

Eumedion recommendations of 23 July 2008 on the authorization to repurchase own shares and on accountability for the dividend policy

1. Reason

The bill on the implementation of the amended Second EU Company Law Directive came into effect on 11 June 2008. The new legal provisions make it possible, in principle, for listed companies to repurchase their own shares up to the limit of 50 percent of the issued capital. Until 11 June 2008 the stipulation applied that the general meeting could authorize the management board to repurchase own shares up to the limit of 10 percent of the issued capital. The validity period of the authorization granted by the general meeting remains 18 months, as a consequence of an amendment passed by the lower house of the Dutch parliament. The new legal provisions also permit companies to grant loans to third parties to enable them to repurchase shares in the company, subject to certain conditions. The shareholders' meeting must approve a loan of this kind by a majority of 95% of the votes, which means in practice that it is practically impossible for listed companies to grant loans to third parties.

A number of companies (including Philips, Van der Moolen and Arcadis) amended their articles of association during the 2008 AGM season to conform with the bill, and more companies will probably follow suit in the 2009 AGM season. It is important for institutional investors to prepare a number of recommendations on how to deal with the new powers in advance of the 2009 AGM season. The point of departure for these recommendations does not have to be the new legal provisions alone and other aspects of the repurchase of own shares can also be examined. Although the authorization to repurchase own shares is an item on the agenda of practically every annual shareholders' meeting, this is no reason why it should be treated as a matter of routine. The repurchase of own shares is worthy of attention, both from the point of view of capital maintenance and in relation to the duty of care that a company has towards its shareholders (equal treatment where possible). Furthermore, the possibility of using the repurchase of own shares as an anti-takeover measure must be prevented.

Paragraph 2 proposes a number of recommendations that institutional investors can use as tools when assessing the item on the agenda relating to the authorization of the management board to repurchase own shares. In view of the fact that granting loans is an illusion where listed companies are concerned, no recommendations have been formulated in this respect. It should be noted that it is already laid down by law that companies cannot vote shares repurchased and that shareholders must receive equal treatment.

The University of Groningen carried out research commissioned by Eumedion into the policy of Dutch listed companies with regard to dividend distribution and the repurchase of own shares, and one of the conclusions of this study is that the information provided on the dividend policy and the repurchase of own shares is rather meagre and capable of improvement. In addition, the relevant information is

given at different places in the financial statements. Paragraph 3 makes a number of recommendations for more transparency.

The Eumedion recommendations on the repurchase of own shares and the dividend policy are an addition to the Eumedion Corporate Governance Manual published in May 2008.

2. Recommendations on delegation of the power to repurchase own shares

The following recommendations are proposed, which follow more or less naturally from the recommendations on the authorization to issue new shares published by Eumedion at the start of 2008.

(a) **Organs involved in delegation.** In the event of the delegation of the power to repurchase own shares, the management board is designated by the general meeting for this purpose. If shares are actually repurchased on the basis of the granted authorization to repurchase, the repurchase requires the prior approval of the supervisory board. In the case of a one tier board structure, the actual repurchase requires the approval of the non-executive board members.

(b) **Placement on the agenda and explanatory notes.** A clear explanatory note must be provided on the item on the agenda concerning delegation of the repurchasing powers. This note must set out the reasons for the proposal and the conditions for the exercise of the powers to be delegated (including the maximum number of shares to be repurchased, the delegation period and the method of establishing the repurchase price). In the event of delegation of the powers to repurchase different kinds of shares, these proposals must be included as separate items on the agenda with separate explanatory notes.

(c) **Maximum number of shares to be purchased.** The company is permitted to *acquire* shares to an amount of no more than half of the issued capital during the delegation period. If no material reorganization of the capital structure is foreseen in the delegation period envisaged, however, the company is entitled, in principle, to *hold* no more than 10 percent of the issued capital in own shares at any time during this delegation period. This means that the maximum number of own shares that a company has “on the shelf” at any moment must not, in principle, exceed 10% of the issued capital. If a material reorganization of the capital structure is foreseen during the delegation period envisaged, the number of own shares that may be held at any time during the delegation period may be raised to 20 percent of the issued capital¹. The company must, however, provide a clear explanation for authorization of this kind. If the company wishes to repurchase more of its own shares within the authorization period, the own shares previously repurchased must first be withdrawn, which requires a resolution by the general meeting. It is advisable, therefore, certainly in the event of a material reorganization of the capital structure, that the request for authorization to repurchase own shares should be accompanied by a request for authorization to withdraw the shares repurchased.

¹ Other maximums may apply in the event of a proposal to purchase financing preference shares and/or protective preference shares.

(d) **Re-issue of repurchased shares.** When authorization for the repurchase of own shares is requested, it must always be clearly stated whether it is intended to re-issue these shares (in connection with stock option and/or share plans for example). In the absence of an explanation of this kind, it must be assumed that the shares repurchased will not be re-issued. Repurchased shares may not be issued to a party with the objective of facilitating a takeover, or of preventing a takeover by another party ('targeted stock placement').

(e) **Delegation period.** Delegation of the power to repurchase own shares can be granted for a maximum period of 18 months as from the moment of the resolution to delegate. The resolution to delegate must state that the general meeting is entitled to withdraw the delegation and the conditions for withdrawal must be set out in detail in the resolution to delegate. It is preferable in the event that a delegation period is still current, to formulate the proposal as an extension to this current delegation, in order to prevent uncertainty as to whether the current delegation will continue to exist alongside the new delegation.

(f) **Method of repurchase.** When authorization for the repurchase of own shares is requested, it must be clearly stated how the shares in question will be repurchased; on the stock exchange or by a different method. It must always be clear that all shareholders in equal measure can offer their shares to be repurchased. In unusual cases in which shares from one or a number of shareholders are repurchased, clear reasons must be provided for these transactions and these must be clearly apparent to all shareholders.

(g) **Permitted repurchase price.** The repurchase price must not, in principle, be higher than the market price of the share. The market price is the price quoted for the share on the stock exchange on the day of the repurchase, or the average share price over a certain period, which must not be longer than 5 days. If the management board requests authorization for a higher repurchase price, a clear explanation must be provided for this.

(h) **Rate of repurchase.** Repurchase transactions are not intended to influence the price of the share temporarily and the company must provide clear information, therefore, on what precautions have been taken to prevent repurchase transactions from influencing the price on the stock exchange each day. The maximum number of shares to be repurchased per day of trading must always be stated (or what maximum percentage of the shares traded each day), how repurchase transactions are connected with the share-price related objectives in the remuneration policy and which internal or external party has been charged with the repurchase.

(i) **Transparency on repurchase transactions.** The company will include a summary of transactions in the financial statements showing developments in the number of own shares repurchased, in order to provide clear insight into the development of the repurchasing transactions during the financial year.

3. Recommendations dividend policy

- (a) **Reporting.** The dividend policy must be clearly and transparently described at a place in the annual report. Transparency would benefit if the relationship between the dividend policy and other possible relevant aspects of the strategic policy of the company could be clarified; these aspects could relate to long-term development, innovation, mergers and takeovers, and executive remuneration. A company that is paying dividend states which criterion or criteria is/are applied in determining the rate of the dividend and provides sound substantiation for this. A company that is not paying dividend (as yet) reports in the annual report why it is not doing so (as yet) and when and under what conditions the management board will actually consider paying dividend. A company that is considering paying dividend states when it is possible that dividend may be distributed.
- (b) **Placement on the agenda.** A company's dividend policy is dealt with and accounted for as a separate item on the agenda for the general meeting.