MIDDLENEXT GOVERNANCE CODE
FOR SMALL AND MIDCAPS

The Governance Code for Small and Midcaps is based on the analyses presented in the Gomez Report, *Guidelines for Reasonable Governance of French Companies,* attached to the present document.[1] Those *Guidelines* describe the general governance principles required for reasonable evaluation of good practice. This code adapts these principles to Small and Midcaps.[2] These principles may also be adopted by companies whose stock is not traded on regulated markets, and in particular by companies whose stock is traded on multilateral trading facilities (Alternext…), or by unlisted companies.

This process is in no way in opposition to that of the AFEP/MEDEF corporate governance code for listed companies. It offers an alternative for Small and Midcaps, as some of the recommendations in the AFEP/MEDEF code are not completely suited to such companies.

Small and Midcaps are characterised by their size. They have a wide variety of shareholding structures, however. In particular, many of them have a large reference shareholder, often holding a majority of the capital, who may be a family or the entrepreneur. The companies are generally managed by the representatives of the majority shareholders.

For these reasons, a large number of these Small and Midcaps are far removed from the underlying principles on which existing codes of "good governance" are based. Such "good governance" principles are based on shares being diluted among the public, thereby requiring the Board of Directors to play a particularly active role in defending shareholders' interests. In the case of Small and Midcaps, however, the genuine governance issues will concern finding the right balance between:

- on the one hand, the **entrepreneurial freedom of action** of the managers who are also, in most cases, the majority shareholders and, as such, **bear the main risk in the event of poor management**,

- on the other, **protecting minority shareholders** whose interests might be harmed by certain management decisions,

it being understood that the board of directors or, if applicable, the supervisory board, whatever its composition, is a collegiate body which collectively represents all the shareholders and is bound by the obligation to take account of the corporate interest of the company at all times.

Reasonable governance of Small and Midcaps therefore requires rules in sufficient numbers to ensure effective and fair governance practice. However, these rules must not enter into the detail of situations that arise either never or only extremely rarely.

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[1] Pierre-Yves GOMEZ, *Guidelines for Reasonable Governance of French Companies,* Report to the MiddleNext Board, July 2009

2 Small and Midcaps are companies with stock market capitalisation of less than €1 billion: they are all the stocks in Segments B and C of Euronext (position of the *Autorité des Marchés Financiers* (AMF) of 9 January 2008).

It is this need for precision and efficiency that has guided the commission in charge of elaborating this Code. Working along the lines set out in the *Guidelines for Reasonable Governance*, a distinction has been made between two categories of proposals:

- **Points to be watched**. These are the main questions to be asked when seeking to ensure the effective working of governance. Due to the wide diversity of Small and Midcaps, these points to be watched cannot give rise to identical sets of requirements for all companies. The purpose of these points is to incite the board of directors of companies to take a look at their specific issues, without requiring them to give explicit, detailed responses on these points. Companies referring to this Code are asked to indicate, in their Chairman's Report, that the Board of Directors (or Supervisory Board) has informed itself of the issues presented in the "Points to be watched" section. The emphasis is therefore on a pedagogical and responsible approach to the questions they raise.

- **Recommendations**. These are the rules to be complied with by those companies choosing to adopt this Code. In these cases, the Chairman's Report must clearly indicate how they apply them and if not, why not, on a "comply or explain" basis.

The points to be watched and recommendations are presented successively in three chapters on the three key powers of governance defined by the *Guidelines*:

- "Executive Power": "the managers",
- "Supervisory Power": the power to direct and control: "the directors"
- "Sovereign Power": expressed notably at the general meeting of shareholders: "the shareholders".

The idea is therefore that companies adopting this Code **keep a close watch on the quality of their governance**. This can assure investors, stakeholders and public authorities that the governance of Small and Midcaps benefits from genuine attention on the part of the companies in question. In this respect, this Code stands out from most texts on "good governance" by identifying points to be watched that encourage companies not just to settle for proving that they comply with some general rules, but to address the question of their governance actively.

Companies adopting this Code shall be expected to **comply with these recommendations**, and to provide due justification for any exceptions to them.

By basing itself on greater responsibility of companies in evaluating their governance on the one hand, and on a framework of clear rules on the other, this Code makes a considerable contribution to ensuring reasonable governance for Small and Midcaps.

It is also pointed out that this Code draws on the laws, regulations and recommendations of the AMF that are applicable in such matters. The Code will be amended, if the need should arise, in line with any changes to the legislative or regulatory context.

NB 1: Small and Midcaps that draw up a Chairman's Report on corporate governance, internal control and risk management, may use this Code to fulfil their legal obligation to make voluntary reference "to a corporate governance code drawn up by the representative organisations of companies" by the terms of Article L. 225-37 or L.225-68 of the Commercial Code.

NB 2: These recommendations have been written in reference to corporations with a Board of Directors. They should be adapted for corporations with an Executive Board and Supervisory Board or, if applicable, to joint stock companies.

1. EXECUTIVE POWER

EXECUTIVE POWER: POINTS TO BE WATCHED BUT NOT SUBJECT TO SPECIFIC RECOMMENDATIONS

Executive power is defined in pages 16 and following of the *Guidelines*.

Background: *Most Small and Midcaps have large reference shareholders and/or a manager wielding significant influence. The entrepreneurial know-how of such managers, in particular when they are also the founders of the company, is decisive to the value of the company, either because the manager represents the shareholders very directly, or because he embodies the know-how of the company in the eyes of investors. The qualities of the manager and the team surrounding them are therefore an essential asset in the life of mid-sized companies. Attention must therefore be paid to the risks to the company arising from this personal dimension of the position.*

Four points to be watched[3] for the executive function:

1. Does the "manager" have the right skills?
This consists in assessing the extent to which the multiple and complementary skills required for preparing and monitoring strategy are concentrated among a small number of people, in the interests of the sustainability of the company.

2. Is the "manager" isolated?
This consists in observing whether the manager has access to sufficient formal forums (generally the Board of Directors or the Executive Committee) and informal forums to allow them to share and discuss their decisions objectively and seriously. It is also preferable that executive power should be in the hands of a "management team" rather than a single manager.

3. Can the "manager's" compensation affect their judgement?
Is the manager's compensation – the amount and type of compensation – likely to limit their ability to make judgements, and therefore be detrimental to the exercise of their mission? (For example, the level of compensation should provide an incentive but should not be so high that the manager might lose awareness of the realities of life of the other stakeholders in the company; the type of compensation must not induce preferences for some strategies rather than others.)

4. Are there arrangements for the succession of the "manager"?
Given the far-reaching role of the manager, it would appear reasonable that the governance system should address the issue of preparing for their succession and the means to be deployed if they should be unable to fulfil all or part of their functions.

Companies adopting this Code are expected to pay careful attention to these points.

[3] Cf. Chapter II of the *Guidelines for Reasonable Governance*, pages 16 to 20

THE MANAGERS: MIDDLENEXT RECOMMENDATIONS

The managers may be the Chairman, the Managing Director or Deputy Managing Director in a business corporation with a Board of Directors, the Chairman and members of the Management Board in corporations with a Management Board and a Supervisory Board, or the Manager in joint stock companies.

R 1: Corporate officers and employment contracts

Context: *Given the size and/or youth of the companies targeted by this Code, the compensation of their managers tends to be somewhat modest in relation to the actual risks incurred. In addition, to hold on to talented staff, it is often necessary for managers to retain the benefits inherent to an employment contract. It is therefore important that each company should have the freedom to make its decision in the light of the realities of its situation.*

Recommendation

Subject to compliance with the regulations, the Board of Directors should assess whether or not to authorise managers to have employment contracts when they are serving as corporate officers as Chairman, Managing Director or Deputy Managing Director (business corporation with a Board of Directors), Chairman of the Management Board (corporations with a Management Board and a Supervisory Board), or Manager (joint stock companies). The report to the general meeting explains the grounds for this decision.

R 2: Definition and transparency of the compensation of corporate officers

Context: *For the same reasons as those given previously, compensation of the corporate officers, who in the majority of cases are either large shareholders or founders of the company, is rarely excessive, if only in relation to their relative impact on the company's income statement.*
Rather than focusing on the level of compensation, the important thing is therefore to ensure that the rules defining it are clear.

Recommendation

The Board of Directors of each company should determine the level of compensation of its managers and the information disclosed on the subject, in accordance with the law and regulations. They should base themselves on the following seven principles:

- **Exhaustive**: the determination of corporate officers' compensation must be exhaustive: fixed part, performance-related part (bonus), stock options, bonus shares, directors' fees, pension terms and particular benefits must be taken into account in assessing overall compensation.

- **Balanced** between the various components of the compensation: each component of the compensation must be justified and correspond to the general interest of the company.

- **Benchmarked**: compensation must be assessed, to the extent possible, in relation to a reference profession and market, and must be in proportion with the situation of the company, while paying attention to any inflationary effects.

- **Consistent**: the manager's compensation must be set in a manner that is consistent with that of the company's other managers and employees.

- **Clear** rules: the rules must be simple and transparent; the performance criteria used for the performance-related components of compensation or for allocating any options or bonus shares must correspond to the purposes of the company, must be demanding, explainable and, to the extent possible, sustainable.

- **Measured**: the compensation and allocation of options or bonus shares should find the right balance and take account of the general interest of the company, market practices and manager performance.

- **Transparent**: annual information disclosure to shareholders on the compensation of the managers must be made in accordance with the applicable regulations.

R 3: Golden handshakes

Context: *In Small and Midcaps, due to their shareholding structure, golden handshakes other than the severance pay due under the terms of employment contracts are rare and in any case limited in their amounts. Such sums must be consistent with the company's compensation policy.*

Recommendation

If provision has been made for a golden handshake in conditions that comply with the law, its maximum amount, after inclusion of any severance pay under the terms of any employment contract, should not exceed two years of (fixed and performance-related) compensation, except in cases where the compensation of the manager is clearly out of touch with the market (as is the case in start-ups, for example).

Payment of a golden handshake should be excluded for a manager and corporate officer who is leaving the company at their own initiative to take up new functions, or changing functions within a group. Artificially inflating their compensation in the period prior to their departure should also be avoided.

R 4: Supplementary retirement schemes

Context: *Very few Small and Midcaps have set up supplementary retirement schemes for their managers. It was therefore not deemed necessary to limit them. It is possible to have a complementary retirement scheme for managers as long as it is transparent and reasonable.*

Recommendation

In addition to applying the authorisation procedures provided by law, the company should indicate in its report to the shareholders any defined-benefit supplementary retirement schemes it has set up for its managers and should provide justification for them, in the interests of transparency

R 5: Stock options and bonus shares

Context: *In small and medium-sized companies, the allocation of stock options and/or bonus shares is often necessary to attract key skills and high-quality managers. This corresponds to the initial spirit in which these tools were created (attracting talents the company cannot yet afford to pay). The company's policy in this domain must be adapted to its situation and must be part of a sustainable global approach, taking account of the general interest of the company, market practices and manager performance. It is important that clear performance rules should be set, and also that the allocation of stock options and/or bonus shares should not be too concentrated among managers, because performance is always the fruit of collective efforts.*

Recommendation

<u>Allocation conditions</u>:

The allocation of stock options and/or bonus shares should not be excessively concentrated among managers. In addition, stock options and/or bonus shares should not be allocated to managers and corporate officers on the occasion of their departure.

Exercise and final award conditions:

The exercise of all or part of the stock options or the final award of all or part of the bonus shares to the benefit of managers should be subject to relevant performance conditions expressing the medium/long-term interest of the company.

2. “SUPERVISORY” POWER

SUPERVISORY POWER: POINTS TO BE WATCHED BUT NOT SUBJECT TO SPECIFIC RECOMMENDATIONS

Supervisory power is defined in page 21 and following of the Guidelines. It is exercised by the Board of Directors in companies with a Board of Directors, or by the Supervisory Board in companies with an Executive Board and a Supervisory Board.

According to law, in companies with a Board of Directors, in addition to this supervisory role, the Board of Directors is the place of decision-making and control and sets the orientations for the activity of the company.

The Board of Directors is a collegiate body which collectively represents all the shareholders and is bound by the obligation to take account of the corporate interest of the company at all times.

Context: *Most Small and Midcaps have large reference shareholders and/or a manager wielding preponderant influence, especially when it is the founder of the company. Emphasis should therefore be placed on the fact that the reference shareholders are likely to be the first to suffer from any poor management. However, some management decisions can harm the interests of minority shareholders, and the directors must therefore ensure that the right balance is found between the different powers. Their role therefore consists essentially in ensuring that there are no abuses and that the excessively close link between executive power and reference shareholders does not have a negative effect on the quality of governance or on that of strategic decisions, or that the founder and manager does not manage the company without taking account of the shareholders’ interests in cases where capital is diluted.*

Five points to be watched[4] for the “supervisory” function:

1. Does “supervisory” power overlap with executive power?
The company can suffer as much from an absence of supervision as from inappropriate interference in the executive.

2. Are the directors carrying out their supervisory duties effectively?
In the spirit of reasonable governance, supervisory duties imply that the directors act on a collegiate basis to ensure that the interests of all the shareholders are taken into account and respected. They ascertain the ability of the executive to lead the company sustainably.

3. Do the directors have the material means to fulfil their mission?
This concerns providing the necessary information for preparing board meetings (providing knowledge of the subjects to be addressed to allow directors to forge an opinion) and the working of the Board, which must allow respect for, the expression and traceability of any diverging opinions before decisions are made on a collegiate basis. It seems preferable to provide the directors with sufficient information about the activities and organisation of the group when they take up their functions.

4. Do the directors have the right skills?

[4] Cf. Chapter II of the *Guidelines for Reasonable Governance, pages 21 to 25*

The panel of directors must have sufficiently broad and diversified abilities and skills to assess those of the manager, and must be able to verify that the strategy of the company is relevant to its corporate interest.

5. Can the work conditions of the directors create bias and affect their judgement?

The ability of directors to use their judgement depends fundamentally on the material conditions in which they conduct their work:

- level of compensation – if it is too low, it can discourage the involvement of the director, too high and it can render them highly dependent on the company;

- term of office – if it is too short, it can restrict the beneficial effects of experience, too long and it can reduce the quality of supervision.

Companies adopting this Code are expected to pay careful attention to these five points.

THE BOARD OF DIRECTORS: MIDDLENEXT RECOMMENDATIONS

R 6: Introduction of Board Rules of Procedure

Context: *In most Small and Midcaps, there is frequent confusion between the three "executive", "supervisory" and "sovereign" powers, meaning the managers, board and shareholders, due to the presence of reference shareholders who often hold a majority interest. It is therefore preferable to define what is expected of directors as clearly as possible, in the form of Rules of Procedure setting down the rules in accordance with the situation of the company in question.*

Recommendation

Rules of Procedure should be introduced for the Board and should cover at least the following five points:

- the role of the Board and any operations that are subject to prior authorisation by the Board, if applicable;

- the composition of the Board /independence criteria applicable to directors;

- directors' duties (ethics: loyalty, non-competition, disclosure of conflicts of interest and the duty to abstain, confidentiality etc.);

- the working of the Board (frequency, convening, transmission of information to directors, use of video conferencing and telecommunications facilities) and, if applicable, of the committees;

- directors' compensation rules.

The Rules of Procedure or substantial extracts from them should also be made public.

R 7: Director ethics

Context: *Directors are not always aware of governance systems and the responsibilities they have. This is particularly true of largely family-owned companies in which the directors representing the family or families are not always properly informed of their duties. The aim is to foster common "professional ethics" for all directors.*

Recommendation

The following ethical rules are recommended:

- on taking up their appointment, each director must be informed of the obligations arising from their appointment, and notably those relating to the rules on holding several positions, before they accept it; they must sign the Board Rules of Procedure;

- the number of shares in the company that must be held by each director is at the discretion of the Board and is indicated in the Rules of Procedure, subject to the provisions of the company by-laws;

- in the event of any conflict of interests arising after their appointment, a director must inform the Board, abstain from voting or taking part in its deliberations and, if necessary, resign. The absence of any information to this effect will be deemed to be acknowledgement that no such conflict of interest exists;

- directors should have good attendance records and should take part in meetings of the Board and committees on which they sit;

- each director must ensure that they have obtained all necessary information on the subjects to be addressed in meetings;

- each director should observe genuine professional secrecy;

- each director should attend general meetings.

When the director holds a position as a "manager", they should not accept more than three other positions as directors in listed companies, including in foreign companies or companies outside their group.

R 8: Composition of the Board – Independent directors

Context: *The existence of a large reference shareholder can lead to the Board over-representing the interests of those shareholders to the detriment of the minority shareholders, but also in backing strategic visions or representations of the situation that might prove to be wrong. It is therefore preferable that Boards should open up to personalities from outside the company, who can provide a different insight into the decisions made by the Board. However, as the size of the companies does not always require a large Board, companies might have difficulties attracting such independent directors. Realism is therefore required regarding the number of independent directors.*

Recommendation

The Board should include at least 2 independent members. This number may be reduced to one member when the Board has 5 members or less. This may be increased on boards with a large number of members.

There are five criteria justifying the independence of directors, characterised by the absence of any significant financial, contractual or family relationship likely to affect their independence of judgement:

- they must not be a salaried employee or corporate officer of the company or of a company in its group, and must not have held such a position within the last three years;

- they must not be a significant client, supplier or banker of the company or its group, or a client, supplier or banker for whom the company or its group represents a significant share of its business;

- they must not be a reference shareholder of the company;

- they must not have a close family relationship with a corporate officer or reference shareholder;

- they must not have been an auditor of the company in the course of the previous three years.

It is the responsibility of the Board of Directors to examine the situation of its members on a case by case basis in the light of the criteria listed above. On condition that it justifies its position, the Board may consider one of its members to be independent if they do not fulfil all these criteria, and may consider one of its members who does fulfil all these criteria not to be independent.

R 9: Choice of directors

Context: *Even taking account of the complexity and difficulty for small and medium-sized companies of finding independent directors, it is essential that shareholders must really be able to give their opinion on the choice of each director.*

Recommendation

Sufficient information about the experience and skills of each director should be supplied to the General Meeting and the appointment of each director should be the subject of a distinct resolution.

R 10: Directors' term of office

Context: *It is quite a complex and difficult matter for small and medium-sized companies to find independent directors. A certain realism should therefore prevail over the renewal of appointments, avoiding the excessively long terms that could ultimately detract from the director's independence, and also excessively short terms that might discourage them from investing in the company.*

Recommendation
The Board should ensure that the statutory term of office is adapted to the specifics of the company, within the limits set by the law.

R 11: Board member information

Context: *The information provided to the directors is crucial to the proper working of the Board. Board members must be in possession of all the necessary information for fulfilling their mission. This information must be concise, relevant and comprehensive. The timescale for supplying this information must be reasonable. In practice this is a complex problem, however, in that the exhaustive nature of the information and the time required to analyse it must be taken into account. Given the wide variety of practical situations, it seems reasonable that the directors themselves should take responsibility for this issue.*

Recommendation
The directors themselves should assess whether the information supplied to them is sufficient, and demand any additional information that they might judge useful, if the need should arise.
The Rules of Procedure should provide the practical terms for the supply of this information and should set reasonable timescales.
The company should also provide the directors with all necessary information between Board meetings, when developments in the company so justify.

R 12: Creation of committees

Context: *The varying situations of companies and sizes of their boards require a very realistic approach to the number and efficiency of committees. Pragmatism would suggest that companies should have the greatest possible latitude in choosing how they address this.*

Recommendation
Each company should decide whether to create one or several specialised or ad hoc committees (audit, compensation, appointments, strategy…), according to its own situation. Concerning the setting up of an audit committee, the company decides, in accordance with the applicable regulations and in the light of its particular situation, whether to set up an audit committee or to organise a board meeting to fulfil that mission itself in the conditions defined by the texts.

R 13 Board and committee meetings

Context: *The size of the company, that of the Board, current issues and major events affecting the life of the company are all decisive factors in finding the right frequency.*

Recommendation
The frequency and duration of meetings should allow in-depth examination of the themes that are addressed. This frequency is at the discretion of the company, depending on its size and specific characteristics, but a minimum of 4 meetings a year is recommended. Minutes are drawn up of each Board meeting summarising the debates. The Chairman's report must indicate the number of meetings held yearly and the attendance rate of the directors.

R 14: Directors' compensation

Context: *Average compensation of directors in Small and Midcaps remains significantly lower than the amounts distributed by other listed companies. As the responsibilities of directors increase, setting the compensation of directors in Small and Midcaps must take account of the increasing involvement and professionalism demanded of them.*

Recommendation

The distribution of attendance fees, the global amount of which is determined by the general meeting, should be determined by the Board on the basis of the attendance record of the directors and the time they dedicate to the function. In its Annual Report and Chairman's Report, the company provides information on the attendance fees that have been paid out.

R 15: Introduction of Board evaluation

Context: *Given the characteristics of Small and Midcaps, formal external evaluation is not indispensable, although it may prove useful as a means of providing a fresh insight into company practice.*

The emphasis should be placed on internal assessment by the directors and on their ability to evaluate the relevance of their work on an annual basis.

Recommendation

Once a year, the Chairman of the Board should call upon the directors to express themselves on the working of the Board and the preparation of its work. This discussion is recorded in the minutes of the session.

3. “SOVEREIGN” POWER

“SOVEREIGN” POWER: POINTS TO BE WATCHED BUT NOT SUBJECT TO SPECIFIC RECOMMENDATIONS

Sovereign power is defined in pages 26 and following of the *Guidelines*.

Context: *As previously mentioned, many Small and Midcaps are characterised by large reference shareholders. This favours the connection between sovereignty over the company and involvement in its continuity, which is the very basis of corporate governance, but it also raises the risk of harming the rights of minority shareholders due to the excessively close link between executive power and the reference shareholders. The objective of introducing reasonable governance requires all shareholders to exercise their sovereign power to the full, in particular during the general meeting of shareholders*

The purpose of this Code is not to issue recommendations for shareholders. It would nonetheless like to draw attention to the following five points to be watched, to which the Board of Directors should be particularly attentive**:**

1. Are the shareholders informed of the major foreseeable risks that might threaten the sustainability of the company?

Over and above the question of legal risk disclosure requirements, the point to be watched consists in assessing whether the existing governance system would enable shareholders to be properly informed in the event of risks threatening the sustainability of the company.

2. *Do the shareholders really choose the directors?*

The point to be watched consists in assessing whether the shareholders are actually placed in a position to exercise their power to appoint directors by making credible, properly informed choices. (cf. Recommendation R9)

3. Do the shareholders take part in votes?

Depending on the various forms of company and shareholding structures, attention should be paid to the various concrete voting practices to encourage effective voting by shareholders.

4. Is there the risk of harming the rights of minority shareholders?

The aim here is to avoid any practices that might lead to the interests of minority shareholders being harmed, notably on the occasion of transactions between related parties (such as regulated agreements, for example…). In this respect, the importance of the information provided to shareholders on this subject is emphasised.

5. Is the development of share ownership properly managed over time?

Reasonable governance must include thorough knowledge of the company's shareholders and effective management of those shareholders over time.