TRADE UNION ADVISORY COMMITTEE
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COOPERATION AND DEVELOPMENT
COMMISSION SYNDICALE CONSULTATIVE
AUPRÈS DE L'ORGANISATION DE COOPÉRATION
ET DE DÉVELOPPEMENT ÉCONOMIQUES

22nd meeting of the Working Party on State Ownership and Privatisation Practices

TUAC submission

Paris, 31 March 2014

1. TUAC welcomes the opportunity to comment on the documents that are for discussion at the 22nd meeting of the Working Party on State Ownership and Privatisation Practices, 2-3 April 2014. The review process of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs) is a key item on the agenda. In what follows, we submit our comments and recommendations on the review of the Guidelines based on the OECD draft proposal for consideration by the Working Party (document DAF/CA/SOPP(2014)1). Overall, the proposed amendments to the Guidelines contained in the draft constitute a net improvement to the text. We believe however, that the draft could be further improved in light of this submission and our proposals of amendment.

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Government "rationale" for state-ownership

2. In the draft, a new chapter I on "The Rationale for State Ownership" is added, bringing the draft Guidelines to a total of six different chapters. We are not convinced by this proposal. Governments' "rationale" for having SOEs may differ substantially from one country to another. It is an issue that appears dependent on political choices, if not historical heritage – issues that are beyond the scope of the Guidelines. The text should remain focussed on SOE governance and should not address broader public policy issues. Furthermore, as it reads, there seems to be overlapping with Chapter II on the "State's role as an owner" notably with regard to ownership policy (I.A & II.D) and accountability (I.B & II.E).

Board nomination process

3. Guidance on board nomination processes should be strengthened. Evidence suggests that, even within OECD countries, transparency and integrity of the SOE board nomination processes have been lacking. The current text makes, rightly so, the case for the independence of the process from political spheres. This concern need to be highlighted. The need for greater diversity of board composition

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(diversity of gender, of professional backgrounds and where relevant of geographic origin) is another policy concern of SOE board – a concern that is not limited to SOEs however. Governments should lead by example and ensure that their own board nomination processes contribute to SOE board diversity and to reducing conflicts of interest that arise from narrow "gene pools" of directors.

4. TUAC proposals of amendment:

Curbing political interference & contributing to board diversity	II.F.2 Ensuring ~~Establishing~~ well-structured, merit-based, free of political interference and transparent board nomination processes in fully or majority-owned SOEs, ~~and~~ actively participating in the nomination of all SOEs' boards and contributing to board diversity of gender, of professional experience and, where appropriate, of geographic origins.

Active and responsible use of shareholder ownership rights

5. The text could benefit from more ambitious wording on the State responsibility to act as an active and informed owner. The current draft takes for granted that the State is an informed and active owner *per se* (Guideline II.F). That is not always the case, in particular with regard to the effective exercise of shareholder rights at the AGM of shareholders. Governments should also help promote responsible investment practices – including setting limits to board remuneration and dividend policy and requiring SOE reporting on environmental, social and governance performance and impact. Best practice would also require disclosure of *individual* board and key executive management remuneration, not just remuneration policy at large.

6. TUAC proposals of amendment:

Proactive call for active and informed ownership	II.F The state should act as an informed and active owner ~~should~~ and exercise its ownership rights accordingly ~~to the legal structure of each company~~. Its prime responsibilities include:
Effective exercise of voting rights	II.F.1 Being represented at the general shareholders meetings and effectively exercising voting rights ~~the state's shares~~; (…)
Limiting executive remuneration…	II.F.7 Ensuring that remuneration schemes for all SOE board members ~~foster the long term interest of the company~~ do not fuel short-termist behaviour by directors, are set at reasonable levels and can attract and motivate qualified professionals. Remuneration levels observed in comparable private sector companies should not necessarily be considered as a benchmark for setting SOE board and executive remuneration.
and dividend levels.	II.F.8 Establishing and monitoring the implementation of financial and, where appropriate, non-financial targets and setting dividend and retained earnings policies that contribute to ~~for~~ SOEs ~~engaged in economic activities~~ long term investment capacity and resilience of their balance sheets.

Individual remuneration of board members and executives

VI.D. SOEs should disclose material financial and non-financial information on the company in line with high quality internationally recognised standards of corporate disclosure, and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest. Examples of such information include: (…)

4. Information on board member and key executives individual remuneration ~~policies~~ as well as their qualifications, selection process, roles on other company boards and whether they are considered as independent by the SOE board;

The human right responsibilities of SOEs

7. SOEs should have a policy commitment to respect human rights and should conduct human rights due diligence. Under Pillar II of the United Nations Guiding Principles for Business and Human Rights (UNGPs)[1], the *Corporate Responsibility to Respect Human Rights*, and under Chapter IV (Human Rights) of the OECD Guidelines for Multinational Enterprises, all enterprises – including SOEs – are required to respect human rights, which means that they undertake human rights due diligence in order to avoid infringing on the human rights of others.

8. Additionally, with regard to SOEs and as shown in annex 1, Pillar I of the UNGPs, the *State Duty to Protect*, requires governments to "take *additional* steps to protect against human rights abuses by business enterprises that are owned or controlled by the State" (Principle I.B.4). The commentary explains with regard to SOEs: "Where a business enterprise is controlled by the State or where its acts can be attributed otherwise to the State, an abuse of human rights by the business enterprise may entail a violation of the State's own international law obligations". Under Principle I.B.3.c States are required to "Provide effective guidance to business enterprises on how to respect human rights throughout their operations". Furthermore the annotations to the UN Principles make clear that this includes guidance on corporate governance: "policies in this area should provide sufficient guidance to enable enterprises to respect human rights, with due regard to the role of existing governance structures such as corporate boards".

9. TUAC proposals of amendment:

Referencing the UN Guiding Principles in the Preamble

[preamble] #6. SOEs also face some distinct governance challenges. (…)To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge. The United Nations Guiding Principles on Business and Human Rights require governments and states to "take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State". Because states, and their representative governments, individually are the primary duty-bearers under international human rights law, an abuse of human rights by an SOE may entail a violation of the State's own international law obligations.

[1] http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

Recognising the human rights responsibilities of SOEs	V.A Governments, the co-ordinating or ownership entities and SOEs themselves should take additional steps beyond generally-observed market practices, to ensure compliance with internationally recognised standards and protect against human rights abuses ~~recognise and respect stakeholders' rights established by law or through mutual agreements~~, and refer to the ~~OECD Principles of Corporate Governance~~ United Nations Guiding Principles on Business and Human Rights in this regard.

Raising the voice of workers

10. When asked what is the most "valuable asset" of the firm, CEOs invariably respond: their staff and employees. Workers' firm-specific investments are an essential source of corporate wealth creation through human capital development and intangible assets. Workers are equally exposed to firm-specific risk, including market and production risks but also occupational and health and safety risk. SOEs are no exemption. To address workers' firm-specific risk, workers' right to information, consultation and negotiation is recognised and upheld by several ILO conventions and by the OECD Guidelines for Multinational Enterprises (Chapter V). Various mechanisms exist across OECD and G20 economies to ensure workers' voices in the governance of the firm. The most fundamental form of contractual governance consists of collective bargaining between senior management and worker representatives, including at MNE-level "international framework agreements"[2]. But other important mechanisms to participate in company decision-making exist such as works councils and board-level employee representation. Works council representation is mandatory in 13 OECD countries. Board-level employee representation is mandatory for all companies beyond a given threshold, including SOEs, in 14 jurisdictions, and for SOEs only in another 5 jurisdictions in Europe[3].

11. The current text poorly reflects on the common practice for worker information and consultation mechanisms within SOEs: it simply refers to the OECD Principles of Corporate Governance (Chapter IV). The draft should be revised to include a stand-alone Guideline on SOE employees' right to be informed and consulted on and make their views known on (i) the long term strategy of the company, (ii) the foreseeable risk factors, and – where appropriate – on (iii) any business restructuring that may affect their working conditions and pay.

12. TUAC proposals of amendment:

New guideline on worker representation…	V.# Mechanisms should be in place for employees and their representatives to be informed and consulted about the business plan and foreseeable risk factors and to negotiate with management in case of substantial change in working conditions and pay and in case of restructuring process. The annotations could refer to collective bargaining, international framework agreements and to various governance mechanisms including works councils and board-level employee representation and to the OECD Guidelines for Multinational Enterprises with regard to the substance of workers' right to information, consultation and negotiation.

[2] http://www.global-unions.org/framework-agreements.html

[3] http://www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation2

…and reporting on it

VI.D. SOEs should disclose material financial and non-financial information (…). Examples of such information include: (…)

8. Any relevant issues relating to employees, including remuneration, training, collective bargaining coverage, mechanism for employee representation, and other stakeholders.

Public-Private Partnerships

13. The current text does not address the specific governance challenges which an SOE may face when engaged in a Public-Private Partnership (PPP). Yet the OECD Principles for Public Governance of Public-Private Partnerships (extracts reproduced in Annex II) specifically mention SOEs as a "particular challenge" for the "prudent and transparent usage" of PPPs: "SOEs can engage in PPP-type of arrangements that often, but not necessarily, require explicit, or implicit, guarantees from the central government. SOEs may have long-term obligations to purchase goods and services from the private sector, such as power and water purchase agreements. As these obligations in general are not included in the definition of public debt they may not be properly monitored by the central government" (annotation to Principle C11). Accordingly, PPPs "should be treated transparently in the budget process", "budget documentation should disclose all costs and contingent liabilities" and "special care" should be taken to ensure that "budget transparency of Public-Private Partnerships covers the whole public sector" (Principle C11).

14. More broadly, given the complexity of PPPs, the OECD Principles recommend that "procuring authorities" (including contracting SOEs) be "entrusted with clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability" (Principle A2), be "prepared for the operational phase" of PPPs and take "particular care (…) when switching to the operational phase (…), as the actors on the public side are liable to change" (Principle B7). The selection process should "carefully investigate which investment method is likely to yield most value for money", evaluate "key risk factors and characteristics of specific projects" (Principle B5) and bring particular attention to "contractual arrangements and monitoring capacity at later stages of a project so as to ensure that incentives do not deteriorate as the cost of non-compliance falls" (annotation to Principle B7).

15. There are several ways the revised Guidelines could address the specific risks associated with PPPs and their implications for the governance of SOEs. In what follows we suggest to enhance the scope of Chapter IV beyond the protection of (private) minority shareholders to include PPPs.

16. TUAC proposals of amendment:

Enhancing the scope of Chapter IV to cover SOE business relationships with private investors and PPPs

IV. ~~EQUITABLE TREATMENT OF SHAREHOLDERS~~ RELATIONSHIPS WITH PRIVATE INVESTORS

Where SOEs are listed in stock exchanges or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure their equitable treatment and equal access to corporate information. SOEs involved in complex co-investment projects such as Public Private Partnerships should have the critical skills and resource to engage contractual negotiations and manage the operational phase of the projects.

New Chapter IV guideline on SOEs involvement in PPPs

IV.D SOEs that are contractually engaged in Public Private Partnerships should have the sufficient resources and the critical skills to ensure a prudent procurement process and when switching to the operational phase of the projects. SOEs should refer to the OECD Principles for Public Governance of Public-Private Partnerships.

Enhancing SOE disclosure on exposure to PPP risk

VI.D SOEs should disclose material financial and non-financial information on the company (…). Examples of such information include: (…)

6. Any financial assistance, including explicit and implicit guarantees, long-term contractual obligations and other contingent liabilities, received from the state and commitments made on behalf of the SOE including contractual commitments arising from Public-Private Partnerships;

Board-level employee representation

17. The current text on the role of board-level employee representation (Guidelines VII.E) could be fine-tuned in light of national laws and practices. The appointment process can take different forms and is not limited to direct election by employees. Representatives can also be appointed by the trade unions with which the SOE has a collective agreement or, more rarely, by the company's own works council.

18. Board independence is, rightly, defined in the text as independence vis-à-vis executive management, not the company as whole, and where appropriate vis-à-vis controlling shareholders, and in the case of SOEs, from government. This definition needs to be reasserted to ensure that board level employee representatives can qualify as independent directors. In this regard, the proposal to extend the criteria of independence to include any "business relationship" (draft Guideline VII.D) could become problematic should it cover wages and hence aim for an implicit exclusion of employee representatives – who in the vast majority of cases are salaried employees of the SOE – from the list of independent directors. The annotations to Guidelines VII.E could also be amended to avoid stigmatising board level employee representatives with regard to independence (what is "true" independence?), the use of the term "professionalism" (which could be replaced by access to skills and expertise) and the insistence on board confidentiality requirements (employee representatives are required to have the same duties as other board members, including confidentiality, and in practice there is no evidence that the presence of employee representatives increases the risk of board confidentiality breach).

19. TUAC proposals of amendment:

Board independence should refer to executive management, not to any business relationships with the SOE

VII.D Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties. Independent directors, where applicable, should be independent from management~~,~~ and government ~~and business relationships~~.

VII.F If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence.

Access to information right training & expertise, reporting to SOE employees, deleting stigmatising language

[annotations to VII.F] #201. Procedures should be established to facilitate access to information, training and expertise ~~the professionalism~~ and the ~~true~~ independence of employee board members from government and SOE management~~, and to make sure that they respect their duty of confidentiality~~. These procedures should also include adequate, transparent appointment ~~and democratic election~~ procedures, rights to report to SOE employees on a regular basis – provided that board confidentiality requirements are duly respected – training and clear procedures for managing conflicts of interest. A positive contribution to the board's work will also require acceptance and constructive collaboration by other members of the board as well as by the SOE management.

Reporting and risk management

20. We welcome the change of the title of Chapter V on stakeholder relations to include reference to "sustainable business". The notion of sustainability should be properly reflected in the Chapter's guidelines however, as well as in Chapters VI (Transparency and Disclosure) and VII (The Responsibilities of Boards of Directors) regarding the scope of SOE reporting and risk management. In line with the OECD Guidelines for Multinational National Enterprises (Chapter III.4), SOE reporting should include environmental and social reporting, and this regardless of their public policy objectives or their ownership structure as stated currently under Guideline V.B. And as discussed above, because SOEs are required to conduct human rights due diligence under the UN Guiding Principles on Business and Human Rights (Principle I.B.3.c&d, see annex I), they should be expected to include human rights-related risks in their reporting framework and in the scope of board risk management. SOE board risk management and reporting should also be extended to tax-related risks (in line with the OECD Guidelines for Multinational National Enterprises, Chapter XI.2).

21. TUAC proposals of amendment:

Human rights, ESG & tax reporting

V.B ~~Listed or large SOEs, as well as~~ SOEs ~~pursuing important public policy objectives,~~ should report on stakeholder relations and on human rights, labour environmental and tax-related risks and how these risks are being addressed and mitigated.

VI.D. SOEs should disclose material financial and non-financial information (…) Examples of such information include: (…)

5. Any material foreseeable risk factors, including human rights, labour, environmental and tax-related risks, and measures taken to manage such risks; (…)

Board risk management responsibilities

VII.B SOE boards should carry out their functions of supervising management, including oversight of the SOE's risk management policy, and providing strategic guidance, subject to the objectives set by the government and the ownership function. They should have the power to appoint and remove the CEO.

Annotations to VII.B could refer to the need for SOE boards to have risk management policies that include human rights due diligence to identify, prevent, mitigate and account for how the SOE addresses adverse human rights impacts, as well as labour, environmental and tax-related issues.

Annex I: UN Guiding Principles on Business and Human Rights (extracts)

source: http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf)
Text underlined by TUAC Secretariat.

"**I. The State duty to protect human rights**
(…)
A. Foundational principles
(…)
1. States must protect against human rights abuse within their territory and/or jurisdiction by third parties, including business enterprises. This requires taking appropriate steps to prevent, investigate, punish and redress such abuse through effective policies, legislation, regulations and adjudication.
(…)
2. States should set out clearly the expectation that all business enterprises domiciled in their territory and/or jurisdiction respect human rights throughout their operations.
(…)
B. Operational principles
(…)
General State regulatory and policy functions
(…)
3. In meeting their duty to protect, States should:
(a) Enforce laws that are aimed at, or have the effect of, requiring business enterprises to respect human rights, and periodically to assess the adequacy of such laws and address any gaps;
(b) Ensure that other laws and policies governing the creation and ongoing operation of business enterprises, such as corporate law, do not constrain but enable business respect for human rights;
(c) Provide effective guidance to business enterprises on how to respect human rights throughout their operations;
(d) Encourage, and where appropriate require, business enterprises to communicate how they address their human rights impacts.
(…)
The State -business nexus
(…)
4. States should take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State, or that receive substantial support and services from State agencies such as export credit agencies and official investment insurance or guarantee agencies, including, where appropriate, by requiring human rights due diligence.
(…)
5. States should exercise adequate oversight in order to meet their international human rights obligations when they contract with, or legislate for, business enterprises to provide services that may impact upon the enjoyment of human rights.
(…)
6. States should promote respect for human rights by business enterprises with which they conduct commercial transactions."

Annex II: OECD Principles for Public Governance of Public-Private Partnerships (extracts)

(Source: http://www.oecd.org/gov/budgeting/PPP-Recommendation.pdf)

"A. Establish a clear, predictable and legitimate institutional framework supported by competent and well-resourced authorities

(…)

2. Key institutional roles and responsibilities should be maintained. This requires that procuring authorities, Public-Private Partnerships Units, the Central Budget Authority, the Supreme Audit Institution and sector regulators are entrusted with clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability.

(…)

B. Ground the selection of Public-Private Partnerships in Value for Money

(…)

5. Carefully investigate which investment method is likely to yield most value for money. Key risk factors and characteristics of specific projects should be evaluated by conducting a procurement option pre-test. A procurement option pre-test should enable the government to decide on whether it is prudent to investigate a Public-Private Partnerships option further.

(…)

7. The procuring authorities should be prepared for the operational phase of the Public-Private Partnerships. Securing value for money requires vigilance and effort of the same intensity as that necessary during the pre-operational phase. Particular care should be taken when switching to the operational phase of the Public-Private Partnerships, as the actors on the public side are liable to change.

(…)

Particular attention should be paid to contractual arrangements and monitoring capacity at later stages of a project so as to ensure that incentives do not deteriorate as the cost of non-compliance falls.

(…)

C. Use the budgetary process transparently to minimise fiscal risks and ensure the integrity of the procurement process

(…)

11. The project should be treated transparently in the budget process. The budget documentation should disclose all costs and contingent liabilities. Special care should be taken to ensure that budget transparency of Public-Private Partnerships covers the whole public sector.

(…)

A particular challenge for the prudent and transparent usage of PPPs is the application of this tool outside of general government but within the public sector, in particular state owned enterprises (SOEs). SOEs can engage in PPP-type of arrangements that often, but not necessarily, require explicit, or implicit, guarantees from the central government. SOEs may have long-term obligations to purchase goods and services from the private sector, such as power and water purchase agreements. As these obligations in general are not included in the definition of public debt they may not be properly monitored by the central government. However, given the political importance of the provided services central government might very well be expected to assume some financial responsibility if needed. This may require that the Central Budget Authority actively monitors and mandates the use of PPP-like arrangements in the Public Sector at large.

Annex III: Consolidated marked-up proposal by TUAC

DRAFT OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES – MARKED-UP PROPOSAL OF DAF/CA/SOPP(2014)1 BY TUAC, 2 APRIL 2014

PREAMBLE

1. In many OECD countries, state-owned enterprises (SOEs) represent a substantial part of GDP, employment and market capitalisation. A number of non-OECD countries have significant state-owned sectors, which in some cases are even a dominant feature of the economy. These countries are in many cases reforming the way in which they organise and manage their SOEs and have sought to share their experiences with OECD countries in order to support reforms. Moreover, in all countries SOEs are often prevalent in utilities and infrastructure industries, such as energy, transport and telecommunications, whose performance is of great importance to broad segments of the population and to other parts of the business sector. Consequently, the governance of SOEs is critical to ensure their positive contribution to economic efficiency and competitiveness. OECD experience has also shown that good corporate governance of SOEs is an important prerequisite for economically effective privatisation, since it will make the enterprises more attractive to prospective buyers and enhance their valuation.

2. Over the years, the rationale for state ownership of commercial enterprises has varied among countries and industries and has typically comprised a mix of social, economic and strategic interests. Examples include industrial policy, regional development, the supply of public goods and the existence of so called "natural" monopolies. Over the last few decades however, globalisation of markets, technological changes and deregulation of previously monopolistic markets have called for readjustment and restructuring of the state-owned sector. These developments are surveyed in a number of OECD reports that have served as input to these Guidelines[4].

3. The *Guidelines on Corporate Governance of State-Owned Enterprises* were first developed in 2005. In 2014, the OECD Corporate Governance Committee asked its subsidiary Working Party on State Ownership and Privatisation Practices to review and revise this instrument in the light of almost a decade of experiences with its implementation. A report had previously taken stock of changes in corporate governance and state ownership arrangements in OECD countries since 2005 and concluded that national reform efforts have, with few exceptions, been consistent with the Guidelines[5]. Based on this the Working

4 "Accountability and Transparency: A Guide for State Ownership", OECD, 2011; "Competitive Neutrality: Maintaining a Level Playing Field Between Public and Private Business", OECD, 2012; "Boards of Directors of State-Owned Enterprises", OECD, 2013; and "Financing State-Owned Enterprises: An Overview of National Practices", OECD, 2014.

5 "Corporate Governance of State-Owned Enterprises: Change and Reform in OECD Countries since 2005", OECD, 2010.

Party concluded that the Guidelines should continue to set high levels of aspiration for SOE owners and serve as a guidepost for their continued reform efforts.

4. The Guidelines remain an "OECD Recommendation" – that is, a set of non-binding guidelines and best practices to which the OECD members and associate countries have expressed their commitment. The World Bank and the Republic of Lithuania act as Participants in the Working Party with observer status, and a number of other countries (e.g. Brazil, China, Colombia, Latvia, Russia and South Africa) have taken part as invitees in many of the Working Party's meetings. The following countries acted as Associates (with the same rights and duties as OECD member countries) in the revision of the Guidelines and have formally associated themselves with the revised instrument: Colombia, Latvia, Russia, [more to be added]. Extensive consultations with stakeholders were organised during the revision of the Guidelines. Draft versions of the text were posted on the OECD website for public comment and resulted in a significant number of useful and constructive comments from business and trade unions, civil society, academia and non-member governments.

5. In order to carry out its ownership responsibilities, the state can benefit from using tools that are applicable to the private sector, including the OECD Principles of Corporate Governance. The Guidelines are intended as a complement to the Principles, with which they are fully compatible. This is especially true for listed SOEs. For fully-owned SOEs as well the Guidelines may be read as providing advice on how government can ensure that SOEs are as accountable to the general public as a listed company should be to its shareholders.

6. SOEs also face some distinct governance challenges. One is that SOEs may suffer just as much from undue hands-on and politically motivated ownership interference as from totally passive or distant ownership by the state. There may also be a dilution of accountability. SOEs are often protected from two major threats that are essential for policing management in private sector corporations, i.e., takeover and bankruptcy. More fundamentally, corporate governance difficulties derive from the fact that the accountability for the performance of SOEs involves a complex chain of agents (management, board, ownership entities, ministries, the government), without clearly and easily identifiable, or with remote, principals. To structure this complex web of accountabilities in order to ensure efficient decisions and good corporate governance is a challenge. The United Nations Guiding Principles on Business and Human Rights require governments and states to "take additional steps to protect against human rights abuses by business enterprises that are owned or controlled by the State". Because states, and their representative governments, individually are the primary duty-bearers under international human rights law, an abuse of human rights by an SOE may entail a violation of the State's own international law obligations.

7. As the Guidelines are intended to provide general advice that will assist governments in improving the performance of SOEs, the decision to apply the Guidelines to the governance of particular SOEs should be made on a pragmatic basis. For example, the term "ownership entity" refers to the state entity responsible for executing the ownership rights of the state, whether it is a specific department within a ministry, an autonomous agency or other. The term "board" as used in this document is meant to embrace the different national models of board structures. In the typical two tier system, found in some countries, "boards" refers to "supervisory board", whereas in countries with one-tier boards the term "board member" will normally refer to non-executive directors. Finally, the Guidelines should be considered as an integrated instrument. Several recommendations are intended to be implemented in unison with others and might, if applied in separation, have little or no effect on good governance.

8. The document is divided into two main parts. The Guidelines presented in the first part of the document cover the following areas: I) Rationales for State Ownership; II) The State's Role as an Owner; III) State-Owned Enterprises in the Marketplace; IV) Equitable Treatment of Shareholders; V) Stakeholder Relations and Sustainable Business; VI) Transparency and Disclosure; VII) The Responsibilities of Boards of

Directors. Each of the sections is headed by a single Guideline that appears in bold italics and is followed by a number of supporting sub-Guidelines. In the second part of the document, the Guidelines are supplemented by annotations that contain commentary on the Guidelines and are intended to help readers understand their rationale. The annotations may also contain descriptions of dominant trends and offer alternative implementation methods and examples that may be useful in making the Guidelines operational.

CONTEXT AND APPLICABILITY

9. The Guidelines provide guidance that is generally relevant to any corporate asset in public sector ownership. However, no one size fits all and not every aspect of the recommendations is applicable in every context. This section reviews some of the questions and trade-offs that the owners of enterprises need to address in order to decide on the applicability of the Guidelines.

10. ***Ownership and control.*** The Guidelines apply to enterprises that are effectively controlled by the state, either by holding a majority of the voting shares or otherwise exercising an equivalent degree of control. The latter applies, for instance, where legal stipulations or corporate articles of association ensure continued state control over an enterprise or its board of directors in which it holds a minority stake. Some borderline cases need to be addressed on a case-by-case basis. For example whether a "golden share" amounts to control depends on the extent of the powers it confers on the state. Also, minority ownership by the state can be considered as covered by the Guidelines if corporate or market structures confer a non-trivial degree of influence on the state. Conversely, corporate assets held indirectly via asset managers operating independently of the government would normally not be considered as SOEs.

11. ***Defining an enterprise.*** A very broad definition of an SOE, applied for instance by national account statisticians, includes all autonomous government entities that generate at least half of their income through the sale of goods and services and have autonomous budgets and balance sheets. However, most national authorities apply a narrower concept, which is in many cases anchored in SOE-related legislation. For the purpose of the Guidelines, any state-owned corporate entity recognised by national law as an enterprise should be considered as an SOE. This includes joint stock companies, limited liability companies and partnerships limited by shares. Moreover statutory corporations, with their legal personality established through specific legislation, should be considered as SOEs if their purpose and activities are of a largely commercial nature. Whether or not to consider other units of general government as SOEs would need to depend on a value judgement, including regarding their degree of market orientation.

12. ***Economic activities***. The Guidelines are principally applicable to SOEs engaging in economic activities. By economic activity is meant an activity which involves offering goods or services on a given market and which could, at least in principle, be carried out by a private operator in order to make profits. The market structure (e.g. whether or not it is characterised by competition, oligopoly or monopoly) is not decisive for determining whether an activity is economic.

13. ***Competitive activities***. A subset of the economic activities can be characterised as competitive. Competitive activities means selling goods and services in economic markets where competition with other enterprises already occurs or where competition given existent laws and regulations could occur. The Guidelines are applicable in their entirety to SOEs that pursue only competitive activities, and to the competitive activities of any SOE.

14. ***The level of government***. Enterprises in which the central or federal levels of government exercise the ownership rights should be considered as SOEs. Enterprises held at subnational levels of government may, according to national context and legislation, also qualify as SOEs. In federal structures a strong case can

be made for including enterprises at the level of "states" which are constitutionally assigned important sovereign powers. At the local and municipal level the applicability and usefulness of the Guidelines will in practice often depend on whether the enterprise owners hold significant powers of regulation, taxation, etc. that might contrast with their role as enterprise owners.

15. ***Boards of directors.*** Some SOEs have two-tier boards that separate the supervisory and management function into different bodies. Others only have one-tier boards, which may or may not include executive directors. In the context of this document "board" refers to the corporate body charged with the functions of governing the enterprise and monitoring management. In the case of one tier boards, the term "director" normally refers to non-executive directors. Many governments include "independent" directors in the boards of SOEs, but the definition of independence varies considerably according to national legal context and codes of corporate governance.

I. RATIONALES FOR STATE OWNERSHIP

The state exercises the ownership of SOEs on behalf of the general public. It should carefully evaluate and disclose the public policy objectives that justify enterprise ownership and subject these to a recurrent review.

A. The government should develop an ownership policy. The policy should *inter alia* define the overall rationales for state ownership, the state's role in the corporate governance of SOEs, and how it will implement its ownership policy.

B. The ownership policy and company-specific priorities should be subject to appropriate procedures of political accountability and disclosed to the general public.

C. The government should review at regular intervals its ownership policy as well as the rationale for continued ownership of individual SOEs.

D. Any obligations and responsibilities that individual SOEs, or groups of SOEs, are required to undertake beyond generally accepted commercial norms should be clearly mandated by laws or regulations. Related costs should be covered in a transparent manner.

II. THE STATE'S ROLE AS AN OWNER

The state should act as an informed and active owner, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner, in accordance with the ownership policy and with the necessary degree of professionalism and effectiveness.

A. Governments should strive to simplify and streamline the operational practices and the legal form under which SOEs operate.

B. The government should not be involved in the day-to-day management of SOEs and should allow them full operational autonomy to achieve their defined objectives.

C. The state should let SOE boards exercise their responsibilities and respect their independence.

D. The exercise of ownership rights should be clearly identified within the state administration. This can be achieved by the centralisation of the ownership function, or, if this is not possible, by establishing a co-ordinating entity.

E. The co-ordinating or ownership entity should be held accountable to representative bodies such as the Parliament and have clearly defined relationships with relevant public bodies, including the state supreme audit institutions.

F. The state should act as an informed and active owner ~~should~~ and exercise its ownership rights accordingly ~~to the legal structure of each company~~. Its prime responsibilities include:

1. Being represented at the general shareholders meetings and effectively exercising voting ~~the state's shares~~rights;

2. Ensuring~~Establishing~~ well-structured, merit-based, free of political interference and transparent board nomination processes in fully or majority-owned SOEs, ~~and~~ actively participating in the nomination of all SOEs' boards and contributing to board diversity of gender, of professional experience and, where appropriate, of geographic origins;

3. Informing SOE boards of the state's objectives and priorities, through the appropriate channels to ensure the board maximum autonomy and independence in carrying out its functions;

4. Setting up reporting systems allowing regular monitoring, auditing and assessment of SOE performance;

5. Developing and communicating an external reporting policy for individual SOEs and monitoring its implementation;

6. When permitted by the legal system and the state's level of ownership, maintaining continuous dialogue with external auditors and specific state control organs;

7. Ensuring that remuneration schemes for all SOE board members do not fuel short-termist behaviour by directors, are set at reasonable levels~~foster the long term interest of the company~~ and can attract and motivate qualified professionals. Remuneration levels observed in comparable private sector companies should not necessarily be considered as a benchmark for setting SOE board and executive remuneration.

8. Establishing and monitoring the implementation of financial and, where appropriate, non-financial targets and setting dividend and retained earnings policies that contribute to~~or~~ SOEs long term investment capacity and resilience of their balance sheets~~engaged in economic activities~~.

III. STATE-OWNED ENTERPRISES IN THE MARKETPLACE

Consistent with the rationale for state ownership, the legal and regulatory framework for state-owned enterprises should ensure a level playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions.

A. There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.

B. Stakeholders, including competitors, should have access to efficient redress through unbiased legal or arbitration instances when they consider that their rights have been violated.

C. Where SOEs combine commercial and public policy objectives, high standards of transparency and disclosure regarding their cost structures must be maintained, allowing for an attribution of costs and liabilities to main activity areas.

D. SOEs should not be exempt from the application of general laws, tax codes and regulations. At the same time, SOEs should not be subject to additional liabilities compared to private companies in like circumstances.

E. SOEs should face market consistent conditions regarding access to debt and equity finance. In particular:

1. SOEs' relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.

2. SOEs' competitive activities should be required to earn rates of return that are, taking into account their operational conditions, consistent with those obtained by competing private enterprises.

F. When SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

IV. RELATIONSHIPS WITH PRIVATE INIVESTORS~~EQUITABLE TREATMENT OF SHAREHOLDERS~~

Where SOEs are listed in stock exchanges or otherwise include non-state investors among their owners, the state and the enterprises should recognise the rights of all shareholders and ensure their equitable treatment and equal access to corporate information. SOEs involved in complex co-investment projects such as Public Private Partnerships should have the critical skills and resource to engage contractual negotiations and manage operational phase of the projects.

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A. When the state is not the sole owner of SOEs it should strive toward an unqualified implementation of the OECD Principles of Corporate Governance regarding all aspects of the enterprises' operations. Concerning minority protection this includes:

1. The state and SOEs should ensure that all shareholders are treated equitably.
2. SOEs should observe a high degree of transparency towards all shareholders.
3. SOEs should develop an active policy of communication and consultation with all shareholders.
4. The participation of minority shareholders in shareholder meetings should be facilitated so they can take part in fundamental corporate decisions such as board election.
5. Transactions between the state and SOEs should take place on market consistent terms.

B. Existent national corporate governance codes should be adhered to by all listed and, where feasible, unlisted SOEs.

C. Where SOEs are required to pursue public policy objectives, adequate information about these should be available to non-state shareholders at all times.

D. SOEs that are contractually engaged in Public Private Partnerships should have the sufficient resources and the critical skills to ensure a prudent procurement process and when switching to the operational phase of the projects. SOEs should refer to the OECD Principles for Public Governance of Public-Private Partnerships.

V. STAKEHOLDER RELATIONS AND SUSTAINABLE BUSINESS

The state ownership policy should fully recognise the state-owned enterprises' responsibilities towards stakeholders and request that they report on their relations with stakeholders. It should make clear the state's expectations of SOEs in respect of responsible business conduct.

A. Governments, the co-ordinating or ownership entities and SOEs themselves should take additional steps beyond generally-observed market practices, to ensure compliance with internationally recognised standards and protect against human rights abuses~~recognise and respect stakeholders' rights established by law or through mutual agreements~~, and refer to the United Nations Guiding Principles on Business and Human Rights~~OECD Principles of Corporate Governance~~ in this regard.

#. Mechanisms should be in place for employees and their representatives to be informed and consulted about the business plan and foreseeable risk factors and to negotiate with management in case of substantial change in working conditions and pay and in case of restructuring process.

B. ~~Listed or large~~ SOEs~~, as well as SOEs pursuing important public policy objectives,~~ should report on stakeholder relations and on human rights, labour environmental and tax-related risks and how these risks are being addressed and mitigated.

C. The boards of SOEs should be required to develop, implement and communicate compliance programmes for internal codes of ethics. These codes of ethics should be based on country norms, in conformity with international commitments and apply to the company and its subsidiaries.

D. Where governments have expectations regarding responsible business conduct by SOEs, these should be publicly disclosed and mechanisms for their implementation be clearly established.

E. SOEs should not be used as vehicles for financing political activities, nor should they on their own make political campaign contributions.

VI. TRANSPARENCY AND DISCLOSURE

State-owned enterprises should observe high standards of transparency and disclosure.

A. The co-ordinating or ownership entity should develop consistent and aggregate reporting on state-owned enterprises and publish annually an aggregate report on SOEs. Good practice calls for the use of web-based communications to facilitate access by the general public.

B. SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.

C. SOEs should be subject to the same high quality accounting and auditing standards as listed companies. SOEs should also be subject to an annual independent external audit based on international standards. Specific state control procedures do not substitute for an independent external audit.

D. SOEs should disclose material financial and non-financial information on the company in line with high quality internationally recognised standards of corporate disclosure, and including areas of significant concern for the state as an owner and the general public. This includes in particular SOE activities that are carried out in the public interest. Examples of such information include:

1. A clear statement to the public of the company objectives and their fulfilment (for fully-owned SOEs this would include any mandate elaborated by the state ownership function);

2. Company financial and operating results;

3. The governance, ownership and voting structure of the company, including the content of any corporate governance code or policy and implementation processes;

4. Information on board member and key executives individual remuneration ~~policies~~ as well as their qualifications, selection process, roles on other company boards and whether they are considered as independent by the SOE board;

5. Any material foreseeable risk factors, including human rights, labour, environmental and tax-related risks, and measures taken to manage such risks;

6. Any financial assistance, including explicit and implicit guarantees, long-term contractual obligations and other contingent liabilities, received from the state and commitments made on behalf of the SOE including contractual commitments arising from Public-Private Partnerships;

7. Any material transactions with the state and other related entities;

8. Any relevant issues relating to employees, including remuneration, training, collective bargaining coverage, mechanism for employee representation, and other stakeholders.

VII. THE RESPONSIBILITIES OF BOARDS OF DIRECTORS

The boards of state-owned enterprises should have the necessary authority, competencies and objectivity to carry out their functions of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

A. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The role of SOE boards should be clearly defined in legislation, preferably according to company law. The board should be fully accountable to the owners, act in the best interest of the company and treat all shareholders equitably.

B. SOE boards should carry out their functions of supervising management, including oversight of the SOE's risk management policy, and providing strategic guidance, subject to the objectives set by the government and the ownership function. They should have the power to appoint and remove the CEO. [amendments to the annotations]

C. SOE board composition should allow the exercise of objective and independent judgement. All board members, including any public officials, should be nominated based on qualifications and have identical legal responsibilities.

D. Mechanisms should be implemented to avoid conflicts of interest preventing board members from objectively carrying out their board duties. Independent directors, where applicable, should be independent from management~~,~~ and government ~~and business relationships~~.

E. The Chair should assume responsibility for boardroom efficiency and, when necessary in co-ordination with other board members, act as the liaison for communications with the state co-ordinating or ownership entity. The roles of CEO and Chair should be separate.

F. If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence. [amendments to the annotations]

G. When necessary, SOE boards should set up specialised committees, composed of independent and qualified members, to support the full board in performing its functions, particularly in respect to audit, risk management and remuneration. The establishment of specialised committees should improve boardroom efficiency and should not detract from the responsibility of the full board.

H. SOE boards should carry out an annual, well-structured evaluation to appraise their performance. The outcomes of the board evaluations should inform the board nomination process.