Executive summary

1. Research

This report concerns the evaluation of the regulation which is, as per 1 January 2014, enshrined in s. 135 (7), Book 2 Dutch Civil Code ('DCC'). This section of the DCC applies to directors of public companies and aims to prevent directors holding shares, depository receipts, or share options in the company of which they are a director, from agreeing to a takeover of the company, or any other major corporate event, out of an interest in personally realising financial gain relating to a rise in share price. The section mandates the furnishment of any gains so realised, by means of deduction of said gains from the director's remuneration. Only securities obtained by the director by way of remuneration are within the section's scope of application. It is in force until 1 July 2017. The minister has promised to assess the effectiveness of the regulation after two years of its being in force having been transpired. This report represents the delivery upon that promise.

2. Methods

In answering the main research question regarding the effectiveness of the regulation, several methods have been used. These methods comprise a study of the legislative history with the aim of a correct interpretation of the law, a study of the relevant legal academic literature, as well as an empirical study of the experience with the regulation's application in practice. To gain insight into the latter, interviews have been conducted at companies to which the regulation was applicable, as well as at two special interest groups for shareholders. To this end, a list has been made of all Dutch companies listed at Euronext Amsterdam, following which the inside dealing registry of the Financial Markets Authority has been consulted, on the basis whereof the researchers could determine which companies had experienced a major corporate event. As regards the sixteen companies resulting from this selection method, the researchers established whether the price of the companies' shares had risen during the relevant period. The remaining eleven companies where a rise in share price was established, were then examined for the applicability of remuneration plans involving shares, depository receipts, and/or share options. This last step resulted in ten companies, comprising eight public takeovers, one legal merger, and one fundamental change as defined in s. 107, Book 2 DCC. Six of these ten companies have been willing to collaborate for this report. An interview regarding the decision-making has been conducted at five of these companies.

3. Findings

The legal academic literature on the regulation can be summarised in two points.

1. It is easy to circumvent the regulation, e.g., by using forms of remuneration not covered by the section's wording.

2. The regulation is not regarded as attuned to the general rules on conflict of interest.

All interviewees have indicated that the regulation did not have any influence on the position and conduct of the directors in decision-making regarding major corporate events, the reasons for which being that (i) in practice, the supervisory board is highly involved in the decision-making, (ii) directors will not give priority to their personal interest because of their business ethics as well as their awareness of the primacy of the company's interest, and (iii) directors' incentives are, to a higher extent, determined by personal reputation and career perspectives.

An indicated side effect of the regulation is that it has a negative impact on the relationship between the board of directors and the supervisory board (in a period of time in which good cooperation between the two boards is of great importance), *inter alia* while the supervisory board administers the application of the regulation. Moreover, it has been indicated that the complexity of the regulation, e.g., regarding the question whether its scope extends to certain forms of remuneration, gives rise to high costs in terms of both time and financial expenditure. Also, the regulation can form an incentive for directors to end their directorship prematurely in advance of the first reference date at which the regulation is triggered, particularly if they are not offered a position in the company after the major corporate event. It was also indicated in the interviews that the regulation could interfere with the alignment-philosophy often underpinning remuneration policy agreed by the company in general meeting. These policies aim to align the interests of directors and shareholders. A related side effect is that practice has demonstrated attempts made to negate the interference with the alignment philosophy, e.g., by offering a director a higher amount of financial compensation at a moment in time after the major corporate event.

Points of attention for the case in which the regulation is continued are, firstly, that it will prove very difficult, to redraft the regulation so as to cover all forms of remuneration linked to share value development. Secondly, the statutory reference dates deserve attention. For example, the trigger date related to a legal merger is the day of the announcement of the merger, while in practice a share value increase might have manifested itself prior to such date on the basis of a previously published press release. This also applies generally to any information which is published prematurely (e.g., as a result of a leak). It appears hardly feasible to adapt the regulation so as to deal with such eventualities effectively. A related point is that the reference dates related to major corporate events as described in s. 107a, Book 2 DCC are linked to the convening date of the general meeting, and not to the (earlier) immediate publication of inside information as is mandatory pursuant to the Law on Financial Supervision. If, however, the first reference date were to be changed to said date of immediate publication, the timeframe between the first and the second reference dates may be very large. The larger this timeframe, the more the share price may be influenced by external factors unrelated to the major corporate event. In general, it can be concluded that the reference dates appear somewhat arbitrary. Thirdly, the purchase price in case of a mandatory bid is statutorily regulated, for which reason the regulation should not be applicable to mandatory bids. Fourthly, the regulation only covers three explicitly listed situations of s. 107a, Book 2 DCC, but not the broad description of events in the section's first paragraph. This, to the opinion of the researchers, does not align with the spirit of s. 107a. Fifthly, questions arise regarding the regulation's scope of application, when viewed in light of the proposal for a new Corporate Governance Code, which includes the possibility for supervisory directors to be remunerated in shares. The question arising in this regard, is whether the regulation should be applicable to supervisory directors, too, and, in such event, who should administer the application of the regulation. Sixthly, under current law, there is no instance of reporting regarding the application of the regulation, or such report is published only after an extended period of time. This relates to the fact that the obligation to report on the application of the regulation (s. 383c (6), Book 2 DCC) only arises in the year in which director's gains are furnished to the company, as well as with the fact that some companies might not be under the obligation to publish (full) annual accounts after a major corporate event, or might not continue to exist as a separate entity after such event.

In the context of the question whether the regulation should be maintained, it deserves attention that the absence of a regulation such as the section currently in force does not appear to negatively affect the protection of the company against incentives which could impede the propriety of decision-making procedures. With regard hereof, the importance of the company's governance structure and the role of the supervisory board therein should be stressed. In practice, the supervisory board can be seen to professionalise, and forms of regulation such as the Corporate Governance Code show an intensified expectation of cooperation between the board of directors and the supervisory board in control transactions. Also, the researchers would want to emphasise that the situations covered by the regulation are also covered by the general rules on conflicts of interest, which, under current law, also cover the situations listed in the regulation. If the legislator were to elect for continuation of the regulation, discretionary powers for the supervisory board could be considered. Such discretionary powers would allow for a more nuanced weighing of the facts and interests involved in the case at hand (such as the influence of external factors on the share price). Discretionary powers would also be better attuned to the existing rules assigning the supervisory board with powers to claw back variable remuneration.

4. Conclusion

The research conducted does not lead to the conclusion that the regulation is effective. It does show that the consistency of the regulation is debateable, as well as that the regulation harbours a number of objectionable side effects.