Public Consultation

OECD Guidelines on Corporate Governance of SOEs

- *Param Pandya*[1]

A. General Comments

1. The inclusion of a new chapter on State-owned enterprises and sustainability is a very welcome move. However, the language needs to be made more robust. For example, the term 'stakeholder relations' has been generally mis-construed and reduced to a PR exercise. The OECD Guidelines is a key policy document in the field of corporate governance which must set aspirational standards. Currently, the Draft restricts itself to requirements under existing legal and regulatory framework. This is not ideal and more innovative approaches must be explored such that SOEs are nudged towards actively considering sustainability issues in their decision-making.

2. SOE Guidelines should also include more details within Chapter IV on minority shareholders of SOEs. Discussion on these aspects is as crucial as sustainability and stakeholder protection as minority shareholders also tend to suffer if SOEs or the State is constantly ignoring their rights. This chapter could include how competing public and private interests must be balanced, what newer frameworks of minority rights protection could be inserted in the context of SOEs in particular and the role that non-state minority shareholders and institutional investors play in SOE governance.

3. The OECD Guidelines are aspirational standards, particularly when dealing with SOEs. Its implementation depends heavily on the state and thus, very difficult to enforce. These factors make it very pertinent to set highest standards of corporate governance, in the first place. In fact, commentators have argued that for this very reason of state inefficiencies and political economy, SOEs must be subjected to higher scrutiny than private companies.

4. The current Draft is definitely a leap forward in addressing corporate governance reforms in SOEs. However, it may also be argued that it takes a small step backwards by inserting certain adjectives/ phrases which serve as 'exceptions' to the rule effectively reducing the intensity of the principles. This must not be resorted to unless there are exceptional circumstances requiring such carve-outs.

5. Please see my chapter-wise remarks and suggestions for changes in the following section.

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B. Chapter Specific Comments

Introductory Chapter: Applicability and definitions

Comments

1. Definition of SOE – While the definition is all encompassing, State-owned Holding Companies (SOHC) must be specifically included. Alternatively, for a broader criterion, one may include the definition of 'Ownership entity' within SOE definition.

2. Definition of Ownership and Control – The revised version of the definition aimed at covering minority shareholding is a welcome move. However, the tests used to define control operate in some contradiction. While the intent as clearly state is to govern 'negative control' and 'influence' , the bright line test exemption for those companies where the state is holding less than 10 percent will be counter intuitive. The exception to the exceptions such as 1- percent holding that does 'not confer control' or not implying a 'long-term interest' are not necessary as they are already excluded in the earlier definition of 'Ownership'.

3. Definition of economic activities, public policy objectives, and public service obligations –

   The usage of the phrase 'SOEs' operations may include economic activities or a mix of economic and non-economic activities' in the definition of economic activities is not well-placed. It must be moved to the definition of SOEs.

   It is important to draw the connection between these definitions. Non-economic activities broadly include activities in furtherance of public policy objectives and public service obligations. This definition may also be defined.

4. Definition of the governing bodies of SOEs - This definition has another important provision cramped up. The discussion on the independent board members needs a specific definition on its own, corroborated with the provisions in Chapter VI.

5. Definition of Listed SOEs – It reads 'In some jurisdictions SOEs that have issued preference shares, exchange-traded debt securities and/or similar financial instruments *may* also be considered as listed.' However, this is a settled principle of securities law that listing of any securities (not just shares) would amount to listing. The word 'may' must be removed as the subjectivity is already provided by the term 'in some jurisdictions'.

6. Definitions of Stakeholders and Sustainability – These definitions are a great addition and must be retained. This makes the current draft of the Guidelines – a path-breaking reform in the global corporate governance framework.

7. Definition of level playing field – The original principle of 'competitive neutrality' must be used for consistency and enriched understanding stemming from other OECD reports. For a study on competitive neutrality in Indian SOEs, please see link here.

8. Applicability – The phrase 'Entities solely carrying out a public service obligation should ~~only~~ be expected to apply relevant provisions of the Guidelines, particularly with regards to governance, sustainability, integrity and transparency' must be changed for better clarity and broader coverage.

Chapter I – Rationales for State Ownership

Comments

1. The addition of 'sustainable manner' in this chapter is an important addition. However, I understand that this is in furtherance of the term 'sustainability' that has been defined in this draft for the first time. Thus, for clarity, I (A) must be redrafted to use the 'sustainability' as it to convey the intended purpose. Changes must be made to the annotations as well.

Chapter II – The State's Role as an owner

Comments

1. In the Annotations to Chapter II A, it reads – '*The state should ensure that as many elements of the Guidelines as possible are implemented in a consistent manner, despite different legal or corporate forms for SOEs throughout its portfolio*.' However, the differences highlighted after the quoted line are those of differences between SOEs and privately held companies. In fact, if one would read these two points together, it may be concluded that SOEs themselves can differ within its structures which may legitimise special treatment to board structures, shareholder rights, disclosure rights, and applicability of insolvency and bankruptcy laws. This language needs to be reworked. Further, if the intent was to sever the portfolio holdings of a SOHC and its forms, a specific mention must be made. Also, a specific mention to the principle of 'competitive neutrality' must be made when discussing this in following paras in the annotations of Chapter II A.

2. Point B of Chapter II – The changes in this point of Chapter II are not necessary. These changes included addition of the word '*unduly'* intervening in the management of the SOE. This exception is not required. Further, the wordings of this line does not sound proper - *The government as a shareholder should avoid redefining SOE objectives in a non-transparent manner and only in cases where there has been a fundamental change of mission.* I suggest the following be redrafted as follows - *The government as a shareholder should avoid redefining SOE objectives in a non-transparent manner. ~~and only~~ ~~.~~ In exceptional cases, where there has been a fundamental change of mission, the government must make adequate public disclosures.*

3. The discussion regarding the active role of the state is wrongly inserted in the Annotations of Chapter II C. This discussion includes the following statements:

"*Active ownership means that the state should have clearly defined rationales, and objectives as an owner, electing competent boards, undertake systematic and continuous monitoring of the SOEs and vote at the general meeting*."

This point should be moved to the Annotations of Chapter II F. Further, similar principle should be put in place for those institutional investors which are owned or controlled by state, SOHCs and corporate group structures to avoid a situation where more complex ownership structures in SOEs make it difficult for the state to actually monitor SOEs. A language to this effect is found in last para in the Annotations to Chapter II C.

4. Annotations to Chapter II C, mention that if there are public policy objectives for an SOE, they must be approved in the annual general meeting if there are non-state shareholders. This point deserves a specific mention and description to cover treatment to minority shareholders in SOEs, which is far worse in case of SOEs. It should be dealt in greater detail as much as the new G20/ OECD Principles on Corporate Governance 2023 in the Chapter IV of this draft which is dedicated to minority shareholder protection.

5. As discussed earlier, certain unnecessary clarifications have been provided which may dilute the force of the Guidelines. For instance, in Chapter II F, the words '*and depending on its respective degree of ownership and control*' have been inserted. If this is meant to carve out state interference in case of portfolio companies of a SOHC, a specific language to that effect must be inserted (which has actually been inserted in the Annotations to Chapter II F (before sub-points). Change of language of key principle which may be understood to mean to justify interference or passive behaviour by the state.

6. The additional principle in Chapter II F (2) requiring 'gender and other forms of' board diversity is key. The Annotations have provided a more detailed version of the same and this is definitely a huge plus.

7. The idea of the state to engage on a 'whole of government' basis is interesting. It basically allows for active role of the state as a shareholder, holding through various entities. This is a plus for shareholder-board engagement however, this may also become an instrument to shut the voices of minority shareholders. Thus, the chapter IV on minority protection must also be reviewed comprehensively.

Chapter III – State-owned Enterprises in the marketplace

Comments

1. This Chapter and the Annotations to the chapter are fairly detailed, well-thought through and encompassing most problematic practices in SOE governance.
2. However, the interface and treatment of SOEs pursuing public policy objectives and public service obligations as non-economic activities must be made clear, as suggested earlier.

Chapter IV – Equitable treatment of shareholders and other investors

Comments

1. As discussed earlier, minority shareholder protection is and remains a central question in SOE governance. However, this Chapter does not even do the minimum task of reviewing, much less of revising and the least of reforming the role of minority shareholders in SOEs. This conclusion is made based on the key change that has been introduced regarding use of virtual and remote participation in shareholder meetings.

2. This aspect already existed in, sufficient detail in the earlier version of the SOE Guidelines. For instance, the newly added paragraph in the Annotations of Chapter IV 4 has two preceding paragraphs which state the same point regarding using electronic means to increase shareholder participation.

3. This chapter needs an overhaul, given the enhanced role of institutional investors (including the state-owned institutional investors) and increased retail investor participation across emerging economies and their investment in SOEs.

Chapter V – Disclosure, Transparency, and Accountability

Comments

1. One of the key features of this draft is the inclusion of disclosures stemming from matters relating to sustainability and stakeholder relations. My primary and strong objection is with the usage of the terms 'stakeholder relations' as it may be reduced to a mere PR exercise. I understand that the rest of the draft does use the language which is stronger – for instance, it requires SOE boards to take account of the interests of stakeholders. Further, it also incorporates a new chapter on sustainability. Thus, it may be a good idea to tie the disclosure requirements under Chapter V A (10) with Chapter VI A. I propose addition of a phrase such that the principle A (10) reads as under:

   "Any relevant issues matters and objectives relating to employees sustainability and ~~other stakeholders relations~~ the manner in which the board of directors of SOEs have considered the interests of stakeholders in case of key corporate decisions."

2. Such usage will propose a market-driven disclosure-based enforcement mechanism in case the SOE directors fail to account for the interests of stakeholders in corporate decision-making. This approach is currently practised in the UK where companies, under the Reporting Regulations, 2018, are required to disclose how directors considered interests of stakeholders (non-shareholder stakeholders in particular) read within the fold of Section 172 of the UK Companies Act, 2006. This principle will also be in line with the requirements set out in the Annotations to the Chapter VII D (1) (second para) which requires state to report issues that affect stakeholders.

3. It is pertinent to note that the Annotations to the Chapter V A(10) refers to many leading international standards including the UN Guiding Principles of Business and Human Rights, Global Compact and 2030 Agenda. This is certainly a welcome move.

Chapter VI – The composition and responsibilities of the boards of state-owned enterprises

Comments

1. This chapter introduces key requirements regarding the composition of the board of directors laying emphasis on having appropriate number of independent directors on SOE boards. However, in the substantive provisions and the Annotations to the Chapter VI, it fails to provide a more robust criteria of independent directors in a comprehensive manner.

2. In case of SOEs, there is a need to establish a dual-independence criteria – Independent Directors must not only be independent from the company and its management but also from the controlling shareholder. More detailed guidance in this regard is missing in the current draft of the Guidelines. Please see, for the issues that may stem emerge and as they have in India here. Further, a detailed disclosure requirement may also be tied with the independence criteria and how the appointed directors are meeting the same.

3. Most importantly, the additional requirement for the SOE board 'to take into account interests of stakeholders' is a positive development. However, the Annotations to Chapter VI A refers to consideration of stakeholders' interests as a 'good practice'. This reduces the robustness as many jurisdictions such as the UK, India, (expressly in their statutes) and other jurisdictions through development case law requires the board of directors of all companies to consider stakeholders' interests. Thus, this principle which gives a thrust to the draft must be rectified of this minor issue as well. Further, some thought may also be put on the possible ways to enforce breach of directors' duties to remedy a situation when the board fails to take into account interests of stakeholders.

Chapter VII – State-owned enterprises and sustainability

Comments

1. This is a new chapter and a legendary one in so far as the governance of SOEs and sustainability is concerned. This is certainly welcome.

2. However, it is a chapter that largely confines itself to existing law, regulation, or policy on sustainability without providing for any new requirement. I propose that, in line with the ownership policy as envisaged in this Guidelines, a "Sustainability Policy" for SOEs must be introduced.

3. This policy should provide for a roadmap of how a respective SOE will be aligning with the sustainability commitments made by the State, with domestic law being the bare minimum standard of compliance.

4. Such sustainability policy should be revised on an annual basis and must be publicly disclosed. The contents of the policy could be combination of objectives, metrices, strategies and targets. In fact, these could include the Principle C in Chapter VII of this draft guidelines.