Business Law

Chapter VII – Corporate Governance

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1. Introduction

- Corporate governance, by consisting of the system through which companies are directed and controlled, aims to protect shareholder rights, enhance disclosure and transparency, facilitate effective functioning of the board and provide an efficient legal and regulatory enforcement framework. It addresses the 'Principal/Agency' problem through a combination of Company Law provisions, stock exchange listing rules and self-regulatory codes.

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- The movement towards more democratic forms of corporate governance, empowering owners by creating new forms of accountability is important not only for creating wealth. More vigilant shareholders are also more likely to be “socially responsible”, in the true meaning of that term, thereby increasing triple bottom line returns, through adding economic, environmental and social value.
- The initiatives for improvement in corporate governance stem mainly from three sources, namely, Market, Regulatory and Legislative.

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- The legislative initiative is directed at streamlining the existing corporate legal framework, including certain fundamental provisions relating to corporate governance. In contrast, dynamic aspects of corporate governance, such as disclosures and accounting standards, are being pursued through regulatory initiatives.
- However, the most prominent role in this context is played by market forces and mechanisms which encourage and promote improvement in the quality of governance by fostering and incentivising better practices of accountability and transparency in corporate management.

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- In a country such as Portugal, where there are only a limited number of companies with more than half of their share capital in free-float, and where the free trade in shares, as well as shareholder assessment of management bodies' performance, are impaired by the existence of defensive mechanisms such as golden shares or capped voting rights, it is fundamental that a legal and regulatory framework encourages companies to raise their management standards, aligning themselves with those of most European countries, in accordance with the principle of transparency.

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- The momentum is for maximising shareholder value, fostering shareholder activism and rendering boards accountable in their management of companies.
- The growing media and public interest in governance issues, in particular investor concerns with corporate governance practices and the need for transparency in corporate management, has led the Portuguese law maker and regulators to develop and reform the legal framework in order to adjust it to market changes, globalisation and the internationalisation of companies.

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- The Portuguese legal and regulatory framework on corporate governance includes not only regulations and recommendations from CMVM, but also specific legal provisions from the Portuguese Companies Code and the Portuguese Securities Code. CMVM recommendations (as opposed to mandatory regulations) gained binding force in light of the amendments to Regulation 7/2001, enshrining provisions requiring all companies to disclose, in an annual corporate governance report, those recommendations which they have not followed, and to explain every non-compliance (the so called “comply or explain” principle).

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- In this sense, the influence of the Action Plan on corporate governance and company law presented in May 2003 by the European Commission, focused on the requirements to disclose information by boards and on an increase in shareholder influence over the company, setting limits on the ability of national governments and companies to obstruct international takeover operations that may result in the transfer of decision centres to other countries, is determinant on the drive imposed on recent Portuguese corporate governance provisions.

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- Effectively, in 2003, CMVM amended Regulations 11/2000 and 7/2001 with Regulation 11/2003, implementing the Action Plan and EU Commission Recommendation regarding independence of auditors.
- This amendment also added new information and disclosure obligations, namely through the company's website. The main goal is to raise the regulatory standard applicable to domestic companies, thus fostering investor trust placed in the Portuguese stock market.
- Regulation 7/2001 was later amended by Regulations 10/2005 and 3/2006.

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- Regulation 11/2000 was subsequently replaced by Regulation 4/2004, as amended by Regulations 10/2005, 3/2006 and 5/2006.
- The provisions on corporate governance are primarily aimed at publicly traded companies, but they may also play an important role in setting standards for corporate governance in private or State-owned companies.

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2. Disclosure of Information and Transparency

- Both CMVM's recommendations and regulations provide that companies are bound to disclose information on preparatory documents for general meetings as well as financial information, through the use of new technologies.

- The applicable provisions of the Portuguese Companies Code dispose that preparatory information must be made available to shareholders in the 15 days before general meetings and also that shareholders have the right to accurate and complete information at the general meetings, concerning subjects under discussion, namely referring to relations between the company and other companies, which are paramount.

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- They also entitle shareholders to, during the general meeting, request complete and clear information on the subjects under discussion. This information may only be refused if disclosure may seriously harm the interests of the company (or another with which it is in a group relationship) or if disclosure is prohibited.

- CMVM Recommendations advise in this sense on the implementation of mechanisms to promote equal access to information for all shareholders. Recommendations II.1.1.2 and III.1 advise the creation of an internal system for risk control, which should also specifically promote the disclosure of information on the matter of assessment of risks inherent to the company's activities.

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- Recommendation II provides for the disclosure of remuneration of each board member and advises the remuneration committee to submit to the general meeting a document outlining its recommendations on the attribution of remunerations for the following year and also a general explanation of the previous year's remuneration distribution policy.
- Plans for the allotment of shares and/or stock options to employees and/or members of the board of directors must be submitted to CMVM, following the applicable provisions of CMVM's regulations.

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- Duties of communication outlined by these provisions also refer to the acquisition or disposal of shares, by the members of the board of directors of a subsidiary or its parent company, as well as the number of shares held by that subsidiary and the percentage of voting rights counted according to Article 20 of the Portuguese Securities Code.
- Such duties of information must be complied with within 7 working days of the transaction and/or relevant allocation, which, in the issue of shares, is deemed to be signature of the public deed.

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- The amended Regulation 7/2001 also requires that all companies, who issue shares to be negotiated in regulated markets, provide up to date information that includes the following:

(i) Corporate name and head office;

(ii) Articles of association;

(iii) Identification of members of the corporate bodies;

(iv) Investor's Advice Bureau or a similar service;

(v) Proposals to be submitted at the general meeting.

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- The information is to be made available through an Internet site, observing the respective requisites.
- Accuracy of the disclosure of the level of compliance with CMVM recommendations in the annual company report, as well as detailed information on the management structure, are specific information duties by which companies are bound.

2.1. Independent Directors

- Portuguese boards tend to differentiate between non-executive and independent directors, and to include a certain number of both. Non-executive directors can be independent or not and this definition of 'independence' is linked to the non-representation of dominant shareholders of the company.
- It is recommended that the board includes a number of independent directors. Ideally, the majority of non-executive directors should be independent, not only from shareholders, but also from any operational business of the company.

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- Their role is important in representing the interests of minority shareholders and in overseeing executive directors in financial areas and matters affecting the strategy and future of the company, as well as, in areas where executive directors may have conflicts of interest.
- Independent and non-executive directors also have an important role to play in appointment and remuneration committees and audit boards.

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- Finally, and in line with CMVM, the appointment of independent executive directors is also recommended, in order to prevent corporate decisions from being taken in the interests of dominant shareholders alone and to ensure that the best interests of the company are preserved.
- Regulation 7/2001, as amended by Regulations 11/2003, 10/2005 and 3/2006, sets out certain criteria for determina-tion of the independence of the board members. Article 1 lists those who cannot be considered independent directors:

(a) Members of the board holding cross-directorships;

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b) Members of the board holding qualified shareholdings of at least 10% of the company's share capital or voting rights or equal holdings in a controlling or group company;

(c) Members of the board who are employed or carry out duties of management in a competing company;

(d) Members of the board earning remunerations from the company, or of other companies with a controlling or group relationship, except for the remuneration earned when carrying out duties of management;

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(e) Members of the board which have a significant commercial relationship with the company or with other companies which are in a group relationship with the former;

(f) Members of the board who are married or have close family ties with any of the abovementioned individuals;

(g) Members of the board which are associated with any specific interest groups in the company or which are in a situation deemed capable of affecting their analysis and decision-making independency.

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- Ownership of stock or affiliation with a dominant shareholder does not itself preclude a member of the board from being independent, except where the shareholding is 10% or higher.
- Finally, the board has the power at any time or in light of the emergence of new information to assess the independence of its members.

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2.2. Annual Report on Corporate Governance Compliance

- Regulation 7/2001, as amended, disposes that companies must prepare, as an annex to the annual management report, an annual report on corporate governance compliance.
- Effectively the “comply or explain” clause, previously included in paragraph 2 of the annex to Regulation 7/2001, as amended, has now been shifted, unchanged, to a new Chapter 0 of the Annex, according to which, wherever the company fails to comply with any of CMVM’s recommendations, it must provide explanation for such non-compliance.

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- Chapter I of the annex stipulates the information that the report must contain:

(i) Diagrams showing the distribution of responsibilities between the different corporate bodies and departments of the company;

(ii) Description of the risk control system;

(iii) Description of the increases or decreases in stock quotation;

(iv) Description of the company's policy for the assessment of dividends; the new version of the annex adds the need to disclose the value of every share distributed over the last three financial years;

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(v) Detailed description of the main characteristics of the schemes for the allotment of buy options for shares adopted or valid in the financial year in question and disclosure and thorough explanation of any share non-transferability clauses;

(vi) Reference to the existence of an Investor Relations desk or equivalent body, and description of its responsibilities in the company's website on the Internet;

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(vii) List and description of the committees created by the company, namely a remuneration committee, an ethics committee, an investment committee and a committee for the assessment of corporate structure and governance;

(viii) Description of transactions made between the company and members of its board(s), committees and departments, or any relevant owners of preference shares, or held in parent companies;

(ix) Disclosure of the independent and non-independent members of the remuneration committee.

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(x) Disclosure of auditor remuneration and of auditing services fees.

(xi) Description of the internal risk-control system.

- Chapter II of the annex to Regulation 7/2001, as amended, stipulates which information must be disclosed in the report, with regard to the exercise of voting and representation rights, namely concerning postal voting, the introduction of the possibility of electronic voting, existence of a mandatory time period between the receipt of votes and the general meeting and determination of the number of shares required to exercise voting rights.

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- Chapter III of the annex to Regulation 7/2001, as amended, determines which information concerning the company's rules, must be disclosed by the report:

(i) Description of internal procedures adopted to monitor risks inherent to the activities of the company, namely the existence of risk management units.

(ii) Indication of existing restrictions which may impede potential takeovers, especially caps on voting rights, special rights held by any shareholder, or shareholders agreements.

(iii) Codes of conduct adopted by the company regarding all matters in general, as for instance, codes of conduct in conflicts of interest, secrecy and incompatibility, and the means provided to shareholders, for accessing those codes and regulations.

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- Chapter IV of the annex to Regulation 7/2001, as amended, concerns the management structure and stipulates which information must be disclosed by the report:

(i) Board structure and identification of board members, with distinctions between executive and non-executive, as well as independent and non-independent, including professional qualifications and positions held in other companies of the same group;

(ii) Existence of an executive committee, or other committees, with management duties, including a description of the duties and composition of those committees, as well as discrimination of independent and non-independent members;

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(iii) Indication of whether remuneration of board members is dependent on the results of the company or share price performance;

(iv) Indication of payments awarded to all members of the board, distinguishing between executive and non-executive members and the fixed and variable part of the remuneration, disclosing the amounts paid by other companies of the same group;

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(v) Description of how the board exercises effective control over the company, particularly information regarding:

- matters brought before the executive committee;
- matters that are not open for discussion in the executive committee;
- number of meetings held by the board during the year in question;
- procedures put in place to ensure that the members of the board are aware of the subject discussed by and decisions made by the executive committee and information disclosed to this effect;

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- distribution of competencies between the president of the board and the president of the executive committee;
- confidentiality duties concerning matters discussed by the board;
- conflicts of interest within the board, and the maximum number of positions which directors may hold on the boards of other companies.

3. Exercise of Shareholder Rights

3.1. Exercise of Shareholder Voting and Representation Rights

- The cornerstone of CMVM's Recommendations is the promotion of shareholders' activism and power by encouraging companies to develop legal and technical mechanisms that will foster frequent exercise of voting rights and participation at general meetings. In this sense, they vigorously advise the active use of voting rights, whether directly or by proxy, and the withdrawal of any statutory restrictions.

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- Voting by proxy, by one or more than five shareholders, is governed by the applicable provisions of the Portuguese Companies Code, which ensure that they are provided with clear and complete information on the matters to be discussed and voted on in a general meeting. These principles are further developed by the Portuguese Securities Code.
- The mandatory blocking' of voting shares before the general meeting for a period longer than 5 working-days is deemed to be a restriction on the exercise of voting rights.

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4. Minority Shareholder Rights

4.1. Introduction

- As the practice of investing in capital markets gains ever increasingly in popularity, the single most important factor to investors is investment security. They have a clear need to know that the necessary steps have been taken in order to safeguard their interests and this, ultimately, is linked closely with the existence of good corporate governance practices.
- Put simply, corporate governance is about striking a sensible balance between ownership and control in companies and its most basic premise is to maximise shareholder value through practices such as openness, transparency and shareholder democracy.

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- Shareholder democracy, as a fundamental part of the different processes that govern a company, enables shareholders, through the exercise of their voting rights, to elect the board of directors and make decisions which are of core importance to the company.
- Effective exercise of the voting rights of shareholders will need to ensure that they have the right to make proposals at general meetings and to receive adequate and correct information.

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- A well functioning shareholder democracy must also ensure that the board of directors consists of qualified individuals who are able to promote the interests of all shareholders and control the management of the company to prevent potential conflicts among shareholders on typical matters of overall corporate policy and strategy.

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- The treatment of minority shareholders provides a good indication of the degree to which such democratic values have been instilled into a company's operations and as such may be regarded as one of the key indicators of a healthily functioning corporate governance regime.
- Effectively, minority shareholders may be defined as those that hold the minority of voting rights capable of being cast at general meetings.

4.2. Current Portuguese Investment Environment

- Portugal has keenly demonstrated its willingness to attract and facilitate investment.
- The resulting surge in takeover offers has begun to ignite the capital markets where some of the country's biggest and most visible companies are the centre of intense battles for control. These events have attracted attention from private and institutional investors, hedge funds and private equity, alike.

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- For the smaller investor Portugal is no less of an intriguing opportunity for lucrative business. Nevertheless, the investment landscape in Portugal still consists of a fairly high concentration of shareholdings under the control of just a few shareholders.

- Given such circumstances, minority shareholders will benefit from increasing their awareness of what protection they are afforded by the law wherever confronted by the more powerful interests of these larger stakeholders.

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- The following section will consist of a brief introduction to minority shareholder rights, as they stand under the provisions of Portuguese law, and as such may prove to be of particular interest to anyone considering the possibility of investing in Portugal.

4.3. Protection of Minority Shareholder Rights under Portuguese Law

- The existing legal framework which governs minority shareholder rights is spanned across numerous provisions of the Portuguese Companies Code and Portuguese Securities Code as well as the regulations and several recommendatory documents issued by CMVM.

- It makes the protection of such rights its objective, both in public and privately-held companies, by specifically addressing the following corporate matters:

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(a) Shareholder voting rights.

- The basic principle of "one share-one vote" is set out in Article 384 of the Companies Code. Accordingly, wherever not contractually stipulated otherwise, all shareholders holding ordinary shares have the right to vote, all votes have the same weight and only the shareholders may vote. This rule is applicable to both private and publicly held companies.

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- However, the company's articles of association may include provisions setting out a minimum number of shares (not to exceed a value equivalent to € 1,000 of the nominal share capital) necessary to grant a single vote, thereby preventing attendance at general meetings by those investors holding very few shares or a low amount of share capital.

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- Notwithstanding, company law does not neglect the interests of individual and minority shareholders since it allows them to aggregate their shareholdings in order to meet the minimum value or number of shares required by the articles of association, and therefore to appoint an individual from among themselves who will act as their representative at the general meeting.
- In limited companies each shareholder has one vote per Euro cent of the nominal value of its shareholding. Shareholders with less than 20 per cent of the company's share capital may be statutorily allowed to have two votes per Euro cent.

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(b) Electronic voting.

- One of the Portuguese lawmaker's priorities has been to meet the new developments in technology, thus adapting the existing legal framework.

- Following the strategy of the so-called 'Green Book for the Information Society in Portugal' ("Livro Verde para a Sociedade da Informação") drafted by the Information Society Commission and approved on 17th April 1997 by the Portuguese Council of Ministers, the National Initiative for Electronic Commerce was created in 1998 and several important laws have been enacted, some of them with direct impact on companies such as those on electronic documents and electronic signatures and another on the equivalence between digital and paper form invoices.

- Internal Operation of a Company: General Meetings and Electronic means of participation.

- Voting by electronic means at general meetings is permitted. However, its proliferation clearly presupposes the promotion and development of an adequate technical infrastructure.

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- This is an important development in relation to minority shareholders, particularly in a globalised context of international investors, as it virtually eliminates otherwise potentially prohibitive travel costs by allowing the shareholder with a minority shareholding to participate alongside larger shareholders in the voting process on a much more level playing field.

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(c) Rights to information access.

- The Portuguese Companies Code grants those minority shareholders holding at least 1 per cent of the overall share capital the right to access any information, regarding the company, as and when it may be required by them. The shareholder who has been refused this information may file court proceedings.

- The disclosure of preparatory documents for general meetings, for shareholders with at least 1 per cent of the share capital, can either be sent by email or else made accessible through the company's website.

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- However, all electronic documents and signatures must satisfy the legal requirements of the written form, in the same manner as a declaration or statement satisfies the civil law requirements of the written form.
- Any shareholder of a limited company has the same right to information, as well as a right to consultation and inspection of the company's documents.

(d) Power to call a general meeting.

- The shareholder with at least a 5 per cent holding can call a general meeting to discuss a particular agenda or can add a particular issue to one which has already been called but not yet convened.
- In the case of limited companies, any shareholder will have these same rights.

(e) Appointment and dismissal of directors.

- Appointment rights

- The Portuguese Companies Code provides for a mechanism that can be utilised as a protective device to safeguard minority interests whereby it is possible to stipulate in the articles of association that directors can only be appointed by a specified majority.

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- Furthermore, special rules on the election of directors provide that certain shareholders may submit a list of nominees/candidates for this purpose, the number of whom will vary according to the total number of directors within a given company. This list may be submitted only by those shareholders who hold between 10 and 20 percent of the overall share capital.

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- Equally, according to paragraph 6 of the same article, it may be stipulated in the articles of association that the minority shareholders who, during the election, voted against a winning list may appoint one director providing they hold at least 10 percent of the share capital.

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- Dismissal rights

- According to Article 386 of the Portuguese Companies Code, directors are appointed and dismissed by means of the general meeting. The required majority is a simple majority of votes, whereby one vote will correspond to each person present, and not according to the distribution of the share capital.

- However, the articles of association may specify a requirement for an absolute majority, and make it conditional on the ownership of a certain percentage of the share capital, which may include the minorities.

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(f) Director accountability.

- Directors may be held both civil and criminally liable by the company or the shareholders for any acts or omissions where they have not respected, or else have neglected to protect, the rights, needs and best interests of the company or the shareholders.

- Shareholders representing at least 5 per cent of the share capital can file court proceedings on behalf of the company against directors who have failed in their corporate duties and obligations.

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(g) Veto over certain management and policy matters.

- Veto powers for a certain director can also be set out in the articles of association, in the sense it maybe specified therein that certain resolutions must also be passed by a certain number of directors, including the one representing the minority.

(h) Dividends policy.

- The company is bound to distribute half of its profits. It may, however, distribute less wherever there is a clause to this ef-fect in the articles of association, or such a resolution has been passed by at least a 75 per cent majority of the shareholders at a general meeting. The same applies to limited companies.

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(i) Prevention of dilution of the equity stake.

- To prevent dilution of the equity stake, articles 85, 87 and 456 of the Companies Code stipulate that increases in the share capital, wherever not previously specified by the articles of association, constitute an amendment to the same.
- Therefore, the resolution necessary to authorise such an increase will need to be passed by an absolute majority, which can be trained in such a way as to require the votes of the minority shareholders.

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(j) Limitations to the transfer of shares/pre-emption rights.

- Article 328 of the Companies Code states that the transfer of nominative shares can be limited in certain circumstances, but not excluded, via the articles of association. These limitations include the following possibilities: that the transfers are submitted to the prior authorisation of the company, or that certain pre-emption rights, or other criteria with respect to the commercial interests of the company, are observed.

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- The company can refuse authorisation based on any motives specified in the articles of association or, in their absence, on just cause of protection of the interests of the company.
- If this company refuses authorisation for the transfer of shares in question, either on the basis of certain criteria foreseen in the articles of association or on the basis that the interests of the company will not be served, it must then find another buyer, on the same terms.

(k) “Compulsory sale mechanism”.

- The Portuguese Securities Code and the Portuguese Companies Code also provide protection for minority shareholders, who, as a consequence of a takeover bid, are left, directly or indirectly, with less than 10 per cent of the voting rights of the target company.
- Their stakes must then be acquired within six months following closure of the offer (compulsory takeover bid or “squeezing out mechanism”). This mechanism applies to both joint stock and limited companies.

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- Should the controlling shareholder fail to submit the respective proposal to buy out minority shareholdings, each of the minority shareholders can, by means of written notification, oblige the acquirer to make an offer for the shares ("compulsory sale mechanism").
- Moreover, in compulsory acquisition proceedings, equal treatment of shareholders of the same class must be assured, in particular with regard to the calculation of the consideration for the shares.

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(I) Veto powers.

- The minority shareholder holding more than one quarter or one third of the voting rights, in a limited company or a joint stock company, respectively, will have the power to veto the passing of resolutions to approve changes to the share capital structure, mergers, demergers or any other transformations of the company, as well as amendments to the articles of association.

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4.4. Shareholders Agreements

- When a minority investment is made a shareholders agreement may be drawn up to set out basic rules about the treatment of minority shareholders in relation to the functioning of the company and how it will be run by the directors. As such these agreements often constitute an effective means to regulate the unrestricted power of the controlling majority.
- However, they must also find the right balance by ensuring that minority shareholders do not have disproportionate rights or the rights to be generally obstructive either.

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- The criteria for exercising the rights of minority shareholders may be the target of shareholders agreements clauses in relation to the following matters:
- Approval rights reserved for shareholders;
- Powers to appoint directors;
- The right to elect the chairman and his powers;
- Tag along and drag along rights;
- Quorum and majority provisions;
- Minimum dividend;
- Restrictions on share transfers;
- Pre-emption rights on new share issues.

4.4.1 Information Rights

- Minority shareholders may also seek to impose an obligation on the directors that they provide regular reports on the business.

- The rights of shareholders to receive such information are otherwise rather limited.

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- Provisions within shareholders agreements concerning information rights will address the mechanisms to effect such flows wherever a given shareholder statutorily, and most frequently for reasons attributed to the minority of its stakeholding, is not empowered to obtain such information.

- The most common clauses in this regard dispose that several shareholders may combine their stakes and votes to reach the minimum level required to obtain access to information.

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4.4.2. Management

- Management control may also be addressed by specific provisions of shareholders agreements. Although management structure of the joint venture company will be defined by the articles of association, matters such as balance of powers, appointment rights and devices to prevent conflicts of interest are preferably defined in the shareholders agreement.

- Shareholders agreements provisions will address agreed criteria to differentiate operational management decisions from major shareholder decisions as well as the veto rights of directors.

4.5 CMVM: A Code of Best Practice

- Codes of best practice are designed to protect the interests of minority investors, improve the accountability of companies and maximise shareholder value.
- Although the documents are non-binding sets of principles, they do require listed firms to disclose whether or not they abide by the codes - the so-called "comply or explain" approach.
- Hence, non-compliance will generally carry a cost to the company in the form of a not insignificant discount in the value of the share price.

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- The Portuguese Stock Market Supervisory Authority (“CMVM - Comissão do Mercado de Valores Mobiliários”) is responsible for drafting and issuing Portugal’s code of best practice which, with its regulations and recommendations on corporate governance, has played an important and complementary role to the existing legal framework.
- Surveys carried out by CMVM have indicated that year on year companies have shown improvement in the number of recommendations which they have adopted.

4.5.1. Independent Directors

- CMVM recommends that in public companies the board also includes a number of independent directors not representing the interests of the majority shareholders and in this sense they provide important input in the life of the company.

- Independent directors bring to the table a wide range of experience, knowledge and judgement as they draw on their varied proficiencies which helps to foster varied, unbiased, independent and experienced perspectives and companies benefit immensely from their inputs in achieving strategic direction.

- Accordingly, their role is of significant importance in representing the interests of minority shareholders and in overseeing executive directors in both financial and other areas that affect the future of the company, as well as those where executive directors may potentially have conflicts of interest.

4.5.2 Disclosure of Company Information by Electronic Means

- In accordance with CMVM Regulations, companies listed and admitted to trading on the Portuguese regulated market, located or operating in Portugal, are required to maintain an updated and publicly accessible website.

- It must display all the most basic information of interest to shareholders and potential new investors, including the company's identity and registration, the identity of members of the board of directors, details of its accounts, earnings and other financial statements, dates and reports of general meetings, and proposals presented for discussion and voting at these events.

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- The aim of these provisions is to improve the efficiency of securities markets via the use of electronic means, while ensuring the integrity of the markets in general and, in particular, the protection of investors and the quality of the information disclosed.

- It simplifies the process of preparing general meetings, which is critical given the demands imposed by increasingly globalised markets with stakeholders in multiple locations.

4.6 Shareholder Democracy: Further Considerations

- The principle of "one share, one vote" is the most fundamental tenet of shareholder democracy and has clear implications for the building of investor confidence in a given company.
- However, data recently gathered in a Deminor survey has indicated that 35 per cent of all companies in the FTSE Eurofirst 300 index have some sort of mechanism in place for defending themselves against this principle.

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- Fortunately, significant steps are being taken towards achieving a better integration of shareholder democracy in European companies with the ultimate objective of having the “one share, one vote” principle accepted unanimously across the region.
- Given the enormous variation in many factors among Member States, getting this passed in all of them will not be an easy task but success will be good for Europe’s economy and for the tens of millions of investors currently denied their rights.

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- For the time being, the EU Takeover Directive sets out important provisions on the use of defensive measures, restrictions on votes and multiple voting rights. It also affords better protection to minority shareholders with its amendments concerning the acquisition of companies.
- Any company launching a takeover bid to buy all the target company's shares is obliged to do so at an equitable price and, under the new compromise, the definition of "equitable price" is more generous to minority shareholders.

5. Defensive Devices against Takeover Bids

- Defensive devices against takeover bids are regarded as being disruptive of the so-called market for corporate control. Such devices frequently prove incompatible with shareholders' interests wherever they seek to frustrate hostile takeover bids at all costs, thereby protecting the interests of incumbent managers rather than those of the shareholders.

- In effect, hostile takeover bids are often considered an effective means by which shareholders may replace badly performing managers.

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- Some of the most significant consequences of these defensive devices are that shareholders, who neither have management control nor are able to exercise the voting rights corresponding to their shareholdings, see their stakes highly depreciated.

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- Therefore, the applicable provisions of the Portuguese Securities Code stipulate that, from the moment the target company acquires knowledge of the takeover bid to the final assessment of the result, the board may not take any action exclusively aimed at frustrating such bid.
- The Portuguese Securities Code specifically addresses this matter by preventing the board of the target company from practising any act that may materially affect the net asset situation of the company; thus, frustrating the objectives announced by the offeror.

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- During the standstill period, the board may only practise acts of day-to-day management of the company, and is bound by the bona fide principle.
- Exception is made for:

a) acts which are a consequence of the fulfilment of obligations undertaken before the board becomes aware of the takeover bid;

b) acts authorised by a resolution passed by a special two thirds majority of the voting rights at a general meeting exclusively called for that purpose during the offer period, and

c) acts involving the soliciting of competing bids.

5.1. Capital Increase

- The Portuguese Securities Code provides examples of what may constitute a relevant or material change in the net assets of the target. One of them is precisely the issue of shares or other securities conferring the right to their subscription or acquisition.

- Moreover, the issuance of any other securities during the standstill period, such as bonds, is also considered a material change in the net situation of the target.

- Thus, the use of a defensive strategy such as Macaroni defence, where the target company issues a large number of bonds that come with the guarantee that they will be redeemed at a high price if the company is taken over, is prohibited during the standstill period.

5.2. White Knight

- The target company is allowed to seek alternative bids, the so-called white knight ("The knight in shining armour gallops to the rescue"), which shall be formalised through a competing offer. Competing offers may be launched for at least the same quantity of securities as that of the initial offer and the consideration of these should be at least 2% higher than that of the initial offer, and cannot enshrine less favourable conditions.

- However the target company is not allowed to finance directly or indirectly, partially or totally, or in any other way financially assist the white knight's bid.

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- Furthermore the target company is not allowed to provide solicited competing bidders with any type of privileged information.

- The white knight may only acquire securities issued prior to the standstill period. As mentioned above, the issue of new shares and other securities during this period is deemed to be considered as a material change in the net assets of the target company and, thus, it is not allowed.

5.3. Crown Jewels

- The target company is also deterred from entering into contracts representing the sale of important parts of the company's assets (or crown jewels) or of all the company's assets (corporate suicide) during the standstill period.

5.4. Golden Shares

- Golden shares held by the Portuguese State in companies operating in areas considered of strategic interest to the Portuguese economy permit the right of veto on strategic M&A decisions or the right to intervene in dealings affecting important company assets.
- Compatibility of the golden shares held by the Portuguese State in terms of the EUF Treaty has already been addressed by the European Court of Justice (ECJ) in the context of the Law regarding privatisations.

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- Specifically on golden shares, the ECJ held that, depending on the circumstances, certain concerns may justify the retention by Member States of a degree of influence within companies that were initially public but have been subsequently privatised, where those companies are in the public interest or provide strategic services.
- Accordingly, golden shares are not in themselves contrary to the EUF Treaty.

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- In fact the European Court of Justice has stated on several occasions that government influence in companies could be justified where these companies supply services that are in the public interest or of strategic importance.
- However, the specific manner in which the rights they confer are exercised by the State should not restrict the exercise of the freedoms provided for by the EUF Treaty, including the free movement of capital.

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- This means that the rights they provide for must be proportionate to the aim pursued, inasmuch as the same objective could not be attained by less restrictive measures, they should not be discriminatory on the grounds of nationality, and their exercise should follow precise criteria rather than a discretionary power.
- Ultimately, with regard to takeovers, golden shares should not allow the State to veto acquisitions in Portuguese companies above a certain threshold.

5.5. Multiple Voting Rights

- Multiple voting rights are forbidden by the Portuguese Companies Code. Exception is made, however, for companies that had this provision enshrined in their Articles of Association prior to the enactment of the new Companies Code (1986).
- These companies can lawfully continue to use such a device.

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5.6. Maximum Voting Rights - Breakthrough Rule

- Voting caps leave Portuguese listed companies with reduced trading volume in the stock exchange and therefore with low market capitalisation.

- The breakthrough rule now in force in the Portuguese legal framework is aimed at facilitating takeover activity, enforcing the one share - one vote principle, as the degree of control that shareholders exercise should be proportionate to the degree of risk which they take, and provides for contractual and property rights to be broken through where they are exercised in ways which inhibit legitimate bids.

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- Voting caps are also a guarantee that the control of the company remains in the hands of the so-called “blockholders” or “national champions”.
- Voting caps, known in Portuguese as “blindagem de estatutos” (literally, “armouring the company’s articles of association”) is a quite common device among Portuguese listed companies.
- They leave Portuguese listed companies with reduced trading volume the stock exchange and therefore with low market capitalisation.

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- In this sense voting caps would have to be regarded as having no effect, during the time of acceptance of the bid at the general meeting deciding on any defensive measure against a hostile takeover bid.
- Restrictions on the transfer of shares or rights to its subscription or acquisition would also have no effect vis-à-vis the offeror during the period of acceptance of the bid.

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- Furthermore, voting caps or special rights on the appointment or removal of the board would have to be regarded with no effect at a general meeting held immediately after the bid, in order to amend the offeree's articles of association or to appoint new board members, when the offeror becomes a majority shareholder with 75% or more of the shares or voting rights, following the bid.
- There are two exceptions to the breakthrough rule. It does not apply when restrictions are compensated for by specific pecuniary advantages, and it does not apply to legal golden shares held by Member States.

5.7. Poison Pill

- Poison pills are designed to automatically decrease the value of the company's assets in case of a takeover bid and may also imply a capital increase. Therefore such instruments are forbidden by provisions of Article 182 (2) (b) of the Securities Code.
- Such prohibition is only valid during the standstill period, hence, only poison pills of the flip-in type are not allowed, as opposed to poison pills of the flip over type.

6. Board of Directors

- Pursuant to the applicable dispositions of the Portuguese Companies Code, joint stock companies must adopt one of the following three management structures:

(a) A unitary management structure, which consists of a board of directors ("Conselho de Administração"), overseen either by:

- a fiscal board ("Conselho Fiscal")
- a single auditor ("Fiscal Único") or
- a fiscal board and a statutory auditor ("Revisor Oficial de Contas");

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(b) A dual structure in which management powers are shared between an executive board ("Conselho Executivo") and a supervisory board ("Conselho Geral e de Supervisão"), overseen by a statutory auditor.

(c) A new structure, inspired by the Anglo-Saxon model, consisting of a board of directors which includes an audit committee ("Comissão de Auditoria"), and a statutory auditor ("Revisor Oficial de Contas").

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- The unitary board structure may involve the appointment of an executive committee whose powers, however, may not encompass decisions which might affect control of the company or its assets and thus interests of the company or shareholders.
- It is recommended that the relationship between the executive committee and board of directors may be governed by carefully drafted internal procedures, in accordance with the principle of transparency, and the board may be permanently and regularly informed of the committee's activities.

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- The recommendations advise companies to create internal control committees for the assessment of matters from which actual or potential conflicts of interests may arise, such as the nomination of directors and managers, remuneration policy, assessment of corporate structure and governance.

6.1. Remuneration Policy

- The implementation of remuneration policies is underpinned by a set of procedures concerning compensation schemes and overseen a remuneration committee which must be independent from the board. In addition it is recommended that directors' salaries, especially those connected with daily management, should be based on independent market surveys and connected to profits.

- According to CMVM Regulation 7/2001, as amended, listed companies must report, in a maximum 7 days after its approval, on plans for the allotment of shares and/or stock options among employees and/or members of the board of directors.

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- This information, must include an explanation for the adoption of the policy, conditions attached to the allotment, criteria concerning the price of shares and stock options, the validity of such options, the number of shares to be issued and characteristics of the same, the existence of incentives to purchase shares and/or stock options and the competence of the board of directors to carry out or amend the plan.

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- The Portuguese Companies Code stipulates that remuneration of the directors is determined by the general meeting, or by a committee designated by the general meeting, and Recommendation IV/10 advises that the members of this remuneration committee should be independent.

7. Institutional Investors

- Institutional investors are those listed in the applicable provisions of the Portuguese Securities Code, as amended by Decree-Law 66/2004, as follows:

(i) Credit institutions;

(ii) Investment companies;

(iii) Collective investment institutions and their respective management companies;

(iv) Insurance companies;

(v) Pension funds and their respective management companies;

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(vi) Other financial institutions, authorised or regulated as securitisation funds, and their respective management companies and other financial companies;

(vii) Financial institutions from non-EU countries which have similar activities to the ones referred to above;

(viii) Entities which negotiate in commodities financial Instruments;

(ix) National or regional governments, central banks, public entities which manage public debt, international and supranational institutions, such as the European Central Bank, European Investment Bank, International Monetary Fund and the World Bank.

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- CMVM Recommendations encourage institutional investors to make an active and diligent use of their voting and rights and disclose information on their policies towards the companies in which they invest.
- CMVM Regulation 15/2003, as amended by Regulation 9/2005, regarding undertakings for investment in transferable securities (UCITS), stipulates duties of information by UCITS management companies, concerning the exercise of voting rights.

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- In accordance with such provisions, management companies must inform CMVM if they voted for or against motions in general meetings. It is mandatory for such management companies and other institutional investors to disclose their voting policies to the public.
- Institutional investors play an important role in corporate governance matters as their independent and critical analysis provides an invaluable assessment of the performance of the companies they invest in. Such scrutiny may also stimulate improvement in the company's management performance.

8. Corporate Governance in the Context of M&A Public and Private Transactions

- Corporate Governance is meaningful in the context of M&A transactions, basically covering the rights and duties of both the offeror and target during the transaction and dealing with the investigation of corporate governance compliance by the target.
- In fact, if the decision to proceed with any given investment in the context of M&A is fundamentally influenced by the good economic performance of the target, the effective application of the corporate governance principles now has considerable impact.

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- Well-run companies which have adopted good governance strategies will essentially enjoy a considerably stronger level of protection in the context of increasing pressure from a burgeoning M&A market.

- In this sense, the implementation of better governance models and practices, by fostering confidence at national and international levels in the capital market and promoting much desired transparency, will lead to a sound and prosperous economic environment.

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8.1. Public Transactions

- Corporate governance matters arising during preliminary talks in a public takeover transaction fundamentally concern the duty of confidentiality on the terms of the deal, prior to publication of the preliminary announcement to launch a takeover bid.
- This duty binds all parties involved, that is to say directors of the offeror and target company, shareholders, members of the companies' bodies and all those who render services on a permanent or occasional basis. It is worth mentioning, however, that there is no formal obligation with regard to the board of the offeror to disclose its intention to launch a takeover bid to the target company, prior to the effective launching.

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- Corporate Governance matters at this stage also comprise rules specially conceived to prevent insider dealing and market manipulation conducts, such as disclosure of price-sensitive information.
- Corporate governance matters raised during negotiations concern duties of negotiating on a bona fide basis, the contents of the preliminary announcement to launch a takeover bid or the offer document, duties of the board of the target company referring to disclosure of information, both to the offeror and to the shareholders of the target, and duties not to frustrate the bid.

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- In a public takeover bid, during the due diligence process, the review of information will be mainly from public sources but in a friendly bid will also be exercised on the information voluntarily disclosed by the target.
- During the due diligence process, corporate governance matters will refer to corporate governance compliance by the target company and especially to the analysis of the governance model, as well as on the information referring to corporate records, shareholder information, securities issuance, corporate finance, financial and tax records, details on employment and management contracts together with any related information.

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- Special attention will be given to the balance between dependent and independent directors, board structure and decision-making processes, directors' compensation schemes and remuneration policies, dividend policy and company stock option plans.
- The special duties binding the target's board following publication of the preliminary announcement of a public takeover bid also bring about relevant corporate governance issues.

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- In fact, after publication of the preliminary announcement, the Portuguese Securities Code imposes on the board of the target an obligation to present a detailed report regarding the opportunity and conditions of the offer, which must be sent to the Supervisory Market Authority and to the offeror, containing detailed financial information and feasibility study reports carried out by a CMVM-registered auditor.

- The disclosure of information contained in this report, issued by the target's board, will not specifically focus on corporate governance matters and its principal contents will to a large extent reflect information which the target must obligatorily supply at this stage.

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- With publication of the preliminary announcement to launch a takeover bid, corporate governance matters will refer to the contents of the document offer which must provide a level playing field to all shareholders, duties of disclosure concerning shares held either in the target by the board of the offeror, third parties on its behalf, or any persons or entities with whom it may have special privileged relationships.

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- The Portuguese Securities Code also expressly prohibits the board of the target company from practising acts that may materially affect the net asset situation of the company, thus frustrating the objectives announced by the offeror, except in very specific circumstances.

- Furthermore, the offeror is also bound by special duties of liability for any damages incurred as a result of the decision to launch a takeover with the main objective of placing the target company in a day-to-day management situation.

8.2. Private Transactions

- In private transactions, relevant corporate governance provisions on preliminary talks refer to general duties of care in terms of the interests of the company and its shareholders, which are also applied to all stages of the transaction.
- In private transactions, corporate governance matters will be dealt with in the establishment of warranties and indemnities to provide for corporate governance compliance by the target.

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- Contrary to what happens in a public takeover bid, in private acquisitions there are no specific duties imposed on directors in relation to the disclosure of information to the potential purchaser. Their general duties remain the same throughout the several stages of the transaction until final completion.
- In a private acquisition or merger, the due diligence process, as far as corporate governance matters are concerned, will mainly focus on the review of documentation provided by the vendor relating to corporate governance compliance, as well as information that may be publicly available at the Companies Registry.

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- Review of corporate records as well as tax and financial information will be carried out.
- The purchaser will ensure that required notifications under the provisions of the Companies Code and provisions referring to corporate governance matters have been complied with, namely the consent of the company to the transaction and in certain cases also the procedures referring to pre-emption rights of the existing shareholders.

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- In the acquisition of a private company there are no specific corporate governance rules on either the offeror's or the target's disclosure duties.
- Corporate governance issues may be raised directly in relation with drafting of documentation, especially when warranties and indemnities are agreed to cover occasional deficiencies in corporate governance by the target.

8.3. Public and Private Transactions

- Frequently, corporate governance matters in public and private transactions will include amendments to the statutes, which may involve restructuring of the board, redefinition of the decision-making process within the company and amendment of the required majorities to pass a resolution.
- They may ultimately concern protective devices enshrined in the statutes.

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- Corporate governance matters associated with a merger project of either private or public companies, will concern experts' and boards' reports on the motives, conditions and objectives of the merger, as well as audit reports on the criteria established by the board for the exchange of shareholdings in the merging companies.

8.4. Mergers

- Mergers in general, of either public or private companies, are subject to specific duties of corporate governance concerning the merger project to be drawn up by the directors of the merging companies, subject to preliminary registration and to subsequent approval by the General Meeting.
- The Board of each of the merging companies must send the merger project to the Audit Committee or to an independent auditor for an opinion on the several aspects concerning the accuracy of the merger project.

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- The merger project must lay out details on any specific advantages that may be gained as a direct consequence of the merger, by either experts or board members of the merging companies.
- Disclosure of the information concerning the merger project to shareholders is compulsory. Directors of each of the companies involved in a merger project are jointly and severally liable for damages to shareholders resulting from the breach of duties regarding verification of the status of the merging companies’ assets.

8.5. The Role of CMVM

- CMVM's recommendations consider the most recent reforms in the legal and regulatory framework and raise significant governance issues, particularly over the matters of management entrenchment versus shareholder sovereignty, promoting ideal governance models that establish a level playing field for international investment in the Portuguese corporate landscape.

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- Such debate is highly relevant, putting forward the argument that the dismantling of corporate barriers, such as protective devices that arm Portuguese companies against takeovers, will raise investor confidence and enhance the ability of market forces to function.

- It is noteworthy that, according to CMVM's Regulation 7/2001, listed companies must publish a report on corporate governance, which must be included or annexed to the annual management report.

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- This report must be publicly available and will include information on the form and level of compliance with CMVM's recommendations, organisation charts or diagrams of the board structure and decision-making process, description of the developments on the quotation of shares in the issuing company, distribution of dividends, policy plans for the allotment of shares and stock options, data concerning the use of new technologies, Investor Relations Department, exercising of voting and representation rights and company internal regulations.

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- In a public takeover bid the review of information will also include this report.
- The board of the target company shall, from the moment of publication of the preliminary announcement until assessment of the result of the offer, inform CMVM on a daily basis of transactions carried out by its members, or those who have qualifying holdings.

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- It shall also supply all information required by CMVM within its supervisory functions and inform its employees of the contents of the document offer.
- Moreover, the board of the target company is bound by special duties to act on a *bona fide* basis, at all time.

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