market Disclosure Rules require listed companies with total assets of not less than 1 trillion won as of the end of the immediately preceding fiscal year and listed financial companies to disclose information about board operations, including committee structures and activities of outside directors, in their corporate governance report to be submitted by the end of May each year.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

There are no evaluations of the board, its committees or individual directors mandated under applicable laws.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

Unless provided otherwise in the articles of incorporation, remuneration of directors is determined by shareholders at the general meeting of shareholders. In practice, shareholders typically set the aggregate amount of funds available for remunerating the board of directors and then authorise the board to decide among themselves the individual remuneration payable to each director. Companies that are required to submit annual reports must include in these reports the amount of remuneration approved at the general meeting of shareholders and the amount of remuneration paid to all directors and statutory auditors.

Under the Korean Commercial Code, the term of office of a director may not exceed three years, with an exception that the term may be extended by the articles of incorporation until the closing of an ordinary general meeting of shareholders convened in respect of the last period for the settlement of accounts within that term of office. In addition, a company may reappoint the director whose term of office has expired, extending the length of the director's service beyond three years as a result.

For any director to enter into a loan or other transaction with the company, they must first obtain the approval of a two-thirds majority of the board of directors in advance, and the terms of these transactions must be reasonable and fair. In the case of listed companies, no transactions involving the lease of property to or from directors are permitted, and these companies are prohibited from extending credit to or guaranteeing the obligations of their directors.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

Unless provided otherwise in the articles of incorporation, remuneration of the most senior management of a company is determined by shareholders at the general meeting of shareholders. In practice, shareholders typically set the aggregate amount of funds available for remunerating senior management and then authorise the senior management to decide among themselves the individual remuneration payable to each individual. Companies that are required to submit annual reports must include in these reports the amount of remuneration approved at the general meeting of shareholders and the amount of remuneration paid to all senior management.

There is no particular law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers; however, in the case of financial institutions, a remuneration committee must be established within the board in accordance with the Act on the Corporate Governance of Financial Companies, and the remuneration of senior managers of these companies must be determined by this committee.

In the case of listed companies, no transactions involving the lease of property to or from the senior management are permitted, and these companies are prohibited from extending credit to or guaranteeing the obligations of their management.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Shareholders can set the aggregate amount of funds available for remunerating the board of directors, but in practice, decisions relating to the remuneration of individual directors and senior management are often delegated to the board. Shareholders may vote on the remuneration of directors and senior management at any general meeting of shareholders.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted under the Korean Commercial Code (KCC). Listed companies and large Korean companies are increasingly adopting these policies into their corporate governance framework. It is common practice for Korean companies to bear the cost of these policies' premiums.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

Under the KCC, a company may indemnify a director by unanimous approval of the share-holders or, in accordance with its articles of incorporation, indemnify the amount of liability incurred by a director that exceeds six times (in the case of outside directors, three times) his or her remuneration for the year; however, this does not apply in respect of loss or damage caused by the wilful misconduct or gross negligence of a director. Subject to the foregoing limits, it is common for companies to adopt an indemnity policy for their directors and officers in the articles of incorporation.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Korean courts have ruled that, as a general principle, a company may advance, pay or otherwise compensate for legal costs and expenses incurred (or to be incurred) by a director or officer resulting from litigation or other legal proceedings in which he or she is named a party; however, the board of directors that approves this advance, payment or compensation may be held liable for the amount advanced, paid or compensated, as the case may be.

In addition, Korean courts have also recognised and applied the principle of the business judgment rule in circumstances where the following thresholds have all been met, in which case the board of directors that approved the relevant advance, payment or compensation will not be held liable:

- the conduct of the director or officer involved in the litigation or legal proceeding qualifies as conduct performed in the name and on behalf of the relevant corporate body (ie, not as an individual);
- such conduct was legitimate (ie, not illegal);
- the company has an interest in the outcome of the litigation or other legal proceeding and its active participation and defence of this litigation or other legal proceeding will ultimately benefit the company; and
- the legal costs and expenses advanced, paid or compensated by the company is within a reasonable range (what constitutes 'reasonable' is determined on a case-by-case basis).

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

A company may limit the liability of a director if contemplated in its articles of incorporation or exempt a director from liability by unanimous approval of shareholders.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

For unlisted companies, the articles of incorporation must be kept at the head office and are not made publicly available, albeit certain portions of the articles (such as the business objectives of the company and the terms of the preferred shares and convertible or redeemable securities) may be gathered from the commercial registry maintained with the court registration office. Any shareholder or creditor of a company may, at any time during its business hours, inspect the articles of incorporation and request a copy thereof.

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For listed companies, the articles of incorporation are attached to their annual report and are publicly available on the website of the Data Analysis, Retrieval and Transfer System (DART) maintained by the Financial Supervisory Service.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

For listed companies and companies that are obliged to submit an annual report, regular disclosures must be made on their business through quarterly, semi-annual and annual reports, which are made available to the public on DART. In addition, these companies must submit timely reports setting forth information on material events that have an effect on the management or assets of the company (eg, merger, spin-off, comprehensive exchange of shares, transfer of a material business (assets), sale or transfer of treasury stocks and issuance of convertible bonds or bonds with warrants). KOSPI Market listed companies with a certain asset size or those that are financial companies must also submit a corporate governance report every year, dealing with core principles of corporate governance on a comply-or-explain basis. These reports are also made available to the public on DART.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

A shareholder or group of shareholders holding more than 3 per cent of the total outstanding shares of the company, excluding non-voting shares (more than 1 per cent for listed companies and more than 0.5 per cent for listed companies with capital in excess of 100 billion won, held for the preceding six-month period) may make a shareholder proposal to the board specifying their candidates to be nominated for election to the board at the general meeting of shareholders no later than six weeks prior to the general meeting. Shareholders do bear the costs of this notice.

With reference to listed companies with total assets of more than 2 trillion won, only candidates nominated by a special committee can be elected as an outside director at the general meeting of shareholders; these candidates must include candidates recommended through the shareholder proposal, submitted at least six weeks prior to the general meeting.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

Companies have limited engagement with shareholders; however, listed companies often have investor relations departments that are in charge of responding to inquiries and requests of shareholders.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

Although reform on laws relating to the mandatory disclosure of corporate social responsibility matters has been advocated in recent years, amendments to these laws have yet to be approved. Therefore, under current law, a company has no obligation to disclose corporate social responsibility matters.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

Apart from the requirement for listed companies to disclose the remuneration of executive officers exceeding 500 million won and the average remuneration of the directors and statutory auditors, there is no requirement to disclose this pay ratio.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

The gender pay gap is not subject to disclosure.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Adoption of a package of measures to strengthen the protection of general shareholders in vertical split-offs

The Enforcement Decree of the Capital Markets Act, amended on 27 December 2022, added a vertical split-off as an event where stock appraisal rights are granted to opposing shareholders of a listed company.

Along with the amendment, additional measures were taken by the Korea Exchange to require additional information on transactions involving a vertical split-off (eg, purpose and expected impact of the transaction, shareholder protection plan, and the expected timeline for an initial public offering of the split-off entity) in the related disclosure (report on material events), and to reinforce a listing review of such entity by considering the sufficiency of efforts taken to protect the existing shareholders of its parent company.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The primary sources of law are the provisions on stock corporations in the Swiss Code of Obligations and, for listed companies, the Swiss Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading. In the financial sector, the regulations and practice of the Swiss Financial Market Supervisory Authority (FINMA) regarding corporate governance also have to be complied with.

Further, there are the listing rules and circulars of the two Swiss stock exchanges, SIX Swiss Exchange (SIX) and BX, in particular the SIX Directive on information relating to corporate governance, obliging issuers to disclose certain information with regard to corporate governance in a separate section of their annual reports on a comply or explain basis.

Also of relevance is the Swiss Code of Best Practice for Corporate Governance published by Economiesuisse, a federation representing the interests of the Swiss business community. The Swiss Code of Best Practice for Corporate Governance contains non-binding recommendations that serve as guidelines for good governance. The Swiss Code of Best Practice for Corporate Governance primarily addresses listed companies, but it is also used by non-listed companies and other organisations. Economiesuisse, in addition, has issued the Guidelines for institutional investors governing the exercise of shareholder rights in Swiss listed companies, containing best practice for the exercise of shareholders' rights by institutional investors.

Lastly, there are proxy voting guidelines of influential proxy advisers, such as Ethos or ISS, which include corporate governance principles. The answers in this chapter are focused on generally applicable corporate law and do not address specific regulations applicable to regulated companies, in particular in the financial sector.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The Swiss parliament (legislative body) and the Federal Council (executive body) enact laws and ordinances. As regards regulations applicable to listed companies, FINMA and the Swiss Takeover Board are responsible for enforcing stock exchange and public takeover law. Stock exchange law is also enforced by SIX and BX.

There are various proxy advisers active in Switzerland, among which Ethos is probably the most influential.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

The shareholders' meeting elects and removes the members of the board of directors (the board). This duty is nontransferable. The shareholders' meeting of listed companies is required to hold these elections on an annual basis; non-listed companies may provide for a term of office of three years, unless the articles of association provide otherwise; but the term of office may not exceed six years. Members of the board must be elected individually; for non-listed companies the articles of association or the chair of the shareholders' meeting in accordance with the consent of all shareholders represented may provide otherwise. Reelection is permitted. The shareholders' meeting of listed companies also elects the chair of the board and the members of the compensation committee, which must be established mandatorily; in non-listed companies, the board may define its organisation without requiring a shareholders' vote but the articles of association may provide otherwise.

Pursuant to the Swiss Code of Obligations, one or more shareholders representing at least 5 per cent of a listed respectively 10 per cent of a non-listed company's share capital or votes may request that the board convene a shareholders' meeting. These shareholders, or any other shareholders representing at least 0.5 per cent of a listed respectively 5 per cent of a non-listed company's share capital or votes may demand that an item be put on the agenda.

There are various rights of individual shareholders, for example, to request information about the company's affaires in shareholders' meetings – in non-listed companies also outside of shareholders' meetings –, to request inspection of certain books and records of the company, to request a special investigation to be conducted regarding the conduct of business by the board (subject to a shareholders' vote with the required quorum) and to present motions to shareholders' meetings, to the extent covered by the agenda items.

Elections of board members and most other resolutions of the shareholders' meeting require the absolute majority of the votes represented at the respective meeting. Beyond these resolutions regarding shareholders' matters, the shareholders have no right to require the board to pursue a particular course of action.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

In listed and non-listed companies, the following non-transferable matters require a resolution by the shareholders' meeting:

- adoption and amendment of the articles of association;
- election of the members of the board and the auditors;
- approval of the management report and, if applicable, the consolidated group financial statements;
- approval of the annual financial statements and use of the balance sheet profits; in particular, the determination of dividends;
- determination of interim dividends and approval of the interim financial statements required therefore;
- repayments out of the statutory capital reserve;
- discharge of the members of the board; and
- adoption of decisions reserved for the shareholders' meeting by law or the articles of association.

In listed companies, the following additional matters require a resolution by the shareholders' meeting:

- delisting of the shares;
- election of the chair of the board;
- election of the members of the compensation committee
- election of the independent proxy; and
- approval of the compensation of the board, the top-level management (the management) and the advisory body.

Swiss corporate law does not provide for non-binding shareholder votes. However, non-binding votes regarding past compensation reports are still held in shareholders' meetings of most listed companies to allow the shareholders to express their opinion.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Companies may introduce classes of shares with a voting preference or a voting limit in their articles of association (ie, a clause that limits the ability to exercise voting rights by a shareholder or group of shareholders to a certain percentage of the total votes). The maximum ratio permitted between common shares and shares with a voting preference is 1:10. Voting preferences do not apply to certain decisions of the shareholders' meeting, in particular the appointment of experts to audit the company's management, special investigations or the initiation of a liability claim against board members.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

In the case of registered shares, a shareholder must be registered in the share register to participate and exercise its membership rights in a shareholders' meeting. With respect to bearer shares, the authority to participate and to exercise the membership rights derives from the possession and presentation of the bearer shares. A shareholder may be represented by a third party, which, unless otherwise provided for in the articles of association, must not be a shareholder.

The membership rights (including the right to vote) in non-listed companies are suspended if and as long as the shareholder fails to comply with its reporting obligation regarding the beneficial ownership of the shares. This reporting obligation applies, with respect to registered shares, if a stake of 25 per cent or more of the share capital or votes is acquired and, for bearer shares, in respect of any acquisition, in both cases unless the shares are issued as intermediated securities in accordance with the Federal Act on Intermediated Securities.

Provided that no shareholder or its representative raises an objection and requests a verbal discussion, shareholders' resolutions may be passed by written consent (wet ink or qualified electronical signature) or in electronic form (eg via email) as a shareholders' circular resolution.

Virtual shareholders' meetings (without a physical meeting) are permitted, provided that the articles of association provide so and the board appoints an independent proxy. For listed companies, the appointment of an independent proxy is mandatory; for non-listed companies, the articles of association may provide the option to waive this requirements. The board is required to regulate the use of electronic means by issuing regulations or directives to ensure that:

- shareholders participating are identified;
- oral contributions are directly transmitted;
- shareholders participating are enabled to propose motions and participate in discussions; and

- voting results may not be manipulated.

Additionally, the board may decide for the conduct of multisite and hybrid shareholders' meetings (including video and sound transmission as well as direct voting). If the articles of association provide so and an independent proxy is appointed, a shareholders' meeting with its location outside of Switzerland is permitted. In this case, the appointment of an independent proxy may be waived by non-listed companies, with the approval of all shareholders.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Outside of shareholders' meetings, shareholders may require extraordinary shareholders' meetings to be convened by the board if, alone or together, they represent at least 5 per cent of a listed respectively 10 per cent of a non-listed company's share capital or votes. Such a request to the board must be made in writing and be sufficiently precise. If such a request is not complied with within a reasonable time period, the shareholders may request a court to convene a shareholders' meeting.

With the exception of resolutions on the convocation of a shareholders' meeting, on the appointment of an auditor, or to carry out a special investigation, an amendment of the agenda will generally be necessary to vote on resolutions against the wishes of the board. Shareholders representing at least 0.5 per cent of a listed respectively 5 per cent of a non-listed company's share capital or votes may demand such an amendment of the agenda, which must be requested sufficiently early to allow the amended invitation to the shareholders' meeting to be issued in time (ie, in accordance with the law, at least 20 days before the shareholders' meeting (the articles of association may prolong this deadline but not shorten it)). However, it is often impossible to obtain a decision of the court in time, so usually it is also necessary to request a convocation of a new shareholders' meeting.

It should be noted that:

- the aforementioned requirements may be made less (but not more) stringent by the company's articles of association (this is often the case in listed companies and is addressed by the Swiss Code of Best Practice for Corporate Governance as a way to comply with the recommendation that companies should endeavour to facilitate the exercise of shareholders' statutory rights);
- during a shareholders' meeting, any shareholder may require a vote on the convocation of another shareholders' meeting; and
- shareholders representing 100 per cent of the share capital are always free to hold a universal assembly, in which case the limitations mentioned above become irrelevant.

Dissident shareholders may require statements to be made into protocols in the minutes of the shareholders' meeting. However, they may not request that the board circulate dissenting statements prior to or after shareholders' meetings. Any shareholder of listed and non-listed companies may request access to the shareholders' meeting minutes within

30 days following the respective meeting. For listed companies, the resolutions and election results with details on the percentage of votes must be accessible electronically within 15 days following the shareholders' meeting.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

In non-listed companies, the only duty of all shareholders, including controlling shareholders, is to pay the issue price for their shares.

In listed companies, shareholders (or groups of shareholders) reaching or exceeding the threshold of 3 per cent of all voting rights have certain disclosure obligations, and shareholders (or groups of shareholders) reaching or exceeding the threshold of one-third of the voting rights have the duty to make an offer to all other shareholders to acquire their shares at a certain minimum price. The threshold for this duty to make a mandatory offer may be increased in the articles of association to up to 49 per cent of the voting rights, or the company may opt out from the requirement to make such an offer. The Swiss Financial Market Supervisory Authority and the Swiss Takeover Board may enforce these duties.

It has become more common for controlling shareholders to enter into relationship agreements with the (listed) company they control. These agreements typically contain provisions regarding the composition of the board, information flow to the shareholders, the decision-taking process, and other matters found in shareholders' agreements.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

The piercing of the corporate veil and, thus, a direct liability of a shareholder for acts or omissions of a legal entity is limited to highly qualified abuse of right situations. Additionally, if a shareholder is involved in the management of a company, he or she may be deemed to be a de facto body of this company and, thus, be held liable for intentional or negligent breach of his or her duties.

Employees

10 What role do employees have in corporate governance?

Employees have no specific role under Swiss corporate law. In particular, there is no obligation to elect an employee representative to the board.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

Yes, in particular, the following:

- transfer restrictions on registered shares;
- voting limits;
- privileged voting shares; and
- introduction of an increased quorum for certain shareholders' decisions.

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Shares may only be issued with prior authorisation by the shareholders' meeting.

Each shareholder has a pre-emptive or preference subscription right to acquire new shares in proportion to its actual participation in the company. However, the shareholders' meeting may exclude pre-emptive rights (or grant the board authorisation to do so) for good cause by at least two-thirds of the voting rights represented in the shareholders' meeting and an absolute majority of the par value of shares, if this cancellation of the pre-emptive rights does not result in any improper advantage or disadvantage to any shareholder.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Non-listed companies may provide in their articles of association that registered shares may only be transferred with the board's approval, which can be denied based on important reasons specified in the articles of association. In any case, the company may acquire the respective shares for its own account, the account of other shareholders or for the account of a third party at fair market value, or refuse the transfer and the registration of the transferee in the company's share register if the acquirer does not explicitly state that it has acquired the shares in its own name and on its own account. In the case of transfers based on inheritance, division of an estate, matrimonial property law or compulsory execution, the company may withhold its consent only if it offers to purchase the shares at their fair market value.

Listed companies are more restricted and may only refuse a share transfer if the acquirer:

- exceeds a certain percentage of the company's voting rights (subject to a respective transfer restriction being included in its articles of association); or
- fails to state that it holds the acquired shares in its own name and on its own account.

In each case, the listed company may only prevent the shareholder from exercising its voting rights but not the transfer of title of the acquired shares (ie, the acquirer will be entitled to any resolved dividends in any case). Transfers based on inheritance, division of estate or matrimonial property law may not be refused by listed companies.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Companies may repurchase their own shares up to a limit of 10 per cent of their share capital (if the repurchase is made in connection with transfer restrictions, a threshold of 20 per cent applies) provided that the company has sufficient freely available equity. These share repurchases are not, and cannot be made, mandatory. The voting right of own shares of a company is suspended.

Dissenters' rights

15 | Do shareholders have appraisal rights?

No, there are no appraisal rights of shareholders. However, in connection with a squeeze-out merger, the company may compensate the squeezed-out minority shareholders with a cash payment at fair market value.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

In listed companies, the predominant board structure is a two-tier structure, as the board normally delegates some of its duties to the management.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The board is responsible for managing the business of the company, in accordance with its duty of care and fiduciary duty, to the extent that tasks have not been delegated to the management. In general, the board may adopt decisions on all matters that are not explicitly reserved to the shareholders' meeting by law, by the articles of association or delegated to the management based on organisational regulations. The board often delegates a major part of the transferable responsibilities to management. In such a case, however, the board remains liable for the due selection, instruction and supervision of the parties to whom it has delegated responsibilities.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board represents the company, and directors are obliged to act in the company's best interest. The company's purpose is stated in its articles of association. There is no clear view in legal literature or court practice as to which interests must be considered by the directors, in particular, whether the focus must be on shareholders' interests or whether and to what extent other stakeholders' interests may have to be taken into account.

The Swiss Code of Best Practice for Corporate Governance is focused on safeguarding 'sustainable company interests', which implies a time component (long-term perspective) often taken into account by boards in their decision-making process.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Any director and any other persons engaged in, and with a significant influence on, the management or the liquidation of a company may, irrespective of whether or not formally appointed as directors, liquidators or any other similar function, be held liable for any intentional or negligent breach of their duties.

Whenever shareholders or creditors suffer direct damage (as opposed to indirect damage resulting from direct damage to the company itself), they are entitled to bring an action for compensation of the damage. With respect to damage to the company, the company as well as the shareholders and, in the case of insolvency only and subject further to the insolvency administrators not having taken legal action, the creditors may bring an action whereby both the shareholders and the creditors may only ask for compensation for the company's damage (ie, payment to the company). The shareholders' meeting may also resolve to oblige the company or its management to file liability claims against directors at the cost of the company.

It is established case law that decisions of the board in compliance with the business judgment rule do not constitute a breach of duty, even if these decisions prove to be wrong retrospectively. To be compliant with the business judgment rule the board must apply the following principles when making business decisions:

- an unbiased and independent board and no conflicts of interest;
- a decision-making process based on appropriate information;
- consideration of alternative scenarios; and
- test of justifiability.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Yes, the directors must act in compliance with their duty of care and loyalty.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

The duties of the individual members of the board do not differ as they are defined by objective criteria. In particular, the duty of care and loyalty requires the board to act in the same way as a diligent and competent member would have acted in the same circumstances. Compliance with these duties is assessed by reference to an objective standard of diligence unless a member of the board is an expert in a certain field. In this case, the standard applicable to this director will be assessed by reference to a diligent and competent director with the same level of expertise in the relevant field.

Delegation of board responsibilities

22 | To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

Except for its non-transferable and inalienable duties, the board may delegate its responsibilities to third parties, individual board members or committees, or to the management, in each case in accordance with organisational regulations issued by the board. The board, however, remains liable for the due selection, instruction and supervision of the parties to whom it has delegated responsibilities.

Non-executive and independent directors

23 | Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

No. Nevertheless, for listed companies, the SIX Swiss Exchange Directive on information relating to corporate governance (DCG) contains certain disclosure obligations for non-executive members of the board, and the Swiss Code of Best Practice for Corporate Governance recommends that the majority of the board should consist of independent members, meaning non-executive members who have either never, or at least not for the past three years, been members of the management, and who have no (or comparatively minor) business relations with the company. In addition, proxy adviser guidelines often contain specific requirements regarding the independence of members of the board, typically based on years of service, the relationship with significant shareholders and commercial arrangements with the company, among other things.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The board must be composed of at least one member; there is no maximum number specified by law or any regulations, but the articles of association may provide for these limits. The size is determined by the shareholders' meeting electing the board members and filling vacancies. The Swiss Code of Best Practice for Corporate Governance recommends that the size of the board should match the needs of the individual company and that the board should aim for suitable diversity in its members with regard to competences, experience, gender, age, background and origin.

Only natural persons may be elected as board members, and there must be at least one Swiss resident – not necessarily also a Swiss citizen – authorised to legally bind the company (with individual signing authority), but this person does not need to be a board member.

Large listed companies that are subject to an ordinary audit and in which each gender does not make up at least 30 per cent of the board and 20 per cent of the senior management must, at the latest by the financial year 2026 and the financial year 2031, respectively, indicate in their remuneration reports the reasons why genders are not represented as required and the measures being taken to increase the representation of the less well-represented gender.

As regards disclosure, the names, functions and residences of each board member are publicly available in the commercial register. The DCG requires listed companies to disclose information on the board composition, including details on the organisation of the board and the compensation of its members.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

The separation of the two functions of board chair and chief executive is generally considered as best practice, even though in many SMEs and even in a small minority of listed companies the board chair and CEO are the same person.

If for company-specific reasons the board decides that a single person should take both roles or the former chair of the executive board moves to the board of directors to take over the role of chair, the Swiss Code of Best Practice for Corporate Governance recommends that the board ensures appropriate controls. The board should therefore appoint an experienced, non-executive member to act as lead director. This person shall be entitled to convene and hold meetings with the independent members of the of directors independently when necessary.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Non-listed companies are not required to establish any board committees. Listed companies are required to establish a compensation committee, whose members are elected by the shareholders' meeting. There are no restrictions with respect to the establishment of (additional) committees.

The Swiss Code of Best Practice for Corporate Governance recommends establishing an audit, compensation and nomination committee as well as further committees, such as committees regarding corporate governance, sustainability, digitalisation/technology, innovation, risk and investments or also ad hoc committees to assess specific transactions.

Listed companies and larger non-listed companies often establish a compensation (and nomination) committee and an audit committee, and some also a strategy committee.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Unless the articles of association provide otherwise, only one board meeting per year is required (to prepare for the annual shareholders' meeting and to resolve on the agenda and the respective motions). The Swiss Code of Best Practice for Corporate Governance, however, recommends a minimum of four board meetings per year.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

Non-listed companies are not required to make any such disclosure. Listed companies are required by the DCG to disclose certain board practices, in particular the allocation of tasks within the board, the members list, tasks and areas of responsibility for each board committee and the working methods of the board and its committees.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

No, there is no formal legal requirement to conduct evaluations. However, boards of larger non-listed companies and of listed companies regularly conduct an annual self-assessment. The Swiss Code of Best Practice for Corporate Governance recommends that the board should self-evaluate its own performance and that of its committees annually. Listed companies that conduct these evaluations may disclose this in their annual reports but are not obliged to make any disclosure (in particular of the results of the evaluation).

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

For non-listed companies, except for the provision of the Swiss Code of Obligations, which limits the maximum duration of a director's mandate to six years, without prohibiting re-election, there is no other regulation or practice restricting the company with respect to the remuneration of directors, the length of directors' service contracts (individual terms may not exceed six years, re-election being possible), loans to directors or other transactions or compensatory arrangements between the company and a director – as long as the arm's length principle is observed. Typically, the board determines the compensation and other relevant matters itself.

For listed companies, the Swiss Code of Obligations requires an annual binding shareholder vote on the maximum amount of remuneration of the board. The articles of association must contain provisions regarding the principles governing the compensation of the board, the maximum amount of loans and similar payments made to members of the board, the permitted number of service contracts of members of the board in other companies, and the maximum term of a service contract of a member of the board, which may not exceed 12 months (re-election being possible). Renumeration matters concerning directors must be published annually in a renumeration report.

The ordinary shareholders' meeting, in which the directors are usually elected or re-elected, must be held within six months after the end of a financial year. In this regard, the Federal Supreme Court has decided in a recent judgment that the term of office of directors, whose term expires, automatically ends six months after the end of the respective financial year. If a company omits to re-elect directors, their term of office is therefore not automatically extended and ends six months after the end of the respective financial year.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

For non-listed companies, there is no regulation or practice restricting the company with respect to the remuneration of senior management, the length of employment contracts, loans to senior management or other transactions or compensatory arrangements between the company and a member of senior management – as long as the arm's length principle is observed. Typically, the board determines the management's compensation and other relevant matters.

For listed companies, the Swiss Code of Obligations requires an annual binding shareholder vote on the maximum amount of remuneration of the management. The articles of association must contain provisions regarding the principles governing the compensation of the management, the permitted number of service contracts of members of the senior management in other companies, and the maximum term of employment contracts with senior management, which may not exceed 12 months; provisions regarding, inter alia, the maximum amount of loans and similar payments made to members of the management are only valid if they are included in the articles of association. Renumeration matters concerning senior management must be published annually in a renumeration report.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Yes, but only in listed companies. The Swiss Code of Obligations requires listed companies to hold an annual shareholders' vote on the maximum amount for the compensation of the members of the board, the management and the advisory board (if any). This vote is binding; that is, the company is not permitted to pay any compensation to the board, senior management or advisory board without having it approved by the shareholders' meeting. While this vote must be held annually, there is some flexibility with respect to its technicalities, in particular, whether the variable compensation is voted on separately, whether the vote is retrospective or prospective, and to which periods the vote relates (often, listed companies approve the compensation for the next business year at the ordinary shareholders' meeting held in the previous business year). In addition, most listed companies conduct an annual non-binding shareholder vote on the compensation report for the previous business year.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

The insurance by a company of its directors and officers against directors' and officers' (D&O) liability, also including the payment of the respective premiums by the company, is generally accepted as permissible. D&O insurance is standard for listed companies and for large non-listed companies.

In addition to liability under civil law, a member of the board may also be liable under criminal law. Furthermore, the board may also be liable for social security contributions and taxes. Typically, these liabilities are excluded from D&O insurance.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

It is generally considered acceptable for the company to undertake to indemnify its directors and officers for the liabilities incurred in their professional capacity, provided, however, that these liabilities were not caused by the director's or the officer's intentional or grossly negligent breach of his or her duties.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Companies may advance expenses if:

- the proceedings were not caused by the director's or the officer's intentional or grossly negligent breach of his or her duties;
- the advancement complies with the rules applicable to loans made to directors or officers of the company; or
- advancement of expenses in connection with proceedings in which directors or officers will be a witness does not violate witness-tampering rules.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

The Swiss Code of Obligations allows the shareholders' meeting to grant directors and officers a discharge for their past activities, which, if granted, will preclude the company and the shareholders who voted in favour of such a discharge from suing the discharged directors and officers for facts that were known at the time the discharge was granted. Shareholders who did not take part in the vote on the granting of the discharge or who voted against it must bring an action against the discharged directors and officers within the twelve months following the vote on the discharge. If they fail to do so, they will also be precluded to act against the discharged directors and officers. The shareholders' meeting may resolve to oblige the company or its management to file liability claims against directors at the cost of the company.

Owing to the lack of clear and recent case law on the topic, there is some uncertainty regarding the validity of any preclusion or limitation, in advance, of the directors' and officers' liability, whether through amendments of the articles of association or through other shareholder action.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

Yes, the articles of association are publicly available in the commercial register at the companies' registered offices; delivery may either be requested from the commercial registry for a low fee or they may be downloaded free of charge . However, the organisational regulations, governing the organisation of the board and the delegation to the management and its reporting, are not publicly accessible.

Listed companies typically make available their articles of association, as well as their organisational regulations, on their websites.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

The publicly accessible commercial register excerpt of each company registered in Switzerland contains certain fundamental pieces of information regarding these companies, in particular their corporate purpose, their share capital, any restrictions on transfers of shares, the identity of their board members and other authorised signatories, their external auditors (if any) and information regarding their histories (such as changes in share capital, registered offices and mergers). Any commercial register filings are also published in the Swiss Official Gazette of Commerce.

Companies are required to issue an annual (financial) report. Non-listed companies must make this report available to their shareholders only, while listed companies must make it publicly available. In addition, various disclosure obligations apply to listed companies, in particular, the following:

- the obligation to make publicly available the disclosure notifications sent by significant shareholders with participations of 3 per cent or more;
- the obligation to report and disclose transactions in shares of the company by members of the board or management (management transactions);
- periodic reporting obligations obliging issuers to, inter alia, publish half-year accounts and a corporate calendar;
- the obligation to inform the market of price-sensitive facts (ad hoc publicity rule); and
- the obligation to disclose a separate corporate governance chapter in their annual reports on a comply or explain basis with information regarding, inter alia, the company's group and capital structure, its board, its management and auditors, executive compensation, shareholdings and loans, shareholders' participation rights, and change of control and defence measures.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

If any item of the agenda covers the appointment of directors, any shareholder (even if holding only one share) may nominate its own candidate by way of a motion, which may be presented either before or during the shareholders' meeting.

If none of the agenda items covers the appointment of directors, a shareholder may not nominate a director by way of a motion. He or she may, however, request an amendment of the agenda to include the appointment of his or her candidate as a director; if the requirements for such a request are fulfilled, the amendment will have to be included by the board in the invitation to the shareholders' meeting.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

In non-listed companies, beyond their involvement in shareholders' meetings, (anchor) shareholders often have their representatives on the board or at least maintain a close relationship and regular contact with the board.

In listed companies, stock exchange law, in particular insider trading rules, restricts interactions between the board and the company's shareholders. Nevertheless, boards of listed companies typically seek to regularly involve their (anchor) shareholders in strategy considerations. Given the need to avoid sharing sensitive information, any meetings among board members and shareholders are typically held following the publication of the company's financial statements, when the risk of sharing price-sensitive facts is lower.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

Companies of public interest that, together with their subsidiaries, have 500 annual full-time equivalent employees and exceed either a balance sheet value of CHF 20 mio Swiss francs or revenues of CHF 40 mio Swiss francs in two consecutive financial years, must report annually on non-financial aspects such as environmental matters, particularly on the company's CO_2-targets, social matters, employee matters, compliance with human rights and anti-corruption.

Companies subject to an ordinary audit and which 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 must produce a report each year on the payments they have made to state bodies and companies controlled by such state bodies. Extracting includes all activities carried out by a company in the areas of exploration, prospecting, discovery, development and extraction of minerals, oil and natural gas and the harvesting of timber in primary forests.

Companies domiciled or with their main administration located in Switzerland that are either involved in transferring minerals from conflict or high-risk regions into Switzerland or offer products or services for which there is reasonable suspicion that they have been manufactured or provided involving child labour must report on compliance with their duty of care in the supply chain.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

No.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

Yes, companies with at least 100 employees must conduct an equal pay analysis every four years in accordance with the provisions of the Federal Act on Gender Equality. The results must be disclosed in writing to their employees. Listed companies must publish the results of the analysis in an annexe to their annual accounts and public sector companies must publish the results of the analysis and the audit of the analysis. A standard analysis tool is provided free of charge by the Swiss Confederation.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

The provisions of the bill aiming to modernise Swiss corporate law have entered into force on 1 January 2023. Provisions in contracts, articles of associations and regulations of companies that do not comply with the modernised Swiss corporate law remain in force until 31 December 2024. Such provisions that are not amended during this two-year transition period will cease to be legally valid as of 1 January 2025. Provisions introduced by the bill aiming to modernise Swiss corporate law are in particular:

- new non-transferable and inalienable duties of the board of directors;
- an extension of the deadline from six to 12 months to bring an action against directors who were granted a discharge (only for shareholders who did not take part in the vote or who voted against it);
- the possibility to state the share capital of a company incorporated in Switzerland in the foreign currency that is essential for its business;
- new rules on restructuring, which, in particular, introduce illiquidity as a triggering event forcing the board to take measures;
- virtual general meetings and shareholders' resolutions by written consent;
- the shareholders' meeting may authorise the board to change the share capital within a specified range (capital band) for a period of five years;
- the shareholders' meeting may resolve to pay an interim dividend on the basis of interim financial statements; and
- the possibility to provide in the articles of association for the chair of the shareholders' meeting to cast a second vote in the event of parity of votes.

In accordance with the modernised Swiss corporate law the revised Swiss Code of Best Practice for Corporate Governance has been published on 6 February 2023.

As of the beginning of 2021 and 2022, a range of disclosure requirements for larger companies with respect to corporate social responsibility matters have entered into force, with reports required to be published for the first time for financial years 2022 and 2023, respectively.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The primary source of law for a private limited company is under the Civil and Commercial Code (CCC), while that of a non-listed public limited company is the Public Limited Company Act, BE 2535 (1992) (PLCA).

Listed companies are also governed by the PLCA, along with the Securities and Exchange Act, BE 2535 (1992) and relevant subordinate rules and regulations mainly supervised by the Stock Exchange of Thailand (SET), and the Securities and Exchange Commission of Thailand (SEC).

From the 2017 Corporate Governance Code (CG Code) issued by the SET, Thailand uses the concept of 'apply or explain', which is more flexible than 'comply or explain' and allows for the application of eight good governance concepts. The application of the CG Code shall be disclosed in the annual report and annual information form (56-1 One Report Form).

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

Many authorities are empowered to make these rules. All types of companies must comply with the rules prescribed by the Department of Business Development of the Ministry of Commerce (DBD). The DBD is also the authority responsible for enforcing these rules.

In addition, for listed companies, the Securities and Exchange Commission of Thailand (SEC) and the SET are also the authorities responsible for making subordinated rules and regulations and are the authorities responsible for enforcing them.

The SEC and the SET have never officially announced that the views of any outside groups affect their decisions. In practice, however, views by various chambers of commerce (eg, the chambers of commerce of America, Japan and China) or other independent associations are often taken into consideration.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Shareholders can appoint and remove directors. If not provided otherwise in the company's articles of association, the appointment or removal of a director in a private limited company requires a simple majority of the votes of the shareholders attending the meeting. However, the removal of a director in a public limited company requires the votes of not less than three-quarters of the number of shareholders attending the meeting with the right to vote, and the total number of shares is not less than half of the number of shares held by the shareholders attending the meeting who have the right to vote.

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

Generally, the board of directors is responsible for day-to-day business operation, while certain issues as stated in the law can only be decided by the shareholders; for example, appointing additional directors, electing new directors to replace those who retire by rotation, appointing auditors, fixing the remuneration of directors and auditors, approving annual balance sheets, declaring dividends (except interim dividends, which can be declared by the board), amending articles or memorandum of association, removing existing directors, increasing capital, issuing new shares as paid in kind other than cash, reducing capital, amalgamating the company and dissolving the company.

In addition, other matters can be agreed upon among shareholders to be listed in a list of 'reserved matters' (matters that can only be decided by shareholders). If the matters do not fall into any mentioned category, then the shareholders can require the board of directors or the directors to decide and act.

There is no concept of non-binding shareholder votes under Thai law.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

In principle, one ordinary share equals one vote in a vote held by poll (one vote per share) or by hand (one vote per shareholder regardless of shares held by each of them. However, the preference share scheme may be adopted to differ its rights from an ordinary share; for example, fixing voting rights and fixing or limiting the priority and rights to receive the different amount of dividends. All shareholders must have the right to vote in the meeting regardless of the rights they are entitled to. The prohibition of a vote agreed among shareholders is void.

Preference shares can be issued upon the company's incorporation and the increase of capital. Ordinary shares cannot be converted into preference shares in private limited companies. However, preference shares can be converted into ordinary shares in public limited companies if it is allowed under the articles of association.

The preference share scheme is available for all types of company where preferential rights cannot be altered once issued.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Shareholders or their proxy have the right to attend and to vote at shareholders' meetings. However, shareholders who have a conflict of interest in any matter are not entitled to vote on such matter.

A circular meeting or written consents from shareholders without a meeting is not allowed. Virtual meetings are allowed under the Emergency Decree re: Electronic Conference, BE 2563 (2020).

In addition, for public limited companies, voting restrictions for a shareholder with a conflict of interest do not apply to the appointment of a company's directors.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

The board of directors of private limited companies can convene a shareholders' meeting at any time. However, a meeting of shareholders must be convened if the company suffers a loss amounting to half of its registered capital. In addition, shareholders holding an aggregate of not less than one-fifth of all the shares of the company can request the board of directors to convene an extraordinary shareholders' meeting. The board of directors must hold the meeting no later than 30 days after receipt of the written request. Failure to do so in the given time grants shareholders the authority to convene the meeting.

The board of directors of public limited companies can convene a shareholders' meeting at any time. In addition, shareholders holding an aggregate of not less than one-tenth of the total number of shares sold can request the board of directors to hold an extraordinary meeting. The board of directors must hold the meeting within 45 days after receiving the written request. Failure to do so in the given time grants shareholders the authority to convene the meeting.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

For private limited companies, unless the shareholders agree otherwise in the shareholders' agreement (as contractual obligations between the parties) or the articles of association, no specific duty of controlling shareholders owe to the company or non-controlling shareholders is stipulated under the Civil and Commercial Code (CCC). The shareholders are responsible to the company only for the payment of their unpaid shares.

Likewise, for public limited companies, there is no specific provision in the Public Limited Company Act, BE 2535 (1992) (PLCA) that imposes specific duties on controlling shareholders.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

In general, shareholders will only be responsible for the payment of the unpaid shares. However, the concept of piercing the corporate veil is uniquely present in the Consumer Case Procedure Act, BE 2551 (2008), in which the shareholders may be held responsible for the amount unable to be paid by the company's assets in a consumer protection case if the court finds that the company is involved in consumer fraud or has transferred its assets to any person. Unlike directors, shareholders are not prohibited to compete with the businesses of the company.

Employees

10 | What role do employees have in corporate governance?

Generally, employees of private limited companies and non-listed public limited companies do not have roles in corporate governance. However, members of the management or a subcommittee of the company's employees shall comply with the corporate governance (if applicable). Specifically, directors and employees for all types of company cannot be retained as an auditor.

For listed companies, the employees shall comply with the corporate governance policy. In addition, the Securities and Exchange Act, BE 2535 (1992) (SEA) applies the whistle-blower concept. The SEC encourages the employees to report any suspicious activity in the company regarding compliance with the SEA. The SEA protects whistle-blowers who are employees reporting to the SEC that there has been a contravention or failure to comply with the SEA.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

There is no specific provision in the Civil and Commercial Code (CCC), the Public Limited Company Act BE 2535 (1992) (PLCA), or the Securities and Exchange Act (SEA) that generally permits or forbids the use of anti-takeover devices. However, for a private limited company some of the anti-takeover devices are in the form of contractual obligations or articles of association (eg, rights of first refusal, share transfer restrictions and golden parachutes).

For listed companies, there are statutory duties to protect minority shareholders in the event of takeovers; the acquirer (in both hostile and friendly takeovers) will be obliged by law to make a tender offer once his or her shareholding in a listed company crosses the threshold of shareholding specified in the relevant laws and regulations (ie, 25 per cent, 50 per cent and 75 per cent).

Issuance of new shares

12 | May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

For private limited companies, issuing new shares must be approved by a special resolution of the shareholders' meeting (requiring at least 75 per cent of the total votes of the shareholders present at the meeting and entitled to vote). New shares shall be offered to the existing shareholders according to the proportion of originally owned shares.

For public limited companies, issuing new shares must be approved by a resolution of the shareholders' meeting with the votes of not less than three-quarters of the total number of votes of the shareholders present at the meeting and entitled to vote. New shares can be offered to original shareholders or other persons, subject to a resolution of the shareholders' meeting.

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

For private limited companies, shares can be transferred without the approval of the board of directors unless these shares are named shares and the company's articles of association stipulate otherwise.

For public limited companies, unless the restrictions are for preserving rights and benefits to which they are lawfully entitled, or for maintaining the ratio of shareholding between Thai and foreign shareholders, they must not make any restrictions on the transfer of shares.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Private limited companies are strictly restricted from holding their own shares. In addition, share repurchase is not permissible.

For public limited companies, there is no specific provision in the PLCA or the SEA that allows compulsory share repurchases. However, voluntary share repurchases are permitted in the following circumstances.

The public limited company may buy shares back from the shareholders who vote against the resolution of the shareholders' meeting to amend its articles of association concerning the right to vote and the right to receive dividends, whereby the shareholders consider it to be unfair to them; or the public limited company may buy shares back for financial management purposes after the company has retained earnings and surplus liquidity, and the buy-back does not cause financial difficulties to the company.

The approval process is dependent on the number of shares to be repurchased by the company.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Private limited companies are strictly restricted from holding their own shares and share repurchase is not permissible.

For all types of companies, in the case where there is a resolution for an amalgamation, but a shareholder raises an objection to the amalgamation, it must arrange for the purchase of shares belonging to this shareholder. For listed companies, the purchase price must be at the price last traded on the Stock Exchange of Thailand (SET) prior to the date on which the resolution of the amalgamation is passed. If there is no traded price on the SET, the price determined by an independent appraiser appointed by the parties is adopted. If the dissenting shareholder does not agree to sell his or her shares within 14 days of the date of receipt of the purchase offer, the amalgamation will proceed, and the shareholder will be deemed to be a shareholder of the surviving company.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 | Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

It is a one-tier or unitary board.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

For private limited companies, the Civil and Commercial Code (CCC) generally provides the scope of the legal responsibilities of directors. It puts the duties of directors into two main categories: duty of care and duty of loyalty.

For private limited companies concerning the duty of care, the CCC stipulates that the directors must apply care and prudence as businesspeople for the operation of a company's business. Directors of private limited companies are jointly responsible for the:

- payment of shares by the shareholders actually being made;
- existence and regular keeping of the books and documents prescribed by law;
- proper distribution of the dividend or interest as prescribed by law; and
- proper enforcement of resolutions of the general meetings.

For private limited companies concerning the duty of loyalty, the CCC stipulates the forbearance of competing for commercial transactions in two cases. A director must not undertake commercial transactions of the same nature as and competing with that of the company, either on their own account or that of a third person or be a partner with unlimited liability in another concern carrying on business of the same nature as and competing with that of the company, in each case, without the consent of the general meeting of shareholders.

For public limited companies concerning the duty of care, the Public Limited Company Act, BE 2535 (1992) (PLCA) stipulates that the directors must act in compliance with the law, the company's objectives, the articles of association, and the resolutions of shareholders' meetings in good faith and with care to preserve the interests of the company. If any director performs any act that fails to comply with these duties or does not perform any act to comply with these duties, the company or the shareholders may, among other things, claim compensation from these directors.

Directors of public limited companies are jointly responsible for any damage to the company in the following cases:

- if subscribers are called to make a payment on a share subscription or to transfer the ownership of the property to the company in a manner that does not comply with the law;
- if spending money for the payment on a share subscription or the disposal of property received in payment for shares of the company in a manner that does not comply with the law;
- performing any act in contravention of directors' duties;
- granting a loan in contravention of the law;
- paying money or giving other property to a director that does not comply with the law;
- paying a dividend to shareholders that contravenes the law, or being liable for causing a disadvantage to the creditors of the company unless it can be proven that the act was performed in good faith and based on evidence or financial reports that were certified to be accurate by the chair of the board or the financial officer of the company or an auditor;
- failing to prepare or keep accounts, registers, or documents of the company, unless it can be proven that they have taken reasonable action to avoid this failure; and
- arranging for the general meeting of shareholders.

For public limited companies concerning the duty of loyalty, the PLCA generally provides that a director cannot operate a business or be a partner with management power or a director in an entity-operating business that is of the same nature and is in competition with the business of a company unless the director notifies the meeting of shareholders prior to appointment.

For listed companies concerning the duty of care, the Securities and Exchange Act, BE 2535 (1992) (SEA) requires that directors, in conducting the business of the company, perform their duties with responsibility, due care and loyalty, and comply with all laws, objectives of the company, the articles of association, resolutions of the board of directors and resolutions of shareholders' meetings. In performing duties with responsibility and due care, a director and an executive must act in a similar manner to an ordinary person undertaking a like business under similar circumstances.

The SEA also provides a list of factors for considering whether a director has performed their duties with responsibility, due care, and loyalty. For instance, in considering whether each director or executive has performed their duty with responsibility and due care, the following factors must be considered:

- the position in the company held by this person at the time;
- the scope of responsibility of the said position in accordance with the laws or as assigned by the board of directors; and
- the qualifications, knowledge, capability, and experience, including the purposes of the appointment.

The PLCA also applies to listed companies concerning the duty of loyalty. The SEA further specifies that board members must act in good faith for the best interest of the listed company, act with proper purpose and avoid acting in ways that significantly conflict with the interests of the listed company.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board of directors is under the control of the shareholders, and the directors owe legal duties to the company.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

For all types of company, a company or a shareholder may initiate litigation against its directors owing to actions or inaction during their terms. However, for a claim made by any third party, directors are generally protected by law for their authorised actions within their delegated authorities and the scope of the objectives of the company.

For listed companies, the SEA states the business judgment rule. Directors or executives will be deemed to have performed their duty with responsibility and due care if they can prove that, at the time of considering this matter, they met the following requirements:

- the decision was made with honest belief and reasonable ground that it was in the best interest of the company;
- the decision was made by relying on information honestly believed to be sufficient; and
- the decision was made without their involvement, whether directly or indirectly, in the matter.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

For private limited companies, the CCC stipulates that the directors must apply care and prudence as businesspeople for the operation of a company's business. Directors are jointly responsible for the:

- payment of shares by the shareholders actually being made;
- existence and regular keeping of the books and documents prescribed by law;
- proper distribution of the dividend or interest as prescribed by law; and
- proper enforcement of resolutions of the general meetings.

For public limited companies, the PLCA stipulates that the directors must act in compliance with the law, the company's objectives, the articles of association, and the resolutions of shareholders' meetings in good faith and with care to preserve the interests of the company. If any director performs any act that fails to comply with these duties or does not perform any act to comply with these duties, the company or the shareholders may, among other things, claim compensation from that director.

Directors are jointly responsible for any damage to the company in the following cases:

- if subscribers are called to make a payment on a share subscription or to transfer the ownership of the property to the company in a manner that does not comply with the law;
- if spending money for the payment on a share subscription or the disposal of property received in payment for shares of the company in a manner that does not comply with the law;
- performing any act in contravention of directors' duties;
- granting a loan in contravention of the law;
- paying money or giving other property to a director that does not comply with the law;
- paying dividends to shareholders that contravenes the law, or being liable for causing a disadvantage to the creditors of the company unless it can be proven that the act was performed in good faith and based on the evidence or financial reports that were certified to be accurate by the chair of the board or the financial officer of the company or an auditor; and
- failing to prepare or keep accounts, registers, or documents of the company, unless it can be proven that they have taken reasonable action to avoid this failure.

For listed companies, the SEA requires that directors, in conducting the business of the company, perform their duties with responsibility, due care and loyalty, and comply with all laws, objectives of the company, the articles of association, resolutions of the board of directors and resolutions of shareholders' meetings. In performing their duties with responsibility and due care, a director and an executive must act in a similar manner to an ordinary person undertaking a like business under similar circumstances.

The SEA also provides a list of factors for considering whether a director has performed their duties with responsibility, due care, and loyalty. For instance, in considering whether each director or executive has performed their duty with responsibility and due care, the following factors must be considered:

- the position in the company held by this person at the time;
- the scope of responsibility in the position of this person in accordance with the laws or as assigned by the board of directors; and
- the qualifications, knowledge, capability, and experience, including the purposes of the appointment.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

For private limited companies and non-listed public companies, the CCC and the PLCA do not differentiate the duties of each member of the board.

For listed companies, an audit committee, which comprises at least three independent directors, is required. At least one member of this committee must have knowledge and experience sufficient for reviewing the reliability of the financial statements. The audit committee has duties to, among other things, review the financial reporting process and monitor compliance with laws and regulations, as well as ensure that the company has appropriate and efficient internal control and internal audit systems, in each case in accordance with the rules of the Stock Exchange of Thailand.

Delegation of board responsibilities

22 To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

The board of directors can delegate any internal responsibilities to anyone including sub-committees. However, the statutory responsibilities (eg, the call for the annual share-holders' meeting, attendance of the board of directors' meeting, and appointing a temporary director to fill a vacancy) cannot be delegated.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

There are no requirements on 'non-executive' or 'independent' directors for private limited companies and non-listed public limited companies.

For listed companies, the board of directors must include independent directors who are non-executive directors that have the qualifications as prescribed by law.

Under the Notification of the Capital Market Supervisory Board No. Tor Jor 39/2559 (as amended) (the Notification), the structure of the board of directors and the management is:

- at least one-third of the board members must be independent directors, and, in any case, the number must not be less than three;
- there must be an audit committee with at least three members appointed by a resolution of the board or shareholders' meeting; and
- if the board of directors appoints a manager or another person to act on the board's behalf in any matter, this appointment must be made in writing or clearly recorded in the resolution of the board of directors' meeting, and the scope of power and duties of the authorised person must be specified clearly.

The independent directors must have the qualifications as stated in the Notification, such as holding less than 1 per cent of all voting rights of the company or none, not being related to the management of the company by blood and having no commercial relationship with the company. The independent directors must perform their duties and express their opinions or report the operating results assigned by the board of directors independently without being controlled by the board or majority shareholders.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

For private limited companies, there is no requirement under the CCC regarding the number of directors where specification of which can be provided in the articles of association, and the criteria that individual directors or the board of directors must fulfil. However, regarding the qualification of directors, in general, a director must be a natural person who has reached the age of maturity and is not incompetent.

For public limited companies, a minimum of five directors are required, half of which must reside in Thailand. A director must be a natural person who:

- is an adult who has reached the age of maturity;
- is not bankrupt, incompetent, or quasi-incompetent;
- has never been sentenced by final judgment to imprisonment for a case against property with dishonest intent; and
- has never been expelled or removed from an official service, a state organisation, or a state agency on the grounds of dishonest performance of duties.

The number and powers of directors of private limited companies and public limited companies are initially designated by the shareholders' meeting. A list of directors and the directors' signing powers of the company must be registered with the Department of Business Development (DBD) and publicly disclosed. In the case of a vacancy on the board of directors for reasons other than retirement, the board of directors may elect a new director as a substitute director (unless the remaining term of the retiring directors is less than two months for public limited companies). In addition, the board of directors may amend the signing powers if it is allowed under the company's articles of association.

For listed companies, there are additional director's duty and criteria provided under the SEA in the notification of the Securities and Exchange Commission of Thailand (SEC). For example, directors shall perform their duty with responsibility, due care, and loyalty; and they must not have characteristics indicating a lack of trustworthiness in managing businesses whose shares are held by public shareholders, such as not having been sentenced under the specified regulations (eg, for insider trading or money laundering) within the period specified in the SEC regulation.

Information regarding changes of directors of listed companies must be filed with the Stock Exchange of Thailand within three business days from the date of change and with the SEC no later than seven business days from the date of change and registered with the DBD within 14 days from the date of change.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

For all types of company, there is no requirement to separate the functions of the board chair and the chief executive officer (CEO), as the CEO position is not a statutory position under Thai law and Thailand applies the one-tier board system. In some cases, in a company having a management team separate from the board of directors, one of the functions of the board of directors is to monitor and control the operation of the management, including the performance of the CEO. If the CEO also acts as the board chair, it may impair the function of the board of directors, as the board chair may, to a certain extent, control the directions of the board of directors (eg, he or she may hold a casting vote (unless otherwise specified in the articles of association)). Accordingly, it may risk the good governance of the company. Thus, best practice is to separate the functions of the board chair and CEO.

For listed companies, while not strictly statutory, the separation of the functions of the board chair and the CEO is advised by the Corporate Governance Code (CG Code) issued by the Stock Exchange of Thailand.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Board committees are not mandatory in private limited companies and non-listed public limited companies.

For listed companies, an audit committee comprising at least three independent directors is mandatory. In addition, the CG Code recommends that a listed company should arrange board committees for specific matters: for example, a nomination and remuneration committee, a corporate governance committee and a risk management committee for risk management. These committees are common and recommended in the CG Code.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

For private limited companies, the CCC does not dictate how often the board of directors should meet in one year. In practice, the board of directors' meeting must be held at least once annually to summon the annual shareholders' meeting.

For public limited companies, the PLCA stipulates that the directors must have a meeting at least once every three months.

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

For private limited companies and public companies, the CCC and the PLCA do not require the disclosure of board practices. However, information relating to the number of meetings and attendances is required to be disclosed in the application form for certain registrations to be made with the DBD. For example, if a private limited company holds a board of directors' meeting to approve the appointment of a director to fill a vacancy, one of the application forms for the change of director to be filed with the DBD must include the number of meetings and the number of attendees. For public limited companies, the number of meetings and the meeting dates are required to be specified in one of the application forms.

In addition, for listed companies, information relating to the board of directors and committee (eg, the committee structure) is required to be disclosed in the 56-1 One Report Form to be filed with the Stock Exchange of Thailand.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

According to the CCC and the PLCA, there is no specific requirement to evaluate the board of directors. However, under the CCC and PLCA, one-third or the nearest numbers of directors are required to retire by rotation every year; the shareholders may use this occasion to evaluate the performance of the retiring director and to determine whether the shareholders will re-elect the retiring director.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

For private limited companies, remuneration must be fixed by a general meeting. The Civil and Commercial Code (CCC) does not contain provisions for determining directors' service contracts, loans to directors, transactions or compensatory arrangements between the company and any director.

For public limited companies, the Public Limited Company Act, BE 2535 (1992) (PLCA) states that remuneration must be in accordance with the articles of association. If there is no such article in the articles of association, remuneration must be in accordance with a resolution of the shareholders' meeting based on a vote of not less than two-thirds of the total number of votes of the shareholders attending the meeting.

For the provision of loans to directors, the PLCA specifies that a company must not grant a loan to any director unless certain conditions provided in the PLCA are met: for instance, the provision of a loan to a director must be in accordance with the regulations on the welfare of the staff and employees. In this regard, the provision of a loan to a spouse or child of a director, or to a juristic entity that meets certain conditions provided in the PLCA, is also considered to be the provision of a loan to a director. The PLCA does not contain any provision in relation to the determining of directors' service contracts, transactions or compensatory arrangements between the company and any director.

For listed companies, the Securities and Exchange Act, BE 2535 (1992) (SEA) does not contain a provision governing the determination of directors' remuneration in addition to the aforementioned requirements for public limited companies. However, the Corporate Governance Code (CG Code) issued by the Stock Exchange of Thailand (SET) provides that the remuneration of directors must be in accordance with their accountability and responsibility. Determination of the remuneration must be approved at the shareholders' meeting.

The SEA, as well as the relevant regulations, requires that a listed company take actions prior to entering into any transaction with its connected person (including directors). The actions required range from the SET disclosure to board or shareholders' approvals.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

For private limited companies and non-listed public limited companies, there is no provision governing the determination of remuneration of management.

For listed companies, there are no rules or regulations requiring the approval of remuneration of the executive by a shareholders' meeting. However, according to the CG Code, the board of directors must determine the remuneration (either in the form of money (wages or bonus) or in the form of other assets (stock option plan)) of executives in a way that encourages the executives to run the company in accordance with its main objectives and would create long-term benefits. There is no distinction or rules for the determination of the remuneration of the most senior executive.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

For private limited companies, remuneration of directors is determined at the shareholders' meeting. There are no other requirements for remuneration of senior management.

For public limited companies, any payment to directors is prohibited unless stipulated as such under the articles of association. Remuneration other than that specified in the articles of association must be approved by a shareholders' meeting with at least two-thirds of the votes of the shareholders present.

For listed companies, in addition to the requirement for public limited companies, according to the CG Code, the amount of remuneration of directors is likely to be advised by the remuneration committee appointed by the board. However, it is not a legal requirement.

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Directors' and officers' liability insurance is permitted. Insurance premiums paid by the company are not prohibited.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

There is no constraint on the company indemnifying directors. These indemnities depend on contractual arrangements.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

There is no specific law to prevent companies from providing advance expenses to directors and officers for litigation or other proceedings, especially for a director acting as an agent of the company, provided that doing so does not contradict the objectives of the company and the articles of association, if any.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

There is no constraint on the company limiting the liability of directors and officers internally, but this does not apply to third parties. For example, a director in a private limited company will no longer be liable to the company for actions that have been approved by a shareholders' meeting. A similar concept also applies to public limited companies. Regardless of the aforementioned, a precaution or limitation might not be applicable in the case of gross negligence or wilful misconduct of the directors and officers.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

They are publicly available. Copies can be requested from the Department of Business Development (DBD).

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

Private companies and non-listed companies are required to submit their financial statements to the DBD on an annual basis. Separately, some corporate documents and information (eg, the articles of association, memorandum of association, directors' names) must be submitted to the DBD at the company's incorporation and every time those documents are amended.

For listed companies, the regulations of the Stock Exchange of Thailand (SET) and Securities and Exchange Commission of Thailand (SEC) apply. Basically, there are two primary types of disclosure, as provided below.

Periodic disclosure

This includes the following.

- The unaudited financial statements reviewed by auditors must be disclosed to the SET and the SEC within 45 days from the end of each quarter, save for the audited financial statements must be submitted within two months from the end of fiscal year.
- The annual information form (56-1 One Report Form) must be submitted within three months of the end of the accounting period. 56-1 One Report Form should contain information regarding important developments of the listed company during the past year and, among other things, a summary of the financial condition and performance and business risk factors.
- The annual report is to be submitted within four months from the end of the accounting period and, at the same time, distributed to the shareholders for the annual general meeting.

According to a guideline issued by the SEC, information to be reported in these forms includes, for example, the company's policy and business overview, risks of the company's business and investors, assets used for the business operation, corporate information, registered capital, the number of shares and the management structure.

Ad hoc disclosures

Under the relevant SET regulations, a listed company must disclose, for example, the following information:

- the date of the shareholders' meeting;
- the shareholders' record date (14 days prior to the record date);
- resolutions of the shareholders' meeting
- the acquisition and disposal of assets, and connected transactions;
- the acquisition or disposition of an investment in another company that results in that other company becoming or ceasing to be a subsidiary company;
- an increase or decrease of capital, and new securities issuance;
- the repurchase or resale of shares;
- the payment or non-payment of dividends;
- significant commercial contract gains or loss;
- financial assistance provided to other persons or juristic persons;
- debt payment default; and
- resignation of a managing director or all the board members or audit committee.

The listed company must disclose this information to the SET within the period specified in the relevant regulations.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

For all types of company, shareholders can appoint directors to be their proxy to attend and vote in a shareholders' meeting as long as there are at least two persons attending the meeting. However, the shareholders' meeting materials will only be sent to the shareholders.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

There is no statutory engagement. Generally, engagement between a company and its shareholders will happen during an ordinary general shareholders' meeting, which usually takes place annually. However, extraordinary general meetings can also be called if there is an urgent matter to consider under special circumstances.

Sustainability disclosure

41 Are companies required to provide disclosure with respect to corporate social responsibility matters?

Private companies and non-listed companies, generally, are not required to provide disclosure with respect to corporate social responsibility matters unless they have to comply with the requirements under specific laws.

Listed companies are required to disclose their corporate social responsibility in their annual report and annual information form.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

For all types of company, there is no requirement to disclose the pay ratio between the CEO's annual total compensation and that of other employees.

For listed companies, if CEO is a company's director, the annual total compensation of the CEO is required to be disclosed and approved by the shareholders' meeting. However, it is not required to disclose the pay ratio.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

There is no requirement for a Thai company to report information about the gender pay gap. Legally, the Labour Protection Act, BE 2541 (1998) (as amended) provides that male and female employees must be treated equally in employment, provided that the nature of their work does not prevent them from being treated as such. However, the criteria that constitute a different nature of work are not given. There is no legal index on how a gender pay gap is measured.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

On 7 February 2023, the Act on Amendment to the Civil and Commercial Code (no. 23), BE 2565 (2022) became effective. The major changes in the amendment include:

- abolishing the local newspaper publication requirement when summoning a general meeting of shareholders;
- dividend payment timeframe where the completion of payment must be made within one month from the date of the resolution approving the dividend payment;
- reducing the minimum shareholder requirement from three to two persons; and
- redefining the amalgamation by including a merger of companies (two companies merging resulting in one company surviving and one ceasing to exist) into the definition of amalgamation which originally means two companies joining together to become a new entity).

A company must still comply with the previous requirement of newspaper publication until its articles of association are amended accordingly.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

The Turkish Commercial Code (TCC) dated 13 January 2011 (Law No. 6102) entered into force on 1 July 2012. The TCC has important objectives, such as ensuring transparency, adopting corporate governance standards and introducing internationally accepted auditing and reporting standards.

In addition to the above, the other laws, communiqués and principles governing corporate rules and practice are:

- Law No. 6335, amending the TCC;
- the Capital Markets Law dated 6 December 2012 (Law No. 6362), which entered into force on 30 December 2012, replacing the former Capital Markets Law dated 30 July 1981 (Law No. 2499);
- the Capital Markets Board Communiqués;
- the Corporate Governance Communiqué dated 3 January 2014, serial II, No. 17.1 (the Communiqué); and
- the Corporate Governance Principles (CGP) listed in Annex 1 of the Communiqué.

According to the Communiqué, publicly held companies that have shares that are traded on a stock exchange are subject to the mandatory implementation of certain corporate governance principles; however, there are minor exceptions to mandatory principles (eg, the number of independent board members). As per the Communiqué, the criteria regarding the number of independent board members shall not be applied to third-group corporations

(corporations that are excluded from the first and second groups, the shares of which are traded on the National Market, the Second National Market and the Collective Products Market), so two board members are sufficient for these corporations.

There are also some listing requirements that are applied on a 'comply or explain' basis. For example, article 4.2.5 of the Corporate Governance Principles stipulates that the responsibilities of the chair of the board of directors and the chief executive or general manager must be explicitly separated; however, if it has been resolved that the roles of chair of the board of directors and the CEO or general manager are considered the same, this decision (and grounds for this decision) will be presented to the shareholders' information at the general assembly together with its justification and the reasoned explanation will be included in the annual report (CGP, article 4.2.6).

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The Ministry of Trade is the regulatory body responsible for enforcing the TCC's provisions on corporations (article 210 of the TCC). The disputes arising from the TCC are mainly resolved before commercial courts.

The Capital Markets Law, the Capital Markets Board Communiqués and the Corporate Governance Principles are enforced by the Capital Markets Board. The Capital Markets Board is the regulatory and supervisory authority in charge of the securities markets in Turkey. It is entitled to hand out administrative sanctions to companies or individuals in the event of non-compliance. If the conditions set forth under the Capital Markets Law and the relevant legislation occur, the public prosecutor may prepare an indictment upon the written request of the Board.

The views of two associations are often considered: the Capital Market Investors' Association (BORYAD) and the Turkish Industry and Business Association (TUSIAD). TUSIAD was established in 1971 to represent the business world, and BORYAD was established in 2001 to defend shareholder rights and promote investment.

Under the TCC, there are legal grounds for proxy advisory firms, especially to protect the rights of minority shareholders in public companies.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

According to the Turkish Commercial Code (TCC), apart from specific exceptions (ie, the appointment of the initial board members of companies by the articles of association), shareholders have exclusive authority to appoint or remove board members. As per article 407 of the TCC, shareholders may use this authority during a general assembly. An exception to this rule is that should a board member leaves his or her post, the board may also temporarily appoint a new member. However, temporary appointments must also be approved during the next general assembly.

Article 408 of the TCC similarly determines the authority of the general assembly to appoint and dismiss board members. Accordingly, a general assembly is authorised to make decisions as set forth under the law and the articles of association. The same article also stipulates the non-transferable duties and authorities of the general assembly. Accordingly, privileges may be granted in respect of the election, nomination, release and dismissal of board members.

Under Turkish law, shareholders holding at least 10 per cent of the share capital of non-public companies and 5 per cent of the capital of public companies are defined as minority shareholders. The minority shareholders may:

- Request the board to call an extraordinary general assembly to question the company's management and request that additional items be added to the agenda (TCC, article 411).
- Ask the general assembly to appoint a special auditor to investigate and clarify certain issues, even if it was not on the agenda. For shareholders to use this option, they must first exhaust their rights of information and examination. If the general assembly accepts this request, minority shareholders can request the commercial court to appoint a special auditor (TCC, article 438). This is applicable not only for minority shareholders but for all shareholders.
- Request the board issue registered share certificates. If made, this request of the minority shareholders must be accepted and registered share certificates must be delivered to owners (TCC, article 486).
- Request the company to be dissolved if there is 'just cause'. The TCC does not define what a 'just cause' is, but it is accepted among scholars that there would be just cause to request dissolution if a general assembly was called to numerous meetings contrary to the law, the rights of minority shareholders were violated (especially the right to examine and demand information) or if the company constantly loses assets and does not generate any profit (TCC, article 531).

All shareholders are entitled to request information for them to examine. Pursuant to article 1.2.1 of the Corporate Governance Principles (CGP), which is applicable to public companies, this right cannot be limited or cancelled by the articles of association or by a decision of the company.

In addition, any shareholder has the right to:

- ask the general assembly to file a lawsuit for damages against board members or auditors (TCC, articles 553 to 555);
- request to inspect the company's books and records and request information from the company's auditor; and
- request a court limit or abolish a managers' right to manage the company, if there is just cause (TCC, article 630).

The shareholder vote required to elect and dismiss directors is the simple majority of the votes represented in a general assembly unless provided otherwise by law or the articles of association. The necessary quorum for the general assembly is shareholders or their representatives corresponding to at least one-quarter of the capital. If this quorum cannot be reached in the first meeting, no quorum is sought for the second meeting (TCC, article 418).

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

According to article 408 of the TCC, a general assembly has exclusive authority over:

- amending the articles of association;
- releasing the auditors and the board of directors or holding them liable;
- appointing the members of the board of directors, determining their fees, term of duties, discharging and replacing them;
- appointing and discharging auditors, except for the cases set forth under the law;
- taking decisions regarding:
    - financial statements;
    - annual reports of the board of directors;
    - savings on annual profits;
    - determining dividends and gain margins (including the injection of reserve funds into capital or the profit to be distributed); and
    - the use of the reserve fund;
- deciding on the company's dissolution, except for cases set forth under the law; and
- selling a substantial part of the company.

If the conditions stated under the Capital Markets Law and related legislation are met, some exclusive powers of the general assembly may be transferred to the board of directors. For example, if a company chooses the registered capital system, the share capital of the company can be increased upon a board of directors' resolution. In addition, when it is permitted by the articles of association, the board of directors may restrict the pre-emptive rights of shareholders (Capital Markets Law, articles 18/2 and 18/5).

Under Turkish law, there are no matters that can be resolved by a non-binding shareholder vote.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

The TCC has a 'one share, one vote' principle. Accordingly, each share grants at least one voting right (TCC, article 434).

Pursuant to article 479 of the TCC, disproportionate voting rights may be granted to privileged shares. However, the voting privileges for private companies are limited to a maximum of 15 votes per share. This number can only be increased by a court decision for the sake of institutionalisation or because of just cause. Thus, under the TCC regime, it is no longer possible to block a capital increase through the use of privileged shares. Privileged votes do not extend to resolutions regarding the amendment of a company's articles of association, or the filing of discharge or liability suits.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Article 1.3.1 of the Corporate Governance Principles stipulates that the announcement regarding general assembly meetings should be made by means of all kinds of communication to reach as many shareholders as possible, including electronic communication, in addition to the procedures stipulated by the legislation, at least three weeks in advance of the meeting.

According to the TCC, shareholders are invited to the meeting as stipulated under the articles of association through an announcement published on the company's website (if the company is required to have a website) and in the Turkish Trade Registry Gazette. This announcement must be made two weeks before the general assembly meeting (TCC, article 414).

Article 415 of the TCC stipulates the shareholders who are entitled to attend meetings. Accordingly, shareholders whose names are written in the attendance list prepared by the board of directors have the right to attend the meeting.

Pursuant to article 437 of the TCC, which regulates the right to examine and demand information, the following must be made available to the shareholders at least 15 days before the meeting:

- financial statements;
- consolidated financial tables;
- annual reports of the board;
- audit reports; and

- the board's suggestions regarding the method of distributing dividends.

Pursuant to the TCC, electronic signatures can be used to prepare meeting documentation, and meetings can be held electronically (TCC, article 1527).

The following requirements have to be met to vote online:

- the company must have a website allocated for this purpose;
- shareholders who wish to participate in the online general assembly meeting must make such a request in advance;
- a technical report must be produced to prove that the electronic platform tools are sufficient for efficient participation and this report should be registered and published; and
- the identities of the online voters must be kept confidential.

The Ministry of Trade issued the Regulation on General Assembly Meetings of Joint Stock Companies Held Electronically (Regulation), regarding the procedures of online general assembly meetings, published in Official Gazette No. 28395 of 28 August 2012. A company must integrate the sample article stating that the meetings can be held electronically into its articles of association. This article can be found in the Regulation published by the Ministry of Trade (Regulation, article 5). The article must be incorporated as is because it is not possible to amend the article while adopting it.

Electronic meetings are mandatory for publicly listed companies.

Shareholders acting by written consent without a meeting can participate in meetings that are held electronically, as explained above.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Article 411 of the TCC stipulates that shareholders holding at least 10 per cent of the company's capital (or at least 5 per cent for public companies), may request a general meeting. If such a meeting has already been convened, then they have the right to request that certain topics to be included on the agenda, including director nominations. If their request is not accepted by the board or not responded to within seven days, these shareholders have the right to apply to the commercial court to enforce their request.

According to article 446 of the TCC, the dissenting opinions of the shareholders must be recorded in the minutes of the general assembly to grant shareholders a right to claim these decisions as invalid.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Under Turkish law, controlling shareholders do not have any specific duties to the company or to non-controlling shareholders. However, all controlling shareholders must exercise their rights by complying with good faith principles. Further, there are special provisions for minority shareholders.

Additionally, the TCC regulates provisions with regard to group companies, and article 202 of the TCC specifically stipulates that the dominant (controlling) company cannot exercise its dominance in a way that may give rise to a financial loss of a subsidiary (eg, instruct the subsidiary to be the guarantor of a loan), unless this loss is compensated within the same financial year or a right to claim compensation is granted to the subsidiary within the same financial year by providing details on when and how the loss will be compensated. The loss concept herein covers causing a potential risk to the company's financial assets or future profitability as well as value depreciation on them. Therefore, not only the actual losses sustained, but also potential risks that may arise thereof, fall within the definition of 'loss'.

Both the shareholders of the subsidiaries and their creditors may claim the indemnification of the loss of the subsidiary company from the dominant company by filing a lawsuit.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

According to the TCC, the shareholders' liability is normally limited to their subscribed capital contribution. This rule is applicable for both joint-stock companies and limited liability companies. There is an exception for limited liability companies concerning government debts. Accordingly, shareholders of a limited liability company are personally liable for government debts and this responsibility should be calculated over the shareholding ratio in the company capital.

Regarding tax debts, the Council of State's General Assembly on Unification of Judgments decided that tax debts that are due and cannot be collected from a limited liability company (in whole or in part, or that are understood to be uncollectible from the company itself) can be collected from its shareholders directly in proportion to their share capitals. In such a case, there is no need to collect the debts in question from the legal representatives first.

Other than the foregoing, the shareholders are not responsible for the acts or omissions of the company, unless such an act or omission results from the shareholders' own acts and has criminal elements.

Employees

10 | What role do employees have in corporate governance?

According to the TCC, employees do not have a specific duty in terms of corporate governance, unless they have been provided with the responsibility to represent the company as commercial representatives under an internal directive to be issued by the board members. However, under the Corporate Governance Principles, employees are also listed as stakeholders, and companies must ensure that the rights and benefits of the stakeholders are protected (CGP, article 3.1.1).

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

At present, share transfer restrictions are not permitted except on legal grounds determined under the Turkish Commercial Code (TCC). However, the TCC introduces specific provisions regarding the restriction of share transfers through the articles of association separately for limited liability companies and joint-stock companies. Unless otherwise is stipulated by law or the articles of association, registered shares may be transferred without any restriction (TCC, article 490/1). Article 492 of the TCC stipulates that the registered shares can be transferred only with the approval of the company and requires that joint-stock companies include the specific reasons why share transfers may be rejected in their articles of association. Article 493 of the TCC stipulates the reasons why share transfers may be rejected. Reasons related to the nature of the shareholders' composition or the scope of the company's activities or the economic independence of the company are deemed as important grounds for rejection under the TCC. This is not an exhaustive list, therefore, shareholders must select predetermined grounds for rejecting share transfers, and be very specific if they want this protection to be reflected in the articles of association. Otherwise, limitations on share transfer will continue as a contractual obligation pursuant to the shareholders' agreement.

Article 493/1 of the TCC provides an escape clause for joint-stock companies through the option to reject a share transfer, without basing its decision on the grounds explained above, by offering to acquire, at real value, the transfer shares itself or on behalf of its shareholders or a third party.

For shareholders to resolve on the transfer restrictions of registered shares, an affirmative vote of 75 per cent of the shareholders or their representatives is required (TCC, article 421/3).

In contrast to the joint-stock companies, the TCC explicitly allows limited liability companies to limit share transfers based on pre-emptive purchase rights, call options or other ancillary or additional obligations by providing for them in their articles of association. These limitations may also be subsequently included in the articles of association by a decision of the general assembly. In this regard, a positive vote of two-thirds of the general assembly is required (TCC, article 621).

In limited liability companies, share transfers are subject to the approval of the general assembly and may be rejected without a just reason, unless otherwise stipulated in the articles of association (TCC, article 577).

Given the differences between limited liability companies and joint-stock companies, investors aiming to reflect the provisions of the shareholders' agreement to the articles of association may prefer to incorporate a limited liability company, provided that the regulations in their field of activity allow this.

Any agreement between the joint-stock company and a third party regarding the third party acquiring the joint-stock company's shares in lieu of the joint-stock company, its affiliate or parent company must comply with the terms set forth under articles 379 and 380 of the TCC. An agreement or obligation to this effect in violation of the terms of article 379 of the TCC will be invalid.

The TCC bans any joint-stock company, a third party, a joint-stock company's subsidiary acting for their parent or a joint-stock company's subsidiary promising shares in its parent, from selling treasury shares (TCC, article 380/2).

Issuance of new shares

12 May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Under the TCC, new shares are issued upon capital increases, and this requires a shareholders' resolution. In public joint-stock companies that adopt a registered capital system, capital can be increased without the approval of the shareholders; thus new shares can be issued accordingly, within the registered share capital (TCC, articles 459 and 460). In addition, according to article 461 of the TCC, existing shareholders have pre-emptive rights to acquire newly issued shares in proportion to their shareholding. Pre-emptive rights of shareholders may be restricted by a decision of the general assembly meeting, in the presence of just cause and with the positive vote of shareholders representing at least 60 per cent of the capital (TCC, article 461).

The TCC has introduced two new systems regarding capital. First, there is the new registered capital system for private joint-stock companies, which was previously available only for public companies. A private joint-stock company can adopt the registered share capital system by a provision to this effect in its articles of association. The articles of association must indicate the aggregate ceiling of the capital and the time limit for the board of directors' authority to increase capital within that set limit, which cannot be longer than five years. The company may then increase its capital without going through the burdensome procedures of holding a general assembly meeting up to a predetermined ceiling (TCC, articles 459 and 460). The minimum capital requirement for a joint-stock company adopting the registered capital system is 100,000 Turkish lira (TCC, article 332).

Second, as a financing method for joint-stock companies, the TCC introduced a conditional capital increase system, through which the company's creditors (eg, holders of bonds or other debt securities) and employees may partake in its equity. The conditional capital increase is not triggered by new capital commitments of the shareholders but through the exercise of exchange (conversion option) and pre-emptive rights by creditors and employees (TCC, article 463).

Restrictions on the transfer of fully paid shares

13 | Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

The Capital Markets Board prohibits restrictions on the transferability of shares of a public company. Accordingly, the transfer of shares must not be limited and other restrictions must not be imposed on shareholders to prevent them from going public. Further, pursuant to article 8(ç) of the Listing Directive issued by Borsa İstanbul, a company is prohibited from including any share transfer restrictions in its articles of association regarding securities to be listed on Borsa İstanbul. Article 490 of the TCC stipulates that fully paid, registered shares can be transferred without any restriction unless otherwise provided by law or by the articles of association. The transfers of bearer shares are subject to the transfer of possession.

Compulsory repurchase rules

14 | Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

A share buy-back system that was already available for listed companies under capital markets legislation has been introduced by the TCC for joint-stock companies in exceptional cases. The conditions for the buy-back are as follows (TCC, article 379):

- authorisation of the board of directors by a general assembly is required;
- the acquisition and pledge may be accepted on the condition that the shares it will acquire in the future and the shares held by its subsidiary companies do not exceed 10 per cent of the company's authorised or issued capital;
- the general assembly can only delegate this authority for a maximum of five years;
- the board of directors is required to state in the authorisation that these legal requirements have been fulfilled;
- the nominal value of the shares that will be accepted as an acquisition or pledge by the authority must be stated;
- the minimum and maximum limits of the consideration that will be paid for the shares must also be stated; and
- acquired shares must be fully paid up (these shares so issued are stripped of any voting rights).

Further, article 385 of the TCC stipulates that shares acquired or accepted as a pledge in a way that is contrary to the principles set forth under the TCC shall be disposed of, or the pledge on them shall be released, within six months of the date of their acquisition or acceptance as a pledge. Any specific procedure regarding selling off or disposing of the pledge has not been provided. The authority to sell off these shares is held by the board of directors, which shall perform its duty according to the principles of equality and public disclosure.

Similar principles apply to share buy-backs in limited liability companies as well. A limited liability company may acquire its own capital shares under two conditions (TCC, article 612): it must have the necessary equity that may be freely used to purchase these shares, and the nominal value of the shares to be purchased must not exceed 10 per cent of the total share capital.

Capital shares acquired in excess of this amount must be disposed of or redeemed through a capital reduction within a maximum period of two years (TCC, article 612/2).

The Communiqué on Share Repurchase (the Communiqué) issued by the Capital Markets Board entered into force on 3 January 2014. According to the Communiqué, the board of directors must be authorised by a general assembly for a publicly held company to repurchase its own shares (Communiqué, article 5/1). There is an exception to this rule where listed companies are allowed to repurchase the shares without the necessity of a general assembly authorisation if the repurchase is necessary to avoid a probable and serious loss. A 'probable and serious loss' is deemed to exist where the daily average price of shares is below the nominal value or has fallen by more than 20 per cent. Unless these circumstances are present, the only way for a listed company to repurchase its shares without a general assembly's authorisation is to obtain the approval of the Capital Markets Board (Communiqué, article 5, subparagraphs 4 and 5).

The nominal value of the repurchased shares cannot exceed 10 per cent of the paid-in capital where the total value of the shares cannot exceed the total value of the resources subject to profit distribution. Repurchased shares may be kept for an indefinite period as long as they do not exceed the aforementioned limits. The shares repurchased in breach of the Communiqué must be sold within one year of the date of the repurchase or else they will be amortised by way of capital decrease (Communiqué, article 19).

The maximum duration of the repurchase programme is three years for the companies listed on the stock exchange and one year for other publicly held companies unless the repurchase programme does not foresee any specific duration (the Communiqué, article 7).

The repurchase of shares is not permitted if there is any postponed disclosure process regarding internal matters or a significant transaction that has not yet been disclosed to the public.

Dissenters' rights

15 | Do shareholders have appraisal rights?

The TCC also provides categories of important reasons that allow joint-stock companies to reject the transfer of registered shares under their respective articles of association. The company may choose not to approve the share transfer by claiming an important reason stated under the articles of association, or to acquire the shares to be transferred on its own, a shareholders' or any third party's behalf by offering the nominal value of the shares to the transferee (TCC, article 493).

If the company prefers to use an escape clause, the nominal value of the shares must be offered to the transferee. There is no definite basis for how the nominal value of shares will be determined, and the transferor may apply to a court for a determination of the nominal value of the shares to be transferred. If the transferee is offered a nominal value and does not reject this value within one month of its acknowledgement, the acquisition offer will be deemed accepted. If the company remains silent for a period of three months from the date of the transferee's application for approval, it will be deemed that the company has approved the share transfer. As long as the company does not approve the share transfer, the ownership of shares will remain with the transferor, together with all monetary and management rights (TCC, articles 493 and 494).

In addition, the TCC regulates an escape fund to be paid to shareholders in the event of a merger or change in the type of company. In this regard, if the shareholders disagree with a merger or change in the type of company, they have the right to sell their shares to the company at a fair value (TCC, articles 141, 183 and 202/2).

Moreover, the Communiqué on Common Principles of Significant Transactions and Retirement Rights, issued on 27 June 2020, determines the extent of significant transactions and shapes the limits of voting rights and shareholders' retirement rights in publicly held companies. According to this communiqué, mergers, division transactions or a change in the type of company, along with other important transactions listed in article 4, require the approval of a general assembly. This communiqué details the provision regarding the retirement right in article 24 of the Capital Markets Law and determines the circumstances where the retirement right does not arise. In this respect, shareholders who voted against a significant transaction at the general assembly meeting and had their dissenting vote recorded in the minutes of that meeting will be able to sell their shares to the subject company.

According to this communiqué, it may be possible to take the general assembly's approval to abandon significant transactions where the total cost of the exercise of retirement rights exceeds their predetermined cost, or where certain shareholders, whose qualifications are specified beforehand, exercise their retirement right. According to article 11 of Communiqué on Tender Offer, in an acquisition of shares or voting rights of publicly held companies in a way that changes the controlling shareholders the transferee is obliged to offer to buy the shares of the other partners.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

Under Turkish law, both listed and unlisted companies use one-tier board structures.

Board's legal responsibilities

17 | What are the board's primary legal responsibilities?

The principal duties of board members are:

- to act prudently and diligently when performing their duties and conducting the business of the company;
- to monitor and supervise the management and the business of the company to ensure that it complies with principles of good faith, and the interests of the company and its shareholders;
- to keep confidential the information obtained during and after the term of duty;
- to refrain from attending board meetings regarding their own interests or the interests of their certain close relatives; and
- not to engage in transactions with the company unless a general assembly meeting authorises the board to repurchase shares (the maximum period this authorisation can last is five years).

In addition to the above, the Turkish Commercial Code (TCC) sets forth the non-transferable duties of board members. The most important non-delegable and indispensable duties and powers of the board of directors are as follows (TCC, article 375):

- determining the company's top-level management and giving instructions in this regard;
- establishing the necessary systems for financial planning, accounting and finance audits to the extent required;
- appointing and dismissing managers (and persons performing the function of a manager) and authorised signatories;
- high-level supervision of whether the persons in charge of management act in accordance with the law, the company's articles of association, internal regulations and the board's written instructions;
- keeping the share book, resolution book of the board and the general meeting and discussion register;
- preparing the annual report and corporate governance disclosure;
- submitting annual reports and governance disclosures to general assembly meetings;
- organising general meetings;
- enforcing resolutions of general meetings; and
- notifying courts regarding the company's state of excess of liabilities over assets.

None of these duties and authorities can be delegated to a representative, the company's management, a committee or managers (TCC, article 367). The general assembly meeting cannot seize or deprive these duties and authorities of the board of directors, or transfer them to the general assembly meeting or committees established under the provisions of articles of association. Similarly, the board of directors cannot waive these duties and authorities.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

The board is responsible for the management and representation of the company (TCC, article 365). Pursuant to article 553 of the TCC, if the board is liable owing to its own faults arising from the law and the articles of association, then the board will owe legal duties to the company, its shareholders and its company's creditors.

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

According to the TCC, the company, its shareholders and its creditors are entitled to file indemnification actions against board members to indemnify the damages that occurred owing to their faults. Shareholders may initiate actions against directors and request the indemnification of the damages that they directly incurred or request indemnification on behalf of the company for the damages that the company has incurred (TCC, article 553).

A voluntary insurance system for the damage incurred by the company through the fault of board members while performing their duties was introduced by the TCC.

In the case of public companies, if the damage is insured at a price exceeding 25 per cent of the company's capital and the company is secured, this must be announced in the bulletin of the Capital Markets Board; and if the company's shares are listed on a stock exchange, it must also be announced in the stock exchange's bulletin. This insurance will be taken into account when assessing compliance with the principles of corporate governance (TCC, article 361).

With regard to the board members' civil and criminal liabilities, the new TCC specifically regulates civil and criminal liabilities (TCC, article 553 and 562). If the board members do not comply with the obligations set forth under the law or articles of association, they will be subject to civil and criminal liability.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

According to article 369 of the TCC, members of the board of directors and third parties in charge of management are obliged to act with care and in compliance with the rules of good faith.

Board member duties

21 | To what extent do the duties of individual members of the board differ?

According to the TCC, it is possible for a legal person to become a member of the board of directors (TCC, article 359/2).

The TCC requires that a chair and at least one vice-chair be appointed among the board members (TCC, article 366). The board members do not have any special duties that should be performed individually, except for calling board meetings. In addition, under Turkish law, board members do not have specific duties individually assigned to them. However, by inserting a relevant provision in the articles of association or regulating an internal regulation, the board can always assign different duties to its members (TCC, article 367). Therefore, each board member can be held to be authorised and liable for different business transactions and may have different specific duties in that regard. If there is this distribution of duties, the duties and authorities of individual board members shall be disclosed in the activity report of the company (Corporate Governance Principles (CGP), article 4.2.2). If the duties are not assigned, management is performed by all board members (TCC, article 367).

Delegation of board responsibilities

22 To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

According to the TCC, the board of directors can transfer all the management rights of the company to one or more executive members, or to a third party, who will then act as the manager. However, at least one of the board members must be entitled to represent the company (TCC, article 370). In such an instance, the transferee would have the same responsibilities as the board of directors had prior to the transfer.

The Corporate Governance Principles stipulate that if there is a delegation of authority among board members, it should be specifically disclosed under the activity report of the company (CGP, article 4.2.2).

An addition was made to article 371 of the TCC, relating to the representative authority of companies, by the Omnibus Law No. 6552 adopted on 10 September 2014. Pursuant to this addition, the board of directors may appoint non-representative members of the board of directors or persons bound to the company by a labour contract as commercial representatives with limited authority or as other commercial assistants. This act of the board of directors, and the powers and duties of the appointed persons, shall be explicitly reflected in the internal directive issued in accordance with article 367 of the TCC and this internal directive shall be registered and announced with the trade registry. This amendment has enabled companies to impose different kinds of limitations or categorisations for their representative authorities.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

Non-executive and independent membership structures are regulated mainly under the Corporate Governance Principles and in certain Capital Markets Communiqués. Pursuant to the Corporate Governance Principles, the majority of the board members should consist of non-executive members (CGP, article 4.3.2) and some of these members should be independent board members (CGP, article 4.3.3). Because all members of the audit committee must be independent board members (CGP, article 4.5.3), it only comprises of non-executive members.

Additionally, the TCC also regulates the non-executive board members. Accordingly, members of the board may solely have non-executive powers provided that it is explicitly stated in the internal guidelines.

According to the Corporate Governance Principles, the board must include the following:

- the majority of the board must consist of non-executive members;
- the total number of independent members shall not be less than one-third of the total number of members;
- in any case, the number of independent members cannot be fewer than two; and
- a person who has been acting as a board member for more than six years within the past 10 years cannot be appointed as an independent board member (CGP, article 4.3).

Pursuant to the Corporate Governance Principles, an individual not having any administrative duties within the company is defined as a non-executive member.

As per the definition of the independent member, the Corporate Governance Principles set forth specific requirements to be met by independent members (CGP, article 4.3.6).

Under Turkish law, non-executive or independent directors do not have different duties from the executive directors. As a general principle, all members of the board are jointly and severally liable to the company, its shareholders and its creditors for damage that occurs due to their fault and owing to the non-fulfilment of the duties stated in the law or the articles of association (TCC, article 553).

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The TCC allows a board of directors to consist of just one member (a real person or a legal entity) assigned by the articles of association or elected by the general assembly. The requirement that a member of the board of directors must be a shareholder in joint-stock companies has been abolished. If a legal entity is elected as a member of the board of directors, a real person should be determined by the legal entity on its behalf and such a decision needs to be registered and announced with the trade registry (TCC, article 359).

In both the TCC and the Capital Markets Law, there is no ceiling stipulated for the size of the board of directors. For listed companies, it is stated that the number of members of the board of directors – provided that the number is not less than five in any case – shall be determined to ensure that the board members conduct productive and constructive activities, make rapid and rational decisions, and efficiently organise the formation and activities of the committees (CGP, article 4.3.1). At least one of the board members shall be a woman (CGP, article 4.3.10).

In limited liability companies, the management and representation of the company may be left to a shareholder or non-shareholder that has been elected as the manager. However, at least one shareholder must possess the right to manage and represent the company. If there is more than one manager of the company, one of these managers must be elected as the chair of the management board by the general assembly.

Article 363 of the TCC stipulates that in the case of a vacancy on the board, the board of directors shall temporarily choose someone who satisfies the legal conditions and present it for the approval of the general assembly. The member chosen this way carries out their duties until the general assembly meeting and, if he or she is approved, he or she continues working until the end of the mandate of their predecessor.

In listed companies, if there is a vacancy on the board and it is not possible to satisfy the board meeting quorum, or it is not possible for the shareholders to convene a meeting to appoint a new board member within 30 days of the vacancy, the Capital Markets Board is entitled to appoint an independent board member (Capital Markets Law, article 128/1(k)).

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

Under Turkish law, it is possible for the same board member to hold both the titles of chair and chief executive. According to the Corporate Governance Principles, the duties and authorities of the CEO and the chair of the board must be specifically distinguished from each other and stipulated under the articles of association. In addition, if it is decided that the CEO and the chair of the board are one person instead of two separate persons, then this decision and the reasons for it must be included in the annual report (CGP, articles 4.2.5 and 4.2.6).

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

According to article 25 of the Capital Markets Board Communiqué, serial X, No. 22 regarding the standards of independent audits in capital markets (as updated by Communiqué serial X, No. 28, published on the Official Gazette on 28 June 2013), it is required that, within the framework of the Corporate Governance Principles, the board appoints an audit committee constituting a minimum of two members of the board. In enterprises where it is not obligatory to establish an audit committee, the duties of the audit committee are fulfilled by the board of directors.

According to the Corporate Governance Principles, the following committees must be formed:

- an audit committee;
- a corporate governance committee;
- an early detection of risk committee;
- a nomination committee; and
- a price committee.

Banks are only required to form corporate governance committees.

If a nomination committee and a price committee cannot be formed, then the corporate governance committee will supersede the duties of these committees (CGP, article 4.5.1).

Pursuant to the TCC, listed companies are under the obligation to constitute a committee that will be in charge of detecting and managing risks in advance. Risk committees submit evaluation reports to their company's board every two months and inform the board of the problems and solutions. These reports are also sent to the company's auditor (TCC, article 378). If their auditors deem it necessary, non-listed companies must also form risk committees.

Board meetings

27 | Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

The frequency of board meetings is regulated under article 390 of the TCC. Accordingly, the law does not require a minimum number of board meetings per year; therefore boards convene meetings when it is deemed necessary unless their company's articles of association require a minimum number of board meetings.

The Corporate Governance Principles state that a board of directors must convene meetings on a regular basis to fulfil their duties effectively (CGP, article 4.4.1).

Board practices

28 | Is disclosure of board practices required by law, regulation or listing requirement?

The structure, members of the board, their term of office and remuneration of the members are determined in general assembly meetings, and the minutes of general assembly meetings are registered with the relevant trade registry and published in the Turkish Trade Registry Gazette. In addition to the TCC, capital stock companies subject to auditing will be required to set up and maintain a company website within three months following the incorporation of the company and must allocate part of the website to the announcements legally required to be made (TCC, article 1524).

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

In listed companies, the board of directors shall issue its annual report in a detailed way within two months following the end of the relevant accounting period that should include, among other things:

- information on the duties of the members of the board of directors and executives conducted in the company and declarations on the independence of the members of the board of directors;
- information on the members of the committees formed within the structure of the board of directors, the meeting frequency of these committees and the evaluation of the board of directors regarding the working principles, including the conducted activities and the efficiency of the committees; and
- the number of meetings of the board of directors in a year and the attendance of the members of the board of directors to these meetings.

The annual report shall be published so that the public can access this complete and accurate information with respect to the activities of the corporation. Additionally, the nomination committee that is mandatory in listed companies regularly evaluates the structure and productivity of the board of directors and submits its advice regarding possible amendments in this respect to the board of directors.

In non-listed companies, a similar annual activity report and affiliation report (necessary for group companies) are also annually prepared by the board, including information on management, activities of the company and related important developments, financial status and risk assessment, and submitted to the general assembly meeting.

The shareholders discuss the activities of the board and decide on the release of the board members' liabilities in the annual general meeting. This is one of the non-transferable duties of the general assembly (TCC, article 408).

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

Remuneration

According to the Turkish Commercial Code (TCC), provided that the amount is determined by the articles of association or the general assembly resolution, directors can be paid a remuneration (TCC, article 394).

The Corporate Governance Principles (CGP) stipulate that the remuneration of independent board members cannot be determined by taking into account the profit share, share options or the company's performance-related payment schedules (CGP, article 4.6.3). Pursuant to the same principle, the remuneration to be paid to independent board members shall be satisfactory so as to protect their independence (CGP, article 4.6.4). The remuneration to be paid to board members and all managers having administrative responsibilities shall be made available to the public in the annual activity report (CGP, article 4.6.6).

Length

There is no requirement as to the length of the service contract of the board members under the TCC. According to the TCC, board members can be appointed for a maximum term of three years, unless otherwise specified in the articles of association of the companies, board members may be re-elected (TCC, article 362). The Corporate Governance Principles also set forth that the term for independent members is three years and that they may be re-elected (CGP, article 4.3.5).

Transactions between the company and board members

In strengthening the arm's-length principle, the TCC prohibits a joint-stock company from financing its shareholders and directors, aiming to preserve the company assets and protect the creditors of the joint-stock company. In this regard, a board member cannot conduct any transaction with the company in his or her or any other person's name without permission from the general assembly and the company can claim such transactions as null and void. The counterparty cannot make such a claim (TCC, article 395).

In addition, in the case of a board member who is not a shareholder, his or her relatives, including spouses, descendants, lineal ancestors and relatives by blood or marriage to (and including) the third degree, cannot be indebted in cash to the company. The prohibition provided for board members includes guarantees as well. In other words, the company cannot provide surety, guarantee or security for the persons listed above, undertake their liability or take over their debts. Otherwise, the creditors of the company are entitled to start execution proceedings directly against these people for the debt of the company in the amount for which the company is liable (TCC, articles 393 and 395).

If the related-party transaction principle is violated, a judicial fine will be imposed on the shareholder or board members (TCC, article 562).

In addition, shareholders cannot become indebted to the company unless the debt arises from their due capital commitments and the company's profit, together with the legal reserves, do not meet the company's losses for the previous years (TCC, article 358). In limited liability companies, the same principles only apply to partners of the company (TCC, article 644).

In addition, according to article 1.3.7 of the Corporate Governance Principles, majority shareholders, members of the board, managers with administrative responsibilities and their relatives (spouse, direct offspring or relatives up to the second degree by blood or by marriage) must provide information in the general assembly about the transactions that may conflict with the interests of the company or its affiliates. Furthermore, according to article 1.3.10 of the previous Corporate Governance Principles, the approval of a general assembly meeting was required for significant transactions (namely transferring or renting out all or a significant portion of company assets, establishing rights in rem on all or significant amounts of company assets, granting concessions to third parties or changing the scope and subject of already provided concessions, acquiring or renting significant amount of assets, and delisting from Borsa İstanbul). If the decision of a general assembly meeting is not required by the relevant board for the execution of such transactions, affirmative votes from most independent directors are required. If this is not achieved, the transaction is submitted to a general assembly meeting for approval. In such cases, the reasoning of the independent directors must be disclosed to the public and the Capital Markets Board and explained to shareholders at a general meeting.

Article 1.3.10 of the current Corporate Governance Principles exemplifies 'significant transactions' as transferring all or a substantial part of a company's assets or establishing real rights on them or leasing them, taking over or leasing a significant asset, granting privileges or changing the scope or the subject of the available privileges, and delisting.

If the above transactions fall under the category of related-party transactions, those parties shall not vote in the relevant general assembly meeting. Accordingly, there is no minimum meeting quorum requirement for the approval of the above transactions (Capital Markets Law, article 29/6).

As per article 21(1) of the Capital Markets Law, in the case of transactions with another enterprise or individual with whom there is a direct or indirect management, administrative, supervisory or ownership relationship, publicly held joint-stock companies, collective investment undertakings and their subsidiaries shall not damage their profits or assets by engaging in deceitful transactions by applying a price, fee or value clearly inconsistent with similar transactions with unrelated third parties, market practices or principles of commercial prudence and honesty.

Compensatory arrangements between the company and board members

Under the TCC, the board members are under an obligation to act with care and in compliance with the rules of good faith (TCC, article 369). If they fail to do so and the company incurs damages as a result, shareholders and creditors of the company may initiate actions against the board members and request indemnification (TCC, article 553). In this context, there is no regulation regarding compensatory arrangements between the company and board members, but it is possible to lay down a clause in the agreement between the company and the board member stipulating how these damages shall be compensated. Accordingly, damages that were incurred owing to the fault of board members can be compensated by the relevant board members.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

According to the TCC, the board shall review the remuneration of the key executives and include the information in the activity report of the board of directors. However, there is no regulation that affects the remuneration of senior managers (TCC, article 516/2).

According to the Corporate Governance Principles, remuneration of the senior management must be prepared in a written form and submitted for the approval of the shareholders. The remuneration paid to the board members and the key executives who have administrative duties, and all other benefits to be provided to them, are disclosed to the public through the activity reports. It is essential to disclose the remuneration for each of them. If a specific disclosure is not made, at the very least a separation must be made between the key executives and board members. The remuneration policies of the company must be published on the company's website (CGP, article 4.6.2). There is no regulation regarding compensatory arrangements between the company and senior managers. However, similarly to the board members, the managers are under an obligation to act with care, and according to article 553 of the TCC, they can be held liable if they fail to do so. In this context, it is possible to lay down a clause in the agreement between the company and the manager stipulating that the damages incurred owing to the fault of the manager shall be compensated by the relevant manager.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

According to the Corporate Governance Principles, a written remuneration policy should be submitted to the shareholders during a general assembly meeting and discussed as a separate agenda article to give them the opportunity to air their views and suggestions in relation to the remuneration policy that applies to members of the board of directors and key executives (ie, senior management). The remuneration policies of public companies are announced on their websites (CGP, article 4.6.2).

DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

A voluntary insurance system for the damage incurred by the company through the fault of board members while performing their duties has been introduced by the Turkish Commercial Code (TCC). If the damage is insured at a price exceeding 25 per cent of the company capital and the company is secured, in the case of public companies, this matter shall be announced in the bulletin of the Capital Markets Board, and if the shares are listed on a stock exchange this shall also be announced in the stock exchange bulletin, and this matter shall be taken into account in the assessment of compliance with the principles of corporate governance (TCC, article 361).

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

There is no regulation preventing a company from indemnifying a director or officer against liabilities, but it should be noted that these indemnification claims are not common.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

There are no mandatory provisions as to the advancement of expenses to directors and officers, and there is no practice regarding this either. The companies may prefer to take these precautionary measures; however, these precautionary measures may not be included in the articles of association of the companies. Even so, the company may execute an internal protocol with the members of the board of directors where they agree on these measures.

For the damage incurred by the company through the fault of board members while performing their duties, the companies may voluntarily execute insurance policies.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

As stated under the Delegation of Board Responsibilities, the liabilities of board members can be restricted by delegating their duties to other board members or managers. This limitation can be realised through issuing an internal directive in accordance with article 367 of the TCC, and this internal directive must be registered and announced with the trade registry. However, the board members have a continuing duty to observe the acts and actions of the third parties to whom liabilities are delegated. The restriction on authority of representation is not effective against third parties in good faith; however, the restrictions that are registered and announced in relation to limiting the authority of representation solely to the business of the headquarters or to the exercising thereof jointly are valid. In addition, they still have the duty to prudently and diligently delegate the responsibilities to persons who are qualified enough and supervise them (TCC, article 371).

As per the addition to article 371 of the TCC, explained under the Delegation of Board Responsibilities, limiting the liability of the board members or managers is only effective in the company and does not relieve them from responsibility against third persons. In this regard, the board of directors shall be liable jointly and severally towards the company or third persons for any damage caused by the commercial representatives with limited authority or other commercial assistants appointed pursuant to an internal directive.

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

The articles of association of a company and any amendments thereto must be registered in the relevant trade registry and announced in the Turkish Trade Registry Gazette as of its incorporation (TCC, article 354). Further, the articles of association of a company that is obliged to launch a website are also announced on the company website. According to article 2.2.2 of the Corporate Governance Principles, articles of association must also be published on the company's website.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

In accordance with the Turkish Commercial Code (TCC), each company subject to independent audit must maintain a company website within three months following the incorporation and must allocate a specific part of the website to making the announcements legally required (TCC, article 1524).

The Presidential Decision No. 6434 on Determination of Companies subject to Independent Auditing (Decision), published in the Official Gazette on November 30, 2022, lists the companies subject to independent auditing. However, even if the company is not listed in the Decision specifically but exceeds the following thresholds for two consecutive accounting periods, this company will also be subject to independent auditing.

- assets worth over 75 million Turkish lira (previously 35 million Turkish lira);
- net annual sales over 150 million Turkish lira (previously 70 million Turkish lira); and
- number of employees more than 150 (previously 175).

In addition to the above, Law No. 6335 amending the TCC has narrowed the scope of the announcements to be made by the companies on their websites and has regulated that the announcements legally required to be made must be announced on the website, as well as having introduced certain time periods for publishing the commercial papers and documents that are required to be published on the website of a company.

Companies that do not launch a website within three months of the date the TCC entered into force will be subject to a judicial fine for between 100 and 300 days, and authorised bodies of companies that do not allocate part of the website to public information within the same period of time will be subject to a judicial fine for up to 100 days (TCC, article 562/12).

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

As per the Turkish Commercial Code (TCC), shareholders may appoint directors provided that it is explicitly stipulated under the company's articles of association. This ability can be granted to specific share groups, shareholders of a specific nature (eg, the founding family shareholders) or minority shareholders. Unless there is a just cause, the nominated director must be appointed as a member of the board of directors. In listed companies, the nominated directors of a corporation must be mentioned in the mandatory information form required to be published by proxy solicitors.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

The shareholders exercise their rights during the general assembly meetings; companies engage with shareholders mainly within the scope of the general assembly.

Under article 408 of the TCC, the management of a company is generally conducted by the board of directors, but the general assembly is also an essential organ of the company and has fundamental duties, including:

- the amendment of articles of association;
- the appointment and removal of board members;
- the appointment of an auditor; and
- the passing of decisions concerning:
    - financial tables;
    - the preparation of the annual report of the board of directors;
    - determining annual income, profit shares and revenues; and

- the inclusion of reserve funds to the capital and profit to be distributed to the shareholders.

An ordinary general assembly shall be convened within three months of the end of each activity period (TCC, article 409). An extraordinary general assembly can be convened whenever it is required. The board of directors invites the shareholders to general assemblies. This invitation shall be made in the form provided in the articles of association.

The invitation to the general assembly shall also be published in the Turkish Trade Registry Gazette. For non-listed companies, the invitation shall be issued at least two weeks prior to the date of the general assembly meeting (excluding the dates of announcement and meeting) (TCC, article 414). All shareholders whose names appear on the attendance list prepared by the board of directors have the right to attend the meeting.

The Ministry of Trade issued the Regulation on General Assembly Meetings of Joint Stock Companies Held Electronically (Regulation), regarding the procedures of online general assembly meetings, published in Official Gazette No. 28395 of 28 August 2012. The companies must integrate the sample article stating that general assembly meetings can be held electronically into the company's articles of association. This article can be found in the article 5 of the Regulation published by the Ministry of Trade. It is not possible to amend the article while adopting it, so it must be integrated as is.

Electronic meetings are mandatory for publicly listed companies.

Shareholders who state in the Electronic General Assembly System that they will attend the meeting electronically may participate in a meeting that is held electronically.

Sustainability disclosure

41 | Are companies required to provide disclosure with respect to corporate social responsibility matters?

Pursuant to article 11-h of the Regulation on the Minimum Contents of the Annual Activity Reports of Companies issued by the Ministry of Trade, the annual activity report should include the information on expenses for donation, philanthropy and social responsibility projects. Within this context, if the company held any social responsibility projects, it is required to disclose the information on expenses in the annual activity report.

Further, article 2.3.2-i of the Corporate Governance Principles (CGP) also stipulates the general content of the annual report by explicitly stating each clause that shall be in the report. Accordingly, in the listed companies, the board of directors shall issue its annual report in a detailed way that should include, among other things: 'Information on the corporate social responsibility projects conducted with respect to the corporate activities result in the social rights and technical training of employees and other social and environmental consequences'.

In addition, the listed companies are obliged to be aware of the rules of social responsibility and comply with the established regulations with respect to the environment, consumers, public health and rules of ethics. The relevant provision sets voluntary requirements for companies to support and to respect the human rights that are considered valid in accordance with international criteria.

CEO pay ratio disclosure

42 Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

Pursuant to article 7/1-b of the Regulation on the Minimum Contents of the Annual Activity Reports of Companies issued by the Ministry of Trade, the financial rights provided to the board members and the key executives should be stated in the annual activity report.

On the other hand, pursuant to the Corporate Governance Principles, the general principles of remuneration of the board members and the key executives who have administrative duties must be prepared in a written form. In listed companies, the written remuneration policy should be submitted to the shareholders during the general assembly meetings and discussed as a separate agenda article to give them the opportunity to air their views and suggestions in relation to the remuneration policy that applies to members of the board of directors and key executives. The remuneration policies of public companies are announced on their websites (CGP, article 4.6.2).

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

The law does not mandate any specific requirement to disclose gender pay gaps from a corporate governance perspective. However, the law mandates not to discriminate between employees.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Notification obligation to Tax Office after registration of changes before trade registry is removed

With the General Communique No. 546 on Tax Procedural Law (Communiqué) entered into force as of February 1, 2023, the taxpayers are no longer required to submit a separate notification to the tax office for the following matters, which had previously been subject to notification:

- opening/closing transactions of branches (changes in the number of workplaces other than branches shall continue to be reported);

- change of business headquarter/branch address transactions;
- conversion of company type transactions;
- entry into liquidation/withdrawal from liquidation transactions;
- closure of liquidation/ ceasing of business transactions; and
- title change transactions.

The Communiqué also authorises the Revenue Administration to abolish the notification obligation for transactions that are not specified in the table annexed to the Communiqué with an announcement to be published on its official website if the information regarding the transactions in question is obtained electronically from the Ministry of Trade.

Extension of the deadline regarding amendments to the Communiqué With Respect to Capital Loss and Negative Equity

The Communiqué (Amending Communiqué) published in the Official Gazette on 8 November 2022, extended the deadline provided under Provisional Article 1 of the Communiqué on the Procedures and Principles Regarding Implementation of Article 376 of the Turkish Commercial Code No. 6101 (the Implementation Communiqué).

Accordingly, joint stock companies, limited liability companies and limited partnerships divided into shares will be able to exclude all the foreign exchange losses, and half of the expenses arising from leases, amortisation, and personnel expenses accrued in 2020 and 2021 in the capital loss and negative equity calculation in their balance sheets until the end of the fiscal year 2023.

Capital decrease taxation

The Law No. 7420 on the Amendment of the Law on Income Tax and Certain Laws and Statutory Decrees, published in the Official Gazette on 9 November 2022 (Amending Law), provides that article 34/B will added to the Law No.5520 on Corporate Tax to regulate the taxation in capital decrease.

Before this amendment, there was no explicit provision in the tax legislation regarding capital decrease taxation. With this amendment, the capital decrease taxation will be determined by taking into consideration the distinction based on whether five full years have elapsed as of the date of the decrease, depending on the date of addition of the equity items added to the capital, or not.

If there is a capital decrease after five full years have elapsed, the capital elements within the amount subject to the decrease are determined by proportioning the capital in cash or in kind and other elements added to the capital to the total capital, and the taxation will be made accordingly.

If there is a capital decrease before five full years have elapsed, the decrease is made in the order specified in the Amending Law (starting with those which require the highest taxation) and the taxation is made accordingly.

Amendment to TCC article 82

The Law No. 7417 on the Amendment of the State Personnel Law and Certain Laws and Statutory Decree No. 375 was published in the Official Gazette numbered 31887 and dated 5 July 2022.

Pursuant to the amendment made in article 82 of TCC, the 15-day period for requesting a document from the competent court where the commercial enterprise is located from the date of learning of the loss of the commercial books and documents due to a disaster such as fire, flood or earthquake or theft within the legal retention period, is extended to 30 days.

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Summary

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SOURCES OF CORPORATE GOVERNANCE RULES AND PRACTICES

Primary sources of law, regulation and practice

1 What are the primary sources of law, regulation and practice relating to corporate governance? Is it mandatory for listed companies to comply with listing rules or do they apply on a 'comply or explain' basis?

In the United States, there are two primary sources of law and regulation relating to corporate governance.

State corporate laws

State corporate law – both statutory and judicial – governs the formation of privately held and publicly traded corporations and the fiduciary duties of directors. Delaware is the most common state of incorporation. Because Delaware law and interpretation are influential in other states, the Delaware General Corporation Law (DGCL) is used in this chapter as the reference point for all state law discussion. Shareholder suits are the primary enforcement mechanism of state corporate law.

Several states have enacted or are considering legislation that would encourage greater board diversity or require disclosure about board diversity.

Federal securities laws

On the federal level, the primary sources are the Securities Act of 1933 (the Securities Act) and the Securities Exchange Act of 1934 (the Exchange Act), each as amended. The Securities Act regulates all offerings and sales of securities, whether by public or private companies. The Exchange Act addresses many issues, including the organisation of the financial marketplace generally, the activities of brokers, dealers and other financial market participants and, as to corporate governance, specific requirements relating to the periodic disclosure of information by publicly held, or 'reporting', companies. A company becomes a reporting company under the Exchange Act when its securities are listed on a national securities exchange or when it has total assets exceeding US$10 million and a class of securities held of record by more than 2,000 persons or a maximum of 500 persons who are not sophisticated ('accredited') (with some exclusions). Both the Securities Act and the Exchange Act have addressed questions of corporate governance primarily by mandating disclosure, rather than through normative regulation.

The Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act) was enacted in July 2002 in response to the corporate failures of 2001 and 2002. The Sarbanes–Oxley Act, which applies to all reporting companies (whether organised in the United States or elsewhere) with US-registered equity or debt securities, amends various provisions of the Exchange Act (and certain other federal statutes) to provide direct federal regulation of many matters that traditionally had been left to state corporate law or addressed by federal law through disclosure requirements. Under the Sarbanes–Oxley Act, many aspects of corporate governance that were previously addressed, if at all, through stock market listing requirements, best practice standards or policy statements from the Securities and Exchange Commission (SEC) are now subjects of direct binding law. Since 2002, the SEC has promulgated a number of rules that implement provisions of the Sarbanes–Oxley Act.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd–Frank Act) was enacted in July 2010 in response to the financial crisis in 2008 and 2009. The Dodd–Frank Act is intended to significantly restructure the regulatory framework for the US financial system and also extends federal regulation of corporate governance for all public companies. The SEC has promulgated several rules that implement provisions of the Dodd–Frank Act. Ongoing rule-making by the SEC and national securities exchanges are required for full implementation.

The Jumpstart Our Business Startups Act of 2012 (the JOBS Act) was enacted in April 2012 to, inter alia, facilitate private capital formation and ease reporting requirements that may apply to 'emerging growth companies' after the initial public offering. The JOBS Act requires the SEC to undertake various initiatives, including rule-making and studies touching on capital formation, disclosure and registration requirements.

Listing rules provide an additional source of corporate governance requirements. To list a security on any of the three major listing bodies – the New York Stock Exchange (NYSE), NYSE American (formerly known as the American Stock Exchange and NYSE MKT) or the Nasdaq Stock Market (Nasdaq) – a company must agree to abide by specific corporate governance listing rules. In 2003, the SEC approved significant amendments to both the NYSE and Nasdaq corporate governance listing rules as described below. The Dodd–Frank Act requires amendments to corporate governance listing rules to be made by the NYSE and Nasdaq.

In addition, a number of corporate governance guidelines and codes of best practice recommend how public company boards should organise their structures and processes. The American Law Institute's Principles of Corporate Governance: Analysis and

Recommendations present a thorough discussion of governance practices from a legal perspective. Other influential recommendations from the business community include:

- the National Association of Corporate Directors (NACD):
    - Key Agreed Principles (developed in collaboration with Business Roundtable and the Council of Institutional Investors (CII));
    - Report of the NACD Blue Ribbon Commission on Director Professionalism;
    - Report of the NACD Blue Ribbon Commission on Building the Strategic-Asset Board;
- the Business Roundtable: Principles of Corporate Governance;
- the Conference Board, Commission on Public Trust and Private Enterprise: Findings and Recommendations; and
- the Commonsense Principles of Corporate Governance issued by a coalition of high-profile representatives of leading public companies and institutional investors in 2016 and updated in the form of Commonsense Principles 2.0 in 2018.

The investor community has also issued a number of corporate governance guidelines, codes of best practices and proxy voting policies that are increasingly influential. These include:

- the CII: Policies on Corporate Governance;
- the Teachers Insurance and Annuity Association of America-College Retirement Equities Fund (TIAA)/Nuveen: TIAA Policy Statement on Responsible Investing;
- the California Public Employees' Retirement System (CalPERS): Governance and Sustainability Principles;
- proxy voting policies of large institutional investors, such as BlackRock, Vanguard, State Street and Fidelity; and
- the Investor Stewardship Group, Corporate Governance Principles for US Listed Companies and Stewardship Principles issued in 2017 by a group of US-based institutional investors and global asset managers representing more than US$20 trillion in assets under management.

In addition, proxy advisory firms, such as Institutional Shareholder Services (ISS) and Glass Lewis, have developed proxy voting guidelines that set forth the voting recommendations that these firms will make on particular issues to be voted on by shareholders. These guidelines are based on what these firms consider to be 'best practices' and have also become influential.

Unlike many corporate governance codes in the European Union and other parts of the world that call for voluntary adoption of their substantive provisions or 'comply or explain' disclosure requirements, the corporate governance rules in the United States are generally mandatory. However, most US federal securities regulation of listed issuers is disclosure-driven and, even where substantive matters are addressed, disclosure is most often used as the vehicle to achieve a desired objective or to add transparency to matters deemed worthy of public attention. For example, with respect to executive compensation, the rules provide for extensive disclosure requirements rather than substantive requirements.

Responsible entities

2 What are the primary government agencies or other entities responsible for making such rules and enforcing them? Are there any well-known shareholder or business groups, or proxy advisory firms, whose views are often considered?

The primary means of enforcing state corporate law is through derivative suits initiated by shareholders. At the federal level, the SEC has the power to regulate, implement and enforce the Securities Act and the Exchange Act (including the Sarbanes–Oxley Act, the JOBS Act and relevant provisions of the Dodd–Frank Act). In addition, the Sarbanes–Oxley Act created the Public Company Accounting Oversight Board (PCAOB) to regulate the services accounting firms provide to companies. The SEC oversees the PCAOB, appoints its members and must approve any rules adopted by the PCAOB.

Several states have enacted or are considering legislation that would encourage greater board diversity or require disclosure about board diversity. Typically the state statute requires periodic reporting to the Secretary of State who is required to publicly report on corporate compliance with the board diversity requirements.

The CII is an influential association of public and private pension funds that often pushes for governance reforms. Pension funds have traditionally been the most activist of the institutional investors, working both in concert and individually. Influential pension funds include TIAA/Nuveen and CalPERS – respectively, among the largest private and public pension funds in the world. The New York City Pension Funds have become increasingly active in recent years with highly effective campaigns urging companies to adopt proxy access and prioritise board composition, diversity and refreshment, and disclosure of workforce diversity. In addition, Vanguard Group, BlackRock Inc and State Street Global Advisors, three of the United States' largest institutional investors, have recently become more assertive in pushing for corporate governance reforms and increased director-shareholder engagement at the companies in which they invest.

The views of proxy advisory firms ISS and Glass Lewis are also influential.

THE RIGHTS AND EQUITABLE TREATMENT OF SHAREHOLDERS AND EMPLOYEES

Shareholder powers

3 What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action? What shareholder vote is required to elect or remove directors?

Under state corporate law, shareholders generally have the right to elect directors (see the Delaware General Corporation Law (DGCL), section 216).

For many years, it was common practice for directors to be elected by a plurality of shareholders that can either vote in favour of, or withhold their votes from, the director candidates nominated by the board; 'withheld' votes are not counted. Accordingly, absent a contested election, the candidates nominated by the board are automatically elected whether or not a majority of shareholders vote for them. From the mid-2000s onward, shareholders have pressed companies for the ability to veto the election of a particular director nominee or nominees in the context of an uncontested election. This can be achieved through the adoption of charter or by-law provisions requiring that director nominees receive the approval of a 'majority of the votes cast' to be elected, or, in lieu of a charter or by-law provision, the adoption of corporate policies that effectively require a director who has not received a majority of the votes cast to resign. In 2006, the Delaware legislature adopted amendments to the DGCL that facilitate both of these options. Specifically, the amended DGCL, section 141(b) expressly permits a director to irrevocably tender a resignation that becomes effective if he or she fails to receive a majority vote in an uncontested election. The amended DGCL, section 216 provides that a by-law amendment adopted by shareholders specifying the vote required to elect directors may not be repealed or amended by the board alone (generally, by-law provisions may be amended by the board).

The proportion of companies in the Standard & Poor's (S&P) 500 that have adopted some form of majority voting in uncontested director elections has increased dramatically from 16 per cent in 2006 to nearly 90 per cent in 2022. The source of the S&P 500 company data referenced in this chapter is the 2022 Spencer Stuart Board Index.

Shareholders can also nominate their own director candidates either before or at the annual general meeting (AGM), although most public companies adopt 'advance notice' bylaws that require nominations to be received by the company several months before the AGM. To solicit the proxies needed to elect their candidates, however, at a company that has not adopted 'proxy access' a shareholder must mail to all other shareholders, at the shareholder's own expense, an independent proxy solicitation statement that complies with the requirements of section 14 of the Securities Exchange Act of 1934 (the Exchange Act). Given these constraints, independent proxy solicitations are rare and usually undertaken only in connection with an attempt to add designated directors to the board and/or seize corporate control. In November 2021, the SEC adopted changes to the federal proxy rules to require the use of 'universal' proxy cards, which allow shareholders to vote for a mix of management and dissident nominees in a contested director election. The rules are now effective for shareholder meetings held after 31 August 2022.

In addition, shareholders generally have the right to remove directors with or without cause or, where the board is classified, only for cause (unless the certificate of incorporation provides otherwise); the vote required to remove directors is a majority of the shares then entitled to vote at an election of directors (subject to certain modifications, for example, where the company has adopted cumulative voting in director elections) (see DGCL, section 141(k)). However, as many publicly held companies do not permit shareholders to call special meetings or act by written consent, this power can be difficult to exercise in practice.

Shareholders' liability for corporate actions is generally limited to the amount of their equity investment. In keeping with their limited liability, shareholders play a limited role in the control and management of the corporation. A number of corporate decisions require shareholder approval. In addition, shareholders can typically enjoin ultra vires acts (see DGCL, section 124) and vote on certain issues of fundamental importance at the AGM, including the election of directors (see DGCL, section 216).

Shareholder decisions

4 What decisions must be reserved to the shareholders? What matters are required to be subject to a non-binding shareholder vote?

Under state corporate law, shareholders typically have a right to participate in the following types of decisions:

- election of directors, held at least annually (see DGCL, sections 141(d), 211(b) and 216);
- filling of board vacancies and newly created directorships, if so provided in the certificate of incorporation or by-laws (see DGCL, section 223);
- removal of directors (see DGCL, section 141(k));
- approval or disapproval of amendments to the corporation's certificate of incorporation (which requires prior board approval) or by-laws, although the board is also typically authorised (in the certificate of incorporation) to amend the by-laws without shareholder approval (see DGCL, sections 109, 241 and 242); and
- approval or disapproval of fundamental changes to the corporation not made in the regular course of business, including mergers, consolidations, compulsory share exchanges, or the sale, lease or exchange of all or substantially all of the corporation's property and assets (see, for instance, DGCL, sections 251(c) and 271).

Other issues that may be brought to shareholder vote include:

- approval of certain business combinations with interested shareholders that would otherwise be prohibited (see DGCL, section 203(a)(3));
- approval of conversion to a different type of entity (see DGCL, section 266);
- approval of transfer, domestication or continuance in a foreign jurisdiction (see DGCL, section 390);
- approval of dissolution and revocation of dissolution (see DGCL, sections 275 and 311); and
- ratification of defective corporate acts that would have required shareholder approval (see DGCL, section 204(c)).

Shareholders may also be asked by the board to approve certain matters, including:

- approval of interested director or officer transactions (see DGCL, section 144);
- the making of determinations that indemnifying a director or officer is proper (see DGCL, section 145); or
- if so provided in the certificate of incorporation, the making of determinations that the consideration for which shares of stock with or without par value may be issued, and treasury stock disposed of (see DGCL, section 153).

Since 2011, the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 has required US public companies to conduct separate shareholder advisory votes on:

- executive compensation – to be held at least once every three calendar years (annual votes are typical);
- whether the advisory vote on executive compensation should be held every year, every two years or every three years – to be held at least once every six calendar years; and

- certain 'golden parachute' compensation arrangements in connection with a merger or acquisition transaction that is being presented to shareholders for approval.

The rules of the New York Stock Exchange (NYSE) and Nasdaq Stock Market (Nasdaq) also require that shareholder approval be obtained prior to:

- any adoption of an equity compensation plan pursuant to which officers or directors may acquire stock, subject to limited exceptions;
- issuance of common stock to directors, officers or substantial security holders if the number of shares of common stock to be issued exceeds either 1 per cent of the number of shares of common stock or 1 per cent of the voting power outstanding before the issuance, with some exceptions including if the issuance is a cash sale for a price that is at least a specified minimum price (NYSE), or could result in an increase in outstanding common shares or voting power of 5 per cent or more (Nasdaq);
- issuance of common stock that will have voting power equal to or greater than 20 per cent of the voting power prior to such issuance or that will result in the issuance of a number of shares of common stock that is equal to or greater than 20 per cent of the number of shares of common stock outstanding prior to such issuance, subject to certain exceptions including any public offering for cash or if the issuance is in connection with an acquisition of the stock or assets of another company and the issuance alone or when combined with any other present or potential issuance of common stock in connection with such acquisition is equal to or exceeds the 20 per cent threshold; and
- issuance of securities that will result in a change of control of the company.

Disproportionate voting rights

5 To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

Under state law, a corporation may issue classes of stock with different voting rights, limited voting rights and even no voting rights, if the rights are described in the corporation's certificate of incorporation (see DGCL, section 151). If, however, a corporation issues a class of non-voting common stock, it must have an outstanding class of common shares with full voting rights.

The NYSE and Nasdaq listing rules also permit classes of stock with different voting rights; however, the listing rules prohibit listed companies from disparately reducing or restricting the voting rights of existing shareholders unilaterally.

In 2017, two major stock index providers (S&P Dow Jones and FTSE Russell) announced changes to their index eligibility requirements that would exclude most companies going public with multiple classes of stock from the primary indices in the United States. Nevertheless, some companies in the technology industry and other industries have subsequently gone public with dual-class or multi-class stock.

Although it prefers equal voting rights, BlackRock acknowledges that newly public companies may benefit from a dual-class structure but endorses a limited duration through a sunset provision or periodic approval by shareholders.

The Council of Institutional Investors (CII) and the California Public Employees' Retirement System have expressed their opposition to non-voting shares. The CII is part of the Investor Coalition for Equal Votes, which was launched in June 2022 by the UK pension fund Railpen and several US pension funds, which encourages IPO companies with dual-class stock structures to include a reasonable time-based 'sunset' provision (ie, seven or fewer years) on the super-voting shares.

ISS will generally recommend voting against or withholding votes from individual directors, committee members or the entire board (except new nominees, who should be considered on a case-by-case basis) if the company employs a common stock structure with unequal voting rights. There are certain limited exceptions to this policy, including for newly-public companies with a sunset provision of no more than seven years from the date of going public.

Glass Lewis believes multi-class voting structures are typically not in the best interests of common shareholders. In the case of a board that adopts a multi-class share structure in connection with an IPO, Glass Lewis will generally issue negative recommendations against directors at the first annual meeting after the company has become public if the company does not submit the multi-class structure to a shareholder vote or adopts a multi-class capital structure that is not subject to a reasonable sunset provision (ie, generally seven years or less). Furthermore, Glass Lewis will generally recommend voting against the governance committee chair at companies with a multi-class share structure and unequal voting rights if the multi-class share structure is not subject to a reasonable sunset provision.

Glass Lewis will generally recommend that shareholders vote in favour of recapitalisation proposals that would eliminate dual-class share structures. Similarly, Glass Lewis will generally recommend voting against proposals to adopt a new class of common stock.

Shareholders' meetings and voting

6 Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders act by written consent without a meeting? Are virtual meetings of shareholders permitted?

Generally, all shareholders, at the record date set by the board, may participate in the corporation's annual general meeting (AGM), and are entitled to vote (unless they hold non-voting shares) in person or by proxy (see DGCL, sections 212(b) and (c) and 213). The proxy appointment may be in writing (although there is no particular form mandated by the DGCL) or provided by telephone or electronically.

In addition, section 14 of the Exchange Act and related SEC regulations set forth substantive and procedural rules with respect to the solicitation of shareholder proxies for the approval of corporate actions at AGMs and special shareholders' meetings. Foreign private issuers are exempt from the provisions of section 14 and related regulations insofar as they relate to shareholder proxy solicitations.

Shareholders may act by written consent without a meeting unless the certificate of incorporation provides otherwise (see DGCL, section 211(b)). The majority of companies in the S&P 500 do not permit shareholder action by written consent.

DGCL, section 211 permits a Delaware corporation to hold a meeting of shareholders virtually if it adopts measures to enable shareholders to participate in and vote at the meeting and verify voter identity, and if it maintains specified records. Prior to 2020, a small but growing number of US companies held virtual annual shareholder meetings, typically in one of two formats: exclusively online with no ability for a shareholder to attend an in-person meeting; or a hybrid approach whereby an in-person meeting is held that is open to online participation by shareholders who are not physically present at the meeting. The primary benefits of virtual shareholder meetings are increased shareholder participation and cost savings.

The number of US companies that held virtual-only annual shareholder meetings skyrocketed in 2020 when the covid-19 pandemic made in-person shareholder meetings impossible or inadvisable. Virtual shareholder meetings, both virtual-only and hybrid format, are becoming commonplace practice as companies and service providers gain more experience.

Currently, ISS prefers a hybrid approach, but it does not have a policy to recommend voting against directors at companies that hold virtual-only meetings. ISS will generally vote for management proposals allowing for virtual meetings so long as they do not preclude in-person meetings. ISS encourages companies holding virtual-only meetings to disclose the circumstances under which virtual-only meetings would be held, and provide shareholders with comparable rights and opportunities to participate electronically as they would have during an in-person meeting. ISS will vote case-by-case on shareholder proposals concerning virtual-only meetings, considering the scope and rationale of the proposal, and concerns identified with the company's prior meeting practices.

Similarly, Glass Lewis prefers a hybrid approach. In egregious cases, Glass Lewis may recommend voting against governance committee members where a company chooses to hold a virtual-only shareholder meeting but does not provide sufficient disclosure in its proxy statement assuring shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

Some large institutional investors (eg, CalPERS and the New York City Pension Funds) oppose virtual-only shareholder meetings and may vote against directors at companies that hold them.

In March 2022, the CII updated its corporate governance policies to give companies more flexibility with respect to the format of their shareholder meetings. The updated policies state that companies should acknowledge that many investors prefer in-person meetings but should have 'the flexibility to choose an in-person, hybrid or virtual-only format depending on their shareowner base and current circumstances.' Companies should use virtual technology 'as a tool for broadening, not limiting, shareowner meeting participation' and should disclose the circumstances under which a virtual-only meeting would be held and provide shareholders participating virtually with comparable rights and opportunities as those whom attend in person.

In January 2022, the SEC staff issued updated guidance for conducting shareholder meetings in light of covid-19 concerns. The staff encourages companies to provide shareholder proponents or their representatives with the ability to present their shareholder proposals through alternative means (eg, by phone) if they are unable to appear at the meeting to present them in person.

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In 2022, Delaware made a number of changes to the DGCL impacting shareholder meetings. First, Delaware amended section 219 of the DGCL such that the list of shareholders entitled to vote is no longer required to be available during the course of the shareholder meeting. Instead, companies will need to make the list available for examination for a 10-day period ending on the day before the meeting date, either on a reasonably accessible electronic network or during business hours at the company's principal place of business. Second, Delaware amended section 222 of the DGCL to clarify that notice of a shareholder meeting is governed by section 232 of the DGCL, which expressly allows for the electronic delivery of notices. Section 222 was also amended to permit adjournments taken to address technical failures and continue a meeting remotely.

Shareholders and the board

7 Are shareholders able to require meetings of shareholders to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

Generally, state law provides that every shareholder has the right to petition the court to compel an AGM if the board has failed to hold the AGM within a specified period of time (see DGCL, section 211). Special shareholders' meetings may be called by anyone authorised to do so in the company's certificate of incorporation or by-laws. The majority of S&P 500 companies permit shareholders meeting a minimum beneficial ownership requirement (such as 20 per cent or 10 per cent) to call special meetings.

Any shareholder of a reporting company who is eligible to bring matters before a shareholders' meeting under state law and the company's certificate of incorporation and by-laws may, at the shareholder's own expense, solicit shareholder proxies in favour of any proposal including director nominations. Such shareholder proxy solicitations must comply with section 14 of the Exchange Act and related SEC regulations, but need not be approved by the board.

Under circumstances detailed in Rule 14a-8 under the Exchange Act, a reporting company must include a shareholder's proposal in the company's proxy materials and identify the proposal in its form of proxy. The shareholder may also submit a 500-word supporting statement for inclusion in the company's proxy solicitation materials. This allows the proponent to avoid the costs associated with an independent solicitation. The SEC adopted rule amendments in 2020 that increased the eligibility requirements for submitting a shareholder proposal to a tiered approach depending on the level of ownership and the relevant holding period: at least US$2,000 if held for at least three years, at least US$15,000 if held for at least two years, and at least US$25,000 if held for at least one year.

Under specific circumstances, a company is permitted to exclude a shareholder proposal from its proxy solicitation, typically after obtaining 'no-action' relief from the SEC staff that concurs that there is a legal basis to exclude the proposal under Exchange Act Rule 14a-8 (eg, if the proposal deals with a matter relating to the company's ordinary business operations).

In November 2021, the SEC's Division of Corporation Finance issued guidance that makes it more difficult for companies to exclude shareholder proposals under Rule 14a-8. New Staff Legal Bulletin No. 14L (CF) rescinds prior interpretive guidance and offers useful insight into how the Division staff will evaluate future no-action requests seeking exclusion of shareholder proposals on the basis of the widely-used 'ordinary business' and 'economic relevance' exceptions. The new guidance will likely result in the exclusion of fewer shareholder proposals, particularly those that raise human capital-related issues that have a broad societal impact (even if not significant to the company) or that request companies to adopt targets and timeframes to address climate change as long as they do not dictate how management must do so.

In July 2022, the SEC proposed rule amendments that would update three of the substantive bases for exclusion of shareholder proposals: the 'substantial implementation' exclusion in Rule 14a-8(i)(10), the 'duplication' exclusion in Rule 14a-8(i)(11), and the 'resubmission' exclusion in Rule 14a-8(i)(12). The proposed amendments would provide the following:

- A proposal may be excluded as substantially implemented if 'the company has already implemented the essential elements of the proposal.'
- A proposal 'substantially duplicates' another proposal if it 'addresses the same subject matter and seeks the same objective by the same means.'
- A proposal constitutes a resubmission if it 'substantially duplicates' a prior proposal, using the same test proposed in the previous bullet.

Since 2011, companies may not exclude from their proxy materials shareholder proposals (precatory or binding) relating to by-law amendments establishing procedures for shareholder nomination of director candidates and inclusion in the company's proxy materials, as long as the proposal is otherwise not excludable under Rule 14a-8. This amendment to Rule 14a-8 has facilitated the development of 'proxy access' via private ordering at companies chartered in states where permissible, as shareholders are able to institute a shareholder nomination regime via binding by-law amendment or request, via precatory shareholder proposal, that such a by-law be adopted by the board. The private ordering process to adopt proxy access has gained considerable momentum since the beginning of 2015.

In November 2021, the SEC adopted changes to the federal proxy rules to require the use of 'universal' proxy cards. The new rules change the methods by which public companies and shareholders have solicited proxies for decades, and allow shareholders to vote for a mix of management and dissident nominees in a contested director election. The new rules will reshape the process by which hostile bidders, activist hedge funds, social and environmental activists, and other dissident shareholders may utilise director elections to influence corporate governance and policy at public companies. The new rules also amend certain forms of proxy and disclosure requirements relating to voting options and standards that apply to all director elections, whether or not contested. The rules are now effective for shareholder meetings held after 31 August 2022.

Shareholders may act by written consent without a meeting unless the certificate of incorporation provides otherwise. The majority of companies in the S&P 500 do not permit shareholder action by written consent.

Controlling shareholders' duties

8 Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Controlling shareholders owe a fiduciary duty of fair dealing to the corporation and minority shareholders when the controlling shareholder enters into a transaction with the corporation. When a controlling shareholder transfers control of the corporation to a third party, this obligation may be extended to creditors and holders of senior securities as well. A controlling shareholder who is found to have violated a duty to minority shareholders upon the sale of control may be liable for the entire amount of damages suffered, instead of only the purchase price paid or for the amount of the control premium. Minority shareholders can bring claims against a controlling shareholder for breach of fiduciary duty on either a derivative or direct basis, depending on the nature of the harm suffered.

Shareholder responsibility

9 Can shareholders ever be held responsible for the acts or omissions of the company?

Shareholders' liability for corporate actions is generally limited to the amount of their equity investment. In unusual circumstances, exceptions may apply.

Employees

10 What role do employees have in corporate governance?

Employees have no formal role in corporate governance at public companies in the United States. However, it is not uncommon for employees to own shares of the corporation's stock directly or through employee stock option or retirement plans. Stock ownership enables employees to participate in corporate governance as shareholders.

A recent Delaware Chancery Court opinion clarified that, as with directors, a corporate officer's fiduciary duties encompass a duty of oversight. (*In re McDonald's Corp Stockholder Derivative Litig* (Del Ch 2023)). Accordingly, officers of Delaware corporations, like directors, must (1) make a good-faith effort to put in place reasonable information systems to generate the information necessary to address risks and report upward to higher-level officers or the board and (2) not consciously ignore red flags indicating that the company may suffer harm. Officers will not be held liable for violations of the duty of oversight unless they are shown to have acted in bad faith.

Unlike the duties of directors, the scope of an officer's duty of oversight may be limited to the context in which the officer operates. For example, although a CEO or chief compliance officer has a 'company-wide oversight portfolio,' a chief legal officer may be responsible only for oversight of risks within the legal function. The court noted, however, that where red flags are 'sufficiently prominent,' any officer has a duty to report upward to the CEO or the board.

Corporate officers are well advised to continue to ensure that they are receiving periodic information and conducting regular reviews of risks in their areas of responsibility and that CEOs and chief compliance officers in particular are receiving such reporting on an enterprise-wide basis. Memorialisation of these risk reviews may also help in establishing that officers have endeavoured to fulfill their oversight duties in good faith.

CORPORATE CONTROL

Anti-takeover devices

11 | Are anti-takeover devices permitted?

In general, anti-takeover devices are permitted. However, there are limits on what types of devices are allowed.

The shareholder rights plan or 'poison pill' is a device adopted by boards to grant existing shareholders the right to purchase large amounts of additional stock for a nominal price if and when an outsider acquires a certain amount of shares (eg, 15 per cent of the outstanding capital). This greatly dilutes the potential acquirer's holdings. Poison pills can usually be 'redeemed' or 'disarmed' by the board of directors before they are 'triggered'. Thus, a poison pill forces a potential acquirer to either negotiate with the existing board or incur the time and expense of initiating a proxy fight to replace the existing directors with directors friendly to the acquirer (who can then redeem the poison pill).

Variations on the traditional poison pill have been designed to make it even more difficult for potential hostile acquirers by restricting the ability of newly placed directors to redeem the poison pill. For example, a 'dead-hand' provision in a poison pill provides that only the specific directors who originally approved the adoption of the poison pill may redeem it. A 'no-hand' poison pill cannot be redeemed at all, and a 'chewable' poison pill gives the incumbent directors a specific period to negotiate before the pill becomes effective. Some states allow the use of dead-hand, no-hand and chewable poison pills (although Delaware does not permit the use of dead-hand or no-hand poison pills). Shareholder activists and proxy advisory firms tend to disfavour poison pills that have not been approved by shareholders. For 2021, the proxy advisory firm Institutional Shareholder Services (ISS) revised its policies to clarify that it will generally recommend voting against all directors if a board unilaterally adopts a poison pill, whether in the short-term or long-term, that includes a dead-hand provision. For 2023, ISS clarified that it will consider the trigger threshold as an additional factor when evaluating the appropriateness of the board's actions in adopting a short-term pill that is not put to a vote. ISS indicated that trigger thresholds of 5 to 10 per cent are very low.

In March 2022, the Council of Institutional Investors updated its corporate governance policies, which now ask companies to hold a shareholder vote on a poison pill within the first 12 months after adoption. The updated policies also state that companies should avoid asking shareholders to approve pills with 'long lifespans, onerous and overly broad 'acting in concert' provisions on shareowners' communications with peers, and pills with excessively low trigger thresholds that may inadvertently target passive investors'.

State corporate law does not prescribe the disclosure of poison pills. However, the Securities and Exchange Commission (SEC) requires reporting companies to disclose any by-law and charter provisions (eg, a poison pill) that would delay, defer or prevent a change in control in the course of an extraordinary corporate transaction, such as a merger, sale transfer or reorganisation. The rights underlying poison pills may also require SEC registration.

A variety of other anti-takeover devices and practices are also available. Courts have upheld the use of the following anti-takeover devices:

- acquisition of another business to increase the chances that the threatened takeover will raise antitrust considerations;
- adoption of voting and other procedures that make it difficult for an acquirer of a majority of voting shares to replace the board of directors (such as board classification, for example, into three classes of directors, pursuant to which one-third of the board is elected every year);
- imposition of restrictions on business combinations with significant shareholders without board approval ('freeze-out' – the default position in Delaware: Delaware General Corporate Law (DGCL), section 203);
- institution of a suit to enjoin the offer for violations of antitrust laws, rules regulating tender offers or other legal grounds;
- issuance, or proposed issuance, of additional shares to persons who oppose the take-over (a lock-up);
- amendment of basic corporate documents to make a takeover more difficult;
- buyout of the aggressor;
- inclusion of supermajority voting requirements in the corporate charter;
- issuance of dual classes of common stock;
- greenmail (but subject to 50 per cent federal excise tax);
- provision of extremely large severance payments to key executives whose employment is terminated following a change in control (golden parachutes);
- undertaking of defensive acquisitions;
- purchase of the corporation's own shares to increase the market price of the stock; and
- imposition of restrictions in connection with the creation of debt that frustrate an attempted takeover.

Under the New York Stock Exchange (NYSE) and Nasdaq Stock Market (Nasdaq) listing rules, listed companies are prohibited from using defensive tactics that would disparately reduce or restrict the voting rights of existing shareholders (eg, the adoption of time-phased voting plans or the issuance of super voting stock).

Issuance of new shares

12 May the board be permitted to issue new shares without shareholder approval? Do shareholders have pre-emptive rights to acquire newly issued shares?

Under Delaware law, the board is permitted to issue new shares without shareholder approval up to the amount of authorised capital set forth in the company's certificate of incorporation. Authorisation of additional shares for issuance will require shareholder approval. The SEC rules require registration of shares prior to their being issued unless an exception applies. In addition, the rules of the NYSE and Nasdaq require that shareholder approval be obtained prior to:

- any adoption of an equity compensation plan pursuant to which officers or directors may acquire stock, subject to limited exceptions;
- issuance of common stock to directors, officers or substantial security holders if the number of shares of common stock to be issued exceeds either 1 per cent of the number of shares of common stock or 1 per cent of the voting power outstanding before the issuance, with some exceptions including if the issuance is a cash sale for a price that is at least a specified minimum price (NYSE), or could result in an increase in outstanding common shares or voting power of 5 per cent or more (Nasdaq);
- issuance of common stock that will have voting power equal to or greater than 20 per cent of the voting power prior to such issuance or that will result in the issuance of a number of shares of common stock that is equal to or greater than 20 per cent of the number of shares of common stock outstanding prior to such issuance, subject to certain exceptions, including any public offering for cash or if the issuance is in connection with an acquisition of the stock or assets of another company and the issuance alone or when combined with any other present or potential issuance of common stock in connection with such acquisition is equal to or exceeds the 20 per cent threshold; and
- issuance of securities that will result in a change of control of the company.

Under Delaware law, shareholders do not have any pre-emptive rights to acquire newly issued shares unless pre-emptive rights are expressly granted to shareholders in the certificate of incorporation (DGCL, section 102(b)(3)) or are granted to shareholders on a contractual basis.

Restrictions on the transfer of fully paid shares

13 Are restrictions on the transfer of fully paid shares permitted and, if so, what restrictions are commonly adopted?

Under the DGCL, section 202, restrictions on the transfer and ownership of fully paid securities are permitted. A corporation may impose these restrictions in its certificate of incorporation or by-laws, or through an agreement among shareholders. However, any restrictions imposed after the issuance of securities are not binding on those securities, unless the shareholders of the securities are parties to an agreement or voted in favour of the restriction. All permitted restrictions must be noted conspicuously on the certificate representing the restricted security, or, in the case of uncertificated shares, contained in the notice sent to the registered owner. Regardless of any such restrictions, all sales or transfers of securities by public (or private) corporations must be made pursuant to (or subject to an exemption under) the Securities Act of 1933.

Compulsory repurchase rules

14 Are compulsory share repurchases allowed? Can they be made mandatory in certain circumstances?

Under the DGCL, section 253, a corporation owning at least 90 per cent of the outstanding shares of each class of the stock of a corporation may merge that other corporation into itself without requiring shareholder approval (known as a 'freeze-out' or 'short-form' merger). Minority shareholders who object to the merger are entitled to appraisal rights.

In addition, corporations may issue shares of stock subject to redemption by the corporation at its option or at the option of the holders of the stock upon the occurrence of certain events.

If a corporation chooses to issue shares subject to redemption, then it must state the time, place and rate at which the stock will be redeemed in the certificate of incorporation or in a board resolution on the issue.

There are two restrictions on a corporation's ability to redeem its own shares. First, state laws, such as the DGCL, section 151, require that immediately following the redemption the corporation must have at least one class or series of stock with full voting powers that is not subject to redemption. The second restriction only applies to listed corporations. Under listing rules, these companies must promptly notify, and provide specified information to, the NYSE or Nasdaq, as applicable, before they take any action that would result in the full or partial redemption of a listed security.

Dissenters' rights

15 | Do shareholders have appraisal rights?

Under the DGCL, section 262, shareholders who do not vote in favour of a merger or consolidation are entitled to an appraisal by the Delaware Court of Chancery of the fair value of their shares unless:

- the shares were listed on a national securities exchange (for example, the NYSE or Nasdaq);
- the shares were held of record by more than 2,000 holders; or
- the merger or consolidation did not require a shareholder vote.

Notwithstanding the applicability of the above points, appraisal rights will be available if shareholders are required to accept anything other than:

1 shares of the surviving or resulting company;
2 shares listed on a national securities exchange;
3 cash in lieu of fractional shares; or
4 any combination of (1) to (3).

For example, a shareholder will retain his or her appraisal rights if he or she is required to accept cash, debt or shares of a private company in exchange for his or her shares in the company to be merged or consolidated.

RESPONSIBILITIES OF THE BOARD (SUPERVISORY)

Board structure

16 Is the predominant board structure for listed companies best categorised as one-tier or two-tier?

The predominant board structure for listed companies in the United States is one-tier. The Delaware General Corporation Law (DGCL), section 141 states:

> *[The] business and affairs of every corporation organised under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.*

The board of directors delegates managerial responsibility for day-to-day operations to the chief executive and other senior executives. Members of senior management may serve on the board, but they are not organised as a separate management board.

Board's legal responsibilities

17 What are the board's primary legal responsibilities?

The primary legal responsibility of the board is to direct the business and affairs of the corporation (see DGCL, section 141). While the functions of a board are not specified by statute, it is generally understood, as noted in the American Law Institute's Principles of Corporate Governance and other codes of best practice, that board functions typically include:

- selecting, evaluating, fixing the compensation of and, where appropriate, replacing the CEO and other members of senior management;
- developing, approving and implementing succession plans for the CEO and senior executives;
- overseeing management to ensure that the corporation's business is being run properly;
- reviewing and, where appropriate, approving the corporation's financial objectives and major corporate plans, strategies and actions;
- understanding the corporation's risk profile and reviewing and overseeing the corporation's management of risks;
- reviewing and approving major changes in the auditing and accounting principles and practices to be used in preparing the corporation's financial statements;
- establishing and monitoring effective systems for receiving and reporting information about the corporation's compliance with its legal and ethical obligations, and articulating expectations and standards related to corporate culture and the 'tone at the top';
- understanding the corporation's financial statements and monitoring the adequacy of its financial and other internal controls, as well as its disclosure controls and procedures;
- evaluating and approving major transactions, such as mergers, acquisitions, significant expenditures and the disposition of major assets;
- providing advice and counsel to senior management;
- reviewing the process for providing adequate and timely financial and operational information to management, directors and shareholders;

- establishing the composition of the board and its committees, board succession planning and determining governance practices;
- retaining independent advisers to assist the board and committees;
- assessing the effectiveness of the board, its committees or individual directors; and
- performing such other functions as are necessary.

Board obligees

18 | Whom does the board represent and to whom do directors owe legal duties?

Directors are elected by shareholders. They are fiduciaries of the corporation and its shareholders. Directors represent the shareholding body as a whole, and not any particular set of shareholding constituents. If a corporation becomes insolvent, directors continue to owe their fiduciary duties to the corporation, not directly to creditors; however, creditors will have standing to assert derivative claims. See *North American Catholic Educational Programming Foundation Inc v Gheewalla* (Del 2007).

Enforcement action against directors

19 | Can an enforcement action against directors be brought by, or on behalf of, those to whom duties are owed? Is there a business judgment rule?

Shareholders can bring suits against the directors on their own behalf or on behalf of the corporation (a derivative suit), depending on the nature of the allegation. To institute a derivative suit, a shareholder must first make a demand to the board of directors that the corporation initiate the proposed legal action on the corporation's own behalf. However, if the shareholder can show that bringing such a demand would be futile, it is not required.

Directors will not be held liable for their decisions, even if such decisions harm the corporation or its shareholders, if the decisions fall within the judicially created safe harbour known as the 'business judgment rule'. The rule states a judicial presumption that disinterested and independent directors make business decisions on an informed basis and with the good faith belief that the decisions will serve the best interests of the corporation. If a board's decision is challenged in a lawsuit, the court will examine whether the plaintiff has presented evidence to overcome this presumption. If the presumption is not overcome, the court will not investigate the merits of the underlying business decision.

This helps courts avoid second-guessing board decisions, and protects directors from liability when they act on an informed and diligent basis and are not otherwise tainted by a personal interest in the outcome. This is true even if the decision turns out badly from the standpoint of the corporation and its shareholders.

Care and prudence

20 | Do the duties of directors include a care or prudence element?

Directors owe duties encompassing both a duty of care and a duty of loyalty to the corporation and to the corporation's shareholders.

Although grounded in common law, the duty of care has been codified in more than 40 states. Most state statutes require that directors discharge their responsibilities in good faith, with the care that an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner that the director reasonably believes to be in the corporation's best interests. Conduct that violates the duty of care may also – in certain circumstances – violate the good faith obligation that is a component of the duty of loyalty. For example, a failure to provide oversight of 'mission-critical' risks (which requires, among other things, a reliable information and reporting system) could give rise to a claim for breach of the duty of care and the obligation of good faith. See *In Re Caremark International Inc Derivative Litigation* (Del Ch 1996), *Stone v Ritter* (Del 2006) and *Marchand v Barnhill* (Del 2019) (discussed below).

The duty of loyalty prohibits self-dealing and misappropriation of assets or opportunities by board members. Directors are not allowed to use their position to make a personal profit or achieve personal gain or other advantage. The duty of loyalty includes a duty of candour that requires a director to disclose to the corporation any conflicts of interest. Transactions that violate the duty of loyalty can be set aside, and directors can be found liable for breach. Thus, whenever a board is considering a transaction in which a director has a personal interest, the material facts about the director's relationship or interest in the transaction should be disclosed to the board and a majority of the disinterested directors should authorise the transaction. Alternatively, the material facts should be disclosed to shareholders, for a vote to approve the transaction.

In 2003, the Delaware Court of Chancery rendered an important opinion concerning the 'duty of good faith' of corporate directors (*In Re The Walt Disney Co* (Del Ch 2003)). In this opinion, the court held that directors who take an 'ostrich-like approach' to corporate governance and 'consciously and intentionally disregard their responsibilities', adopting a 'we don't care about the risks' attitude may be held liable for breaching their duty to act in good faith. The opinion was rendered on a motion to dismiss for failure to state a claim. The opinion is notable for its sharp focus on the importance of good faith, in addition to due care and loyalty, when considering director conduct. By characterising the alleged lack of attention by directors as a breach of the duty of good faith rather than a breach of the duty of care, the court effectively stripped the directors of the protection afforded by the Delaware Director Protection Statute (which allows adoption of a provision in the certificate of incorporation 'eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of a fiduciary duty as a director' with some exceptions (DGCL, section 102(b)(7)).

In 2005, the Delaware Court of Chancery rendered another opinion in connection with the same Disney litigation that further defines the contours of the duty of good faith (*In Re The Walt Disney Co* (Del Ch 2005)). In this opinion, the court focused on the element of intent in identifying whether a breach of the duty of good faith has occurred. Generally, the court determined, the duty of good faith is not satisfied where a director 'intentionally acts with a purpose other than ... the best interests of the corporation'; where a director 'intend[s] to violate applicable ... law'; or where a director 'intentionally fails to act in the face of a known duty to act'. With respect to the specific case at hand, however, the court ruled that the Disney directors did not, in fact, breach their duty of good faith because they did make some business judgments and, therefore, their conduct did not meet the intent elements enumerated by the court as necessary to constitute a breach of the duty of good faith.

In 2006, the Delaware Supreme Court upheld the Delaware Court of Chancery's ruling that the Disney directors were not liable.

The Supreme Court also provided guidance with respect to the contours of the duty of good faith, describing the following two categories of fiduciary behaviour as conduct in breach of the duty of good faith: conduct motivated by subjective bad faith (that is, actual intent to do harm); and conduct involving 'intentional dereliction of duty, a conscious disregard for one's responsibilities'. The Supreme Court further held that gross negligence on the part of directors 'clearly' does not constitute a breach of the duty of good faith.

In 2006, the Delaware Supreme Court held in *Stone v Ritter* (Del 2006) that 'good faith' is not a separate fiduciary duty. The Supreme Court stated that 'the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty' and the fiduciary duty of loyalty 'encompasses cases where the fiduciary fails to act in good faith'.

The duty of directors to provide oversight is based on the concept of good faith. In the oversight context, courts focus on whether the board has taken adequate steps to determine that the corporation's business and affairs are being properly administered by the company's officers and management. Boards are expected to ensure that reasonable information and reporting systems are implemented and maintained to provide the board and senior management with timely, accurate information to support informed decisions and so that directors can reach informed judgments concerning the corporation's performance.

In six recent instances, a Delaware court declined to dismiss a claim alleging that directors had not satisfied their duty to exercise oversight. In one case, the Delaware Supreme Court found that the plaintiff adequately pled that the directors failed to implement any monitoring or reporting system related to the most central safety and legal compliance risk facing the company (*Marchand v Barnhill* (Del 2019)). In another case, the Delaware Chancery Court found that the plaintiff adequately pled that the directors failed to appropriately monitor compliance systems and controls (*In Re Clovis Oncology, Inc Derivative Litigation* (Del Ch 2019)). That decision suggests that Delaware courts will impose a higher standard on directors of companies operating in the midst of mission-critical regulatory compliance risk. In January 2020, the Delaware Chancery Court found that a plaintiff adequately pled that the directors failed to implement and properly oversee a pipeline integrity reporting system which resulted in a pipeline rupture and oil spill (*Inter-Marketing Group USA v Armstrong* (Del Ch 2020)). In addition, the Delaware Chancery Court found that the plaintiff adequately pled that the directors failed to make a good faith effort to put in place a board-level system for monitoring the company's financial reporting (*Hughes v Hu* (Del Ch 2020)). The Delaware Chancery Court also found that the plaintiffs adequately stated a 'Caremark' claim for oversight liability in a case involving board failure to remediate legal issues disclosed in public filings (*Teamsters Local 443 Health Services & Insurance Plan v Chou* (Del Ch 2020)). Finally, in September 2021, the Delaware Chancery Court found that the alleged absence of structures to inform the Boeing Co board about the 'mission critical' issue of aircraft safety gave rise to a reasonable inference that the directors acted in bad faith in breach of their duty of oversight (*In re Boeing Co Derivative Litig* (Del Ch 2021)).

Board member duties

21 | To what extent do the duties of individual members of the board differ?

Generally, all board members owe the same fiduciary duties regardless of their individual skills. However, case law suggests that when applying the standard of due care (namely, that a director acted with such care as an ordinarily prudent person in a like position would exercise under similar circumstances) subjective considerations, including a director's background, skills and duties, may be taken into account. For example, 'inside' directors – usually officers or senior executives – are often held to a higher standard because they more actively participate in and have greater knowledge of the corporation's activities.

A recent Delaware Chancery Court opinion clarified that, as with directors, a corporate officer's fiduciary duties encompass a duty of oversight. (*In re McDonald's Corp Stockholder Derivative Litig* (Del Ch 2023)). Accordingly, officers of Delaware corporations, like directors, must (1) make a good-faith effort to put in place reasonable information systems to generate the information necessary to address risks and report upward to higher-level officers or the board and (2) not consciously ignore red flags indicating that the company may suffer harm. Officers will not be held liable for violations of the duty of oversight unless they are shown to have acted in bad faith.

Unlike the duties of directors, the scope of an officer's duty of oversight may be limited to the context in which the officer operates. For example, although a CEO or chief compliance officer has a 'company-wide oversight portfolio,' a chief legal officer may be responsible only for oversight of risks within the legal function. The court noted, however, that where red flags are 'sufficiently prominent', any officer has a duty to report upward to the CEO or the board.

Corporate officers are well advised to continue to ensure that they are receiving periodic information and conducting regular reviews of risks in their areas of responsibility and that CEOs and chief compliance officers in particular are receiving such reporting on an enterprise-wide basis. Memorialisation of such risk reviews may also help in establishing that officers have endeavored to fulfill their oversight duties in good faith.

Additionally, in 2004, the Delaware Court of Chancery rendered an important opinion concerning the fiduciary duties of directors with special expertise (*Emerging Communications Shareholders' Litigation* (Del Ch 2004)). In *Emerging Communications*, the Court held a director in breach of his duty of good faith for approving a transaction 'even though he knew, or at the very least had strong reason to believe' that the per share consideration was unfair. The Court, in part, premised the culpability of the director (described in the opinion as a 'principal and general partner of an investment advisory firm') on his 'specialised financial expertise, and . . . ability to understand [the company's] intrinsic value, that was unique to [the company's] board members'. As the Court also found that the director in question was not 'independent' of management, the *Emerging Communications* decision should not necessarily be interpreted as a pronouncement holding directors with 'specialised expertise' to a higher standard of care in general.

Delegation of board responsibilities

22 To what extent can the board delegate responsibilities to management, a board committee or board members, or other persons?

State corporate law generally provides that the business and affairs of the corporation shall be managed by or under the direction of the board of directors. The board has wide-ranging authority to delegate day-to-day management and other aspects of its responsibilities both to non-board members and to board committees and even individual directors. Typically, the board delegates wide powers to the corporation's senior managers. State laws generally make a distinction between the matters a board must address directly and those it may delegate to officers or other agents of the corporation, or to board committees. For example, under DGCL, section 141(c), the board of a company incorporated prior to 1 July 1996 cannot delegate the power to:

- adopt, amend or repeal any by-law of the corporation;
- amend the corporation's certificate of incorporation (except that a board committee may make certain specified decisions relating to the rights, preferences or issuance of authorised stock, to the extent specifically delegated by the board);
- adopt an agreement of merger or consolidation;
- recommend to shareholders the sale, lease or exchange of all or substantially all of the corporation's property and assets;
- recommend to shareholders a dissolution of the corporation or a revocation of a dissolution;
- approve, adopt or recommend to shareholders any action or matter that is required by the DGCL to be submitted to shareholders for approval;
- declare a dividend, unless that power is expressly provided for in the certificate of incorporation, resolution or by-laws; and
- authorise the issuance of stock or adopt a certificate of ownership and merger, unless that power is expressly provided for in the certificate of incorporation, resolution or by-laws.

The Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act) and the New York Stock Exchange (NYSE) and Nasdaq Stock Market (Nasdaq) listing rules also require that each listed company has an audit committee comprising independent directors who have responsibility for certain audit and financial reporting matters. As required by the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd–Frank Act), the NYSE and Nasdaq listing rules also require that each listed company has a compensation committee comprising independent directors who are responsible for certain matters relating to executive compensation. The NYSE listing standards require that each listed company have a nominating or corporate governance committee comprising independent directors who are responsible for director nominations and corporate governance. The Nasdaq listing rules require independent directors (or a committee of independent directors) to have responsibility for certain decisions relating to director nominations. These committees are permitted to delegate their responsibilities to subcommittees solely comprising one or more members of the relevant committee.

Directors may also reasonably rely on information, reports and recommendations provided by officers, other agents and committees on matters delegated to them (see DGCL, section

141(e)). Nevertheless, the board retains the obligation to provide oversight of its delegates, to act in good faith and to become reasonably familiar with their services or advice before relying on this advice.

Non-executive and independent directors

23 Is there a minimum number of 'non-executive' or 'independent' directors required by law, regulation or listing requirement? If so, what is the definition of 'non-executive' and 'independent' directors and how do their responsibilities differ from executive directors?

The NYSE and Nasdaq listing rules require that independent directors comprise a majority of the board. Controlled companies (ie, companies in which more than 50 per cent of the voting power is held by an individual, group or another company) and foreign private issuers are exempt from this requirement.

Under the NYSE rules, for a director to be deemed 'independent', the board must affirmatively determine that he or she has no material relationship with the company. A material relationship can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, among others. Under the NYSE rules, directors having any of the following relationships may not be considered independent:

- a person who is an employee of the listed company or is an immediate family member of an executive officer of the listed company;
- a person who receives, or is an immediate family member of a person who receives, compensation directly from the listed company, other than director compensation or pension or deferred compensation for prior service (provided this compensation is not contingent in any way on continued service), of more than US$120,000 per year;
- a person who is a partner of, or employed by, or is an immediate family member of a person who is a partner of, or employed (and works on the listed company's audit) by a present or former internal or external auditor of the company;
- a person, or an immediate family member of a person, who has been part of an interlocking compensation committee arrangement; or
- a person who is an employee or is an immediate family member of a person who is an executive officer, of a company that makes payments to or receives payments from the listed company for property or services in an amount that in a single fiscal year exceeds the greater of 2 per cent of this other company's consolidated gross revenues or US$1 million.

In applying the independence criteria, no individual who has had a relationship as described above within the past three years can be considered independent (except in relation to the test set forth in the final bullet point above, which is concerned with current employment relationships only). The Nasdaq listing rules take a different but similar approach to defining independence.

For NYSE and Nasdaq companies, only independent directors are allowed to serve on audit, compensation and nominating or governance committees. The Sarbanes–Oxley Act, section 301, defines an independent director for audit committee purposes as one who has not accepted any compensation from the company other than directors' fees and is not an 'affiliated person' of the company or any subsidiary. NYSE and Nasdaq listing standards require NYSE and Nasdaq companies to have an audit committee that satisfies the requirements of Rule 10A-3 under the Securities Exchange Act of 1934. That rule, which embodies the independence requirements of the Sarbanes–Oxley Act, section 301, provides that an executive officer of an 'affiliate' would not be considered independent for audit committee purposes. As required by the Dodd–Frank Act, the NYSE and Nasdaq developed heightened independence standards for compensation committee members that became effective during 2014. Under these standards, in affirmatively determining the independence of a director for compensation committee purposes, the board of directors must 'consider' all factors specifically relevant to determining whether a director has a relationship to the listed company that is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including the source of compensation received by the director and whether the director is affiliated with the company or any subsidiary.

Board size and composition

24 How is the size of the board determined? Are there minimum and maximum numbers of seats on the board? Who is authorised to make appointments to fill vacancies on the board or newly created directorships? Are there criteria that individual directors or the board as a whole must fulfil? Are there any disclosure requirements relating to board composition?

The DGCL, section 141(b) requires that the board of directors comprises one or more members, each of whom must be a natural person. Beyond the requirement for at least one director, corporate law does not set a minimum or a maximum. As a practical matter, a board should be of a size sufficient to accommodate an appropriate amount of experience, independence and diversity for the full board and its committees. The number of directors is fixed by or in the manner provided in the by-laws or certificate of incorporation; typically the by-laws will specify a range and the board will fix the exact number of directors by resolution. Directors need not be shareholders of the corporation. The certificate of incorporation or the by-laws may provide for director qualifications and address who is authorised to fill vacancies on the board. Generally, the board is authorised to fill vacancies.

The NYSE and Nasdaq require that listed companies have an audit committee comprising at least three members. Nasdaq requires listed companies to have a compensation committee comprising at least two members; the NYSE does not require a minimum number of members of the compensation committee.

ISS has stated that a company should have no fewer than six nor more than 15 directors, with a board size of between nine and 12 directors 'considered ideal'.

The Securities and Exchange Commission (SEC) requires companies to provide the following proxy statement disclosures relating to board composition:

- which directors qualify as 'independent' under applicable independence standards; and
- for each director and nominee:
    - name, age and positions and offices held with the company;

- term of office as a director;
- any arrangements or understandings between the director or nominee and any other person pursuant to which the director or nominee was or is to be selected as a director or nominee;
- family relationships with any director, nominee or executive officer;
- business experience and other public company directorships over the past five years;
- the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company; and
- whether the director or nominee has been involved in certain kinds of legal proceedings during the past 10 years.

There is no legal requirement or listing rule that mandates a certain number of female or minority directors, with a few exceptions. In September 2018, a California law was enacted that required California-headquartered publicly held domestic or foreign corporations to have at least one female director by the end of 2019 and, depending on board size, up to three female directors by the end of 2021. In April 2022, a judge in the Los Angeles County Superior Court struck down the law as unconstitutional, holding that it posed a 'total and fatal' conflict with the California Constitution's Equal Protection Clause by requiring corporations to use suspect demographic classifications in the selection of board members to the exclusion of other people from different races, sexual orientations or gender identities. A similar California law enacted in 2020 that required such corporations to have at least one director from an underrepresented community by the end of 2021 and, depending on board size, up to three directors from underrepresented communities by the end of 2022, was also struck down as unconstitutional for similar reasons. Several other states have enacted or are considering legislation that would encourage greater board diversity or require disclosure about board diversity.

There is increasing concern in the institutional investor community about the lack of gender and racial diversity on public company boards of directors, as well as long-tenured directors and lack of board refreshment. In 2017, the New York City Pension Funds announced a letter-writing campaign known as the Boardroom Accountability Project 2.0 targeting over 150 US public companies focused on board composition (eg, experience or skill-sets, tenure and diversity), board refreshment and director succession planning. The New York City Pension Funds will vote against all directors at companies with no female directors and against governance committee members at companies with just one female director. In October 2019, the New York City Pension Funds launched the Boardroom Accountability Project 3.0 urging public companies to adopt a diversity search policy requiring that qualified female and racially and ethnically diverse candidates be included in the pool of nominees from which directors and CEOs are selected, and that director searches include candidates from non-traditional backgrounds, such as government, academic or non-profit organisations.

Under its proxy voting guidelines, BlackRock encourages boards to have at least two female directors and at least one director from an underrepresented group and 'should aspire' to 30 per cent diversity of membership. BlackRock may vote against members of the nominating/governance committee of a company that 'has not adequately explained their approach to diversity in their board composition'. Generally, companies should disclose diversity aspects relevant to the business and how these characteristics align with the long-term strategy and business model, as well as the process by which director candidates are identified and selected, including whether outside resources were engaged and whether a diverse slate of nominees is considered for all board seats.

Under Vanguard's proxy voting policy for US portfolio companies, boards should represent diversity of personal characteristics including at least gender, race and ethnicity (disclosed on an aggregate or individual director basis) as well as other attributes including tenure, skills and experience (disclosed on an individual basis). Vanguard may vote against the nominating and/or governance committee chair (or other director if needed) if a company's board is making insufficient progress in its diversity composition and/or in addressing its board diversity-related disclosures, taking into account applicable market regulations and expectations along with additional company-specific context. Vanguard generally will vote for a shareholder proposal seeking enhanced disclosure about board diversity, such as workforce demographics, the board's role in overseeing material diversity, equity, and inclusion (DEI) risks and other material social risks, the company's approach to board composition, inclusive of board diversity, and/or adoption of targets or goals related to board diversity, and inclusion of directors' diversity of personal characteristics (including gender, race, ethnicity and national origin) or skills and qualifications if such information is not already disclosed.

State Street Global Advisors expects all listed companies to have at least one female board member and all Russell 3000 companies to have at least 30 per cent women directors. If these requirements are not met, State Street may vote against the nominating committee chair or the board chair (or all nominating committee members if the failure lasts for three consecutive years). State Street may waive the gender diversity guidelines if a company provides a specific, timebound plan to add the requisite number of women to the board. State Street also expects S&P 500 companies to disclose, at minimum, the gender, racial and ethnic composition of its board and have at least one director from an underrepresented racial or ethnic community on its board. State Street will vote against the nominating committee chair at S&P 500 companies that do not meet this requirement. Further, State Street noted that it may vote against the nominating committee chair at S&P 500 companies that do not disclose certain US Equal Employment Opportunity Commission data (ie, an EEO-1 report).

ISS will generally recommend withholding or voting against the nominating committee chair (and potentially other directors) at all companies where there are no women on the board or the board has no apparent racially or ethnically diverse members, unless there was at least one woman or racially/ethnically diverse director at the preceding annual meeting and the board commits to restore gender or racial/ethnic diversity by the next annual meeting.

In 2022, ISS updated its E&S QualityScore scoring tool to include new or expanded factors relating to diversity, equity and inclusion at the board and executive level (including whether there are LGBTQ+ directors and ethnically diverse directors) and voluntary public disclosure of EEO-1 reports.

As of 2023, at Russell 3000 companies, Glass Lewis will generally recommend voting against the nominating committee chair of a board that is not at least 30 per cent gender diverse and the entire nominating committee of a board with no gender diverse directors. For companies outside the Russell 3000, Glass Lewis will generally recommend voting against the nominating committee chair if there are no gender diverse directors.

Finally, as of 2023, at Russell 1000 companies, Glass Lewis will generally recommend voting against the nominating committee chair of a board that does not have at least one director from an underrepresented community. Glass Lewis may refrain from issuing negative voting recommendations against directors at companies that have provided a sufficient rationale or plan to address the lack of diversity on the board.

Furthermore, as of 2023, Glass Lewis will generally recommend votes against the nominating committee chair at Russell 1000 companies that have not provided any disclosure in their proxy statements in any of the following categories: (1) the board's current percentage of racial/ethnic diversity, (2) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity, (3) whether the board has adopted a 'Rooney Rule' policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees and (4) board skills disclosure. Additionally, Glass Lewis will recommend votes against the nominating committee chair at companies that have not provided any disclosure of individual or aggregate racial/ethnic minority demographic information.

Since January 2021, Goldman Sachs will not take a company public unless it has at least two diverse board candidates, one of whom must be female. As of 2023, Goldman Sachs Asset Management votes against the entire board at any company with no female directors, and against all nominating committee members at any company that does not have at least 10 per cent women directors and at least one other diverse director. At S&P 500 companies, Goldman Sachs will vote against nominating committee members at any company with a board that does not have at least one diverse director from an underrepresented ethnic group.

SEC rules currently require companies to provide proxy statement disclosure regarding whether and, if so, how the nominating committee considers diversity in identifying nominees for director and, if the nominating committee has a policy with regard to the consideration of diversity in identifying director nominees, how this policy is implemented and how the nominating committee or the board assesses the effectiveness of its policy. Under guidance issued by the SEC in 2019, if the board or nominating committee considered 'certain self-identified diversity characteristics' (eg, race, gender, ethnicity, religion, nationality, disability, sexual orientation or cultural background) when determining an individual's specific experience, qualifications, attributes or skills for board membership, then the SEC expects the company to disclose those characteristics and how they were considered in the nomination process. The guidance also requires a company to disclose how its diversity policy, if any, takes into account nominees' self-identified diversity attributes and any other qualifications (eg, diverse work experiences, military service or socio-economic or demographic characteristics).

In August 2021, the SEC approved changes to the Nasdaq listing rules relating to board diversity. The rule changes require each Nasdaq-listed company, subject to certain exceptions, to (1) publicly disclose annually in an aggregated form, to the extent permitted by applicable law, information on the voluntary self-identified gender and racial characteristics and LGBTQ+ status of the company's board of directors, and (2) have, or explain why it does not have, at least two directors who are diverse, including at least one director who self-identifies as female and at least one director who self-identifies as either an underrepresented minority or LGBTQ+. Companies will be required to have at least one diverse director by 31 December 2023 and at least two diverse directors by 31 December 2025 or 31

December 2026, depending on the size of the company and its stock market exchange tier. A Nasdaq-listed company with a board of five or fewer members will be required to have, or explain why it does not have, at least one diverse director by 31 December 2023.

For purposes of the new Nasdaq rules, (1) 'diverse' means an individual who self-identifies as a female, an underrepresented minority or LGBTQ+, (2) 'female' means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth, (3) 'underrepresented minority' means an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities, and (4) 'LGBTQ+' means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community.

Board leadership

25 Is there any law, regulation, listing requirement or practice that requires the separation of the functions of board chair and CEO? If flexibility on board leadership is allowed, what is generally recognised as best practice and what is the common practice?

There is no legal requirement or listing rule that mandates that the positions of board chair and CEO be held separately or jointly. Corporate boards are generally free to decide for themselves the leadership structure of the board and company (although the corporate charter or by-laws could provide otherwise). Shareholder proposals calling for a separation of the board chair and CEO roles have become increasingly since the late 2000s; these proposals tend to receive relatively high shareholder support (typically less than majority although one proposal did pass in 2022).

The NYSE and Nasdaq listing rules require that the non-management directors meet without management present on a regular basis. Under the NYSE rules, companies are required to either choose and disclose the name of a director to preside during executive sessions or disclose the method it uses to choose someone to preside (for example, a rotation among committee chairs). Although the NYSE rules do not set forth other specific duties for the presiding director, some companies have a 'lead independent director' perform the presiding function while also having a role in agenda-setting and determining the information needs of the outside directors. The Nasdaq listing rules also require that boards convene executive sessions of independent directors, but do not include a presiding director disclosure requirement.

In 2009, the SEC adopted rules requiring each reporting company to disclose the board's leadership structure and why the company believes it is the best structure for the company. Each company must disclose whether and why it has chosen to combine or separate the CEO and board chair roles. Where these positions are combined, the company must disclose whether and why the company has a lead independent director and the specific role the lead independent director plays in the leadership of the company.

Independent board leadership is also supported by governance effectiveness guidance that expresses a 'best practice' consensus that boards should have some form of independent leadership. Several best practice codes recommend a clear division of responsibilities between a board chair and CEO to ensure that the board maintains its ability to provide objective judgment concerning management. Some recommend that the board should separate the roles of board chair and CEO, while others recommend designating a lead outside or independent director for certain functions. For example, the Report on Director Professionalism by the National Association of Corporate Directors (NACD) recommends appointing an independent board leader to:

- organise the board's evaluation of the CEO and provide feedback;
- chair sessions of the non-executive directors;
- set the agenda (with the CEO or chair and CEO); and
- lead the board in anticipating and responding to a crisis.

Many companies have recently expanded the responsibilities of the independent lead director in light of the increased appreciation of the importance of independent board leadership (see also the Report of the NACD Blue Ribbon Commission on Fit for the Future: An Urgent Imperative for Board Leadership issued in 2019). These can include, in addition to the items set forth above from the NACD report:

- presiding over board meetings at which the chair is not present;
- approving board schedules;
- approving information provided to the board;
- serving as a liaison between the chair and the independent directors;
- having the authority to call meetings of the independent directors or the full board;
- being available for consultation and direct consultation with major shareholders;
- advising on, recommending or approving the retention of outside advisers and consultants who report to the board; or
- guiding, leading or assisting with the board and director self-assessment process, the CEO succession planning process or the board's consideration of CEO compensation.

Furthermore, under its proxy voting guidelines, ISS will generally vote for shareholder proposals requiring that the board chair position be filled by an independent director, taking into consideration the following:

- the scope of the proposal;
- the company's current board leadership structure;
- the company's governance structure and practices; and
- any other relevant factors that may be applicable.

Many companies combine the roles of CEO and chair; however, separation of the roles has become increasingly prevalent at Standard & Poor's (S&P) 500 companies over the past 10 years – the roles were separated at 57 per cent of S&P 500 companies in 2022, up from 43 per cent in 2012. Chairs who qualified as independent were in place at 36 per cent of S&P 500 companies in 2022 compared with 23 per cent in 2012. The vast majority of companies that do not have an independent chair have appointed an independent lead or presiding director.

Board committees

26 What board committees are mandatory? What board committees are allowed? Are there mandatory requirements for committee composition?

Since 1999, the NYSE and Nasdaq listing rules have required that listed companies have audit committees consisting entirely of independent directors (prior to that time, a majority of independent directors had been a long-standing audit committee requirement for companies listed on the NYSE). In 2003, the NYSE and Nasdaq adopted listing rules that also require companies to have compensation and nominating or governance committees (or committees that perform those functions) consisting entirely of independent directors, although Nasdaq permits nomination decisions (and, until 2014, permitted certain executive compensation decisions) to be made by a majority of independent directors. The Sarbanes–Oxley Act requires that all boards of companies with listed securities have audit committees composed entirely of directors who receive no compensation from the company other than directors' fees and are not affiliated with the company. In addition, companies are required to disclose the name of at least one audit committee member who is an 'audit committee financial expert' as defined by the SEC, or explain why they do not have one. The NYSE and Nasdaq rules also require that the audit committee comprises at least three members and impose requirements with respect to the financial literacy of audit committee members. Since 2014, each Nasdaq listed company must have, and certify that it has and will continue to have, a compensation committee of at least two members, each of whom must be an independent director; the NYSE does not require a minimum number of members of the compensation committee. As required by the Dodd–Frank Act, the NYSE and Nasdaq each adopted heightened independence standards for compensation committee members that became effective in 2014 and require the board to 'consider' the source of compensation received by the director and whether the director is affiliated with the company or any subsidiary, when determining if a director is independent for purposes of serving on the compensation committee.

Board meetings

27 Is a minimum or set number of board meetings per year required by law, regulation or listing requirement?

Under state law, the corporation's by-laws or certificate of incorporation prescribe the requirements for board meetings and may or may not prescribe a set number of meetings; it is typical for companies to not specify a minimum number of meetings in the certificate of incorporation or by-laws. Generally, it is believed that a board should meet at least once per financial-reporting quarter. However, most boards of large publicly traded corporations meet more frequently. For example, companies represented on the S&P 500 held 8.3 board meetings on average in 2022. SEC rules require companies to disclose the total number of board and committee meetings held during the past year and provide details regarding director attendance at these meetings.

ISS and Glass Lewis will issue negative vote recommendations with respect to directors who failed to attend a minimum of 75 per cent of the aggregate of his or her board and committee meetings (with some exceptions).

Board practices

28 Is disclosure of board practices required by law, regulation or listing requirement?

The SEC requires disclosure of certain board practices, including disclosures about the identity and compensation of directors and the composition and activities of the audit, compensation and nominating committees.

Under the NYSE listing rules, listed companies are required to adopt and disclose 'corporate governance guidelines' that address:

- qualification standards for directors;
- responsibilities of directors;
- director access to management and, as necessary, independent advisers;
- compensation of directors;
- continuing education and orientation of directors;
- management succession; and
- an annual performance evaluation of the board.

Nasdaq-listed companies are not required to adopt corporate governance guidelines, but many have done so as a best practice.

The NYSE rules also require listed companies to adopt and disclose charters for their compensation, nominating or governance and audit committees.

The compensation committee's charter must detail the committee's purpose and responsibilities, which include reviewing and approving corporate goals and objectives relevant to CEO compensation, evaluating the CEO's performance in light of those goals and objectives, setting his or her compensation level based on this evaluation, making recommendations to the board with respect to non-CEO executive officer compensation, incentive-based compensation plans and equity-based plans and producing a compensation committee report on executive compensation required by SEC rules to be included in the company's proxy statement. The charter must also provide that the committee will perform an annual self-evaluation. In addition, pursuant to the Dodd–Frank Act, the NYSE and Nasdaq adopted listing standards that became effective in 2014 requiring compensation committees to consider specified independence factors prior to engaging consultants and other advisers and giving compensation committees the authority and discretion to retain or obtain the advice of consultants and other advisers at the company's expense.

The nominating or governance committee's charter must detail the committee's purpose and responsibilities. These include:

- identifying the board's criteria for selecting new directors;
- identifying individuals who are qualified to become board members;
- selecting or recommending that the board select nominees for election at the next annual general meeting;
- developing and recommending to the board a set of corporate governance principles for the corporation; and

- overseeing the evaluation of the board and management.

In addition, the charter must include a provision for an annual performance evaluation of the committee. Unlike the NYSE, Nasdaq does not include a requirement with respect to the charter for the nominating or governance committee, although companies are required to certify that they have adopted a formal written charter or board resolution, as applicable, addressing the nominations process.

The audit committee charter must specify the committee's purpose, which must include: assisting board oversight of the integrity of the company's financial statements, the company's compliance with legal and regulatory requirements, the independent auditor's qualifications and independence and the performance of the company's internal audit function and independent auditors; and preparing the report that SEC rules require to be included in the company's annual proxy statement. The NYSE listing rules require that the charter must also detail the duties and responsibilities of the audit committee, including:

- the ability to hire and fire the company's independent auditor and other registered public accounting firms;
- establishing whistle-blowing policies and procedures for handling complaints or concerns regarding accounting, internal accounting controls or auditing matters;
- at least annually:
    - obtaining and reviewing a report by the independent auditor describing the independent auditor's internal quality control procedures;
    - reviewing any material issues raised by the auditor's most recent internal quality control review of themselves or peer review, or any inquiry or investigation by governmental or professional authorities within the preceding five years; and
    - assessing the auditor's independence;
- discussing the annual audited financial statements and quarterly financial statements with management and the independent auditor;
- discussing earnings press releases, as well as financial information and earnings guidance that is given to analysts and rating agencies;
- obtaining the advice and assistance of outside legal, accounting or other advisers, as necessary, with funding to be provided by the company;
- discussing policies with respect to risk assessment and risk management;
- meeting separately, from time to time, with management, with the internal auditors and with the independent auditor;
- reviewing with the independent auditor any audit problems or difficulties and management's response to such issues;
- setting clear hiring policies for employees or former employees of the independent auditor;
- reporting regularly to the board of directors; and
- evaluating the audit committee on an annual basis.

The Nasdaq listing rules also require an audit committee to have a charter addressing all of its duties and responsibilities under the Sarbanes–Oxley Act, including: having the sole power to hire, determine the funding for and oversee the outside auditors; having the authority to consult with and determine the funding for independent counsel and other advisers; and having the responsibility to establish procedures for receipt of complaints.

In addition, both the NYSE and Nasdaq rules require that companies adopt and disclose a code of conduct applicable to directors, officers and employees that addresses conflicts of interest and legal compliance. The NYSE rules also require that the code address corporate opportunities, confidentiality, fair dealing and protection of company assets.

Public companies post their corporate governance guidelines, board committee charters, codes of conduct and other governance documents on their corporate websites, typically under a heading such as 'corporate governance' or 'investor relations'.

In summer 2022, the SEC's Division of Corporation Finance launched a new comment letter initiative urging targeted public companies to enhance their disclosures about the board's leadership structure and role in risk oversight. The stated reason for the initiative is that the Division Staff have noticed that the disclosure required by Item 407(h) of Regulation S-K has become increasingly standardised rather than tailored to a company's individual circumstances. Disclosure should provide investors with insights about why a company has chosen its particular board leadership structure (regardless of the type of leadership structure selected) or how a company's board is discharging its risk oversight responsibilities in light of the specific challenges facing its business.

Board and director evaluations

29 Is there any law, regulation, listing requirement or practice that requires evaluation of the board, its committees or individual directors? How regularly are such evaluations conducted and by whom? What do companies disclose in relation to such evaluations?

Under the NYSE listing rules, listed companies are required to adopt and disclose 'corporate governance guidelines' that address, among other things, an annual performance evaluation of the board. According to the rules, the 'board should conduct a self-evaluation at least annually to determine whether it and its committees are functioning effectively'. The NYSE listing rules also require that each of the audit, compensation and nominating and governance committee charters provide for an annual performance evaluation of the committee. Companies listed on Nasdaq do not have similar requirements, but many still engage in self-evaluation as a matter of good governance practice. In addition, independent auditors often inquire into the board's evaluation of the audit committee as part of the auditor's assessment of the internal control environment.

There has been a greater focus on director evaluations in recent years as investors are increasingly concerned about board quality and refreshment mechanisms in light of long director tenures, rising mandatory retirement age limits and perfunctory director renomination decisions. A robust performance evaluation of individual directors can help inform the renomination decision process.

In 2022, 98 per cent of boards at S&P 500 companies reported conducting an annual performance evaluation. Forty-seven per cent of S&P 500 boards disclose that they have some form of individual director evaluation. In 2022, 25 per cent of S&P 500 companies reported that they retained an independent expert to facilitate the evaluation process, compared to 20 per cent in 2021 and only 2 per cent in 2017.

The NYSE listing rules include 'overseeing the evaluation of the board and management' as a responsibility of the nominating or governance committee that must be included in its committee charter. Boards should determine the evaluation methodology, for example, the use of a written survey or interviews, or both, followed by a facilitated discussion, and will determine who will lead the evaluation process (eg, the chair, lead director or a third-party facilitator). A composite report of the feedback and any related recommendations are typically distributed to the board, committee or individual directors by the party leading the evaluation and discussed at a meeting.

In 2014, the Council of Institutional Investors (CII) issued a report calling for enhanced disclosure relating to board evaluation. Specifically, the CII provided 'best in class' examples of disclosure that explain the mechanisms of the evaluation process and discuss the key takeaways from the most recent evaluation. The CII acknowledged that the latter type of disclosure is uncommon among US public companies but is more prevalent in Europe and Australia. In 2019, the CII Research and Education Fund, an affiliate of the CII, issued an updated guide to encourage enhanced disclosure relating to board evaluation and endorse certain evaluation best practices. US public companies can expect more pressure to disclose their self-evaluation processes, especially in circumstances where shareholders have concerns about governance failures, the absence of regular director turnover or board composition generally.

In 2017, the New York City Pension Funds announced a letter-writing campaign targeting over 150 US public companies focused on board composition and refreshment. The group asked to engage with directors about the company's processes for refreshing the board, including an explanation of the evaluation process for individual directors and a description of processes for encouraging underperforming directors to come off the board.

The Report of the NACD Blue Ribbon Commission on Building the Strategic-Asset Board issued in 2016 also discusses board evaluation best practices in the context of other continuous improvement board processes.

REMUNERATION

Remuneration of directors

30 How is remuneration of directors determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of directors, the length of directors' service contracts, loans to directors or other transactions or compensatory arrangements between the company and any director?

The remuneration of directors is generally a matter for the board of directors, or a committee of the board (usually, the compensation committee or the nominating or governance committee), to determine.

In determining the appropriate amount of compensation to be paid to directors, many boards and compensation or nominating or governance committees rely on the advice of independent compensation consultants, whose expertise lies in analysing compensation trends in industry or other market segments. The Securities and Exchange Commission (SEC) amended its regulations in 2012 to require enhanced disclosure with respect to a company's use of compensation consultants.

Boards should exercise caution when approving equity compensation plans that permit equity awards to be made to non-employee directors. Even if such a plan includes meaningful limits on the amount of equity that directors can award themselves and the plan is approved by shareholders, the directors must abide by their fiduciary duties when making awards under the plan (*In Re Investors Bancorp, Inc* (Del 2017)).

Compensation given to all directors must be disclosed by reporting companies. Under the Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act), audit committee members can only receive director's fees (including fees for committee work) from the companies they serve. In addition, the board must consider the source of compensation of a director when considering his or her suitability for compensation committee service. The New York Stock Exchange (NYSE) requires listed companies to adopt and disclose corporate governance guidelines, which are required to address, among other things, the compensation of directors. Since 2016, Nasdaq Stock Market (Nasdaq) listed companies have been required to disclose compensatory arrangements between directors or nominees and third parties in connection with that person's candidacy or service as a director ('golden leashes').

There is no law, regulation or listing requirement that affects the length of directors' service contracts. Rather, directors are elected for a term by the shareholders and it is up to each company to determine whether to place any limits on the number or length of such terms, although NYSE listing rules provide that directors' terms of office should not exceed three years.

Term limits are very rare among large public companies, but retirement age policies are common. The average tenure of directors at S&P 500 companies is 7.8 years. Forty-six per cent of independent directors on S&P 500 boards have served five years or less, 28 per cent have served for six to 10 years, 14 per cent have served for 11 to 15 years, and 13 per cent have served for 16 years or more. Sixty-seven per cent of S&P 500 boards have an average tenure between 6 and 10 years. The corporate governance assessment tool of the proxy advisory firm Institutional Shareholder Services (ISS) tracks the proportion of non-executive directors who have 'lengthy tenure', which for US companies is defined as nine or more years. While most institutional investors do not support individual term and age limits applicable to directors, some are adopting policies focused on average director tenure or individual director tenure (eg, by generally considering long-tenured directors to not be independent).

Section 402 of the Sarbanes–Oxley Act prohibits companies from extending or maintaining personal loans to their directors, other than certain consumer credit arrangements (eg, home improvement or credit card loans) made in the ordinary course of business of a type generally made available by the company to the public and on market terms or terms no more favourable than offered by the company to the general public.

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The duty of loyalty restricts directors from competing with the corporation. Thus, while directors are not precluded from engaging in other businesses, they may not:

- use their position as directors to prevent the corporation from competing with their other businesses;
- divert corporate assets to their own uses or the uses of their other businesses;
- disclose the corporation's trade secrets or confidential information to others;
- lure corporate opportunities, business or personnel away from the corporation; or
- receive, unbeknown to the corporation, a commission on a corporate transaction.

Under the corporate opportunity doctrine, directors cannot divert to themselves an opportunity that belongs to the corporation. An opportunity belongs to the corporation if the corporation has a right to it, a property interest in it, an expectancy interest in it, or if by 'justice' it should belong to the corporation. The corporation may renounce any interest or expectancy in an opportunity in its certificate of incorporation or by an action of its board of directors (see the Delaware General Corporation Law, section 122(17)). At times, a director's interest may still conflict with the interests of the corporation. Conflicts that cannot be avoided must be fully disclosed by the interested director and any action that needs to be taken should be taken by vote of the disinterested directors.

Remuneration of senior management

31 How is the remuneration of the most senior management determined? Is there any law, regulation, listing requirement or practice that affects the remuneration of senior managers, loans to senior managers or other transactions or compensatory arrangements between the company and senior managers?

The remuneration of a corporation's CEO and senior management is generally a matter for the board of directors, or a committee of the board (usually, the compensation committee), to determine.

The NYSE listing rules require that a compensation committee comprising independent directors determines the amount of compensation paid to the CEO and makes recommendations to the board with respect to non-CEO executive officer compensation. These provisions are interpreted broadly, such that a compensation committee or group of independent directors, as the case may be, must approve each specific element of CEO compensation at all listed companies. Since 2014, the Nasdaq listing rules have required that CEO and executive officer compensation be determined by a compensation committee comprising at least two independent directors.

In addition, applicable tax and securities rules require the approval of independent directors to grant equity-based awards (eg, stock option and restricted stock awards) to senior management, and best practice would have the board or compensation committee approve the compensation paid to key members of senior management. Historically, the Internal Revenue Code, section 162(m), provided tax incentives for certain performance-based compensation decisions when made by a committee of outside directors. With the enactment of tax reform in the United States in 2017, this performance-based compensation exemption has been eliminated except with respect to grandfathered arrangements. The responsibility between the board (or compensation committee) and the CEO in determining the elements and amount of compensation paid to senior managers (other than the CEO) differs from company to company and, even within a company, from element of compensation to element of compensation.

In determining the appropriate amount of compensation to be paid to the CEO and other senior managers, many boards and compensation committees rely on the advice of independent compensation consultants, whose expertise lies in analysing compensation trends in industry or other market segments. The SEC amended its regulations in 2012 to require enhanced disclosure with respect to a company's use of compensation consultants.

In August 2022, the SEC adopted a final rule that requires certain public companies to disclose information regarding the relationship between executive compensation and actual financial performance, beginning with their proxy statements for the 2023 proxy season. This new disclosure, also known as pay-versus-performance, implements section 953(a) of the Dodd-Frank Act.

Section 402 of the Sarbanes–Oxley Act prohibits companies from extending or maintaining personal loans to their executive officers, other than certain consumer credit arrangements (eg, home improvement or credit card loans) made in the ordinary course of business of a type generally made available by the company to the public and on market terms or terms no more favourable than offered by the company to the general public.

Say-on-pay

32 Do shareholders have an advisory or other vote regarding remuneration of directors and senior management? How frequently may they vote?

Since 2011, the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 has required US public companies to conduct a separate shareholder advisory vote on:

- executive compensation – to be held at least once every three calendar years;
- whether the advisory vote on executive compensation should be held every year, every two years or every three years – to be held at least once every six calendar years; and
- certain 'golden parachute' compensation arrangements in connection with a merger or acquisition transaction that is being presented to shareholders for approval.

The predominant practice is to hold a shareholder advisory vote on executive compensation every year.

In August 2022, the SEC adopted a final rule that requires certain public companies to disclose information regarding the relationship between executive compensation and actual financial performance, beginning with their proxy statements for the 2023 proxy season. This new disclosure, also known as pay-versus-performance, implements section 953(a) of the Dodd-Frank Act.

US public companies are not required to seek shareholder approval of cash compensation for directors. The NYSE and Nasdaq listing rules require companies to obtain shareholder approval of equity compensation plans applicable to directors and executive officers.

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DIRECTOR PROTECTIONS

D&O liability insurance

33 Is directors' and officers' liability insurance permitted or common practice? Can the company pay the premiums?

Companies may purchase and typically do maintain directors' and officers' liability insurance to protect directors and officers against the risk of personal liability (see the Delaware General Corporation Law (DGCL), section 145(g)). Although this coverage has become substantially more expensive, it is usually available and has not been limited by legislative and regulatory actions. Companies are allowed to pay the premiums for directors' and officers' liability insurance.

Indemnification of directors and officers

34 Are there any constraints on the company indemnifying directors and officers in respect of liabilities incurred in their professional capacity? If not, are such indemnities common?

A company may indemnify a director for liability incurred if that director: acted in good faith; acted in a manner that he or she reasonably believed was in the best interests of the company; and in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful (see DGCL, section 145). Many companies employ such indemnities.

Advancement of expenses to directors and officers

35 To what extent may companies advance expenses to directors and officers in connection with litigation or other proceedings against them or in which they will be a witness?

Under Delaware law, expenses (including attorneys' fees) incurred by an officer or a director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of this action, suit or proceeding upon receipt of an undertaking by or on behalf of this director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation, for example, because of a lack of good faith (see DGCL, section 145(e)). Delaware courts have consistently interpreted DGCL, section 145(e) as granting corporations discretion to determine whether to advance litigation expenses to a covered director or officer.

Exculpation of directors and officers

36 To what extent may companies or shareholders preclude or limit the liability of directors and officers?

The Delaware Director Protection Statute allows the shareholders of a corporation to provide additional protection to corporate directors through the adoption of a provision in the certificate of incorporation 'eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of a fiduciary duty as a director' (DGCL, section 102(b)(7)). Such an exculpation provision, however, may not shield directors from liability for: breaches of the duty of loyalty; 'acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law'; unlawful payments of dividends or unlawful stock purchases or redemptions; or 'any transaction from which the director derived an improper personal benefit'.

In August 2022, Delaware approved amendments to the DGCL which allow Delaware corporations to adopt officer exculpation provisions in their certificates of incorporation, thus expanding such protections to certain corporate officers (with the additional exception that claims against officers will not be barred 'in any action by or in the right of the corporation') including the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, the company's most highly compensated executive officers as identified in SEC filings and other officers who consent to being identified as an officer and to service of process. A number of US public companies are seeking shareholder approval of officer exculpation charter amendments at their 2023 annual meetings.

For 2023, ISS will evaluate on a case-by-case basis proposals to amend governance documents to provide for officer exculpation, taking into account the stated rationale and other specified factors. Additionally, ISS will consider the extent to which the proposal would eliminate liability for monetary damages for violating the duty of loyalty but noted that it will generally not support such proposals even if allowed under state law. Glass Lewis will generally recommend voting against any officer exculpation charter amendment proposals unless a compelling rationale is provided by the board, and the provisions are reasonable (ie, they do not go beyond the fullest extent permitted by law).

DISCLOSURE AND TRANSPARENCY

Corporate charter and by-laws

37 Are the corporate charter and by-laws of companies publicly available? If so, where?

Corporate certificates of incorporation are publicly available for a small fee from the office of the secretary of state in the state of incorporation. By-laws of private companies are generally not publicly available because they are not required to be filed with the secretary of state. If the corporation is a reporting company, its certificate of incorporation and by-laws are also available as exhibits to various forms filed with the Securities and Exchange Commission (SEC), which can be accessed over the internet free of charge from EDGAR, the SEC database, which is accessible via the SEC's website.

Company information

38 What information must companies publicly disclose? How often must disclosure be made?

Federal securities laws and SEC rules require reporting companies (or companies making public offerings) to disclose a wide variety of information in annual and quarterly reports, as well as in proxy statements and public offering prospectuses. In general, a company must disclose all information that would be material to investors. This includes:

- a business description;
- a description of material legal proceedings;
- detailed disclosure of the risks associated with the business and market risk;
- related person transaction disclosure;
- the number of shareholders of each class of common equity;
- management's discussion and analysis of the company's financial condition and results of operations (MD&A);
- a statement as to whether the company has had any disagreements with its accountants;
- disclosure regarding the effectiveness of disclosure controls and procedures, and changes in and the effectiveness of internal control over financial reporting;
- financial information;
- executive and director compensation; and
- a signed opinion of the company's auditors with respect to the accuracy of the financial information.

This report from the auditors also needs to discuss any critical audit matters communicated (or required to be communicated) to the audit committee or state that the auditors determined that there were no critical audit matters.

Corporations are expected to keep all this public information current by filing 'current' reports whenever certain specified events occur, as well as issuing press releases and providing website disclosure.

Since the passage of the Public Company Accounting Reform and Investor Protection Act of 2002 (the Sarbanes–Oxley Act) and its accompanying SEC implementing rules, reporting companies are also required to disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and certain other relationships of the company with unconsolidated entities or other persons. In addition, the Sarbanes–Oxley Act requires that a reporting company's financial reports reflect 'all material correcting adjustments' identified by outside auditors.

Section 404 of the Sarbanes–Oxley Act requires that a reporting company's annual report include an internal control report from management containing a statement of the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting and an assessment at the end of the company's most recent fiscal year of the effectiveness of the company's internal control structure and procedures for financial reporting. The company's registered public accounting firm must also attest to, and report on, the effectiveness of the company's internal control over financial reporting.

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Reporting companies are also required to disclose the 'total compensation' received by the corporation's CEO, its CFO and its three most highly compensated executive officers other than the CEO and CFO (together, the named executive officers) and directors. The information is required to be presented in the form of a summary compensation table listing the name of the employee, the year, salary, bonus, other annual compensation, stock and option awards, changes in pension value and non-qualified deferred compensation earnings, all other forms of compensation and total compensation, as well as several other tables relating to grants of plan-based awards, outstanding equity awards, option exercises and vested stock, pension benefits, non-qualified deferred compensation and director compensation. In addition, reporting companies are required to include a 'compensation discussion and analysis' section in their disclosure documents that explains all material elements of the company's compensation of the named executive officers, and includes a description of the company's compensation philosophy and objectives.

The Jumpstart Our Business Startups Act of 2012 affords 'emerging growth companies' (companies that conducted an IPO after 8 December 2011 and have total annual revenues of less than US$1.235 billion) the flexibility to provide reduced disclosures relating to financials, MD&A and compensation for a maximum period of five years.

SEC regulations also require the disclosure of certain information concerning any beneficial owner known to the company to possess more than 5 per cent of any class of the corporation's voting securities, including the amount of ownership and percentage and title of the class of stock owned. Any person acquiring more than 5 per cent of the equity of a reporting company also must publicly disclose its intentions with respect to such acquisition. In addition, the Securities Exchange Act of 1934 requires that officers, directors and beneficial owners of 10 per cent or more of a company's equity securities file a statement of ownership each time there has been a change in that person's beneficial ownership of the company's securities.

In addition, special attention is given to corporate governance. Reporting companies must include a copy of the audit committee report in their annual proxy statements. This report must disclose, inter alia, whether the committee has reviewed the audited financial statements with management, recommended that the audited statements be included in the corporation's annual report to the board, and discussed certain matters with independent auditors to assess their views on the auditors' independence, the quality of the corporation's financial reporting and the name of the committee member with financial expertise (if any). Under section 406 of the Sarbanes–Oxley Act, companies are required to disclose whether they have adopted a code of ethics for their senior financial officers. If a company has not adopted such a code it must explain why it has not done so. Certain changes to or waivers of any provision of the code must also be disclosed.

Under the Sarbanes–Oxley Act, the reliability and accuracy of the financial and non-financial information disclosed in a company's periodic reports has to be certified by the company's CEO and CFO. In each quarterly report both officers must certify, among other things, that:

- they reviewed the report;
- to their knowledge the report does not contain a material misstatement or omission and that the financial statements and other financial information in the report fairly present,

in all material respects, the financial condition of the company, results of its operations and cash flows for the periods covered in the report;

- they are primarily responsible for the company's controls and procedures governing the preparation of all SEC filings and submissions, not just the periodic reports subject to certification; and
- they evaluated the 'effectiveness' of these controls and procedures and reported to the audit committee any significant deficiencies or material weaknesses in the company's financial reporting controls, together with any corrective actions taken or to be taken. Their conclusions must be disclosed in the certified report.

Companies listed on the New York Stock Exchange are required to disclose their corporate governance guidelines. Committee charters (if any) must be disclosed also.

In 2003, the SEC adopted rules that require reporting companies to disclose in their proxy statements or annual reports certain information regarding the director nomination process, including:

- whether the company has a nominating committee and, if not, how director nominees are chosen;
- whether the members of the nominating committee are independent;
- the process by which director nominees are identified and evaluated;
- whether third parties are retained to assist in the identification and evaluation of director nominees;
- minimum qualifications and standards used in identifying potential nominees;
- whether nominees suggested by shareholders are considered; and
- whether nominees suggested by large, long-term shareholders have been rejected.

These rules also require reporting companies to disclose certain information regarding shareholder communications with directors, including:

- the process by which shareholders can communicate with directors (and, if the company does not have an established process, why it does not);
- whether communications are screened and, if so, how;
- any policies regarding the attendance of directors at annual general meetings (AGMs); and
- the number of directors that attended the preceding year's AGM.

In 2006, the SEC adopted rules that require reporting companies to disclose in their proxy statements or annual reports certain information regarding the corporate governance structure that is in place for considering and determining executive and director compensation, including:

- the scope of authority of the compensation committee;
- the extent to which the compensation committee may delegate any authority to other persons, specifying what authority may be so delegated and to whom;
- any role of executive officers in determining or recommending the amount or form of executive and director compensation; and
- any role of compensation consultants in determining or recommending the amount or form of executive and director compensation, identifying these consultants, stating

whether they are engaged directly by the compensation committee or any other person, describing the nature and scope of their assignment and the material elements of the instructions or directions given to the consultants with respect to the performance of their duties under the engagement.

Moreover, in 2009, the SEC adopted rules requiring companies to provide the following enhanced proxy statement disclosures:

- for each director and nominee, the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director of the company;
- other directorships held by each director or nominee at any public company during the previous five years (rather than only current directorships);
- expanded legal proceedings disclosure relating to the past 10 years (rather than five years);
- whether and, if so, how the nominating committee considers diversity in identifying nominees for director;
- if the nominating committee has a policy with regard to the consideration of diversity in identifying director nominees, how this policy is implemented and how the nominating committee or the board assesses the effectiveness of its policy;
- the board's leadership structure and why the company believes it is the best structure for the company;
- whether and why the board has chosen to combine or separate the CEO and board chair positions;
- where these positions are combined, whether and why the company has a lead independent director and the specific role the lead independent director plays in the leadership of the company;
- the board's role in the oversight of risk management and the effect, if any, that this has on the company's leadership structure;
- the company's overall compensation policies or practices for all employees generally, not just executive officers, 'if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company'; and
- fees paid to and services provided by compensation consultants and their affiliates if the consultants provide consulting services related to director or executive compensation and also provide other services to the company in an amount valued in excess of US$120,000 during the company's last fiscal year.

In summer 2022, the SEC's Division of Corporation Finance launched a new comment letter initiative urging targeted public companies to enhance their disclosures about the board's leadership structure and role in risk oversight. The stated reason for the initiative is that the Division Staff have noticed that the disclosure required by Item 407(h) of Regulation S-K has become increasingly standardised rather than tailored to a company's individual circumstances. Disclosure should provide investors with insights about why a company has chosen its particular board leadership structure (regardless of the type of leadership structure selected) or how a company's board is discharging its risk oversight responsibilities in light of the specific challenges facing its business.

In 2010, the SEC also issued an interpretive release on disclosure relating to climate change, which is intended to provide guidance to reporting companies on the application of existing disclosure requirements to climate change and other matters. Also in 2010, the SEC issued an interpretive release relating to disclosure of liquidity and funding risks posed by short-term borrowing practices.

The SEC issued disclosure guidance relating to cybersecurity (2011, which was updated in 2018) and European sovereign debt exposure (2012), among other matters.

In 2011, the SEC approved final rules relating to advisory votes on executive compensation (say-on-pay) pursuant to the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd–Frank Act), which also require companies to include a discussion in the proxy statement as to whether and, if so, how the company has considered the results of the most recent say-on-pay vote in determining compensation policies and decisions and, if so, how that consideration has affected the company's executive compensation decisions and policies.

In 2012, the SEC approved final rules mandated by the Dodd–Frank Act requiring proxy statement disclosure regarding compensation consultant conflicts of interest. Such disclosure became required to be included in proxy statements for annual meetings occurring on or after 1 January 2013.

In 2012, the Exchange Act was amended by the Iran Threat Reduction and Syria Human Rights Act of 2012 to require public companies to provide disclosure if the company or any of its affiliates (including its directors and officers) has knowingly engaged in certain enumerated activities subject to US trade sanctions involving Iran or specified Iranian entities or nationals as well as certain other non-Iranian persons or entities deemed to promote terrorist activities or the proliferation of weapons of mass destruction. Such disclosure became required to be included in quarterly and annual reports beginning in February 2013.

The Dodd–Frank Act amended the Exchange Act to require disclosure relating to conflict minerals (gold, tantalum, tin and tungsten) originating from the Democratic Republic of Congo or an adjoining country. Since May 2014, public companies have been required to make various disclosures where conflict minerals are necessary to the functionality or production of a product that is either manufactured by the company or by a third party with which the company contracts for such manufacture. A group of business groups filed litigation challenging the conflict minerals rule on several grounds, including that the required disclosure would violate the First Amendment to the US Constitution. In April 2014, the US Court of Appeals for the District of Columbia Circuit found that one disclosure provision of the conflict minerals rule violated the First Amendment but upheld the remainder of the rule. The Court reaffirmed its original ruling in August 2015 and the final judgment in the case was entered in April 2017. In January 2017, the acting chair of the SEC had requested comments on the rule and related guidance through March 2017. In April 2017, the staff of the SEC's Division of Corporation Finance announced that it will not recommend enforcement action if a company fails to comply with certain aspects of the rule relating to due diligence on the source and chain of custody of conflict minerals and an independent private sector audit. The acting chair of the SEC released a statement on the same day announcing that this relief is appropriate because the primary purpose of those requirements is to enable companies to make the disclosure that was found to violate the First Amendment. He directed the SEC staff to develop a recommendation for future SEC action on the rule after taking into consideration the public comments received.

In addition, the Dodd–Frank Act amended the Exchange Act to require 'resource extraction issuers' to disclose specified information regarding payments made to a foreign government or the US federal government for the purpose of commercial development of oil, natural gas or minerals. The SEC adopted a resource extraction disclosure rule in 2012 that was vacated by the US District Court for the District of Columbia in 2013. Later in 2013, the SEC announced that it would redraft the resource extraction rule rather than appeal the ruling. The SEC re-proposed the resource extraction rule in 2015. The SEC rule was repealed in 2017, but the underlying Dodd–Frank Act mandate for SEC rule-making remains intact. The SEC proposed rules in 2019 and the SEC adopted final rules in December 2020 that require resource extraction issuers to make annual filings disclosing payments made to foreign governments or the US federal government for the commercial development of oil, natural gas or minerals.

The Dodd–Frank Act mandated several new executive compensation-related disclosures requiring SEC rule-making, including in relation to the CEO pay ratio, corporate policies on hedging of company stock by directors and employees, 'pay versus performance' and compensation clawback policies requiring the recovery of excess compensation paid to executives. The SEC adopted the CEO pay ratio rule in August 2015 requiring US public companies to disclose the median of the annual total compensation of all company employees except the CEO, the CEO's total annual compensation and the ratio of the former to the latter. Most US public companies first had to comply with the new disclosure requirement in their 2018 annual meeting proxy statements based on 2017 compensation. In December 2018, the SEC adopted a rule that requires a US public company to disclose whether it has adopted practices or policies regarding the ability of its directors and employees (including officers) to hedge the company's equity securities. Most US public companies first had to comply with the new disclosure requirement in their 2020 annual meeting proxy statements. In August 2022, the SEC adopted a final rule to implement section 953(a) of the Dodd-Frank Act that requires certain public companies to disclose information regarding the relationship between executive compensation and actual financial performance, beginning with their 2023 annual meeting proxy statements. Furthermore, in October 2022, the SEC adopted final rules relating to the recovery of erroneously awarded incentive-based executive compensation or 'clawback' policies. The new rules direct the national securities exchanges to establish listing standards that require companies to adopt, disclose and comply with a written clawback policy as a condition to listing. The NYSE and Nasdaq proposed their listing standards on compensation clawbacks in February 2023. The rules also require companies to file their clawback policies an exhibit to their annual reports and to disclose certain information if recovery is triggered under the policy.

In 2018, the SEC issued new interpretive guidance on cybersecurity disclosure that reinforced and expanded upon the 2011 guidance issued by the SEC's Division of Corporation Finance. The guidance illustrates the SEC's increased expectations with respect to how US public companies monitor and disclose cybersecurity risks and incidents. In March 2022, the SEC proposed new cybersecurity rules for public companies that will require them to (1) report material cybersecurity incidents within four days, (2) provide updates on material cybersecurity incidents, (3) provide annual disclosures on the company's cybersecurity risk management framework as well as its cybersecurity governance and (4) provide disclosures concerning the cybersecurity expertise of the company's board of directors. Also in March 2022, President Biden signed into law the Cyber Incident Reporting for Critical Infrastructure Act of 2022 as part of an omnibus appropriations bill, which could overlap with some disclosure obligations of the proposed SEC rules. In May 2022, seven US Senators (all co-sponsors of the Cybersecurity Disclosure Act, which encourages public company boards to play a more effective role in cybersecurity risk oversight), released a letter urging the SEC to finalise cybersecurity disclosure rules for public companies.

Since early 2014, the SEC has engaged in a 'disclosure effectiveness project'. The goal of the project is to review existing disclosure requirements to determine whether modifications should be made to reduce the costs and burdens on public companies while also promoting the disclosure of material information to investors and eliminating duplicative disclosures. In September 2015, the SEC requested comment on the form and content of financial statement disclosures required under Regulation S-X. In April 2016, the SEC issued a concept release seeking public comment on modernising certain business and financial disclosures required by Regulation S-K to be included in public companies' periodic reports. In August 2016, the SEC requested public comment on the compensation and corporate governance information to be included in US public companies' proxy statements. In March 2017, the SEC approved rules that will require US public companies to provide hyperlinks to the exhibits to their SEC filings, which became effective for the largest category of filers in September 2017. In August 2018, the SEC adopted rule amendments to eliminate or update certain disclosure requirements that have become redundant, duplicative, overlapping, outdated or superseded as a result of more recently updated SEC or generally accepted accounting principles requirements or changes in the information environment. The amendments became effective in November 2018. The SEC adopted rule amendments in March 2019 intended to streamline and improve disclosure requirements applicable to US public companies. The key rule amendments, which became effective in April and May 2019, streamline MD&A disclosure in annual reports, reduce the need to submit confidential treatment requests to the SEC and simplify exhibit filing requirements. In August 2020, the SEC adopted amendments to modernise its rules requiring disclosure about a company's business description, legal proceedings and risk factors. Most notably, the rule amendments require a public company to describe its human capital resources, including any human capital measures or objectives the company focuses on in managing its business, to the extent material to an understanding of the company's business taken as a whole. The amendments became effective in November 2020. Since then, human capital measures have continued to be a major focus of the SEC, in large part due to a high level of investor interest in these matters and the enhanced human capital disclosure requirements. As a disclosure topic human capital management is becoming less principles-based and more prescriptive. The SEC is contemplating proposing further rule amendments that would require additional disclosure regarding human capital management.

In November 2020, the SEC adopted amendments to modernise, streamline and enhance certain financial disclosure requirements in Regulation S-K. The rule amendments, which became effective in February 2021, are intended to improve the quality of MD&A disclosures by emphasising a principles-based approach and reduce the compliance burden on companies by eliminating several more prescriptive requirements.

In January 2020, the SEC issued new interpretive guidance on disclosure of key performance indicators and other metrics in the MD&A section of public companies' periodic reports.

In August 2021, the SEC approved changes to the Nasdaq listing rules relating to board diversity. The rule changes will require each Nasdaq-listed company, subject to certain exceptions, to (1) publicly disclose annually in an aggregated form, to the extent permitted by applicable law, information on the voluntary self-identified gender and racial characteristics and LGBTQ+ status of the company's board of directors, and (2) have, or explain why it does not have, at least two directors who are diverse, including at least one director who self-identifies as female and at least one director who self-identifies as either an underrepresented minority or LGBTQ+. Companies will be required to have at least one diverse director by 31 December 2023 and at least two diverse directors by 31 December 2025 or 31 December 2026, depending on the size of the company and its stock market exchange tier. A Nasdaq-listed company with a board of five or fewer members will be required to have, or explain why it does not have, at least one diverse director by 31 December 2023.

For purposes of the new Nasdaq rules, (1) 'diverse' means an individual who self-identifies as a female, an underrepresented minority or LGBTQ+, (2) 'female' means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth, (3) 'underrepresented minority' means an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities, and (4) 'LGBTQ+' means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community.

In December 2022, the SEC adopted rules that significantly alter the Exchange Act Rule 10b5-1 framework and add substantial new disclosure requirements. The amendments add new conditions to the availability of the affirmative defence to insider trading liability, impose new disclosure requirements regarding officer and director trading plans, insider trading policies and timing of certain stock awards, and amend Forms 4 and 5 to require earlier disclosure of gifts and explicit disclosure of Rule 10b5-1 transactions.

In May 2023, the SEC adopted rule amendments to require more detailed disclosure regarding repurchases of a company's registered equity securities. Specifically, the rules will require companies to disclose a table of daily quantitative share repurchase information in quarterly reports (the rule proposal from December 2021 had contemplated next-day reporting of repurchases). The rules will also require narrative disclosure in periodic reports about a company's repurchase programmes and practices and details about a company's adoption and termination of Exchange Act Rule 10b5-1 trading arrangements.

In May 2022, the SEC released a sample letter containing guidance for companies on disclosure obligations relating to Russia's invasion of Ukraine. The letter encourages companies to disclose any direct or indirect exposure to Russia, Belarus or Ukraine, new or heightened cybersecurity risk and actions taken to mitigate such risks, as well as known trends or uncertainties impacting the company's financial condition arising from Russia's invasion of Ukraine. Companies are also encouraged to disclose any material impact of import/export bans or supply chain disruptions. Furthermore, the letter addresses critical accounting estimate disclosures, non-GAAP financial measures, and internal control over financial reporting in the context of the Russia/Ukraine war.

SEC recent developments illustrate a heightened focus on matters related to climate and environmental, social and governance (ESG) with momentum toward the SEC developing a comprehensive ESG disclosure framework and increased scrutiny of climate and ESG disclosures. The SEC is taking a 'whole agency' approach to ESG: rulemaking, enforcement scrutiny and interpretive guidance. In March 2021, the SEC created a Climate and ESG Task Force in its Enforcement Division. Since then, the SEC has investigated and filed a number of ESG-related enforcement actions against public companies based on false or misleading disclosures made in publicly available ESG or sustainability reports. In September 2021, the SEC released a sample letter demonstrating the type of comments the SEC's Division of Corporation Finance has been issuing to companies asking detailed questions regarding climate-related disclosure or the absence of such disclosure in companies' Form 10-Ks. In March 2022, the SEC issued proposed rules that would require public companies to include extensive climate-related information in their registration statements and periodic reports. The proposed rules would require disclosure concerning climate-related risks and impacts, oversight and governance of climate-related risks, climate-related financial statement metrics, climate-related goals, and greenhouse gas emissions. If adopted, the rules would present substantial new disclosure responsibilities for public companies. Whereas many public companies have been issuing voluntary climate-related disclosures outside of SEC filings, the proposed rules would require them to disclose such information in SEC filings according to rigorous disclosure methods, and certain information would be subject to attestation or independent audit requirements. The proposed rules would also indirectly compel companies to have monitoring, accounting, planning, and governance practices in place to enable them to satisfy the proposed disclosure requirements. In June 2022**,** the US Supreme Court decided *West Virginia et al v Environmental Protection Agency*, holding that the Environmental Protection Agency lacks authority under section 7411(d) of the Clean Air Act to limit greenhouse gas emissions from power plants. This limitation of a federal agency's administrative authority may complicate the SEC's landmark climate-related rule proposal.

HOT TOPICS

Shareholder-nominated directors

39 Do shareholders have the ability to nominate directors and have them included in shareholder meeting materials that are prepared and distributed at the company's expense?

Since September 2011, companies can no longer exclude from their proxy materials shareholder proposals (precatory or binding) relating to by-law amendments establishing procedures for shareholder nomination of director candidates and inclusion in the company's proxy materials, as long as the proposal is not otherwise excludable under Rule 14a-8. This amendment to Rule 14a-8 facilitates the development of 'proxy access' via private ordering at companies chartered in states where permissible, as shareholders are able to institute a shareholder nomination regime via binding by-law amendment or request, via precatory shareholder proposal, that such a by-law be adopted by the board.

The private ordering process gained considerable momentum during 2015, which saw a significant increase in the number of shareholder proxy access proposals submitted (more than 100) and shareholder support for such proposals (60 per cent of the total proposals voted on passed), as well as an increased frequency of negotiation and adoption of proxy access via board action. In response to shareholder proposals and increasing pressure from institutional investors and proxy advisory firms, nearly 1000 companies have adopted proxy access, including 85 per cent of S&P 500 companies as of May 2023 (up from less than 1 per cent in 2014). Proxy access is extending significantly into the next tier of large public companies with just under 60 per cent of Russell 1000 companies having adopted proxy access as of May 2023. The market standard that has emerged gives a group of up to 20 shareholders who hold 3 per cent of the company's common stock for at least three years the right to nominate up to 20 per cent of the company's directors (or at least two directors) using the company's proxy materials. Proxy access provisions typically include limitations on the use of proxy access (eg, in contested election situations) and require detailed information to be provided in relation to the nominee and the nominating group, among other requirements.

In the past seven years, shareholders have been submitting proposals requesting that companies make amendments to their proxy access by-laws (eg, to increase or remove the limit on the size of the nominating shareholder group). These 'fix-it' proposals have largely been excludable if the SEC staff has agreed that the company has substantially implemented the proposal, or failed to receive majority support. Two 'fix-it' proposals filed by shareholders passed in 2016, but all others filed since have failed.

In November 2021, the SEC adopted changes to the federal proxy rules to require the use of 'universal' proxy cards. The new rules change the methods by which public companies and shareholders have solicited proxies for decades, and allow shareholders to vote for a mix of management and dissident nominees in a contested director election. The new rules will reshape the process by which hostile bidders, activist hedge funds, social and environmental activists, and other dissident shareholders may utilise director elections to influence control and policy at public companies. The new rules also amend certain form of proxy and disclosure requirements relating to voting options and standards that apply to all director elections, whether or not contested. The rules are now effective for shareholder meetings held after 31 August 2022.

Shareholder engagement

40 Do companies engage with shareholders? If so, who typically participates in the company's engagement efforts and when does engagement typically occur?

Shareholder influence is more potent than ever and continued attention to the quality of shareholder relations has become paramount. Companies are engaging with their key large institutional investors more directly and more frequently to hear their interests and concerns, including from a governance perspective. Whereas engagement with shareholders used to occur primarily during the annual meeting season, companies are now engaging with their shareholders throughout the year. There are several reasons for this, including:

- the advent of the shareholder advisory vote on executive compensation;
- a rise in hedge fund activism;
- proxy advisory firm policies that expect companies to respond to shareholder advisory votes that receive significant (but less than passing) support; and
- shareholder expectations.

Shareholders are also increasingly seeking to engage with companies outside of the shareholder proposal mechanism. For example, in addition to more frequent one-on-one meetings between the company and shareholders, it is becoming more common for large institutional investors to send letters on specific issues of concern to portfolio companies. In recent years, public campaigns of this sort have urged CEOs to disclose a long-term strategic plan to shareholders, the adoption of proxy access and more direct engagement between directors and shareholders. In particular, BlackRock, State Street and Vanguard, three of the largest institutional investors in the United States, have recently become more assertive in pushing for corporate governance reforms and increased director–shareholder engagement at the companies in which they invest.

Members of senior management, such as the CEO and CFO, are typically the company representatives who engage with shareholders. Investor relations personnel may also be involved in shareholder engagement efforts. Outside counsel rarely participates. Directors are becoming more involved in shareholder engagement. Which director is involved depends on the topics to be discussed. Often the lead director or the relevant committee chair will meet with the shareholder along with a member of senior management. For example, the compensation committee chair may be called upon to meet with an investor who has concerns with the company's executive compensation programme.

Directors of US public companies should understand the composition and particular interests of their shareholder base and be actively involved in overseeing the company's shareholder engagement and investor relations efforts. Many companies are also engaging with a broader group of shareholders rather than just the top few holders. Companies are also increasingly providing disclosure regarding their shareholder engagement efforts in their annual meeting proxy statements. In 2015, the Council of Institutional Investors (CII) issued a report calling for enhanced disclosure relating to company-shareholder engagement. Specifically, the CII provided 'best in class' examples of disclosure of engagement policies and practices.

Sustainability disclosure

41 | Are companies required to provide disclosure with respect to corporate social responsibility matters?

It is common for US public companies to report on corporate social responsibility (CSR) and ESG matters including environmental, social and ethical issues. Several SEC disclosure requirements tend to trigger disclosure of CSR matters, typically in quarterly and annual reports:

- business description disclosure;
- legal proceedings disclosure;
- material known events and uncertainties disclosure included in management's discussion and analysis of the company's financial condition and results of operations;
- risk factor disclosure;
- guidance regarding climate change disclosure; and
- conflict minerals disclosure.

In August 2020, the SEC adopted rules that require disclosure of any human capital measures or objectives that management focuses on in managing the business (such as those that address the attraction, development and retention of personnel) to the extent material to an understanding of the company's business. The amendments became effective in November 2020. Since then, human capital measures have continued to be a major focus of the SEC, in large part due to a high level of investor interest in these matters and the enhanced human capital disclosure requirements. As a disclosure topic human capital management is becoming less principles-based and more prescriptive. The SEC is contemplating proposing further rule amendments that would require additional disclosure regarding human capital management.

SEC recent developments illustrate a heightened focus on matters related to climate and ESG-related matters and momentum toward the SEC developing a comprehensive ESG disclosure framework and increased scrutiny of climate and ESG disclosures. The SEC is taking a 'whole agency' approach to ESG: rulemaking, enforcement scrutiny and interpretive guidance. In March 2021, the SEC created a Climate and ESG Task Force in its Enforcement Division. Since then, the SEC has investigated and filed a number of ESG-related enforcement actions against public companies based on false or misleading disclosures made in publicly available ESG or sustainability reports. In September 2021, the SEC released a sample letter demonstrating the type of comments the SEC's Division of Corporation Finance has been issuing to companies asking detailed questions regarding climate-related disclosure or the absence of such disclosure in companies' recent Form 10-Ks. In March 2022, the SEC issued proposed rules that would require public companies to include extensive climate-related information in their registration statements and periodic reports. The proposed rules would require disclosure of:

- climate-related risks reasonably likely to have a material impact on the company's business or consolidated financial statements, within the existing definition of materiality
- the actual and potential impacts of material climate-related risks on a company's strategy, business model, and outlook
- the manner in which a company's board oversees climate-related risks and management's role in assessing and managing those risks
- processes for identifying, assessing, and managing climate-related risks
- various climate-related financial statement metrics
- climate-related targets and goals, if the company has set them
- direct (Scope 1) and indirect (Scope 2) greenhouse gas (GHG) emissions data — as well as additional upstream/downstream indirect GHG emissions (Scope 3) if material or if the company has set targets for Scope 3 emissions.

If adopted, the rules would present substantial new disclosure responsibilities for public companies. Whereas many public companies have been issuing voluntary climate-related disclosures outside of SEC filings, the proposed rules would require them to disclose such information in SEC filings according to rigorous disclosure methods, and certain information would be subject to attestation or independent audit requirements. The proposed rules would also indirectly compel companies to have monitoring, accounting, planning, and governance practices in place to enable them to satisfy the proposed disclosure requirements.

In June 2022, the US Supreme Court decided *West Virginia et al v Environmental Protection Agency*, holding that the Environmental Protection Agency lacks authority under section 7411(d) of the Clean Air Act to limit greenhouse gas emissions from power plants. This limitation of a federal agency's administrative authority may complicate the SEC's landmark climate-related rule proposal.

Many companies already report on ESG matters voluntarily (eg, as of 2020, 92 per cent of S&P 500 companies and 70 per cent of Russell 1000 companies published annual sustainability or responsibility reports). In late 2019, the US Chamber of Commerce released a set of best practices to guide companies in making voluntary disclosure about ESG topics and steer the development of a widely adopted approach to voluntary ESG reporting without the need for additional regulatory mandates. Companies may be subject to additional disclosure requirements under state law (eg, certain companies doing business in California are required to disclose measures they take to eliminate slavery and human trafficking in their supply chains).

Many companies consider three influential guides when determining if and what to disclose regarding ESG issues: the Global Reporting Initiative Sustainability Reporting Standards, the Sustainability Accounting Standards Board Implementation Guide (the final standards of which were released in November 2018) and the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

In 2018, ISS launched an Environmental & Social (E&S) QualityScore scoring tool that measures the depth and extent of corporate disclosure on environmental and social issues, including sustainability governance, and identifies key disclosure omissions. This metric for institutional investors to use to evaluate the E&S risk of their portfolio companies has prompted greater disclosure of E&S matters by some US public companies.

For 2023, ISS has expanded the scope of its climate accountability policy to apply globally. ISS will recommend voting against the incumbent chair of the responsible committee (or other directors on a case-by-case basis) at companies that are significant greenhouse gas (GHG) emitters (ie, companies in the Climate Action 100+ Focus Group) in cases where ISS determines the company is not taking the minimum steps needed to assess and mitigate climate-related risks, such as according to the TCFD and quantitative GHG emissions reduction targets covering at least a significant portion of the company's direct emissions. For this same group of companies, Glass Lewis expects thorough climate-related disclosures in line with TCFD recommendations and disclosure of explicit and clearly defined oversight responsibilities for climate-related issues, or it may recommend votes against the chair of the committee (or additional committee members) charged with oversight of climate-related issues.

Glass Lewis will generally recommend voting against the governance committee chair of Russell 1000 companies that have not provided explicit disclosure regarding the board's role in E&S risk oversight.

In recent years, large institutional investors have urged companies to disclose how long-term strategy incorporates corporate sustainability considerations. In January 2021, Larry Fink, BlackRock's chair and CEO released his annual letter to the CEOs of its portfolio companies warning that BlackRock will vote against directors at companies that do not make sufficient progress on implementing sustainable business practices and improving their climate change and sustainability-related disclosures. He called for a single global standard for ESG disclosure but, in the meantime, BlackRock continues to endorse the ESG disclosure framework of the Sustainability Accounting Standards Board (SASB) and TCFD recommendations. He also noted that BlackRock expects public companies to incorporate climate risk as part of their oversight of long-term strategies and to disclose how they are addressing climate-related risks. Finally, BlackRock asked companies to disclose their long-term strategies for improving diversity, equity and inclusion in their sustainability reports.

Mr Fink's 2022 annual letter continued to focus on ESG matters and related disclosures. The letter highlighted that BlackRock expects companies to (1) focus more on human capital management and board oversight thereof and (2) set short-, medium- and long-term targets for GHG reductions and issue reports consistent with the TCFD. In his 2023 annual letter, Mr Fink noted that BlackRock continues to view climate risk as an investment risk and advocated for enhanced disclosures about how companies plan to navigate the energy transition.

BlackRock asks companies to disclose a business plan for how they intend to deliver long-term financial performance through the transition to global net zero, consistent with their business model and sector. BlackRock expects companies to demonstrate their plan's resilience under various decarbonisation scenarios and the global aspiration of limiting warming to 1.5 degrees celsius. BlackRock's guidelines also encourage companies to disclose how considerations related to having a reliable energy supply and just transition affect their plans. Finally, BlackRock expects greater disclosure on capital allocations across alternative energy sources and transition technologies to ensure these are consistent with the company's stated transition strategy. While maintaining the desire for reporting aligned with the TCFD recommendations and supported by SASB industry-specific metrics, BlackRock acknowledges that some companies may report using other reporting standards. In those instances, BlackRock requests that companies disclose the metrics that are specific to the company or industry.

In 2018, State Street sent letters to all companies in the S&P 500 encouraging them to proactively disclose their compliance with the Investor Stewardship Group's corporate governance and sustainability principles. State Street votes against the independent board leader at companies that do not comply with the principles and companies that cannot explain the nuances of their governance structure effectively, either publicly or through engagement.

In its 2023 voting guidelines, State Street Global Advisors endorses TCFD-related disclosures and indicates that it may take voting action against S&P 500 companies that fail to provide sufficient disclosure regarding company-specific climate-related risks and opportunities or board oversight of climate-related risks and opportunities, in accordance with the TCFD framework.

CEO pay ratio disclosure

42 | Are companies required to disclose the 'pay ratio' between the CEO's annual total compensation and the annual total compensation of other workers?

The SEC adopted the CEO pay ratio rule in August 2015 requiring US public companies to disclose the median of the annual total compensation of all company employees except the CEO, the CEO's total annual compensation and the ratio of the former to the latter. For calendar-year companies, the first disclosure was required in 2018 annual meeting proxy statements based on 2017 compensation. In September 2017, the SEC published guidance to assist US public companies as they prepare for compliance with the CEO pay ratio disclosure rule. Taken as a whole, the guidance makes clear that companies have substantial flexibility in developing their response to the new disclosure requirement.

Gender pay gap disclosure

43 Are companies required to disclose 'gender pay gap' information? If so, how is the gender pay gap measured?

US public companies are not required to disclose gender pay gap information. However, in recent years, some investors have filed shareholder proposals primarily at companies in the technology and financial services industries requesting them to measure, disclose and take action to close gender pay gaps. In exchange for withdrawal of the proposals, some of the targeted companies committed to reporting certain pay data by gender and taking steps to reduce any identified gender pay gaps. The first of these reports among US public companies was published by a large financial institution in early 2019. Since 2018, ISS evaluates shareholder proposals seeking reports on a company's pay data by gender, or policies or goals aimed at reducing any gender pay gap, on a case-by-case basis considering specified factors. Glass Lewis adopted a similar policy, which took effect for the 2017 proxy season.

UPDATE AND TRENDS

Recent developments

44 Identify any new developments in corporate governance over the past year. Identify any significant trends in the issues that have been the focus of shareholder interest or activism over the past year.

Public companies are facing increased pressures from investors, customers and employees on environmental, social and governance (ESG) issues, especially board diversity, human capital management and climate issues. Human capital management covers a broad range of workforce matters, including diversity and inclusion, employee satisfaction and engagement, succession and talent management, and ethics, workforce culture and risk. In August 2020, the Securities and Exchange Commission (SEC) adopted rules that require disclosure of any human capital measures or objectives that management focuses on in managing the business (such as those that address the attraction, development and retention of personnel) to the extent material to an understanding of the company's business. The amendments became effective in November 2020. Since then, human capital measures have continued to be a major focus of the SEC, in large part due to a high level of investor interest in these matters and the enhanced human capital disclosure requirements. As a disclosure topic human capital management is becoming less principles-based and more prescriptive. The SEC is contemplating proposing further rule amendments that would require additional disclosure regarding human capital management.

The covid-19 pandemic, together with the shift to a knowledge-based economy, highlighted the value of human capital and triggered changes in business needs, work preferences, the market for human capital, and associated risks (eg, cybersecurity and compliance). Human capital management issues are critical to corporate culture, and are a key area for board oversight. These issues include:

- talent management, including employee recruitment, promotion, and retention;
- employee health and safety;
- fair compensation and benefits, including minimum wage, pay equity, and paid leave;
- DEI at all levels of the company;
- training and career development initiatives;
- workforce management issues, including layoffs;
- efforts to combat discrimination, harassment, and bullying; and
- treatment of whistleblowers.

Calls among investors and other stakeholders for disclosure of EEO-1 workforce demographic data have been gaining traction. Disclosure of EEO-1 reports (which provide a racial, gender and job category breakdown of a company's US workforce) would enable measurement and comparison over time between companies and within individual companies. Sustainability Accounting Standards Board (SASB) Standards for certain industries recommend disclosure of EEO-1 data and recent shareholder proposals have asked for annual disclosures of EEO-1 data. The Office of the New York City Comptroller launched a letter-writing campaign in 2020 urging S&P 100 companies publicly disclose their EEO-1 reports when submitted to the EEOC annually. In December 2022, the NYC Comptroller announced that the number of S&P 100 companies disclosing EEO-1 reports has increased from 14 to more than 90 since 2020 demonstrating the success of the campaign.

US public companies remain under pressure to enhance the diversity of their boards and related disclosures, and the focus has expanded beyond increasing gender diversity to ethnic and racial diversity. In September 2018, a California law was enacted that required California-headquartered publicly held domestic or foreign corporations to have at least one female director by the end of 2019 and, depending on board size, up to three female directors by the end of 2021. In April 2022, a judge in the Los Angeles County Superior Court struck down the law as unconstitutional, holding that it posed a 'total and fatal' conflict with the California Constitution's Equal Protection Clause by requiring corporations to use suspect demographic classifications in the selection of board members to the exclusion of other people from different races, sexual orientations or gender identities. A similar California law enacted in 2020 that required such corporations to have at least one director from an underrepresented community by the end of 2021 and, depending on board size, up to three directors from underrepresented communities by the end of 2022, was also struck down as unconstitutional for similar reasons. Several other states have enacted or are considering legislation that would encourage greater board diversity or require disclosure about board diversity.

In August 2021, the SEC approved changes to the Nasdaq listing rules relating to board diversity. The rule changes will require each Nasdaq-listed company, subject to certain exceptions, to (1) publicly disclose annually in an aggregated form, to the extent permitted by applicable law, information on the voluntary self-identified gender and racial characteristics and LGBTQ+ status of the company's board of directors, and (2) have, or explain why it does not have, at least two directors who are diverse, including at least one director who self-identifies as female and at least one director who self-identifies as either an underrepresented minority or LGBTQ+. Companies will be required to have at least one diverse director by 31 December 2023 and at least two diverse directors by 31 December 2025 or 31 December 2026, depending on the size of the company and its stock market exchange tier. A Nasdaq-listed company with a board of five or fewer members will be required to have, or explain why it does not have, at least one diverse director by 31 December 2023.

For purposes of the new Nasdaq rules, (1) 'diverse' means an individual who self-identifies as a female, an underrepresented minority or LGBTQ+, (2) 'female' means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth, (3) 'underrepresented minority' means an individual who self-identifies as one or more of the following: Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or Two or More Races or Ethnicities, and (4) 'LGBTQ+' means an individual who self-identifies as any of the following: lesbian, gay, bisexual, transgender, or as a member of the queer community.

ISS will generally recommend withholding or voting against the nominating committee chair (and potentially other directors) at all companies where there are no women on the board or the board has no apparent racially or ethnically diverse members, unless there was at least one woman or racially/ethnically diverse director at the preceding annual meeting and the board commits to restore gender or racial/ethnic diversity by the next annual meeting. This policy applies to Russell 3000 or S&P 500 companies and the gender diversity policy will apply to companies outside of those indices beginning in 2023.

In 2022, ISS updated its E&S QualityScore scoring tool to include new or expanded factors relating to diversity, equity and inclusion at the board and executive level (including whether there are LGBTQ+ directors and ethnically diverse directors) and voluntary public disclosure of US Equal Employment Opportunity Commission data (ie, EEO-1 reports).

As of 2023, at Russell 3000 companies, Glass Lewis will generally recommend voting against the nominating committee chair of a board that is not at least 30 per cent gender diverse and the entire nominating committee of a board with no gender diverse directors. For companies outside the Russell 3000, Glass Lewis will generally recommend voting against the nominating committee chair if there are no gender diverse directors.

Finally, as of 2023, at Russell 1000 companies, Glass Lewis will generally recommend voting against the nominating committee chair of a board that does not have at least one director from an underrepresented community. Glass Lewis may refrain from issuing negative voting recommendations against directors at companies that have provided a sufficient rationale or plan to address the lack of diversity on the board.

Furthermore, as of 2023, Glass Lewis will generally recommend votes against the nominating committee chair at Russell 1000 companies that have not provided any disclosure in their proxy statements in any of the following categories: (1) the board's current percentage of racial/ethnic diversity, (2) whether the board's definition of diversity explicitly includes gender and/or race/ethnicity, (3) whether the board has adopted a 'Rooney Rule' policy requiring women and minorities to be included in the initial pool of candidates when selecting new director nominees and (4) board skills disclosure. Additionally, Glass Lewis will recommend votes against the nominating committee chair at such companies that have not provided any disclosure of individual or aggregate racial/ethnic minority demographic information.

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Since January 2021, Goldman Sachs will not take a company public unless it has at least two diverse board candidates, one of whom must be female. As of 2023, Goldman Sachs Asset Management votes against the entire board at any company with no female directors, and against all nominating committee members at any company that does not have at least 10 per cent women directors and at least one other diverse director. At S&P 500 companies, Goldman Sachs will vote against nominating committee members at any company with a board that does not have at least one diverse director from an underrepresented ethnic group.

The national focus on racial justice and equity in the United States in 2020 stemming from the killing of George Floyd created new theories of liability in shareholder litigation. Since 2020, dozens of lawsuits have been filed against large public companies alleging that company directors violated their duties to the company and shareholders by, among other things, failing to have a sufficiently racially diverse board, or claiming that the companies' disclosures about diversity-related initiatives misled shareholders. As of April 2023, several of the lawsuits have been dismissed.

Consistent with their fiduciary obligations to act in the interests of the company, including the long-term interests of shareholders, boards have a responsibility to address social justice issues that affect the company's performance, operations, risk profile and relationships with important stakeholders. This calls for more critical, internal evaluation of how corporate activities may contribute to, or may ameliorate, adverse social impacts, for example, with respect to racial inequity and underrepresented and underserved communities.

Employees and consumers are paying more attention to public companies' policies and practices when deciding where to work and what to buy. Moreover, corporate social responsibility is broadly accepted as a legitimate pursuit of public companies, at least so long as there is a reasonable nexus to long-term shareholder value. Accordingly, it becoming somewhat expected for CEOs to issue personal statements or for their companies to issue public statements to take action on social, environmental and political issues.

The SEC adopted controversial rule amendments in 2020 that increased the eligibility requirements for submitting a shareholder proposal to a tiered approach depending on the level of ownership and the relevant holding period: at least US$2,000 if held for at least three years, at least US$15,000 if held for at least two years and at least US$25,000 if held for at least one year. The rule amendments also increased the prior shareholder support thresholds for resubmitting substantially similar shareholder proposals at the same company in future years and clarify that one person may not submit more than one proposal, directly or indirectly, to a company for the same shareholder meeting.

In late 2022, ISS and Glass Lewis released updates to their proxy voting policies for the 2023 proxy season. The key policy updates relate to the following topics:

- board diversity – both gender and racial/ethnic – and related disclosures;
- officer exculpation charter amendment proposals;
- board accountability for climate-related issues and problematic governance and capital structures;
- board accountability for risk oversight failures related to environmental and social issues and cybersecurity;

- director overboarding;
- shareholder proposals requesting racial equity audits or disclosure about political spending and lobbying congruency; and
- compensation-related matters.

In six recent instances, a Delaware court declined to dismiss a claim alleging that directors had not satisfied their duty to exercise oversight. This unprecedented number of 'Caremark' claims surviving a motion to dismiss re-emphasises the importance of board focus on risk oversight, process and controls. This was especially important amid the covid-19 pandemic which presented companies with unique challenges and risks. To avoid any potential 'Caremark' claim, directors must become informed of the critical risks facing the company (including from covid-19), ask questions and take timely and informed actions to ensure that management is addressing those critical risks.

A recent Delaware Chancery Court opinion clarified that, as with directors, a corporate officer's fiduciary duties encompass a duty of oversight. (*In re McDonald's Corp Stockholder Derivative Litig* (Del Ch 2023)). Accordingly, officers of Delaware corporations, like directors, must (1) make a good-faith effort to put in place reasonable information systems to generate the information necessary to address risks and report upward to higher-level officers or the board and (2) not consciously ignore red flags indicating that the company may suffer harm. Officers will not be held liable for violations of the duty of oversight unless they are shown to have acted in bad faith.

Unlike the duties of directors, the scope of an officer's duty of oversight may be limited to the context in which the officer operates. For example, although a CEO or chief compliance officer has a 'company-wide oversight portfolio', a chief legal officer may be responsible only for oversight of risks within the legal function. The court noted, however, that where red flags are 'sufficiently prominent', any officer has a duty to report upward to the CEO or the board.

Corporate officers are well advised to continue to ensure that they are receiving periodic information and conducting regular reviews of risks in their areas of responsibility and that CEOs and chief compliance officers in particular are receiving such reporting on an enterprise-wide basis. Memorialisation of such risk reviews may also help in establishing that officers have endeavored to fulfill their oversight duties in good faith.

The number of US companies that held virtual-only annual shareholder meetings skyrocketed in 2020 when the covid-19 pandemic made in-person shareholder meetings impossible or inadvisable. Virtual shareholder meetings, both virtual-only and hybrid format, are becoming commonplace practice as companies and service providers gain more experience.

Currently, ISS prefers a hybrid approach but does not have a policy to recommend voting against directors at companies that hold virtual-only meetings. ISS encourages companies holding virtual-only meetings to disclose the circumstances under which virtual-only meetings would be held, and provide shareholders with comparable rights and opportunities to participate electronically as they would have during an in-person meeting. ISS will vote case-by-case on shareholder proposals concerning virtual-only meetings, considering the scope and rationale of the proposal, and concerns identified with the company's prior meeting practices.

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Similarly, Glass Lewis prefers a hybrid approach. In egregious cases, Glass Lewis may recommend voting against governance committee members where a company chooses to hold a virtual-only shareholder meeting and does not provide sufficient disclosure in its proxy statement assuring shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

Some large institutional investors (eg, CalPERS and the New York City Pension Funds) oppose virtual-only shareholder meetings and may vote against directors at companies that hold them.

In March 2022, the CII updated its corporate governance policies to give companies more flexibility with respect to the format of their shareholder meetings. The updated policies state that companies should acknowledge that many investors prefer in-person meetings but should have 'the flexibility to choose an in-person, hybrid or virtual-only format depending on their shareowner base and current circumstances.' Companies should use virtual technology 'as a tool for broadening, not limiting, shareowner meeting participation' and should disclose the circumstances under which a virtual-only meeting would be held and provide shareholders participating virtually with comparable rights and opportunities as those whom attend in person.

In January 2022, the SEC staff issued updated guidance for conducting shareholder meetings in light of covid-19 concerns. The staff encourages companies to provide shareholder proponents or their representatives with the ability to present their shareholder proposals through alternative means (eg, by phone) if they are unable to appear at the meeting to present them in person.

The Delaware Director Protection Statute allows the shareholders of a corporation to provide additional protection to corporate directors through the adoption of a provision in the certificate of incorporation 'eliminating or limiting the personal liability of a director to the corporation or its shareholders for monetary damages for breach of a fiduciary duty as a director' (DGCL, section 102(b)(7)), with certain exceptions. In August 2022, Delaware approved amendments to the DGCL which allow Delaware corporations to adopt officer exculpation provisions in their certificates of incorporation, thus expanding such protections to certain corporate officers (with the additional exception that claims against officers will not be barred 'in any action by or in the right of the corporation') including the president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer or chief accounting officer, the company's most highly compensated executive officers as identified in SEC filings and other officers who consent to being identified as an officer and to service of process. A number of US public companies are seeking shareholder approval of officer exculpation charter amendments at their 2023 annual meetings.

For 2023, ISS will evaluate on a case-by-case basis proposals to amend governance documents to provide for officer exculpation, taking into account the stated rationale and other specified factors. Additionally, ISS will consider the extent to which the proposal would eliminate liability for monetary damages for violating the duty of loyalty but noted that it will generally not support such proposals even if allowed under state law. Glass Lewis will generally recommend voting against any officer exculpation charter amendment proposals unless a compelling rationale is provided by the board, and the provisions are reasonable (*ie*, they do not go beyond the fullest extent permitted by law).

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In late summer 2022, the SEC's Division of Corporation Finance launched a new comment letter initiative urging targeted public companies to enhance their disclosures about the board's leadership structure and role in risk oversight. The stated reason for the initiative is that the Division Staff have noticed that the disclosure required by Item 407(h) of Regulation S-K has become increasingly standardised rather than tailored to a company's individual circumstances. Disclosure should provide investors with insights about why a company has chosen its particular board leadership structure (regardless of the type of leadership structure selected) or how a company's board is discharging its risk oversight responsibilities in light of the specific challenges facing its business.

In December 2022, the SEC adopted rules that significantly alter the Exchange Act Rule 10b5-1 framework and add substantial new disclosure requirements. The amendments add new conditions to the availability of the affirmative defence to insider trading liability, impose new disclosure requirements regarding officer and director trading plans, insider trading policies and timing of certain stock awards, and amend Forms 4 and 5 to require earlier disclosure of gifts and explicit disclosure of Rule 10b5-1 transactions. In 2023, both the SEC and the US Department of Justice have shown a renewed interest in insider trading, including by bringing an enforcement action and criminal indictment, respectively, against a company executive for alleged misuse of a Rule 10b5-1 trading plan.

In May 2022, the SEC released a sample letter containing guidance for companies on disclosure obligations relating to Russia's invasion of Ukraine. The letter encourages companies to disclose any direct or indirect exposure to Russia, Belarus or Ukraine, new or heightened cybersecurity risk and actions taken to mitigate such risks, as well as known trends or uncertainties impacting the company's financial condition arising from Russia's invasion of Ukraine. Companies are also encouraged to disclose any material impact of import/export bans or supply chain disruptions. Furthermore, the letter addresses critical accounting estimate disclosures, non-GAAP financial measures, and internal control over financial reporting in the context of the Russia/Ukraine war.

Since late 2022, the US Department of Justice Antitrust Division (DOJ) has issued a series of warning letters to companies and individuals with purported 'interlocking directorates', alleging violations of section 8 of the Clayton Antitrust Act, then issued a press release announcing several director resignations in response. Under section 8, an individual or entity is prohibited from serving as a director or board-appointed officer of two or more competing companies. Section 8 has traditionally been enforced as part of the Hart-Scott-Rodino (HSR) merger review process, whereby merging parties submit mandatory information about their businesses and competitive overlaps. With these letters, DOJ signaled that it is willing to dedicate both time and resources to identify interlocking directorates in publicly available information (eg, Form 10-Ks), outside of the HSR process.

Shareholder activism

Shareholders are continuing to engage companies and press for reforms in the areas of shareholder rights and board composition and quality, but they are also increasing their focus on ESG issues, such as climate change, diversity, and board effectiveness, and the impact of ESG issues on companies' financial performance. ESG is no longer a fringe issue of interest only to special issue investors – particularly after the widespread impacts of the covid-19 pandemic and the racial and social justice movements in 2020. Mainstream institutional investors are recognising that attention to ESG and corporate social responsibility affects portfolio company financial performance. The rising interest in ESG among investors is apparent in the sharp rise in US-domiciled assets under management using ESG strategies, increasing submissions of shareholder proposals relating to ESG issues, as well as in the focus of engagement efforts.

The 2022 proxy season saw unprecedented numbers of environmental & social (E&S) shareholder proposals submitted – 564 were filed in 2022 compared to 467 filed in 2021. 33 E&S shareholder proposals received majority support in 2022, a decrease from a record 39 in 2021. The most prevalent types of E&S proposals called for setting and publishing targets for reducing greenhouse gas emissions or conducting independent racial equity and civil rights audits. While the number of E&S shareholder proposals spiked in 2022, average support dropped compared to 2021. Companies are more willing than in the past to negotiate withdrawals with proponents. In the 2022 proxy season, some of the more prescriptive proposals that were not withdrawn and went to a vote received lower support from institutional investors like BlackRock.

There was a decrease in the number of governance-related shareholder proposals submitted and voted on in 2022 – 307 were filed in 2022 compared to 374 filed in 2021. Thirty-five governance-related shareholder proposals received majority support in 2022, down from 54 in 2021. A high concentration of the governance proposals called for companies to enhance shareholders' rights to call special meetings.

Governance-related shareholder proposals were the most prevalent category of proposals submitted in 2021. They primarily addressed the following topics: the right to act by written consent, independent chairs and the right to call special meetings. 38 governance proposals passed, most of which related to majority voting (16 proposals) and shareholder action by written consent (9 proposals).

In July 2022, the SEC proposed rule amendments that would update three of the substantive bases for exclusion of shareholder proposals: the 'substantial implementation' exclusion in Rule 14a-8(i)(10), the 'duplication' exclusion in Rule 14a-8(i)(11), and the 'resubmission' exclusion in Rule 14a-8(i)(12). The proposed amendments would provide the following:

- A proposal may be excluded as substantially implemented if 'the company has already implemented the essential elements of the proposal.'
- A proposal 'substantially duplicates' another proposal if it 'addresses the same subject matter and seeks the same objective by the same means.'
- A proposal constitutes a resubmission if it 'substantially duplicates' a prior proposal, using the same test proposed in the previous bullet.

The proposed amendments represent a continuation of the SEC's efforts to streamline the no-action review process and provide market participants with clear, objective, and specific frameworks for evaluating whether or not a shareholder proposal is excludable under Rule 14a-8.

The most common shareholder proposals filed so far in the 2023 proxy season call for an independent chair, setting and publishing targets for reducing greenhouse gas emissions and requiring shareholder approval for severance pay arrangements.

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Boards are facing mounting pressure from investors to integrate ESG considerations into corporate strategies and operations and to disclose information relating to ESG matters. Activists are increasingly bringing ESG-related campaigns seeking changes to board composition or strategic direction at target companies that they argue will increase the stock price. ESG themes can be the main focus of an activism campaign, supplement activist investors' traditional requests (such as M&A, share repurchases, dividends and director seats), or both.

In November 2021, the SEC adopted changes to the federal proxy rules to require the use of 'universal' proxy cards. The new rules change the methods by which public companies and shareholders have solicited proxies for decades, and allow shareholders to vote for a mix of management and dissident nominees in a contested director election. The new rules will reshape the process by which hostile bidders, activist hedge funds, social and environmental activists, and other dissident shareholders may utilise director elections to influence control and policy at public companies. The new rules also amend certain form of proxy and disclosure requirements relating to voting options and standards that apply to all director elections, whether or not contested. The rules are now effective for shareholder meetings held after 31 August 2022.

In August 2022, ISS issued a special situations research note on the new, mandatory universal proxy card rules instituted by the SEC. In its note, ISS declared the new rules the 'superior' way for shareholders to exercise their voting franchise and observed that this system will make it 'dramatically easier' and 'cheap' for activist shareholders to launch proxy fights. ISS also offered perspectives on how the new system could help activists in their campaigns. Public companies should pay close attention to these perspectives in light of the weighty influence of ISS's proxy voting recommendations on the outcomes of contested director elections. The most notable of ISS's perspectives are that under the new framework, directors' individual qualifications may come into greater focus relative to the merits of an overall slate and that a board's 'weakest' members may now become more vulnerable in a proxy contest.

This 2023 proxy season is shaping up to be an uncommon tempest for companies and shareholders alike: macro-economic conditions are stressing corporate performance, trading multiples are depressed, and — last, but not least — the universal proxy card regime has finally come into effect.

Universal proxy cards dramatically alter how shareholders vote for directors at contested shareholder meetings. Whether they will cause companies, dissidents, proxy advisers, and shareholders to change their behavior in proxy contests has been hotly debated by market participants and observers since even before the universal proxy card rule was originally proposed by the SEC in 2016. Now that universal proxy cards are mandatory for all contested director elections, these predictions are starting to give way to preliminary observations.

Here are some initial key observations as to how the mandated use of the universal proxy card has changed the tactical and legal considerations of a proxy contest so far in the 2023 proxy season:

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- Success in a proxy contest has not been guaranteed by having a slate composed of highly qualified candidates, nor by having a compelling argument that is disconnected from the composition of the slate.
- Dissidents are seeking to exploit the change to candidate-based voting in the universal proxy card to warp settlement negotiations in their favor, leading certain activists to take aggressive settlement positions.
- Taking advantage of the elimination of the 'short slate' rule in the universal proxy card rules, some activists are more frequently nominating larger and 'control' slates to achieve favorable leverage in negotiating settlements.
- Because only validly nominated candidates must be included on a universal proxy card, advance notice provisions are even more important for companies to obtain relevant information about dissidents and their candidates and ensure that dissidents comply with the requirements of the new rules.
- Special interest and other non-traditional activists may seek to leverage the universal proxy card to make nominations and launch proxy campaigns with non-traditional objectives, but despite expressed interest these activists have not yet successfully taken advantage of this possibility in large numbers.

We expect the dynamics of proxy campaigns to remain in flux for several years as activists, companies, and other market participants continue to assess and respond to the impact of the new universal proxy card regime.

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