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THE REVIEW OF THE OECD PRINCIPLES OF CORPORATE GOVERNANCE

Report on a meeting of trade union experts held under the OECD Labour/Management Programme

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OECD LABOUR/MANAGEMENT PROGRAMME

THE REVIEW OF THE OECD PRINCIPLES OF CORPORATE GOVERNANCE

Report on a meeting of trade union experts
held under the OECD Labour/Management Programme

(Paris, 19 June 2003)

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FOREWORD

Under the OECD Labour/Management Programme for 2003, a meeting of trade union experts on "The Review of the OECD Principles of Corporate Governance" was held in Paris on 19 June 2003. The meeting was prepared in collaboration with the Trade Union Advisory Committee to the OECD (TUAC).

Below, you will find the Agenda of this meeting, along with the overall report of the discussions of the meeting of experts, which was prepared by Ms. Sue Kendall-Bilicki, designated as General Rapporteur for this activity.

**THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS REPORT
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AGENDA

Opening session

- Introductory remarks by the Deputy Secretary-General, Mr. Richard Hecklinger
- Discussion

Setting the Stage

- Presentation of the Issues Paper by Mr. Richard Tudway
- Tour de Table: The challenges at national level based on comments from Trade Union Representatives
- Discussion

Second Session: Work of the OECD Steering Group and Role of Stakeholders

- Presentation by the OECD Directorate for Financial, Fiscal, and Enterprises Affairs
- Trade Union Presentation
- Discussion

Third session: Discussion on Key Issues: The Rights and Responsibilities of Shareholders, Executive Remuneration and the Board

Brief Presentations on each topic to be made by:

- The OECD Secretariat
- Trade Union Experts

Fourth Session: Discussion on Key Issues (continued): Transparency, Disclosure, Accounting Standards, Implementation and Enforcement

- Brief Presentations on each topic to be made by the OECD Secretariat and Trade Union Experts
- Other Issues

Closing Discussion

QUESTIONS FOR DISCUSSION

by Mr. Richard Tudway
Director, Centre for International Economics, (London, UK),
and an advisor to TUAC on corporate governance

I. THE ISSUES IN OVERVIEW

Public anxieties about governance

1. Anxieties across the OECD and beyond about the effectiveness of corporate governance are widely felt. Value measured in billions of dollars has been destroyed, not by commercial error alone, but also as a result of malfeasance. In addition, workers have lost their jobs, and in many instances their pensions and health care benefits, which in many cases represent their sole safety net. Meanwhile, public confidence in financial markets has been severely undermined. Recent corporate irregularities have not been confined to the United States. They have and continue to appear globally, even if differences exist around the extent of the problem. Trade unions have legitimate fears that these may in turn be symptomatic of a systemic failure in the framework of corporate governance.

2. In response a plethora of national level initiatives to reform corporate governance regimes have been introduced, or are being planned. Trade unions have welcomed these, but fear that they have not gone deep and wide enough, and that the emphasis on voluntary codes and standards, rather than a binding regulatory framework is an insufficient response to ensure effective implementation and enforcement of the new reforms.

3. The OECD Principles of Corporate Governance are the only multilaterally agreed benchmark to guide debates around reform efforts in this key area of public policy. They include chapters on the following topics: The Rights of Shareholders; The Equitable Treatment of Shareholders; The Role of Stakeholders in Corporate Governance; Disclosure and Transparency; and The Responsibility of the Board. Upon their adoption, TUAC welcomed the Principles, in particular, the stakeholder chapter, which it saw not as the last word, but as a platform for further development.

4. Though non binding, the Principles are nevertheless emerging as the de-facto international comparative framework. For example, the World Bank and IMF use the Principles as a template to assess their members' corporate government environment, as part of the ROSC initiative (Reports on the Observance of Standards and Codes). The Principles are now being reviewed by the OECD. Views differ as regards the scope of the review. Some have argued to maintain the status quo, while others have suggested cosmetic changes. Trade unions have argued that the revisions should be deep and wide-ranging, with the addition of new chapters. They believe that the OECD has a unique opportunity to re-write the corporate mission for the 21st Century.

5. To set the stage for the OECD-TUAC Labour/Management Programme meeting the paper will discuss some of the underlying issues identified by trade unions as causing what they see as a systemic crisis in corporate governance. It then identifies reforms that they believe should be included in the review.

II EMERGENT PROBLEMS IN CORPORATE GOVERNANCE

Collapse of accountability

6. Serious concerns have been raised concerning the collapse of corporate accountability, involving companies such as Enron and WorldCom in the US, and Marconi in Britain, and Ahold in the Netherlands. Though the corporations headlined are not alone - they are some of the best known. That raises disquieting concerns about the ownership and control mechanism of the corporation and its public accountability. One key issue surrounds the debate about the role and function of shareholders as owners, whether banks, pension funds or other institutional investors. The following questions have been raised as to whether:

- Shareholders lack the means of effective control; and
- They may be perceived as “absentee landlords” whose only wish is to receive regular dividends and capital gains in a rising share market with no direct responsibility for the affairs of the corporation;

7. Complications in determining the duties and obligations of shareholders have it is felt left the corporation operating outside a credible framework of control and accountability, irrespective of jurisdiction. Overall there is the impression that many shareholders are in reality proxies and are in any case *conflicted* in acting straightforwardly as direct, interested, shareholders might otherwise do. These conclusions are difficult to avoid. The implications are far reaching for governance.

The issue of “tomorrows money today” – the new permissive-ism

8. A corrosive economics of greed is seen by much of the public, trade unions, and some opinion formers as being increasingly present in many corporations, resulting in a climate change in terms of managerial attitudes. They fear that corporations now pursue short-term commercial and financial goals with scant regard for whether such moves are strictly legal or are consistent with longer-term sustainable development. What could be termed a new corporate permissive-ism has been driven, it is argued by a combination of:

- An over-emphasis on stock options as a means of rewarding senior management that has fuelled a climate of greed;
- A corrosive, illegal insider trading culture within corporations;
- A pervasive copycat practice of bidding up executive remuneration;
- Chronic failures in the scope, composition, and regulatory framework governing the activities and the accountability of boards of directors; and
- An undue corporate influence on the global political process.

9. These influences have been compounded by a preoccupation with internal accounting devices that have the effect of overstating revenues and the real profitability of the corporation. *Off-balance sheet vehicles* have been widely abused in the pursuit of these ends with the collusion of financial and legal advisers, brokerage firms and other market makers. Though not in themselves illegal, these devices were used for example by Enron to deliberately conceal the true ownership of liabilities arising from these vehicles by methods of guarantee that were ultimately fraudulent. They were also used to siphon-off fees in underwriting and other service charges in a number of instances to benefit senior managers within Enron. Serious concerns have also been raised about the activities of external accounting and auditing firms – the gatekeepers. The collapse of Arthur Andersen was seen as graphic proof of a serious breakdown in the

nature of the auditing profession. Widespread conflicts of interests arising as a largely self-regulated industry were allowed to expand and to offer non-auditing services to their corporate clients. Similarly, questions remain over the role of other market makers such as rating agencies, etc.

The issue of globalisation

10. Globalisation, especially financial market liberalisation and deregulation has impacted on corporate governance with unanticipated consequences. Though recognised regional corporate governance mechanisms are beginning to appear, for example at the level of the EU, and the trans-boundary aspects foreseen by Sarbanes Oxley, the dominant systems in terms of implementation and enforcement remain at the national level. The emergence of global corporations has encouraged management to exploit opportunities for regulatory arbitrage between different national jurisdictions¹. In some well-publicised instances this has resulted in corporations relocating their headquarters to offshore tax havens to evade fiscal responsibilities, and other responsibilities, for example employee pension obligations. Veiling true beneficial ownership behind complex legal arrangements is used to hide the underlying intention. Globalisation has, furthermore created *grey areas* where national level regulatory bodies and other parties are uncertain as to which regulatory framework governs a corporation operating within their territories.

III CORPORATE GOVERNANCE REGIMES ACROSS THE OECD

Diversity is the norm

11. While much is said about the convergence of corporate governance regimes across the OECD, key differences remain, for example, in the form and function of boards; the underlying philosophies of accounting practices, or to whom the board and corporation is legally accountable to. This is especially true as regards the way in which key stakeholders such as workers and trade unions are included, or excluded, from the governance process. In many European countries and Japan, law and practice is different when compared with Anglo American based jurisdictions. The former view these issues from a different perspective. Stakeholders often have established rights in law, or collective agreements, and direct representation in the governance of corporations. Here, for example, workers may appoint or recommend for appointment representatives from their own ranks to sit on the supervisory and executive boards of enterprises. Their rights and duties as directors are also clearly defined, including that they have a fiduciary duty to the company. In some instances trade unions also have that right. At the same time workers and trade unions often have institutionalised consultative rights at other levels of governance over key employment related issues. Similarly, pan-European legislation conferring rights to information and consultation on some issues, currently for workers in multinational enterprises operating in the EU, will shortly be extended to all domestic enterprises, subject to certain thresholds. At the same time EU wide legislation on collective redundancies confers the right to information and consultation for workers.

12. However, this participatory approach to corporate governance should not be taken to infer that workers and unions have no voice in Anglo American based jurisdictions. In the United States workers have a voice and are represented as investors through their private retirement savings plans and ESOPS. This is increasingly the case in the UK as well. And, it is argued new and expected regulatory changes are widening and deepening these rights.

¹ Some large institutional investors are warning companies not to relocate or set up business in countries with weak corporate governance regimes. See "Funds warn companies favouring lax regimes". Financial Times Weekly Review of the Investment Industry, June 2 2003.

IV SOME PROGRESS IN NATIONAL-LEVEL CORPORATE GOVERNANCE REFORMS

13. In response many government are now enacting or in the process of enacting reforms to their national corporate governance regimes. The most high profile example is the Sarbanes Oxley Act of 2002 which has strengthened the scope for civil and criminal sanctions, including for gatekeepers. But reform efforts are underway across most of the OECD. The exact form of the reforms varies across countries, but includes: financial reporting and disclosure, the role of institutional investors, internal and external audit procedures, the form and composition of boards of directors, conflicts of interest, and implementation and enforcement. The UK has now released a consultative document on directors' remuneration. The reforms have enjoyed widespread support, though many, including trade unions are of the view that more can be done. Disquiet has also been expressed that an over-reliance on voluntary codes and standards for implementation and enforcement will be insufficient to overcome the failures of corporate governance.

V THE REVIEW OF THE OECD PRINCIPLES OF CORPORATE GOVERNANCE

14. The paper has already touched upon the review of the OECD Principles of Corporate governance, which is being conducted by its Steering Group on Corporate Governance, to which TUAC and BIAC participate on an ad-hoc basis. The road map for the review was agreed at its meeting on 19-20 March 2003, and it is expected that the revisions will be presented for adoption to the Spring 2004 meeting of the OECD Council at Ministerial level. It has also been noted that views differ on the extent to which the Principles should be revised. The paper next indicates revisions that TUAC and its affiliates believe should be incorporated into the review.

Broadening stakeholder representation

15. TUAC believes that the case for broader stakeholder representation on the boards of corporations is compelling, and is underpinned by sound economic thinking. Within this paradigm workers like shareholders are investors in the corporation. Their investment, takes the form of human capital, for example in on and off the job training, where the returns are not captured in the wage. And, just as financial investors are now seen as having a right to a say in the governance process, so too are workers as investors. Similarly, current practices whereby workers are investors in corporations through their pension funds, or employees share option programmes (ESOPs) gives them a right to a voice in the governance process. At the same time, provisions are in place in a large number of OECD countries that give workers a right to be informed and consulted by the board about key issues surrounding the future direction of the enterprise.

16. As currently drafted however, the stakeholder chapter is limiting in that it focuses solely on the recognition of a stakeholder voice in the governance process as "established by law", while other performance enhancing mechanisms should be "permitted". To bring the Principles into conformity with current practices, the text should be revised to generalise a worker voice in the governance process.

Expanding the gene pool of directors

17. Any changes in the Principles might very well seek to reflect measures anticipated in new national initiatives – in particular those in America and Britain. The Sarbanes Oxley Act, 2002 is wide ranging. It covers board membership, the duties of board committees, accounting and auditing standards and conflicts of interest. Severe punishments are foreseen for breaches of law. Furthermore, changes have and continue to be introduced to the New York Stock Exchange and Nasdaq listing requirements (overseen

by the SEC) for companies, that are seen by some as more far ranging. In Britain proposals for changes to company law have been advanced by the Company Law Reform Steering Group (CLRSG). Most recently the Higgs Enquiry has reported on the role of independent directors, as has the French Bouton Report.

18. Higgs recognises the need for strengthening the independence of non-executive directors. The appointment of a chairman should be independent from earlier allegiances or association with the corporation in question. Higgs also recommends a systematic widening and deepening of the gene pool from which directors are selected. The British CLRSG's report also places particular emphasis on the need for corporations and their boards to be responsive to changing stakeholder and societal expectations. This has important institutional implications as well as implications for training and education in *directorship*. The Principles might wisely reflect these matters in any changes to the drafting of the Principles.

The responsibilities of shareholders

19. There need to be a new chapter to cover the Responsibilities of Shareholders. This chapter needs to differentiate between institutions such as pension funds and Employee Share Associations (ESAs), and short term speculative institutions such as "hedge funds"². Although both groups have fiduciary duties, pension funds are, however, providers of *patient capital*, with the implication that the investments they make are *long-term*. The option to 'exit' would normally in such cases be limited to *times of crisis*. In contrast hedge funds measure their investment over a much shorter time frame – sometimes one or a few days - and as such face different expectations over their responsibilities.

20. Pension funds have, in effect, a responsibility to the workers as stewards of the capital they are entrusted to manage. The Principles should set out clearly the need for institutional investors, including pension funds, to exercise the closest oversight of the corporations in whose firms they hold equity; how that can most effectively be achieved; and the necessary transparency and disclosure required to allow trustees to ascertain whether effective oversight is being discharged. Examples might include requiring such investors to vote in AGMs, and to disclose their voting patterns, and most importantly to allow them to nominate directors.

Disclosure and transparency

21. The existing chapter on Disclosure and Transparency chapter could benefit from revisions in key areas. A key issue for investors and worker alike is access to clear unambiguous and timely information on the exact geographical location of a corporation's particular operations, regardless as to whether this applies to a subsidiary or its supply chain. There is a similar need for transparency and disclosure on all aspects relating to ultimate beneficial ownership, including full details in respect of incorporation. There is a need to specify more clearly what is understood by foreseeable risk factors, what constitutes materiality and how these are expected to impact upon employees and other stakeholders.

The Board – roles, responsibilities and conflicts of interest

22. Against the background of recent corporate scandals, there is also a need now for a new chapter covering the Roles and Responsibilities of CEOs and Senior Management. It should cover issues such as the separation of roles of CEO and Chair; remuneration, especially the use of stock options, and full disclosure on ethical issues and conflicts of interest in respect of individual directors and employees.

² The distinction between pension funds and hedge funds is merely used to illustrate the different functions, and responsibilities of financial investors.

23. The need to avoid conflicts of interests between for example the services offered by external auditors and the corporations that they audit need also to be incorporated, along with those concerning credit rating agencies. Finally, implementation and enforcement were not included within the original Principles. Events demonstrate clearly that these twin issues should be included.

Implementation and enforcement

24. All OECD member countries have mechanisms to ensure the implementation and enforcement of their corporate governance regimes, but differences exist as to the mix of hard and soft law, and voluntary codes of practice that are utilised to ensure compliance. Yet, the current Principles could be termed “light” on implementation and enforcement. Developing and transition countries would certainly benefit from guidance in this area when contemplating reforms. There is therefore a need for the inclusion of a set of Principles and annotations that reflect the current practices in this area. Moreover, whilst the use of market mechanisms and incentives should be included as possible compliance mechanisms, so too should binding and soft law mechanisms, the latter including international arrangements.

Concluding remarks

25. In conclusion, governments in all jurisdictions face fundamental challenges in effectively addressing public concerns around corporate governance. Trade unions believe that the OECD Principles of Corporate Governance have a key role in informing and guiding the ongoing and future national level debates, as well as any emerging international framework required as part of the process of managing globalisation.

FINAL REPORT

by
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BACKGROUND AND INTRODUCTION

Corporate governance emerged as a major issue of public concern in the wake of the Asian financial crisis of the late 1990s. The OECD Principles of Corporate Governance were adopted in 1999 as part of broader multilateral efforts to improve global financial stability in reaction to that crisis.

The Principles consist of five chapters: The Rights of Shareholders; Equitable Treatment of Shareholders; The Role of Stakeholders in Corporate Governance; Disclosure and Transparency; and The Responsibilities of the Board. In 2000 the Principles became one of 12 key standards of global financial stability and are now used as a benchmark by international financial institutions.

Corporate governance hit the headlines again in late 2001 in the wake of Enron and other financial scandals in the U.S. and elsewhere, coupled with steep falls in stock markets. These raised concerns not only about measures to limit fraud but also the effect on shareholders, pension funds and jobs of collapsing share prices, as well as rising public criticism of compensation packages for some top executives.

OECD ministers decided at their annual meeting in May 2002 in light of these developments that a review of the Principles scheduled for 2005 should be brought forward for delivery to ministers in 2004.

The Trade Union Advisory Committee to the OECD (TUAC) has been involved in the work on the Principles of Corporate Governance since its inception, and participates on an ad hoc basis in the OECD Steering Group on Corporate Governance which is carrying out the current review.

As part of the review process, TUAC requested a meeting under the auspices of the OECD's Labour/Management Programme (LMP) to discuss the major failures, weaknesses and challenges, and policy responses that have arisen in corporate governance. TUAC was responsible for setting the list of participants and for an issues paper to guide the discussion. This meeting followed a two-day session of the steering group the same week.

CONTEXT OF THE REVIEW AND ISSUES AT STAKE

1. Objectives of the review

There was a clear commitment from all participants to the need for such a review and to achieving the best possible outcome, although there were diverging views on how far the principles should be changed and in what way.

The secretariat said that the recent corporate scandals had in fact shocked industrial governments out of what may have been complacency that what had happened in Asia could not happen to them because they had strong and credible corporate governance systems. That is what had spurred them into calling for an accelerated review.

Participants noted that the 1999 Principles have been instrumental in attracting foreign direct investment (FDI) and more importantly in boosting domestic investment in developing and transition countries. It was argued that had the Principles been followed strictly in the past, corporate collapses and scandals would not have occurred. Participants said that how the Principles could be strengthened, provide guidance on legal constraints, and help prevent conflicts of interest were key considerations.

The secretariat said that the review would increase awareness by all sides of what issues need to be addressed; to enable countries to learn from each other's experience of what has been done at national level and to produce an even more effective tool for countries that want to improve their practices. There were also suggestions that the Principles should offer guidance to help countries not just to implement an improved governance regime but also to effectively enforce it.

For TUAC participants, the overarching question for the review was whether the revised text will pass the "post-Enron test" and provide a way to restore legitimacy to corporations. TUAC participants argued that the principles should provide an international "standard of reference" for corporate governance in both the industrial and the developing world as well as a point of reference for national reforms. Many felt that to achieve this, the principles require radical rethinking and redrafting. Some warned that the changes proposed so far are not enough and do not pass the "post-Enron" test.

Several participants expressed concern that the sense of urgency from governments and business immediately after the scandals, which had led to the review being accelerated, had apparently evaporated. There were now signs of complacency, both from some governments and from business, and of reluctance to change anything. Some TUAC participants said this is short-sighted, arguing that it is in the interest of all parties to improve the environment for investment and confidence in businesses. For that to happen, measures need to be put in place that will restore confidence and credibility. One TUAC participant questioned whether the goal of the review was to react to past crises or to prevent future ones. The secretariat replied that the review would target both, by being "proactive in preventing".

2. Coherence of the review with other global actions

Participants generally agreed that the OECD is the best place to deal with corporate governance since it groups the major industrial countries which are the home base of many of the world's large multinationals. Several TUAC participants stressed that the purpose of the principles is not corporate governance per se and to prevent future corporate collapses but corporate governance to achieve economic and social development worldwide. They said the principles should also be linked to the development agenda laid out in such forums as Monterrey and Johannesburg, the IMF/World Bank Poverty Reduction Strategy Paper agenda, the promotion of the ILO 1998 Declaration on core labour standards, the work of the UN and the OECD on prevention of money laundering, as well as issues such as auditing and accounting standards. If the various frameworks are to work well, they need to be compatible. Several

TUAC participants also said the principles should be better integrated into the OECD's work as a whole, particularly the OECD Guidelines for multinational enterprises (MNE Guidelines) and the OECD's work on public governance

These links were supported by the OECD Development Centre representative, who highlighted the important relationship between corporate and public governance, competition policy and regulatory governance in a developing country perspective.

The secretariat agreed that coherence with the rest of the OECD's work was important, particularly for developing countries, since they are often trying to bring various elements of OECD work together into a single package to create a climate that encourages growth and investment.

3. Review process and consultation

The secretariat said that following the two meetings of the steering group it was clear that there was a commitment from all participants to the need for such a review and to achieving the best possible outcome, although there were diverging views on how far the principles should be changed and in what way.

The secretariat noted that differences of culture, history and views as to the role of social partners between OECD members make it difficult to reach agreement on how to make the principles of corporate governance more specific. However, there was a consensus that the principles should remain aspirational and outcome-oriented, leaving flexibility as to how a particular principle might be achieved. In these circumstances there is a lot that the OECD and other international organisations can do to lay out best principles and good practice that can form the basis of legal and regulatory frameworks for OECD countries and beyond. The OECD seeks to guide the development of corporate governance regimes that will encourage investment and give confidence to investors and stakeholders.

The secretariat stressed the open and transparent nature of the process, which involves not just the steering group and interlocutors such as BIAC and TUAC but also meetings with other stakeholders, and a public invitation to comment from any interested party. The secretariat said it would try to take comments from all these into account when drafting texts for submission to the Steering Group.

Several participants agreed that it was important not to become bogged down in detail and lose sight of the fundamental point of the review: to look at what a good company is and how to make it work.

Several TUAC participants noted that one problem in reaching agreement on difficult issues such as stakeholder participation was that the steering group is made up of representatives of a broad range of ministries from different countries, with very different concerns. It was suggested that this problem could be resolved by giving the steering group more status and resources, by converting it into a fully fledged committee.

4. Review issues

The role of the company was taken up by several participants as fundamental to the review. Some TUAC participants said the current principles implicitly share the business view of the company as an entity owned by shareholders. But, they said, there is now a broader social awareness that the company is not simply a private institution but has wider responsibilities and duties. The wealth of society, in short, is not just a matter of private property or private institutions. The corporate entity is a major driver of growth and development in all economies, and must be allowed to grow and prosper. But it follows from the TUAC position that it is critical to have principles that respect the role of trades unions and other stakeholders in the governance of the corporation if its legitimacy is to be restored and enhanced.

TUAC participants called for the principles to be made broader and deeper, with a greater emphasis on the role of stakeholders, particularly workers, and how this should be given expression at board level; the duties and obligations, as well as the rights, of shareholders; and the role of the board, particularly the chief executive officer (CEO). TUAC called for a new chapter to be added covering the CEO and for the chapters on stakeholders, the board and its functioning to be developed further. Conflict of interest and the role of institutional investors were also included as topics missing from the current Principles that need to be addressed.

The secretariat agreed that the role of corporations in growth creation in our societies has become increasingly important. As a result, the company, how it is governed, its influence on society and the way it accommodates demands from society are increasingly a policy issue and the OECD is well-placed to serve that policy dialogue.

The secretariat noted fundamental changes in ownership structure, including the shift from large individual investors to institutional investors and the increased reliance on capital markets. Two cross-cutting issues could be singled out following the consultations of March, the steering group meeting that followed, and the non-OECD roundtables over the past three years, participants said: conflicts of interest and the role of institutional investors. TUAC said the existing language on conflict of interest was short of what is required to ensure an independent board and effective enforcement of the Principles. Concerning institutional investors, it was argued that the Principles should be more explicit on the right incentives to use their voting rights in an intelligent and cost-effective way.

5. Assessment of national differences and implementation

The secretariat said that a key element in reviewing the Principles is the fact that there is no “one size fits all” solution. Cultural and social differences between countries, such as differences in board structure between the Anglo-American and continental European models, have to be recognized and taken into account if the Principles are to be useful. This meant looking at the actual situation in individual countries and creating practical, workable solutions that could work for everyone, rather than crafting regulations for an ideal corporation in an ideal world that does not exist. The secretariat said its survey of current practice in participating countries had revealed differences between perception and practice in several areas, for instance showing that in many cases shareholder rights existed on paper but in practice were ineffective.

Several participants raised the question of how companies, whatever structural system they follow, go about putting the principles into practice and how to find a way to avoid simple “box-ticking” by directors. They cited examples of companies which had put audit committees or executive pay monitoring committees in place essentially to be able to say they had set them up rather than to perform a real function. There are also differences of perception between countries as to what such committees’ functions are.

Several TUAC participants highlighted the differences in the way different countries deal with corporate governance. The extent of formal union involvement varies, with participants from continental Europe detailing methods of regulation in which labour is formally involved in drawing up corporate codes while the Anglo-American model tended to favour a mixture of laws and rules set by regulatory bodies, with boards being left with wide discretionary powers under “comply or explain” provisions. In some cases, codes were backed up with government threats of legislation if they were not strict enough. Both types of system can be rendered more complex in the case of federal systems where regulatory responsibilities are divided between national and federal authorities.

THE ROLE OF STAKEHOLDERS

6. The role and definition of stakeholders

Several stressed that the principles needed to define more clearly what a “stakeholder” is, and their role, responsibilities and rights, in order to avoid national systems that paid lip-service to the idea of stakeholder involvement without spelling out just who they meant.

One TUAC participant said a stakeholder could be defined as anyone who affects or is affected by the company, such as society in general or people living around a plant. This begs the question of how such a general concept of stakeholderhood can ever be effectively extended to involvement in governance. But stakeholders who are clearly “constituents”— meaning someone who adds to the corporation’s productive resource and needs to be protected – would also have rights and responsibilities. By this definition, shareholders and workers should have the same level of rights and responsibilities since they have the same kind of relationship to the corporation. The case for a worker voice in corporate governance was also made in a developing country perspective, where contractual arrangements may not be the norm and labour rights may not be guaranteed by law.

The secretariat cautioned that pushing the worker as stakeholder argument too far and over-estimating the firm-specific capital carried by individuals could backfire and be used as a basis to create a “free agent” category of worker responsible for their own unique contribution to the process, which is happening in some hi-tech companies. This is then reflected in the wage structure and can be used to divide the workforce into types of firm-specific knowledge, which could cut out a large part of workforce who are not work-specific and can easily be replaced.

7. Worker participation as a contribution to corporate performance

TUAC participants noted that there is a literature showing that higher employee involvement in decision-making makes for a more flexible, successful business. This would support the case for a clear statement of these benefits in the stakeholder section of the principles. Since workers participate in creating the products that in turn generate the wealth, they are as much a stakeholder as a shareholder in the company.

A World Bank survey of 1,000 studies on the economic effects of unions and collective bargaining, for example, found that high unionisation rates were linked to improved economic performance. It should be possible to draw at least a passive analogy from this on the effect of employee participation in corporate governance. Looking at the question from the reverse perspective, if employees do not play a major role in strategic decisions affecting them it leads to conflict, lack of loyalty, grievances, and ultimately a less stable business environment for the company.

The secretariat said that one problem with arguments for stakeholder representation and involvement in board decisions is the lack of a large body of evidence to demonstrate the outcome and benefits. A lot of studies have been done on labour-related questions such as wage-setting, but relatively little work has been done specifically on the contribution of stakeholders.

TUAC participants acknowledged that there may not be an extensive literature specifically linking employee involvement and better corporate governance, but said that in many countries where worker involvement and social partnership have been the practice for many years, little research work has been done because there is a general consensus that this is clearly the best way to get results. A recent ILO study of several European countries found that in times of rapid change, countries with extensive social dialogue and stakeholder involvement cope much better with challenges and suffer less friction and unemployment than those without.

Several TUAC participants also said that the economic argument in support of worker involvement was far from new, and asked why the secretariat wanted unions to produce proof of their argument when companies and governments operating systems based on shareholder control without worker involvement were not being asked to prove their benefits.

8. Workers as bearers of corporate risk

Several TUAC participants said that the argument for stronger worker involvement in corporate governance was not only motivated by their contribution to corporate performance, but also because they bear risks equal to or higher than shareholders. Shareholders do not “own” the company in any real sense – they cannot sell it or use its assets, but they do bear the residual risk, as do stakeholders and constituents. Workers also have a stake in the firm, in the shape of firm-specific knowledge which is of value to the company and they bear a risk since that value is lost if the company fails. Employees are in fact more exposed to risk than shareholders because they are not fully in control of the contractual relationship: shareholders always have a choice whether to sell but a worker can be forced to leave even if he wants to stay. Furthermore, the worker’s risk is undiversified as he has only one job whereas a shareholder generally spreads ownership of shares across several companies. The case was said to be even stronger for transnational corporations, because these workers face higher risks of unemployment due to jobs going abroad following internal restructuring. TUAC participants were therefore of the view that workers should have a voice in board decisions since they cover items with a direct impact on workers, such as restructuring or foreign direct investment allocation, that directly affect the livelihood of workers and their families.

The secretariat said that if the benefits to all were straightforwardly obvious, corporations would want to take action. But it is not easy to convince everyone that employees bear the same kind of risk as shareholders or creditors. They are paid, and are thus the first beneficiaries of profit, and can walk away when they want without finding someone else to do their job, whereas shareholders have to find a buyer for their shares to replace them.

9. Worker representation on company boards

The meeting spent some time discussing the case of worker and trade union representation on company boards. One TUAC participant cited the case of a European company that chose to have trades unionists seated on the board of directors in the one-tier system to ensure quality of the social dialogue within the company as it was facing major restructuring.

However, TUAC said, worker representation on the board was not necessarily a guarantee of full access to the decision-making process. One TUAC participant cited the case of union representatives on the board of a European company who had been excluded from discussions about an upcoming takeover bid although it would affect jobs. Another pointed out that in the Anglo-American single-tier board model even when workers are shareholders, either directly or via worker pension funds, they still may have no power over the board.

The secretariat raised the question of conflict of interest arising for workers as stakeholders, or worker pension funds on the board: who do they represent – their own constituency which put them on the board, or the company as a whole? Similar issues also arose with special representation for minority shareholders.

TUAC participants replied that the risk of conflict of interest was low because the bottom line was that both need long-term sustainable growth in the corporation to be successful. Another said that when it came to worker representatives on the board, how they were chosen could affect the role they were expected to play. In countries with two-tier boards, union representatives can be chosen by a union or a

federation and the further away from the shop floor they were, the more likely they were to represent general interests.

For TUAC, the question of conflict of interest was not only a concern for worker representation on boards; the same question could be applied to any board member, and the answer from national company laws is ambiguous: are they responsible to shareholders or to the company, or both? In a sense it is both, and in any case if the board is responsible to the company then it is responsible to all its constituents. One problem when talking about corporate governance and conflict of interest is that the view about appropriate responsibilities has changed. In the 1950s and 1960s there was a prevailing view that the board was responsible to all the constituents of the company, but in the 1980s the equation shifted in almost all countries to become one of responsibility to shareholders only. Worker shareholders and worker representation on boards were widespread already. The answer in regard to their role was that they should be seen as shareholders when dealing with issues of the company as a whole, and employees when dealing with issues such as wages.

10. The review of the stakeholder chapter

TUAC participants expressed disappointment that the steering group had shown reluctance to change the existing chapter on stakeholders. TUAC is particularly interested in ensuring that the role of stakeholders is clearly articulated in the principles.

Some TUAC participants stressed that in looking at the role of stakeholders, and particularly workers, the principles must take account of other ways of doing business than the Anglo-American model, and recognize that other countries have a strong social dialogue culture, notably through works councils and worker representation on boards.

Some TUAC participants said the principles should state that corporations are bound to justify and explain their actions to stakeholders and involve them in the decision-making process.

The secretariat said it was quite clear to all that consensus about the stakeholder section was going to be difficult to find. To inform the discussion the secretariat for its part had sought to inform the debate with the results of recent research. The corporate governance principles certainly put the issue of stakeholders on the table, the secretariat said, noting that when they were first issued these principles were the only multilateral document with any clout to have any significant section on stakeholders. But most participants in the steering group had said they felt fairly comfortable with the way stakeholders are currently dealt with.

The secretariat also cautioned against getting too bogged down in detail of wording and definitions, noting that experience to date in working with the principles, particularly in non-OECD countries, had shown that what is really important is that the principles provide an underlying rationale to discuss the issue.

SHAREHOLDER RIGHTS AND RESPONSIBILITIES

11. The role of institutional shareholders

TUAC participants said it was clear that, in many cases, shareholders lack effective control of corporations and this has to be addressed. Shareholders are reacting, but in many cases companies are still resisting control either by shareholders or other outside regulators. Some noted that despite corporate mantras about shareholder control in the US, in many cases they had no voice in selecting the board, and even when they could bring a vote it was not binding.

TUAC participants supported the idea of giving shareholders more power over the board, including by being able to nominate directors. Business has raised the problem of the extra burden that will be imposed on companies if shareholders have the right to raise proposals at annual general meetings (AGMs). But the mere ability to make such proposals may not in itself be enough to achieve change. Cases were cited where shareholders had put a resolution to the AGM which were noted but not acted upon. Others stressed that any such resolutions from shareholders must be binding or there was little point in having them.

The secretariat noted that the survey of actual practice in countries had been able to make clear the difference between perception and practice, and how ineffective shareholder rights actually were in some cases. There are wide differences in current practice between countries when it comes to shareholder rights, and transparency, in terms of executive remuneration. Some countries allow shareholders to vote, but only in an advisory capacity, others have a binding vote but only on an overall package and in some cases shareholders can determine what an individual package will look like.

Several TUAC participants said the principles should state that active ownership is better than passive ownership. The secretariat agreed that active ownership is better than passive ownership, but said what is really important is to have “informed ownership”. It also cautioned that mandatory voting by major shareholders, as suggested by some TUAC participants, is not the best incentive to active, informed, ownership as it could simply lead to lots of proxy voting.

TUAC participants said they wanted the revised principles to include not just the rights but the responsibilities of shareholders. This should include making institutional investors responsible for exercising close oversight of companies in which they hold equity. There was a suggestion that institutional investors could be given tax breaks for example, to keep their holding in a particular company for a longer period than is now the case with some institutional investors.

Some participants said it is clear from the evidence of the past few years that however many rights you give investors, without the right cost-effective incentives they will not invest. This means making the decision-making process accessible to shareholders. So the principles should cover not only the rights of investors but also seek to ensure that the regulatory framework facilitates participation. There was a view that in this case it should be clear that “facilitating” meant making it easier for investors to fulfil their responsibilities, rather than just exercising their rights. But shareholders and proxy shareholders also have to be able to act in an effective way in controlling the activities of the corporation and bringing it to account.

12. Governance and engagement of pension funds

Some TUAC participants said there was a need to give pension fund investors incentives, such as tax breaks, to be active in the companies where they held shares and to stay to sort out problems rather than selling up. Worker pension funds have to have a voice, they said, citing losses to worker pension funds due to falling stock markets, in some cases linked to financial scandals within companies, and lack of worker involvement in managing these funds. However, pension funds often choose to be passive to increase their efficiency and the rate of return on their investment, and do not have any exit strategy when problems of corporate governance arise. More transparent financial markets were needed, TUAC said, but the review also had a role to play in facilitating the transparency of proxy voting. Although institutional investors require greater transparency from corporations, they refuse to disclose their own voting policy and many trustees hire financial intermediaries with serious conflicts of interest. One TUAC participant recalled the distinction between pension funds and mutual funds managed by banks, as well as within pension funds, between large public pension funds that manage their investments internally (with low risk of conflict of interest) and smaller ones that appoint trustees to manage their investments.

One TUAC participant said workers must have representatives on their own pension funds. These are more the workers' property than that of the company but workers are often not represented. US pension funds have lost three trillion dollars, a gap that now has to be bargained back from employers; if workers were on the pension fund boards in the first place they would be handled with a more responsible attitude. It is important to get elected worker representatives on pension funds in the revised principles.

The secretariat said there is good support from member countries on the importance of having the need to deal with conflict of interest in the principles and this might well be strengthened as part of the review.

THE RESPONSIBILITIES OF THE BOARD

13. Remuneration of the Board and executives

Several TUAC participants said it was clear that current systems of checks and balances, and systems of self-regulation, were not working, citing changes in style and ways of working that have led to over-remuneration and unhealthy levels of payment via stock options etc, resulting in cases where directors and other executives brought corporations to their knees and still walked away with million-dollar packages.

The secretariat noted that the move toward more disclosure of executive, and especially director, remuneration had met resistance on the grounds that this would break solidarity between members of the board. However more and more countries were calling for individual executive and board remuneration to be declared.

TUAC participants said shareholder votes for remuneration should be binding and on an individual basis, as a global sum covering several people was not sufficiently transparent to enable shareholders to make a proper judgement. They also said that there were myriad ways of organizing this in detail, but the bottom line was that the principles should be able to state that the board must have a way to determine compensation in relation to performance of the company as measured against standards set by the board. One TUAC participant suggested that stock options should be replaced by actual shares, and that executives should be forced to keep them for a minimum period after leaving the company to ensure they acted in the best long-term interests of the enterprise.

14. Composition of the Board

There were also several calls for broader participation in boards, because too many boards are self-perpetuating and drawn from a narrow group of people. TUAC participants said the revised principles should give a clearer idea of how to widen board participation. Adding worker and minority shareholder representation, some said, would immediately broaden the perspective of the board as a whole. It was important to achieve an expanded gene pool of directors, to enable the boards to respond effectively to society's changing expectations in terms of corporate social responsibility and "environmental governance" issues. TUAC participants also said there are too many examples of the same people sitting on multiple boards with little time to devote to any of them.

The secretariat noted that several countries have expressed concern that a narrow "gene pool" can affect the quality of the board and are trying to improve it. But one crucial question comes back to the issue of whether the members of the board would feel that they were representing a certain electorate rather than working for the company as a whole. In some two-tier boards, for example, there is a need for more members not representing narrow interests but representing all the interests of the company.

15. Independence of the board and separation of functions

TUAC participants wanted a new chapter in the principles dealing specifically with the CEO and senior management that would cover separation of roles between the CEO and chair, remuneration packages, and full disclosure of conflicts of interest, especially when it came to outside auditors.

Some TUAC participants said the current principles do not give a satisfactory delineation of the purpose, role and responsibility of different members of the board or of different tiers in multi-tier boards. There may be different ways of organizing things, but the bottom line is that whatever board model is being followed, all corporations need an executive and supervisory function and to allocate responsibility. Therefore it would make sense for the principles to go into more detail about the division of responsibility between the CEO and chairman and their functions. Furthermore, separating the role of chair and chief executive in the one-tier system should be given in the principles not as best practice but as a minimum standard.

The secretariat said that one way to help with this would be to facilitate effective shareholder influence on the composition of the board, and indeed some countries are moving in this direction.

The secretariat said that the principles already state that the board should be able to exercise objective judgement on corporate affairs independent, in particular, from management. But it warned that some formulae being put forward by TUAC participants for governing “independent” shareholder representation on the board could be too prescriptive in terms of defining independence. At the same time, the secretariat said, perhaps there is a need to talk more about the requirements to ensure independence – which in a number of countries also means independence from a block shareholder -- and how to implement this aspect of the principles. For instance, in some countries there are proposals that companies should specify their corporate governance arrangements, and identify who their independent directors are, detailing their area of expertise and how many board meetings they have attended. In any case, the question of who is “independent” or not, and how many are on the board, cannot be sorted out until you resolve how the board is chosen. And, the secretariat noted, if shareholders were choosing the board, rather than say a CEO, the problem would no longer be the same.

OTHER ISSUES: TRANSPARENCY AND ENFORCEMENT

16. Disclosure and transparency

TUAC participants said that the chapter on disclosure and transparency needed to be more detailed to pass the “post-Enron test” and should shift from good practices to minimum standards. The review should cover disclosure and transparency not just in financial terms but also covering a number of other elements, including geographical location, foreseeable risks such as potential site cleanup bills in future, and “sustainability” factors such as training and development. Geographical location in particular should be seen as an issue for everybody, especially in developing countries, as it was an element in risk management for institutional investors.

Several TUAC participants raised the problem of transparency of internal procedures and safeguards in accounting/auditing systems and elsewhere, as well as transparency of proxy voting. This would favour shareholder activism. At least one survey showed that once proxy voting became transparent in a country, proxies had to be much more careful about how they voted and not blindly supporting management to serve just one client. Such moves can help protect workers’ savings.

TUAC participants also stressed that shareholders need full transparency and disclosure when it comes to beneficial ownership. Some said the transparency section should delineate what kind of information shareholders should have.

The secretariat said the principles are clear about disclosure requirements but that in practice disclosure was not often the same thing as transparency. There has been an enormous proliferation of ways to improve board functioning and in many countries this has led to the creation of a large number of committees but often their actual function is not understood by anyone. A Swedish report found that major companies there had “audit committees” that were nothing like audit committees in the US, for example, which could be misleading for shareholders unless clearly explained.

17. Enforcement of the Principles

Often corporations say they are owned by shareholders but it is difficult for them to make their voices heard, and most importantly to have their views respected, TUAC participants said.

TUAC participants said that the principles should also deal more with the types of legal mechanism countries can use to enforce the principles. Self-regulation clearly is not an option, one said, citing the fact that the Enron board voted three times to suspend its own corporate governance code in the run-up to the 2001 scandal. A lot remains to be done to enforce independence of directors, auditors and disclosure of compensation, as well as to prevent insider trading and corporate malfeasance.

Several TUAC participants said that the corporate governance principles should take the revised MNE guidelines as an example on enforcement. The review of this part of the MNE guidelines may have been a painful process, but it did result in a crucial strengthening of the enforcement part and this is a lesson for the corporate governance principles. One TUAC participant said that if the current review deals with implementation and enforcement of laws at national level, future discussion should look at the possibility of international rules and regulations.

The secretariat noted that enforcement differs widely between countries. In at least one country now, for example, there is personal responsibility for directors who make decisions that adversely impact pensions.

CONCLUSION

TUAC participants welcomed the efforts of the steering group in pushing for a substantial review of the Principles and looked forward to continuing work on the review. TUAC suggested the OECD secretariat could elaborate in a concept paper on “what is a good company?” and propose to the member states to reflect on it. Several TUAC participants mentioned the Peterson report as a good example of a report on corporate governance reform that the steering group could take aim at.

The secretariat said that the meeting was beneficial in getting at length the analytical and factual arguments underpinning TUAC positions. This will enable the secretariat to give the maximum amount of “intelligence” to the steering group to enable them to make an informed decision.

It also said, in response to comments about the challenge of finding a solution acceptable to all in the steering group as well as BIAC, TUAC and other groups that having diverging views on the table was an asset, not a liability, as it meant ideas would be tested and this would help improve the quality of the final product. There are real conflicts and if participants try to deny that, the process will never move forward.

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