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Government-owned companies: ensuring good corporate governance in Curaçao

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Analysis

Few people would argue that the rules issued by the state (government) must also be correctly and strictly observed by that same state. It cannot be well conceived that, for example, the police and Public Prosecutor's Office (as instruments of the state) should be allowed to violate the law with impunity.

Though there may be very different opinions about the nature and the role of the state (particularly from a philosophical and jurisprudential viewpoint), this article addresses the question of how we should consider government-owned companies, and in particular, what level of influence the government should be allowed to exercise over these companies (government-owned foundations will not be discussed in this context).

It is probably true for most government-owned companies that their activities originally belonged within the remit of regular governmental duties. At some point, these activities were grouped together, forming one united organisation (often some form of legal spin-off), concluding with the creation of a publicly held company which then oversees those activities.

GOVERNMENT (NOT) AT A DISTANCE?

Being a director of a government-owned company is certainly not always easy. Neither is being a shareholder in a government-owned company. The directors will usually complain that there is too much influence from politicians, while conversely the politicians will argue that they have too little influence over government-owned companies. This conflict raises two principal concerns that ought to be considered:

- Where are the boundaries between the government and the market?
- How much distance should there be between government and government-owned companies?

Let us first consider the boundaries between the government and the market. Which activities should be considered as duties of the government and which can be left to the market? Generally speaking, there is a consensus of opinion that the government should regulate public interests through legislation and regulations. As a result, to use an example, the government should not have to nationalise bread production in order to guarantee that this daily necessity remains affordable, though it may effectively control affordability by means of price regulation.

However, as we have seen with the banking crisis, there are sometimes special situations where it is necessary for the government to intervene (for example, the government in The Netherlands has become shareholder of ABN Amro Bank and Fortis Bank Nederland (which merged in 2010)). However, even with this intervention the starting point is that the government will eventually dispose of these shares again. There is no reason to keep these shares in the hands of the government indefinitely.

We will also consider how much distance there should be between government and government-owned companies. There are principally two opposing views which need analysis:

- Government at a distance.
- Government not at a distance.

Government at a distance

Proponents of this viewpoint believe that government should remain at a distance as much as possible and behave as an "ordinary" shareholder of a government-owned company. In other words, government-owned companies must be managed and run commercially from a business perspective. There are several reasons that support this argument:

- Politicians are too busy to concern themselves with business operations.
- Politicians have no powers of judgement regarding "business" matters.
- Politicians manage from a social perspective and undermine the business aspect.
- The involvement of politicians risks too much party-political interference, which puts the company's integrity in danger.

Proponents of the government at a distance viewpoint argue that:

- Politicians should set policy frameworks, establish priorities and set standards.
- Politicians should develop a justification protocol and steer towards results.
- Politicians should leave the actual business operations in the hands of experts.
- Supervision and control on standards should be led by (independent) supervisory directors.

In theory, this approach should result in the best possible product or service, for the lowest cost and the maximum profit.

Government not at a distance

The opposing view is that government should not be at a distance, but the government-owned company should be managed as if it

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were a government service and therefore part of a department (ministry). The arguments supporting this point of view are as follows:

- Politicians are always called to account and should therefore be able to involve themselves in day-to-day business operations.
- Politicians are there to guard the *patrimonio nashonal* (national heritage) and to protect it against the commercial interests of individuals.
- Government-owned companies serve the common social (and not commercial) interest.
- Government-owned companies do not fit in a more businesslike sphere.

The direct participation by political parties in the supervisory board and board of directors increases the influence that politicians have on the government-owned company. As a result, political parties indirectly exert influence on important decisions within a government-owned company, including:

- Appointments.
- Recruitment of staff.
- Tendering processes.

Politicians promote member loyalty by giving away positions within the government-owned company, and this phenomenon has been a concern in Curaçao for quite some time.

It is the writer's opinion that a government-owned company is no longer part of the public sector, but (apart from matters regarding concessions, licences and other public interests) must be safeguarded against, and be able to function independently from, direct or indirect politically determined government influence, with the exception of the influence that directly ensues from the business (company) position of the government as shareholder. On a daily basis, we can read in the newspapers that the practice is different here in Curaçao.

In our opinion, a government-owned company must function in a manner that is to a large degree comparable to every other professionally run commercial company. It should be in free competition with other market parties, and be oriented towards achieving financial gain for the shareholder (in this case, the government or the community).

In addition, it seems desirable to us that the government should make a clear choice. If any of its activities are placed in a public limited liability company or a private limited company, then the government's direct influence over those activities should be kept at a minimum, to ensure good corporate governance. If the government wishes to exert a larger influence of the activities, then they should remain within the duties of government itself and fall within the remit of the national budget, so that everyone knows where they stand.

THE GOVERNMENT IS NOT AUTOMATICALLY AN "ORDINARY" SHAREHOLDER

It is obvious that in a small community such as that of Curaçao there is bound to be tension when it comes to appointing directors and supervisory directors, as:

- There is only a limited choice of candidates for these positions.
- Familial and social networks appear to play an important role in the decision-making process.

For these reasons it is even more important that government has a clear vision regarding its shareholding, and that clear and transparent procedures are put in place concerning the appointment of directors and supervisory directors.

We do not believe that Curaçao corporate law currently imposes an obligation on the shareholding government to appoint the best candidate as director (rather than merely the candidate who best represents a particular political party). Provided a shareholder does not abuse his voting rights, he is free to appoint whoever he wants. The appointment of political "friends" (provided they at least marginally meet the quality test) is therefore not a form of abuse under general corporate law (it could be seen as an abuse of administrative law, though that is another matter, of course).

However, the Organisation for Economic Co-operation and Development (OECD) has issued guidelines (*Guidelines on Corporate Governance of State-owned Enterprises*) on the matter, which state:

> "The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of the state-owned enterprises (SOEs) is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness. (...) The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives. (...) The state should let SOE boards exercise their responsibilities and respect their independence."

The OECD believes that policies should be formulated so that it is clear how the government should behave as shareholder. The basic principles of transparency and accountability to the state (the public) should be adhered to, with the government taking a professional and results-oriented approach. The government:

- Should not be involved in the daily management of the enterprise (day-to-day business).
- Should allow the enterprise full operational autonomy.

The following corporate governance questions arise when a government acts as a shareholder of a bank (as was briefly discussed above in the context of The Netherlands government becoming a shareholder of ABN Amro Bank):

- Is the government as shareholder allowed to use the voting rights attached to the shares to promote the public's interests, for example by ordering banks to use favourable conditions to credit applications for investments in sustainable energy?
- Will the government, as shareholder of these banks, behave differently from the "ordinary" shareholder as it now concerns pillars of the financial system that "cost what it may" have to be kept standing?
- Is the government, as shareholder, allowed to pursue a more stringent policy concerning bonuses because it is simply the policy of the government, even though an "ordinary" shareholder may not do so for business reasons?
- Is the government allowed to give instructions to a state bank to take out loans with government-owned companies that contain more favourable conditions than those applied for other companies?
- Is the government allowed to use information it receives as shareholder regarding situations of abuse within the enterprise or about environmental offences in its public duty as enforcer of the law?

- When, and to what extent, does information that is connected to the shareholding fall under the rules for open government?
- In which cases can employees of an enterprise of which the government holds all shares be considered a "civil servant" for the purposes of the Penal Code? In which cases are they not considered to be civil servants?
- Does the government's shareholding raise issues concerning conflicts of interest (for example, where a government-owned enterprise is given concessions not available to other privately owned enterprises)?

These questions clearly illustrate the fact that the government is not automatically an "ordinary" shareholder.

On 1 January 2010, the National Ordinance Regarding Corporate Governance (National Ordinance) came into effect. Based on this, the Curaçao Corporate Governance Code (CGC) was created (which also came into effect on 1 January 2010). In it, reference is still made to the Executive Council and the island territory of Curaçao, but as from 10 October 2010 these are understood to mean the government of Curaçao and the country of Curaçao.

The National Ordinance undertook an obligation to both:

- Establish a CGC.
- Implement the CGC in government-owned companies.

In 2011, this obligation led to the drafting of Model Articles of Association (which are further discussed below).

In addition, the National Ordinance provided an obligation to establish an independent advisory and supervisory body, leading to the formation of the Foundation Office Supervision and Standards Government Entities (*Stichting Bureau Toezicht en Normering Overheidsentiteiten*) (SBTNO). The SBTNO has been operational since 1 May 2012. Prior to that date, the duties of the SBTNO were performed by SOAB (*Stichting Overheids-Accountants Bureau*) as temporary Corporate Governance Adviser.

The National Ordinance also imposes an obligation on government-owned enterprises to seek the SBTNO's advice on certain matters (for example, the appointment and dismissal of directors/supervisory directors, and the establishment of appointment procedures and profiles). This advice must be sought prior to the decision-making process, and the advice given is published by the SBTNO on their website. Any serious objections against the enterprise's decisions are indicated by the SBTNO in their advice. The government-owned enterprise can still deviate from the SBTNO's advice, but must provide notification of this to the SBTNO in writing, with their reasons for deviating from the advice.

To illustrate, if the government as a shareholder of a government-owned enterprise wishes to dismiss a director, it must notify the SBTNO of this fact. The SBTNO will then provide its advice on the matter, and publish this advice. If the SBTNO has no serious objections against the intention to dismiss, the dismissal decision can then be taken by the government as shareholder. Where objections are raised by the SBTNO, the government must notify the SBTNO in writing of its intention to deviate from the advice, and its reasons for doing so (though the decision can still be taken).

It must also be noted that the National Ordinance leaves Book 2 of the Civil Code of Curaçao (Civil Code) intact, under which it is a basic principle that, under the articles of association, a director can be dismissed "at all times". As a result, it has been necessary for the government to draft Model Articles of Association for government-owned enterprises, so that the rules concerning corporate governance and the Civil Code are in line with each other.

Any review of the Model Articles of Association must therefore consider both the terms of the Civil Code and the rules and principles of corporate governance. In particular, the National Ordinance contains the following provision in relation to the creation of the CGC:

> "The government lays down by order a Corporate Governance Code, regulating according to internationally accepted standards a good and transparent management of companies and foundations and the supervision thereon in conjunction with each other."

Provision is made for the CGC to be reviewed every two years following its adoption, and after seeking the opinion of the SBTNO. Where there have been changes to the internationally accepted standards concerning corporate governance, the CGC should be adjusted to reflect this fact. These internationally accepted standards include, in the writer's opinion, the OECD Guidelines on Corporate Governance of State-owned Enterprises.

The first Model Articles of Association date from 15 March 2011, and gave rise to considerable debate. Though many of these initial provisions have since been deleted from the current version of the Model Articles of Association, we will discuss the main points of contention that arose from the first draft.

MODEL ARTICLES OF ASSOCIATION (FIRST DRAFT)

Article 2, paragraph 1

The Model Articles of Association (for limited liability government-owned enterprises) initially contained a provision that the enterprise must realise its objectives "with due observance of a proper social-economic development, and also in fact the general interest of Curaçao". Though this provision has since been deleted from later versions, it is worthy of consideration for a number of reasons.

In the explanatory notes that accompany this provision it is pointed out that these companies usually occupy an exceptional position for several reasons:

- They can often be monopolist.
- They are usually also charged with the performance of public duties.
- They owe, to a large extent, their origin and wealth to the country of Curaçao (or its predecessors).
- They carry a special responsibility to society.

However, how can a director or supervisory director of a government-owned enterprise ascertain what can be construed to be in "the general interest of Curaçao"? What, precisely, does "proper social-economic development" mean? How can these interests be measured and taken into account during the decision-making process? The terms are too general and do not adequately deal with the situation where the government effectively wears multiple hats (for example, where they are both a shareholder of an enterprise and

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the regulator of the sector within which that enterprise operates). They also appear to be inconsistent with the OECD Guidelines on Corporate Governance of State-owned Enterprises, which states:

> "The state often plays a dual role of market regulator and owner of SOEs with commercial operations, particularly in the newly deregulated and often partially privatised network industries. Whenever this is the case, the state is at the same time a major market player and an arbitrator. Full administrative separation of responsibilities for ownership and market regulation is therefore a fundamental prerequisite for creating a level playing field for SOEs and private companies and for avoiding distortion of competition."

In addition to its regulating duties, government is also responsible for creating industrial policy, though of course this should not fall within the remit of an SOE. The OECD gives the following guidance on this point:

> "Another important case is when SOEs are used as an instrument for industrial policy. This can easily result in confusion and conflicts of interest between industrial policy and the ownership functions of the state, particularly if the responsibility for industrial policy and the ownership functions are vested with the same branch or sector ministries. A separation of industrial policy and ownership will enhance the identification of the state as an owner and will favour transparency in defining objectives and monitoring performance. However, such separation does not prevent necessary co-ordination between the two functions. (...) In implementing effective separation between the different state roles with regard SOEs, both perceived and real conflicts of interest should be taken into account."

As an SOE should not be responsible for economic development, we would argue that the initial inclusion of a clause concerning "proper social-economic development" has no place in the articles of association of a government-owned enterprise. Issues of macro-economic policy fall squarely within the remit of government, but are not the concern of a shareholder, director or supervisory director of a private enterprise.

Article 12, paragraph 1

The first draft of the Model Articles of Association also included a provision that the board of directors must "follow specific instructions given by the general meeting in accordance with the articles of association". This provision has now been deleted.

The explanatory notes to the provision clarify the position on the right to issue instructions, which meant that, in practice, the board of directors, on the shareholders' instruction, would be obliged to perform certain juristic acts. This means that the board of directors of a government-owned enterprise would be obligated, for example, to:

- Employ certain people.
- Purchase or sell assets.
- Enter into, or terminate, certain contracts.

This provision would pose too great a risk of political influence, favouritism and other forms of abuse, and has been removed with good reason.

Article 3.2 of the CGC already confirms that the board of directors of a government-owned enterprise must exhibit both transparency and integrity, and conflicts of interest must be avoided. This is why it is not possible for political figures to become board members of government-owned enterprises. It would therefore be untenable to allow politically-motivated shareholders to be able to dictate courses of action to "ordinary" directors.

Article 13, paragraphs 8b(iv) and 8d(ii)

The original draft included this provision stating that resolutions of the board with regard to investments that are "of a fundamental nature" and resolutions with regard to participations that are of "significant meaning or fundamental nature" are subject to the approval of the general meeting.

This provision has also been deleted with good reason. The wording is much too vague and could easily be open to misinterpretation or abuse.

The new draft states that resolutions that are subject to the approval of the general meeting are those resolutions of the board as the general meeting determines by further written resolution. This new wording at least allows such a significant restriction on the management's authority to be clearly and unambiguously formulated, so that there is no risk the provision can be misinterpreted.

Article 18, paragraph 2

Under this provision, every supervisory director of a government-owned company must, in particular, protect the general interest of Curaçao and weigh this interest relatively heavily. This provision has also now been deleted.

The term "general interest" is much too vague and general to be able to be used as a practicable criteria (though the law does provide that a supervisory director can be charged with special interests).

Article 19, paragraph 7 of the Civil Code already provides that the board of supervisory directors has a duty to look after the interests of the enterprise itself.

Article 18, paragraph 6

This provision allows the board of supervisory directors to seek advice (at the enterprise's expense) where this is desirable in the proper performance of its duty, and it remains in the current version of the Model Articles of Association.

In itself, this is an understandable and useful provision. However, the first draft stated that individual supervisory directors could be represented by external financial, legal or other experts at the enterprise's expense. This could have led to favouritism, with individual directors being able to give assignments to whomever they pleased. Since it must now be the board (and not the individual) who seeks the advice, a certain brake has been placed on the right to appoint advisers.

CONCLUDING THOUGHTS

Though many claim to adhere to corporate governance rules in Curaçao, in practice it remains the case that it is often regarded as a bothersome matter. Certain politicians even openly propagate that the Corporate Governance Council should be abolished as a waste of taxpayers' money, since politicians are perfectly capable of controlling public funds without its interference.

The OECD Guidelines remain the international benchmark with respect to corporate governance. Policies should be formulated that:

- Make it clear how government will behave as shareholder.
- Adopt the basic principles of transparency and public accountability.
- Encourage the government to adopt a professional and results-orientated position.

Government should not be allowed to be involved in the day-to-day business of SOEs, and should allow the enterprise full operational autonomy.

Transparency does not only mean that the government must have a clear vision when it comes to government-owned companies, but that it also publishes that vision and makes it reviewable. This review should not only take place in parliament, but also with the SBTNO and, of course, with the public.

The rules of corporate governance themselves do not contain any penal or other sanctions. The legislation and regulations primarily relate to the behaviour of the government, and leave company law out of it. The regulations instruct the government to exercise its influence as shareholder to arrange for government-owned companies to comply with the regulations as much as possible (that is, include them in their articles of association). Perhaps it is now time for us to consider attaching sanctions to the regulations concerning corporate governance, to ensure their compliance.

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Publications.

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