



**Testimony provided to the U.S. House of Representatives, Committee on Financial Services  
"Shell Games: Corporate Governance and Accounting for Oil and Gas Reserves",  
Wednesday, July 21 2004**

Mr Chairman, Ranking Member Frank, and Members of the Committee:

**Introduction**

My name is Eric Knight and I am the managing director of Knight Vinke Asset Management, a New York based asset management firm registered with the SEC as an Investment Adviser under the Investment Advisers Act of 1940. Our investment strategy involves investing in fundamentally sound public companies where sub-optimal stock market performance can be attributed in some way to poor governance structures and practices, which we interpret in the broadest sense. In such cases, we work with the company's institutional and other shareholders to overcome or redress these governance-related problems and aim, thereby, to obtain a re-rating of the stock and make a profit on our investment.

Through Knight Vinke Institutional Partners ("KVIP"), an investment fund which invests in European equities, we hold approximately 1.32 million shares of Royal Dutch Petroleum with a market value of approximately \$70 million. CalPERS, who have a \$ 200 million commitment to invest in KVIP, separately also have holdings in Royal Dutch Petroleum ("Royal Dutch") and Shell Transport & Trading ("Shell Transport") amounting to 6.58 million shares and 31.31 million shares, respectively, with a combined market value of approximately \$580 million.

We have been working closely with CalPERS and other institutional shareholders of the Royal Dutch Shell Group, both in Europe and in the U.S., with a view to pressing its boards and management into re-examining their unusual governance practices and accepting a more orthodox corporate governance framework.



## **Why are we interested in governance at Shell?**

Although, as recently as 2002, the boards of the Royal Dutch Shell Group declared that they prided themselves on upholding "the highest standards of integrity and transparency in their governance of the Company" and that they aimed to be "at the forefront of internationally recognised best governance practice" (2002 annual reports), we believe that reality presents a different picture. In light of the multiple reserve restatements over the past few months and the astonishing revelations of the Davis Polk report, shareholders can perhaps be forgiven for being sceptical. The Group concedes that "the framework within which the Boards operate is conditioned to some extent by Royal Dutch's unique relationship with Shell Transport, and this results in some special arrangements which may not be appropriate in other companies". We felt it necessary, therefore, to look carefully into these "special arrangements".

During the course of our due diligence, we asked our counsel in the Netherlands, the U.K. and the U.S. to prepare a report on the Royal Dutch Shell Group's governance structures based on publicly available information and a copy of this report is included in the attached materials (see Exhibit 4).

## **Shell's Unorthodox Corporate Governance Structures**

By way of background, the Royal Dutch Shell Group of companies is 100% owned by two holding companies: Royal Dutch (60%), which is the largest listed company in The Netherlands, and Shell Transport (40%), which is one of the ten largest in the U.K.

Royal Dutch is managed by a Supervisory Board and a Management Board, as is usual in The Netherlands, whereas Shell Transport has a unitary board comprised of non-executives and executives, which is the structure most commonly found in the U.K. It is important to realise, however, that both Royal Dutch and Shell Transport are pure holding companies, with no operating activities of their own.

The following is a summary of some of the more surprising facts which emerged from our analysis:

- The operating companies of the Royal Dutch Shell Group (i.e. the group of companies below the two parent holding companies) are managed on a day-to-day basis by an informal committee of senior managers -- the so-called "Committee of Managing Directors" (or CMD) -- and not by a chief executive officer. Substantial power and autonomy is given to the CEOs of each of the Group's four main Operating Companies, and, although there is a chairman of the CMD, none of these executives reports formally to this person.
- The "boards" of Royal Dutch and Shell Transport are comprised of different groups of individuals -- responsible to separate shareholder constituencies -- and it is unclear, therefore, exactly to whom the CMD and its Chairman report or are accountable. The two parent company boards come together on a regular basis in a large gathering known as "the Conference", but this is yet another informal body, vested with no formal powers and unaccountable directly to the shareholders of either holding company.
- The Royal Dutch supervisory board (perhaps the most powerful of the different Shell governing bodies as it controls the majority shareholder in the operating companies) is effectively a close-knit, self-perpetuating body. This results from the existence of a class of so-called "priority" shares, which have the exclusive right to nominate board representatives at Royal Dutch and to reject nominations by shareholders. As of now, the members of the Royal Dutch supervisory and management boards hold or control 100% of these priority shares and thus have the ability to control their own nominations. This self-perpetuating mechanism is wholly inconsistent with internationally accepted principles of good governance.

Despite mounting evidence of poor internal communication, inadequate controls, lack of accountability and unclear reporting lines, Shell's management and board members still maintain that the reserves debacle had nothing to do with structure.

We disagree. Shell's management has operated for years, indeed decades, with none of the basic building blocks of modern governance: its divisional management did not report

formally to a group chief executive; its divisional CFOs did not report to a Group CFO; the person presented as the chief executive, the Chairman of the CMD, apparently lacked either the authority, responsibilities or the accountability normally associated with a chief executive; he reported to two boards composed of different individuals, and so effectively to none; and the boards of Royal Dutch were shielded from shareholder intervention through the priority share mechanism which made them a “closed shop”. The Royal Dutch Shell Group’s unusual board and management structures may not be entirely to blame for the misstatement of reserves, but we believe that they, and the corporate “culture” they foster, certainly contributed to the problem.

### **Exemption from US Proxy Rules**

Royal Dutch – as a “foreign private issuer” – is currently exempt from the “proxy rules” under the U.S. securities laws despite that fact that some \$25 billion in market value of its shares are represented on the US markets. Nevertheless, in the buildup to this year’s annual meeting Royal Dutch employed a prominent U.S. proxy solicitor to obtain support for a resolution giving a shareholder “discharge” to its Supervisory and Management Board members (see Exhibit 3). In itself, this would not be remarkable were it not for the fact that the resolution was strongly opposed by the mostly European shareholders who attended the annual meeting and that, despite this opposition, the resolution was passed thanks to a large block of proxies coming mostly from the U.S. held by the board.

Approximately 25% of Royal Dutch’s shares are held in the U.S. in the form of ADRs and in this context, we ask ourselves:

- Did U.S. shareholders know (or were they made aware) that item 2 of the Agenda, covering approval of the accounts, payment of the dividend and discharge of the board members – all presented as a single item – were in fact separate resolutions, each to be voted on separately?
- Did they know, for instance, that shareholders could have voted in favour of the accounts and the dividend but against the discharges?



Had Royal Dutch not been exempted from the provisions of the U.S proxy rules, we believe that the SEC could have asked for clarification on these points and that, in light of recent events, the vote could well have gone the other way.

In conclusion, if Shell and other multinationals want substantial access to the U.S. capital markets, it seems anomalous that they should be held to lower disclosure standards than their U.S. peers – and this applies to proxy solicitation just as it does to reserve accounting.

Thank you.

Washington, July 21 2004

# FINANCIAL TIMES

WEDNESDAY JUNE 16 2004

## LEADERS & LETTERS

### Nothing less than fundamental governance changes will satisfy Shell Group shareholders

*From Mr Eric Knight  
and Mr Ted White.*

Sir, The views expressed at the recent meetings held between shareholders of the Royal Dutch/Shell Group and its board members, in which we participated, evidenced a powerful shareholder consensus concerning the need for a fundamental and wide-ranging re-examination of the special arrangements between the group parent companies and the manner in which the group is managed and governed. Protestations to the contrary notwithstanding, it remains our view – shared by many institutional shareholders – that, at the very least, a portion of the blame for the reserves debacle is to be attributed to the prevailing governance culture of the group and the absence of orthodox board structures. Whether or not this be true, this is the market's perception today.

As must have been apparent to the directors of Royal Dutch Petroleum and Shell Transport & Trading, many of their shareholders desire that this re-examination of board and management structures, a process Jeroen van der Veer, Shell Group president, has dubbed the "thinking phase", be both coherent and comprehensively transparent. In particular, we and other shareholders believe that, if the process is to be at all credible, the directors must disclose publicly the terms of reference of this review – namely: the specific issues to be considered; the composition of the body conducting it; and a timetable,

involving further shareholder consultation before formal approval of any changes is sought.

It was our collective hope and expectation that this rather basic information would be disclosed to shareholders concurrently with publication of the agendas for the group's annual general meetings on June 28. This opportunity has been lost. We now, therefore, explicitly request that the directors provide the market with this minimal level of disclosure – sufficiently in advance so as to enable shareholders to form a well-balanced point of view in preparation for the meetings.

We believe there is a significant opportunity for the group to repair some of the confidence that has been lost by conducting this process in a manner that embraces openness and candour.

We look forward to meeting the directors in The Hague and in London on June 28, and in anticipation thereof it may be of use to them to consider responses to the following questions, which may well be posed at each meeting:

● Please disclose to the assembly of shareholders the specific issues to be considered in the detailed re-examination of Shell's board and governance structures. Will the issues to be considered include at least the following: first, the role and authority of the chief executive and this person's formal relationship with the group's boards and senior management; second, the need for transparency with

respect to management succession; third, the need for shareholder involvement in board succession; and fourth, the composition of the group's boards?

● Could they please tell their shareholders who exactly will be conducting this re-examination, how this body's independence will be assured and what outside parties have or will be retained to assist this body?

● When will this body's findings be reported to the group's boards and to its shareholders? Will the group's shareholders be consulted with respect to alternative proposals put forward and, if so, when and in what manner will this consultation take place?

Finally, while we do not wish to be prescriptive about the most appropriate company structure for the Royal Dutch/Shell Group (a task best left to the boards and their professional advisers), we do wish to re-emphasise our belief that fundamental changes are required in the governance of Royal Dutch and Shell Transport, and that we and other shareholders will not be satisfied by compliance with minimal governance standards at the expense of this longer-term objective.

**Eric Knight,**  
Managing Director,  
Knight Vinke Asset Management,  
New York, NY 10017, US

**Ted White,**  
Director, Corporate Governance,  
California Public Employees'  
Retirement System (Calpers),  
Sacramento, CA 95814, US

# FINANCIAL TIMES

MONDAY MARCH 15 2004

## COMMENT

ERIC KNIGHT

# Shell must improve relations with its investors

Following the precipitous departures of Sir Philip Watts and Walter van de Vijver from Royal Dutch/Shell, the company's shareholders may recall the recent appointment of Rex Tillerson to the board of ExxonMobil. The board and shareholders of ExxonMobil will have at least a year to evaluate Mr Tillerson and other candidates for chief executive before a decision is made.

Shell shareholders will also have noted with interest Coca-Cola's decision to break with a 100-year tradition by extending the search for its next CEO to outside candidates - seeking to appoint "the best player out there for this type of business in the world", to quote Warren Buffett.

This is in striking contrast to Royal Dutch/Shell, where replacements for Sir Philip, chairman of Shell's Committee of Managing Directors (CMD), and for Mr van de Vijver, head of exploration and production, were announced immediately from within the ranks, and the reshuffle was portrayed as a *fait accompli*. How could this happen?

The answer lies in the fact that Royal Dutch Petroleum is the dominant partner in the Royal Dutch/Shell Group and that the selection of all management and supervisory board positions at Royal Dutch is controlled by incumbent members of

those boards. Management succession is tightly controlled from within - it is effectively a "closed shop".

There are other governance-related issues of concern to Shell's shareholders, but one stands out. At both Shell Transport and Royal Dutch, executive management has been delegated by the boards to the CMD, a committee comprising senior executives from each of the two public companies. It is perhaps not well appreciated that the members of

---

Sir Philip Watts and Walter van de Vijver were replaced immediately. The reshuffling of management was portrayed as a *fait accompli*.

---

this committee, in particular the CEOs of the main operating divisions, do not report and are not formally responsible to the CMD chairman. This is because the CMD is an informal body, with no formal executive authority; the position of chairman is, therefore, also informal. As a consequence, Shell's top management operates in what Shell refers to as a "collegiate" fashion, with no CEO having authority or responsibility for management of the group as a whole.

Taking the analysis a step further, the group has two

entirely different main boards (one at each publicly quoted company) and separate bodies of shareholders. In effect, the group's senior management must serve two masters - seriously weakening management's accountability and making it very difficult for either of the two boards to intervene effectively to safe guard shareholders' interests.

Shell's response to such criticism in the past has been to say that, in reality, it operates as a single company and its boards operate as a single board. Shell points to yet another committee - the "conference" - which includes the entire membership of the two boards and appears to function internally as a group board. However, the efficiency of a board comprised of 23 individuals and its lack of direct accountability to shareholders require careful consideration.

Through these various committees Shell has created the illusion of normality: a unitary board overseeing a unified management team headed by a group chief executive.

Shell has operated like this for decades. But this may have fostered inefficiency, lack of adequate control and unclear lines of accountability. Shell is now going through an unprecedented crisis, partly attributed to a loss of confidence by the market in its unorthodox

governance structures - and a lingering concern that the reserves fiasco could in some way be related.

The US Securities and Exchange Commission will soon conclude its investigation and this may intensify pressure for change in the way the group is managed. Meanwhile, shareholders can and should seek transparency in the processes leading to top management changes and the way governance-related issues are evaluated.

Shell's management has reconfirmed its willingness to listen to shareholders' concerns about governance for the next few weeks, to think about these issues and to announce changes, if any, in April 2005. As presented, this process is unstructured, opaque and conveys no sense of urgency. It has been coldly received by many of the group's institutional shareholders.

Ensuring that Shell has the "best player out there" as its next CEO and, equally important, that its leader is given sufficient authority and responsibility to be effective, are the two most potent ways for Shell's boards to create true value for shareholders over the years to come.

*The writer is the managing director of Knight Vinke Asset Management, a shareholder in Royal Dutch*

## Royal Dutch Petroleum Company

---

### Notice of Meeting - Agenda

**Agenda for the General Meeting of Shareholders of Royal Dutch Petroleum Company to be held on Monday, June 28, 2004, at 10.30 a.m. in the Circustheater, Circusstraat 4 in The Hague.**

1. Annual Report 2003.
2. Annual Accounts 2003.

Finalisation of the Balance Sheet as at December 31, 2003, the Profit and Loss Account for the year 2003 and the Notes to the Balance Sheet and the Profit and Loss Account.

Declaration of the total dividend for the year 2003.

~~Discharge of the Managing Directors of responsibility in respect of their management for the year 2003.~~

~~Discharge of the members of the Supervisory Board of responsibility for their supervision for the year 2003.~~

3. Appointment of a Managing Director.
4. Appointment of a member of the Supervisory Board.
5. Appointment of a member of the Supervisory Board owing to retirement by rotation.
6. Reduction of the issued share capital with a view to cancellation of the shares acquired by the Company in its own capital.
7. Authorisation of the Board of Management, pursuant to Article 98, Book 2 of the Netherlands Civil Code, as the competent body to acquire shares in the capital of the Company.

The Annual Report and the Annual Accounts 2003 are available for inspection at and may be obtained free of charge from the Company (Carel van Bylandtlaan 30, PO Box 162, 2501 AN The Hague, The Netherlands, tel. +31-70-377 4540 or per email: [ir-hague@shell.com](mailto:ir-hague@shell.com)) and the offices of ABN AMRO Bank N.V. (for inspection: Foppingadreef 22, 1102 BS Amsterdam, The Netherlands; for obtaining free of charge: tel. +31-76-579 9455), and Fortis Bank (Nederland) N.V. (Rokin 55, 1012 KK Amsterdam, The Netherlands). The Annual Report and the Annual Accounts 2003 are also accessible at [www.shell.com/annualreport](http://www.shell.com/annualreport). Copies of the nominations pertaining to items 3 to 5 on the agenda are available for inspection at and may be obtained free of charge from the Company.

## CONFIDENTIAL MEMORANDUM

### A REVIEW OF CORPORATE GOVERNANCE AT ROYAL DUTCH / SHELL AND PROPOSALS FOR CHANGE

#### SCOPE

The dual-headed structure of the Royal Dutch / Shell group (the "**Group**"), has resulted in the adoption of an uncommon corporate governance structure which has been in place for a considerable time. This paper, which has been prepared in conjunction with Ashurst (London), Nauta Dutilh (Rotterdam/Amsterdam) and Cleary Gottlieb (New York), reviews the current governance structure of the Group and, in particular, considers the following matters:

- The dominant position of Royal Dutch within the context of its joint venture with Shell Transport, and its implications for Shell Transport directors and shareholders.
- The exclusive right of incumbent Royal Dutch supervisory and management board members (through control of the Company's priority shares) to nominate board representatives at Royal Dutch and to reject nominations by shareholders. This mechanism is self-perpetuating and is inconsistent with internationally accepted principles of good governance.
- The apparent absence of external competition to fill executive vacancies at the highest level that is perpetuated by this mechanism - with no shareholder involvement - particularly in view of Sir Philip Watts' retirement as Chairman of the Committee of Managing Directors within 18 months.
- The concept of a large multi-national quoted group being run by committee without a group chief executive.
- The roles of chairman and senior group executive being exercised by the same person.

The aim of this memorandum is to propose changes, without necessarily advocating an end to the dual-headed structure, which would result in: (a) the appointment of a Group CEO with clearly delineated responsibilities and accountability to the Group's main boards, (b) the appointment of a non-executive Group Chairman, (c) a more balanced relationship between the executive and non-executive elements on these boards, with increased influence at Group level for the Shell Transport directors than that which they currently enjoy, and (d) the possibility for shareholders to participate in the nomination process with respect to the Group's directorate without requiring approval from the same.

These measures would bring the Royal Dutch Shell group more into line with modern generally accepted principles of good governance relevant to a major quoted multi-national.

#### IMPORTANT NOTICE

This memorandum has been prepared by Knight Vinke Institutional Partners ("**KVIP**") for its own use and is distributed for information purposes only. The information relating to Royal Dutch and Shell Transport and their respective subsidiaries, businesses and assets contained in this memorandum has not been verified. Further, this memorandum has been prepared principally using information in the possession of KVIP and its advisers. No information has been sought from the Group. Accordingly, this memorandum does not purport to provide a complete description of the matters to which it relates. No representation, warranty or undertaking, express or implied, is or will be made in, or in relation to, and no responsibility or liability (including, without limitation, any liability in negligence) is or will be accepted by KVIP or by any of its connected persons as to, or in relation to, this memorandum or the accuracy or completeness of the information contained within it and any liability therefor is hereby expressly disclaimed. In particular, but without prejudice to the generality of the foregoing, no representation or warranty is given as to any of the opinions contained in this memorandum. Any prospective buyer of securities of either Royal Dutch or Shell Transport is recommended to seek his own financial advice and must make his own independent assessment of each company and the Group as a whole.



## 1. GROUP STRUCTURE AND GOVERNANCE

### 1.1 Group Structure

NV Koninklijke Nederlandsche Petroleum Maatschappij ("**Royal Dutch**") and The Shell Transport and Trading Company pic ("**Shell Transport**") came together in 1907. The two top tier companies, Royal Dutch and Shell Transport, jointly own the Group and share in its net assets on a 60:40 basis through three intermediate holding companies (the "**intermediate holding companies**") - Shell Petroleum NV in the Netherlands, Shell Petroleum Company Limited in the U.K. and Shell Petroleum Inc. in the U.S. (see *Appendix 1*).

Royal Dutch and Shell Transport are entitled to 60 per cent. and 40 per cent., respectively, of the dividend and interest income received from Group companies. An equalisation agreement (the "**Equalisation Agreement**") between the two top tier companies provides that they share the burden of all charges in the nature of income taxes in respect of such dividends and interest income in the same proportions after taking into account certain tax credits with respect to dividends.

### 1.2 Governance structure

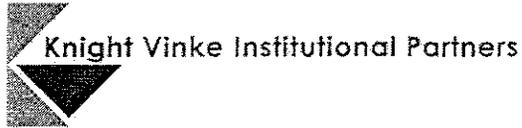
Royal Dutch and Shell Transport do not engage in operational activities; they derive substantially all of their income from their "investments" in the numerous companies comprising the group. As such, they are pure holding companies, with Royal Dutch controlling a majority of both the share capital and the board seats within each of the intermediate holding companies and Shell Transport holding a minority. As of today, Royal Dutch controls 6 of the 9 board seats at each of Shell Petroleum NV and Shell Petroleum Company Limited (*See Appendix 1*). Royal Dutch's control over the board of Shell Petroleum Inc. is not apparent - perhaps for tax reasons - but is assumed effectively to follow the model of the other two intermediate holding companies.<sup>1</sup>

As a consequence, the Shell Transport board appears to have little direct control over the affairs of the Group from a strictly formal perspective, other than as may be permitted under the Equalisation Agreement. The Equalisation Agreement covers matters such as the distribution of board seats at the intermediate holding company level, dividend rights and the like. The strongest right appears to be a veto right over "the disposal or transfer of any shares in any company coming wholly or partly within the circle of the Royal Dutch Shell Group".

The Royal Dutch/ Shell group describes itself as "a decentralised, diversified group of companies" and it is mentioned that "each Shell company has wide freedom of action" (Statement of General Business Principles). Furthermore, "the management of each Operating Company is responsible for the performance and long term viability of its own operations" (Form 20-F). It appears, therefore, that substantial power and autonomy is given to the CEOs of the four main globally organised Operating Companies, with each such company having its own finance, business development, technology and/or personnel functions.

It is of significance to note that the current CEO's of these four businesses (Exploration & Production, Gas & Power, Oil Products and Chemicals) each come from the Royal Dutch side. In fact, they are the four members of the Royal Dutch Management Board (see below).

<sup>1</sup> Shell Petroleum Inc, a Delaware corporation, is owned by Royal Dutch and Shell Transport but its dividend income from Shell Oil flows directly to Shell Petroleum NV before being divided amongst the two parent companies.



Given that Royal Dutch and Shell Transport have different executive and supervisory/non-executive directors on their respective boards, the potential exists for conflicting views to be held by the two boards. To alleviate such concerns, the boards have established joint committees to assist with their respective governance responsibilities (see *Joint Committees* below) and a 'senior' executive committee to deal with management on a group-wide basis (see *section 2: Group-wide Management* below). It should be noted, however, that none of these committees is vested with formal powers, their roles being limited for the most part simply to advising and informing the Group's boards.

### 1.3 Royal Dutch Board

Royal Dutch is managed by a Board of Managers comprising four managing directors and a Supervisory Board made up of eight members including two former managing directors (see Appendix 2). Each year one member of the Supervisory Board comes up for re-election.

Appointments to the Board of Managers and the Supervisory Board are made by the Royal Dutch shareholders from two persons nominated by the holders of priority shares in the company. Shareholders may not appoint any person who has not been nominated by the holders of priority shares. Shareholders representing 1 per cent. or more of the share capital may propose a person for nomination by the priority shareholders, but the priority shareholders are not bound to accept such a proposal and may reject it.

Royal Dutch has issued 1,500 priority shares, of which six are held by each Managing Director and member of the Supervisory Board (i.e., by twelve individuals in total) and the rest is held by a foundation constituted under Dutch law (the "**Foundation**"). The board of the Foundation consists of the same twelve directors (of whom six are current or former managing directors and six are "outside" directors) and decides how the priority shares held by the Foundation will be voted.

No person may cast more than six votes, so the Foundation appears to have what amounts to a "casting vote" as between the managing directors, on the one hand, and the "outside" directors on the other. According to Art. 7 of the Foundation's By-Laws, "resolutions of the Board [of the Foundation] shall be passed by an absolute majority of the votes cast. Pursuant to rules **to be laid down by the Board**, this provision may be departed from in the event of an equality of votes in a poll" (emphasis added). Neither the identity of the Foundation's chairman nor the deadlock resolution provisions adopted by the Board of the Foundation appear anywhere in the public domain. In the absence of transparency, one is led to assume that this is a self-perpetuating mechanism designed to shield the "club" of past and present Royal Dutch managing directors from interference in matters concerning succession in the boardroom -- not only from the Royal Dutch shareholders, but possibly from the Supervisory Board as well.

The mechanism of binding nominations for the appointment of directors is very common in Dutch corporate governance but its implementation falls into three distinct categories:

- (a) *The most archaic group*  
Royal Dutch, Akzo Nobel and Unilever all have an archaic "grandfathered" right of binding nomination which prevents shareholders from overriding any nomination put forward by the board and/or from nominating their own candidate(s). This right was formally "grandfathered" (i.e., confirmed by the Dutch authorities) in 1928 and again in 1971, but in the latter case, it was mentioned that the right would not last in perpetuity and that the Dutch Council for Economic Affairs had

the right to investigate and advise upon its cessation. No such investigation has yet taken place.

- (b) *The system pre- 1 January 2004*  
Most Dutch listed NV's have a system of binding nominations whereby a 2/3 majority of shareholders (of those present at the meeting, representing more than 50% of the total issued share capital) may override the nominations put forward by the board and appoint another director (*art. 2:133 Dutch Civil Code: Shell has grandfathered rights and thus is exempted from this shareholder right*).
- (c) *Companies applying the New Corporate Governance Code (Tabaksblad) as from 1 January 2004*  
The new Dutch Corporate Governance Code contains a best practice rule (IV.1.1) stating that an absolute majority (50% plus one vote) of shareholders present may override any binding nomination and that such shareholders need only represent more than 1/3 of the issued capital. If this proportion of the share capital is not represented at the meeting, but an absolute majority of the votes cast is in favour of overriding the binding nomination, a new meeting may be convened at which the resolution may be passed by an absolute majority of the votes cast, regardless of the proportion of capital represented at the meeting. The Dutch Code operates with the "apply or explain" principle. In the next few months, it will become clear which Dutch listed companies will comply with this best practice rule and which will explain why they have decided not to comply (and thus proceed as in (b) above).

In conclusion, the "grandfathered" rights granted to Royal Dutch in respect of binding nominations mean that the Board of Management and Supervisory Board effectively have unfettered power with regard to the appointment of their members. This is inconsistent with modern corporate governance principles and contrary to recent developments in Dutch corporate best practice.

It should be noted, however, that "Royal Dutch aims to be at the forefront of **internationally** recognised best governance practice" (2002 Annual Report, emphasis added). As such, Royal Dutch should be prepared to go beyond local best practice to facilitate the nomination of directors by significant shareholders. In this context, it would be logical for the Company to remove the right of its priority shareholders to reject nominations by holders of 1 per cent. or more of its ordinary share capital and this would place it at the forefront of best governance practice in many of the largest capital markets in which the Group operates -- including the U.K. and the U.S.

#### 1.4 Shell Transport Board

The Shell Transport board (the "**Shell Board**") comprises two managing directors and nine non-executive directors, of which seven are considered by the Shell Board to be independent (see *Appendix 2*).

Accordingly, the structure of the Shell Board observes the UK's Combined Code of Corporate Governance (the "**Code**") provisions that at least half the board, excluding the Chairman, should comprise non-executive directors determined by the board to be independent. Also, in accordance with the Code, the Shell Board has nominated a senior non-executive director.

The articles of association of Shell Transport require that all directors should be subject to re-election at intervals of not more than three years and all directors must vacate office at the age of 70, which is in compliance with the Code.

Non-executive directors are appointed to the Shell Board in consultation with the Shell Transport Nomination Committee and appointments are ratified by shareholders at the next annual general meeting after such appointment. The Nomination Committee is comprised of the whole Shell Board and the Chairman of the Board acts as the Chairman of the Nomination Committee. The Nomination Committee reviews all potential appointments before the candidate is approached and new appointments can only be made by the Shell Board after a recommendation from the Nomination Committee. This ensures that all directors can participate in the nomination process and that the Committee is constituted with a majority of independent non-executive directors.

The appointment of executive directors to the Shell Board is considered in tandem with proposals for appointment of individuals to the position of Group Managing Director and, where appropriate, the Shell Board either co-opts the person concerned as a director or, if timing allows, recommends the person to the shareholders for election at the next annual general meeting. Proposals for the nomination of an individual to the position of Group Managing Director are reserved to a joint committee comprised of representatives from both the Royal Dutch Supervisory Board and the Shell Transport Board -- the Remuneration and Succession Review Committee ("Remco") (see below *1.5 Joint Committees*). Unlike at Royal Dutch, shareholders have the opportunity to nominate directors for election to the Shell Board provided that they can speak for five per cent. or more of the share capital (jointly or on their own), but there is no certainty that a director so elected will be appointed to the position of Group Managing Director since this is Remco's prerogative.

The Shell Board has acknowledged in its 2002 Annual Report and Accounts that the Chairman of Shell Transport is currently also the most senior executive director of the Group, which conflicts with the Code principle that there should be a clear division of responsibilities at the head of the company. It is argued that the existence of the Committee of Managing Directors ensures that no one individual has unfettered powers of decision and therefore that the spirit of the principle set out in the Code is complied with.

However, due to the informal nature and constitution of the Committee, it could be argued that its existence does not, in and of itself, solve the problem since the Committee's legitimacy, when viewed from the outside, is far from clear (see 2.1 below).

### **1.5 Joint Committees**

Royal Dutch and Shell Transport have formed a number of joint Committees to assist with the discharge of their respective governance responsibilities. Of relevance to the provisions of the Code are the Group Audit Committee (to monitor and report on financial and risk matters) and the Remuneration and Succession Review Committee (to make recommendations on remuneration and succession of Group Managing Directors; the exact powers conferred on this committee, beyond those relating to Group Managing Directors, are not clear from publicly available documents).

Each of these Committees is composed of six members, in each case three of whom are appointed by the Shell Board from amongst its independent members and three by the Supervisory Board of Royal Dutch from amongst its members. The requirement for such joint Committees raises the following governance issues for Shell Transport under the Code, each of which have been disclosed in its 2002 Annual Report and Accounts:

- (a) the board committees dealing with audit and remuneration matters are joint committees of the Supervisory Board of Royal Dutch and the Board of Shell Transport with the chairmanship alternating between the two. This means that

the chairman of these committees will sometimes be a nominee of Royal Dutch and as such will not be able to attend the AGM. In these circumstances a Shell Transport member of the committee will deal with any appropriate questions at the AGM;

- (b) the Remuneration and Succession Review Committee comprises six non-executive Directors including two former Group Managing Directors – one UK and one Dutch. The Boards have considered it helpful, given the complexity of the Managing Directors' salary structure in relation to other Group executives, for the Committee to include former Managing Directors, although theoretically the former Managing Directors are not "independent"; and
- (c) the Remuneration and Succession Review Committee, as a joint committee of two independent Boards, is not able formally to "determine" the remuneration package of individual directors (who are not employees of Royal Dutch or Shell Transport). It makes recommendations to the Boards of Royal Dutch and Shell Transport which, if thought fit, pass the proposals on to the employing companies concerned for implementation.

## **2. GROUP-WIDE MANAGEMENT**

The link between the respective top tier parent companies is provided by a committee, known as the "Committee of Managing Directors", and by a working group, known as the "Conference".

### **2.1 The Committee of Managing Directors**

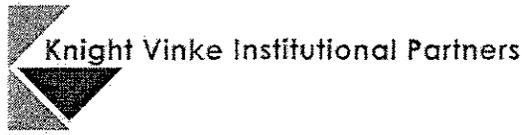
The Committee of Managing Directors is comprised of four managing directors from the Royal Dutch Management Board and two from the Shell Board (such proportional split being indirectly provided for in the Equalisation Agreement as the Committee of Managing Directors mirrors the constitution of the Presidium of Shell Petroleum NV which, it is stipulated in the Equalisation Agreement, must be made up of Royal Dutch representatives and Shell Transport representatives in the ratio 2:1). The members of the Committee of Managing Directors are known as the "Group Managing Directors".

The role of the Committee of Managing Directors is described by the Group as being that of considering and developing "objectives and long-term plans of the Group", yet neither its status nor its responsibilities are set out in the articles of either of the parent companies. Furthermore, no reference is made to such Committee in the trade register extracts of either Royal Dutch or Shell Petroleum NV. As a result, it is unclear what its powers and responsibilities in fact are, and the extent to which it influences and controls policy and decision-making of the Group.

The only conclusion which can be reached is that it is an internal arrangement of function, which is opaque to shareholders and the legitimacy of which is neither confirmed nor explained in the by-laws of the Group parent companies.

### **2.2 The Conference**

Meetings of the Conference comprise some or all of the directors of Shell Transport and members of the Management and Supervisory Boards of Royal Dutch, together with senior executives from the operational companies of the Group. However, it is not clear which such executives or non-executives attend each meeting and whether or not attendees are selected from time to time. The purpose of the Conference is stated in the 2002 Annual



Report and Accounts as being to "receive information from Group Managing Directors about major developments within the Group and to discuss reviews and reports on the business and plans of the Group". In particular, the Conference apparently reviews and discusses, amongst other things:

- the strategic direction of the businesses of the Group;
- the business plans of both the individual businesses and of the Royal Dutch/Shell Group of Companies as a whole;
- major or strategic projects and significant capital items;
- the quarterly and annual financial results of the Group;
- reports of the Group Audit Committee;
- annual or periodic reviews of Group companies' activities within significant countries or regions; and
- governance, business risks and internal control of the Group.

Again, even though the list of responsibilities set out above are key management issues relating to the Group, neither the status nor the responsibilities of the Conference are set out in the articles of either of the parent companies and no reference is made to it in the trade register extracts of either Royal Dutch or Shell Petroleum NV.

One would commonly expect such important issues to be dealt with by a board of directors, the conduct and constitution of which is regulated in a company's constitution and open to public (or, at least shareholders) review, rather than by a guarded and opaque committee.

### **3 DRAWBACKS OF THE EXISTING GOVERNANCE STRUCTURE**

#### **3.1 Management by Committee**

It would seem that, as a result of the Committee of Managing Directors / Conference structure, management of Group-wide policy and strategy is effectively conducted by committee.

Under the UK Combined Code, the delegation of certain board powers to committees for the purposes of, for instance, overseeing audit regulation and setting executive remuneration, are key tenets of the principles of best practice. However, these committees are required to be comprised of independent non-executive directors. In the case of the Committee of Managing Directors, all its members are executive directors and therefore the concept of independent review of its actions is completely by-passed, making it difficult to see how its existence can be considered in line with governance best practice. The Group may argue that the independent control is provided by the Conference, where both independent directors of Shell Transport and members of the Royal Dutch Supervisory Board are invited to attend. However, without any formal guidelines covering the conduct and powers of the Conference, it is impossible to say whether it offers any effective independent check on the operations of the Committee of Managing Directors. This in itself is contrary to overriding principles of good corporate governance, such as the requirement for formal and transparent management structures and clarity of divisions of responsibility.

The concept of group-wide strategy being controlled by a small committee of executive directors from two distinctly separate boards, under the apparent review of a seemingly more independently represented forum (in the shape of the Conference), is highly unusual in the context of UK and Dutch listed companies. It raises the question of upon what basis the directors of each of Royal Dutch and Shell Transport can consider the delegation of such powers to be in the best interests of their respective companies.

### **3.2 Method of appointment to the Royal Dutch Board/ Management Succession**

Another issue arises when one considers the process of succession to these 'super-committees'. The Remuneration and Succession Review Committee (*see above*) reviews and endorses candidates for appointment to the position of Group Managing Director. When considered with the power of the Royal Dutch priority shareholders and the Shell Transport Nomination Committee, it becomes clear that succession to senior group executive posts is very much internally driven and controlled. As a result, there is very little direct shareholder influence on the constitution of these governing bodies and no clear lines of accountability to their members.

This is particularly relevant in the context of Sir Philip Watts' retirement within the next 18 months and the likelihood that his successor will be appointed by virtue of tradition from the Royal Dutch Board of Managers -- the appointment (traditionally) alternating between Royal Dutch and Shell Transport. As mentioned, there is a lack of shareholder input in the nomination process to the Board of Managers and Supervisory Board of Royal Dutch due to the archaic "grandfathered" binding nomination rights enshrined in the articles. This results in no influence for the shareholders on nominations to the various joint Committees, including the Committee of Managing Directors, other than indirectly through participation as a shareholder in Shell Transport.

We are of the view that vacancies for the most senior executive positions within a multinational group such as Royal Dutch Shell -- in particular to the position of Group CEO -- should be open to the very best possible candidates, both internal and external, and that the selection process needs to be as transparent as possible.

### **3.3 Conflict at top tier Board level**

The Boards of the two top tier companies are comprised of two different groups of executive and non-executive/supervisory board directors. Each Board is bound to consider the separate interests of their respective companies and their own shareholders. This can obviously result in conflict at the top tier level which can be detrimental to the Group as a whole. The Conference, which attempts to alleviate this problem, is too large a body to be effective in case of true need and, as discussed above, is lacking in legitimacy.

### **3.4 Transparency of Group decision-making body**

The present decision-making body at a Group level takes the form of the Committee of Managing Directors, which is an internally appointed body, lacking in transparency and accountability and with no defined lines of succession. Fundamental decisions regarding overall strategy and direction of the Group are seemingly taken without review from any independent body or representative in the absence of any defined powers or specific responsibilities being reserved to the Conference.

### **3.5 Direct accountability of Chief Executives**

The distribution of executives across the two top tier companies and the Committee of Managing Directors, dilutes and blurs lines of accountability to the Group's divisional chief executives in respect of performance and management of the Group. The amalgamation of the roles of Chairman and Chief Executive at Shell Transport blurs the individual responsibilities of the two roles.

#### **4 UNILEVER AS A PRECEDENT**

By way of comparison, set out below is a brief summary of the situation at Unilever, also a dual-headed group, which has recently announced a radical reform of its antiquated governance structures.

Unilever NV and Unilever Plc, the top tier companies of the Unilever Group, have operated under a dual-headed structure since 1929. The two top tier companies operate together as one company, with identical boards of executive directors, therefore avoiding the danger of the two boards moving in separate directions as can occur where the top tier company boards are different.

The identical composition of the two boards is ensured because the NV's articles of association grant to the holders of ordinary shares numbered 1 to 2,400 inclusive the right to draw up a binding nomination list for the appointment of directors by the general meeting of shareholders, and because the Plc's articles of association provide that no persons shall be eligible to be elected as directors except such persons as shall have been nominated by the holders of the company's deferred stock. NV Elma, a group company of NV and United Holdings Limited, a group company of Plc, each hold 50 per cent. of the ordinary shares numbered 1 to 2,400 in NV and 50 per cent. of the deferred stock in Plc. These two group companies, therefore, together draw up the nomination lists for the election of directors and only the persons nominated by them may be elected.

Each top tier company of the Unilever Group has advisory directors appointed by their respective boards. Although not required under the articles of association, the advisory directors appointed by each board tend to be the same. They are the principal external presence in Unilever's governance. Although they are not able to vote at board meetings they have a supervisory role and are members of the various joint committees such as the executive committee, audit committee, corporate risk committee and the nomination committee.

Included in the announcement of the Unilever Group's annual results published on 12 February 2004, was the following statement which outlines the group's response to developments in corporate governance regulation in its main reporting countries:

"The most important change is a move to a unitary board for both parent companies, Unilever N.V. and Unilever Plc. Our current Advisory Directors will be proposed as Non-Executive Directors, ensuring that both Boards will be identical in composition and will be comprised of a majority of independent Directors. All Directors will stand for election each year. This governance structure will further enhance transparency and will be, at all times, subject to shareholder choice."

The result will be to introduce an independent element to both boards and shows a willingness to provide more effective shareholder participation in the appointment of directors. This sets an appropriate precedent for other multi-national quoted companies and highlights a welcome shift in approach with respect to issues of governance best practice and shareholder participation.

#### **5. PROPOSALS FOR CHANGE**

It is stated in the Royal Dutch and Shell Transport 2002 Annual Reports and Accounts that they "aim to be at the forefront of internationally recognised best governance practice". The recent statement by Unilever referred to above shows that other similarly structured multi-nationals have recognised the need continually to update and refine their



governance structures to enhance transparency and shareholder influence. With this in mind, the following proposals for change could be raised with the boards of Royal Dutch and Shell Transport with a view to improving the Group's corporate governance structure and increasing the ability of its shareholders to influence its management, whilst maintaining the present dual-headed corporate structure.

#### **5.1 Appointment of Group CEO and non-executive Group Chairman**

It is proposed that two individuals be appointed to the boards of both Royal Dutch and Shell Transport, functioning, respectively, as Group Chief Executive and non-executive Group Chairman. The CEO position needs to be at the top of an unambiguous chain of command, with clearly delineated responsibilities and accountability to the Group's boards. Finding a world-class CEO to step into Sir Philip Watts' shoes will necessarily involve both an internal and an external search, and if clarity is not achieved in this respect, the best candidates are unlikely to be interested. Responsibility for considering and developing objectives and long-term plans for the Group should pass to the boards of the top tier parent companies.

#### **5.2 Reorganisation of the Committee of Managing Directors**

The Committee of Managing Directors should be reorganised to function in much the same way as the "executive committee" of other similar sized multi-national groups. With unified boards (see below), the *raison d'être* of the Committee of Managing Directors as a means of arbitrating between the interests of each board no longer applies.

#### **5.3 Unification of the top tier Boards by symmetrical appointment**

The appointment of the same executive and non-executive directors (including independents) to each of the Royal Dutch and Shell Transport Boards, thereby effectively appointing a de facto Group board, would ensure clarity of responsibility and accountability at the top tier level and minimise inefficiencies and conflicts. It would also give the Shell Transport non-executive directors more of a say in the way the Group is managed.

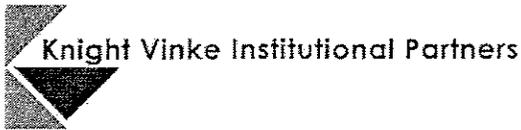
#### **5.4 Modification of Royal Dutch Shareholder Rights/ Adoption of Tabaksblat Rules**

Royal Dutch should be bound to accept nominations for board appointments put forward by shareholders holding one per cent. or more of its issued share capital and, furthermore, should abide by the Tabaksblat rules concerning binding nominations.

### **6. BENEFITS OF THE CHANGES PROPOSED**

#### **6.1 Appointment of Group CEO and non-executive Group Chairman**

It has been argued in the past that the unorthodox corporate governance structures in place at Royal Dutch and Shell Transport have worked successfully for decades, so why change them? The circumstances today are somewhat different: the recent reclassification of reserves has cast significant doubt on the Group's reputation for conservatism; its reserve replacement track record appears to have fallen behind that of its peers; its stock price is near its 5-year low; and the Group faces class action lawsuits and investigation by the SEC. It may be hard to demonstrate strict cause and effect with respect to the past booking of reserves – but a more orthodox corporate governance structure combined with



an internal and external search for a world-class Group CEO should set the scene for regaining the market's confidence and a re-rating of the Royal Dutch and Shell Transport shares.

## **6.2 Reorganisation of the Committee of Managing Directors**

The reorganisation of the Committee of Managing Directors along the lines of an "executive committee" reporting directly to the CEO would allow key decisions regarding the Group to be centralised and to be subject to review and input by independent/supervisory directors, thereby better reflecting generally accepted rules of best governance. It would also bring greater transparency to the management of the Group, improving lines of accountability and efficiency and returning management power to bodies that are directly answerable to the shareholders.

## **6.3 Unification of the top tier Boards by symmetrical appointment**

The effective unification of the top tier boards would remove the need for any unifying management committee and return ultimate group-wide management control to the top tier company boards where non-executive, and particularly independent non-executive, directors will be able to contribute to and supervise Group-wide decision-making. A unitary board would also make it easier to highlight and enhance the role of the Group's chief executive, whilst ensuring that the decision-making process is reviewed by an independent body of directors. In addition, the proposed changes would bring shareholder influence closer to the Group executive, especially if coupled with changes to the director nomination procedure as outlined below

An instructive example is that of Reed Elsevier, which itself was formed from a merger between UK and Dutch companies - the removal of its four-person management committee in 1999, in favour of a unified command led to greatly improved performance.

In order to implement and maintain a unitary board structure, an arrangement similar to the appointment structure adopted by Unilever could be used (except that non-executives would be appointed directly onto the main boards rather than constituting an Advisory Board), as follows:

- shareholders of Royal Dutch to appoint 60% of executives and non-executives of Royal Dutch ("A directors");
- remaining 40% of executives and non-executives of Royal Dutch are appointed (by shareholders of Royal Dutch) upon the (binding) nomination of the priority shares, which are held by a foundation of which the board always nominates the persons appointed by the shareholders of Shell Transport ("B directors");
- shareholders of Shell Transport appoint 40% of executives and non-executives of Shell Transport (the "B directors"); and
- remaining 60% of executives and non-executives of Shell Transport to be appointed by a subsidiary of Shell Transport holding deferred shares in Shell Transport and instructed to vote in favour of the same persons as the A directors.

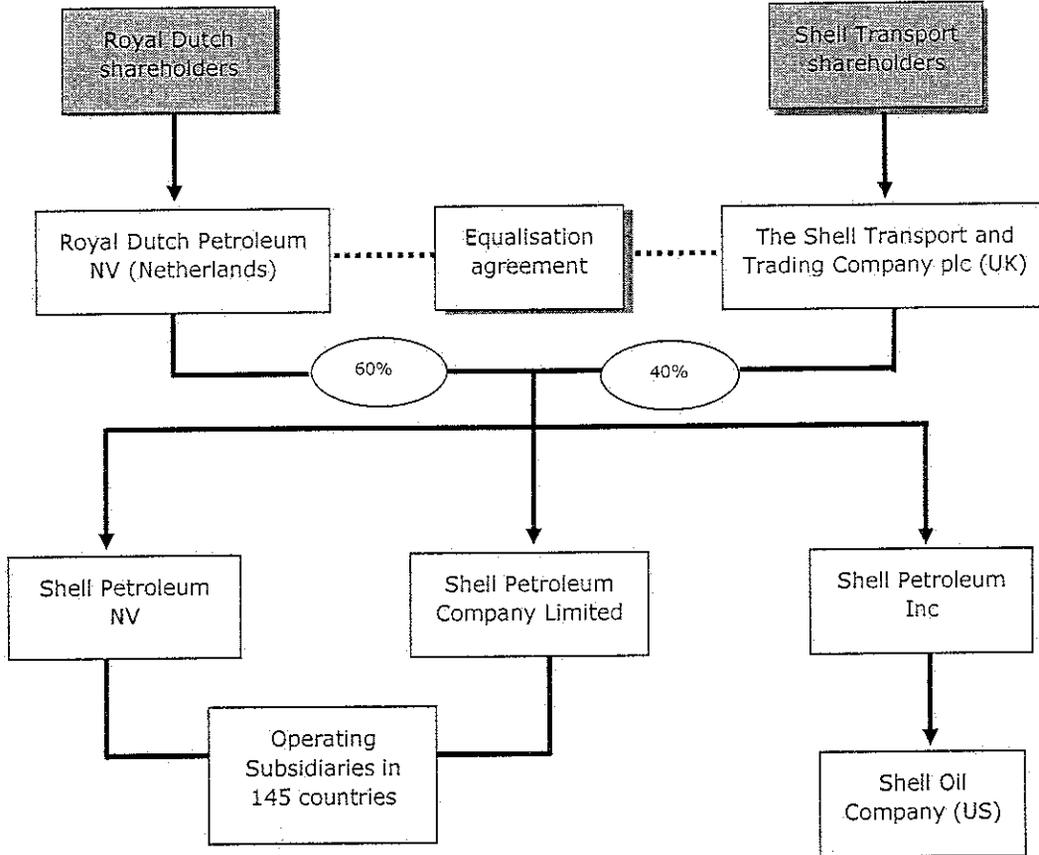
**6.4 Modification of Royal Dutch Shareholder Rights/ Adoption of Tabaksblat Rules**

The articles of association of Royal Dutch currently allow shareholders (acting individually or in concert) holding 1 per cent. or more of the share capital to propose nominations for appointment to the Board. However, the priority shareholders are not bound to accept such proposals and may, at their sole discretion, disregard them when proposing nominations to be voted on by the shareholders in general meeting. Abolition of the right for the priority shareholders to disregard nominations duly proposed by shareholders and replacing it with an obligation for the priority shareholders to nominate such persons would ensure shareholder participation in the lines of succession to the Royal Dutch Board.

The mechanism of binding nomination rights needs to be brought into line with modern-day governance principles and should at the very least follow best practice in the Netherlands. Although most Dutch listed NVs currently permit shareholders to reject the board's nominations (and to appoint their own nominees) by a two thirds majority of the shareholders present at the general meeting (provided they represent 50% of the share capital), this system is considered to be unworkable in the ambit of large listed companies with wide shareholder bases, such as Royal Dutch. The new Dutch Corporate Governance Code contains a best practice rule (IV.1.1) stating that an absolute majority (50% plus one vote) of shareholders present may override any binding nomination and that such shareholders need only represent more than 1/3 of the issued capital. This is the minimum standard which Royal Dutch should be setting for itself.

New York  
24 February, 2004

**APPENDIX 1**  
**ROYAL DUTCH/SHELL**  
**combined group**



**APPENDIX 2  
ROYAL DUTCH/ SHELL CORPORATE GOVERNANCE**

<b>TOP TIER COMPANIES</b>	<p><b><u>ROYAL DUTCH PETROLEUM NV</u></b></p> <p><b><i>Board of Managers</i></b>            Jeroen van der Veer (President)            Walter van de Vijver (CEO)            Malcolm Brinded            Rob Routs</p> <p><b><i>Supervisory Board</i></b>            Aad Jacobs (Chairman)            Wim Kok            Jonkheer Aarnout Louden            Prof Hubert Markl            Prof Joachim Milberg            Lawrence Ricciardi</p> <p>Maarten van den Bergh (former Executive)            Henny de Ruiter (former Executive)</p>	<p><b><u>THE SHELL TRANSPORT AND TRADING COMPANY PLC</u></b></p> <p><b><i>Board of Directors</i></b>            Sir Philip Watts (Chairman &amp; Managing Director)            Judy Boynton (CFO)</p> <p>Sir Mark Moody-Stuart (Non Exec &amp; former Chair)            Teymour Alireza (Non Exec)</p> <p>Sir Peter Burt (Ind Non Exec)            Dr Eileen Buttle (Ind Non Exec)            Luis Giusti (Ind Non Exec)            Mary Henderson (Ind Non Exec)            Sir Peter Job (Ind Non Exec)            Sir John Kerr (Ind Non Exec)            Lord Oxburgh (Ind Senior Non Exec)</p>
-------------------------------	--	---

<p><b><i>Committee of Managing Directors</i></b>            Sir Philip Watts (Chairman)            Jeroen van der Veer (Vice Chairman and <b>CEO Chemicals</b>)            Walter van de Vijver (MD and <b>CEO Production &amp; Exploration</b>)            Judy Boynton (MD and CFO)            Malcolm Brinded (MD and <b>CEO Gas &amp; Power</b>)            Rob Routs (MD and <b>CEO Oil Products</b>)</p>
--

<b>INTERMEDIATE TIER COMPANIES</b>	<p><b><u>SHELL PETROLEUM NV</u></b></p> <p><b><i>Board of Directors</i></b>            Sir Philip Watts (Presidium)            Jeroen van der Veer (Presidium)            Walter van de Vijver (Presidium)            Judy Boynton (Presidium)            Malcolm Brinded (Presidium)            Rob Routs (Presidium)</p> <p>Henny de Ruiter            Sir Mark Moody Stuart            Maarten van den Bergh</p>	<p><b><u>SHELL PETROLEUM COMPANY LIMITED</u></b></p> <p><b><i>Board of Directors</i></b>            Sir Philip Watts            Jeroen van der Veer            Walter van de Vijver            Judy Boynton            Malcolm Brinded            Rob Routs</p> <p>Henny de Ruiter            Sir Mark Moody Stuart            Maarten van den Bergh</p>	<p><b><u>SHELL PETROLEUM INC</u></b></p> <p><b><i>Board of Directors</i></b>            Robert F Daniel            Vilma S Martinez            Lynn Elsenhans            Curtis R Frasier            Steven L Miller            Gordon R Sullivan            M Fran Keeth            Raoul Restucci            Sir Philip Watts</p>
--	---	--	---

<b>OPERATING TIER</b>	<b>Non US Operating Companies</b>	<b>US Operating Companies</b>
---------------------------	-----------------------------------	-----------------------------------

# Royal Dutch Shell Internal Review of Governance Related Issues:

-----

## the Need for a More Transparent and Structured Approach

Notes for a Meeting with Messrs.  
Aad Jacobs and Jeroen van der Veer  
May 2004

# The Royal Dutch Shell Group and Corporate Governance

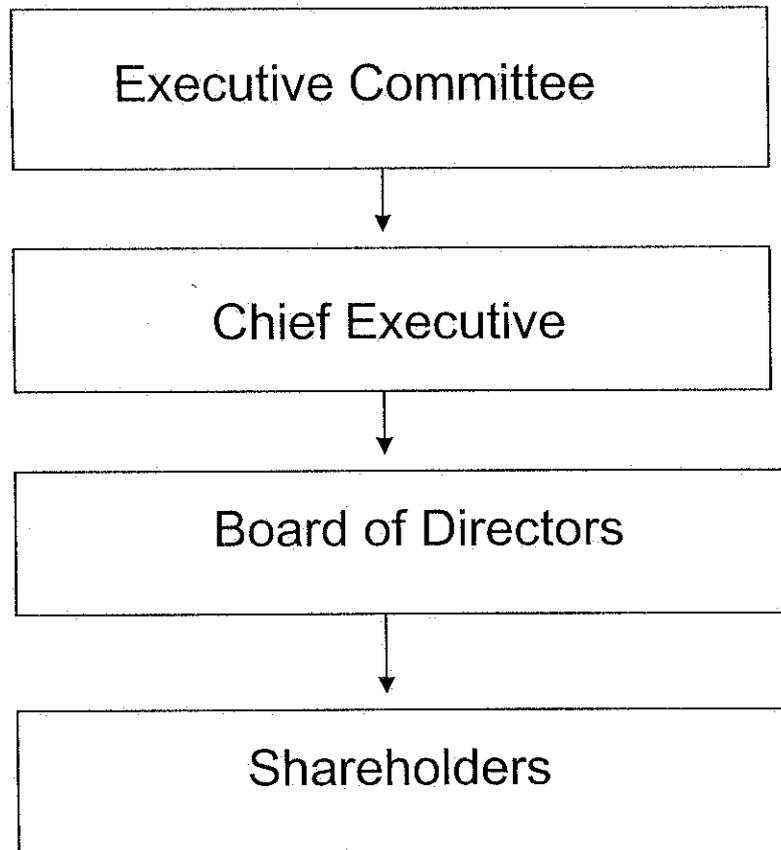
- Royal Dutch Shell's Boards are each "committed to upholding the highest standards of integrity and transparency in their governance of the Company".
- They also each aim "to be at the forefront of internationally recognised best governance practice".

Royal Dutch and Shell Transport Annual Reports 2002

# Royal Dutch and Shell Transport Special Arrangements

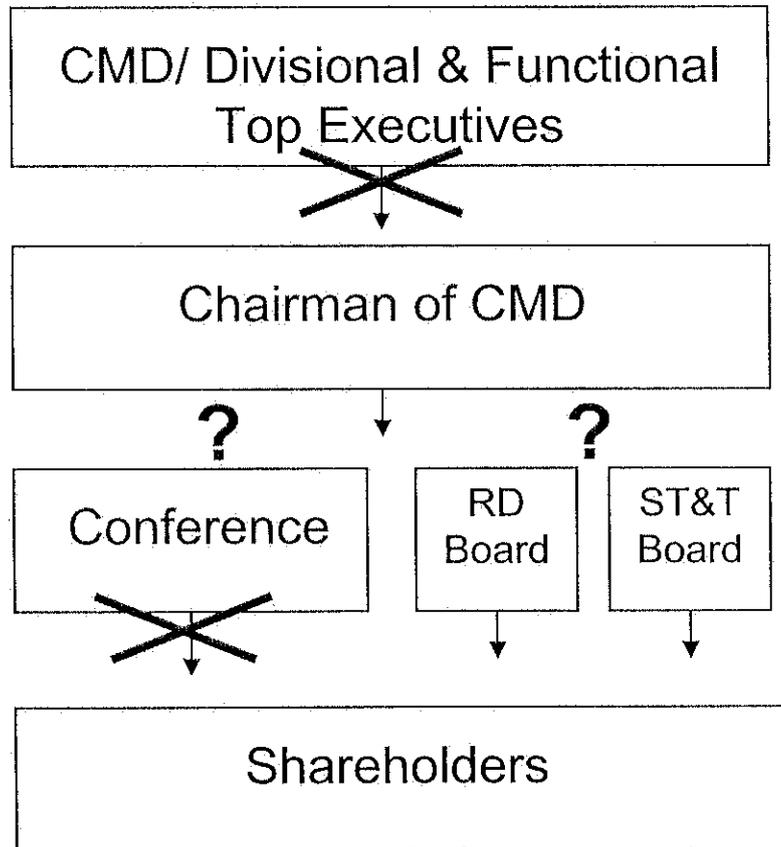
- “The framework within which the Boards operate is conditioned to some extent by Royal Dutch’s unique relationship with Shell Transport, and this results in some special arrangements which may not be appropriate in other companies”.
- The Group’s main justification is that these have existed for decades and have served shareholders well.

# Public Company Governance – Typical Building Blocks



- Senior Management reports to the Chief Executive
- The CEO is accountable and reports to the Board
- The Board is accountable and has a fiduciary duty to the Shareholders

# Structures - Royal Dutch Shell



**In Red:** Informal Bodies/ Positions

- It would appear that the Group's most senior executives do not report formally to the Chairman of the CMD.
- It is not clear to whom the Chairman of the CMD reports and to whom he is truly accountable.
- The Conference as an entity is not directly accountable to shareholders and yet appears to have appropriated the Boards' main functions.
- Shareholders are not able unilaterally to nominate directors to the RD Board in case of under-performance
- Nominating to the ST&T Board is of limited effect (given ST&T's limited control).

# Shareholder Concerns

- Royal Dutch Shell's governance structures are unorthodox and have survived unchallenged mainly due to lack of serious crises in the past.
- The “reserves débacle” is blamed on one or two “bad apples”. According to the Company, the system is not at fault.

Whether or not this is true, the market's confidence has been shaken badly and this issue needs to be addressed with sensitivity.

# Shareholder Concerns

- We and other shareholders believe that Royal Dutch Shell's "special arrangements" may have fostered management inefficiency and unclear lines of accountability.
- We also believe that they may act as a deterrent to the emergence of strong leadership in the future and the creation of shareholder value.

# Listening and Thinking Process

## 5th February

“We need to think hard about group structure. I think we have to get into some serious conversations with our shareholders and see what they have to say. But this is not a commitment to do anything.” *Sir Philip Watts*

## 5th March

“Shell will remain in listening mode until its annual meetings on 23rd April. After that, there will be a thinking phase and it would be natural for the Company to address these issues at its 2005 annual meeting.” *Jeroen van der Veer*

## 18th March

“Shell is considering the views of investors in respect of overall governance of the Group, including the composition and operation of the parent and holding company boards...The outcome of this review will be made public in good time to enable the process to be concluded at the AGMs in 2005.” *Jeroen van der Veer*

## 19th April

“In light of today’s [Davis Polk] report, the Boards have decided to accelerate the review. A working party has started and is empowered to take external financial, legal and tax advice and is exploring all possibilities for improving governance and structure.”

“An update on its progress and an expected timetable for its conclusions will be given at this year’s AGM on June 28, 2004.” *Jeroen van der Veer*

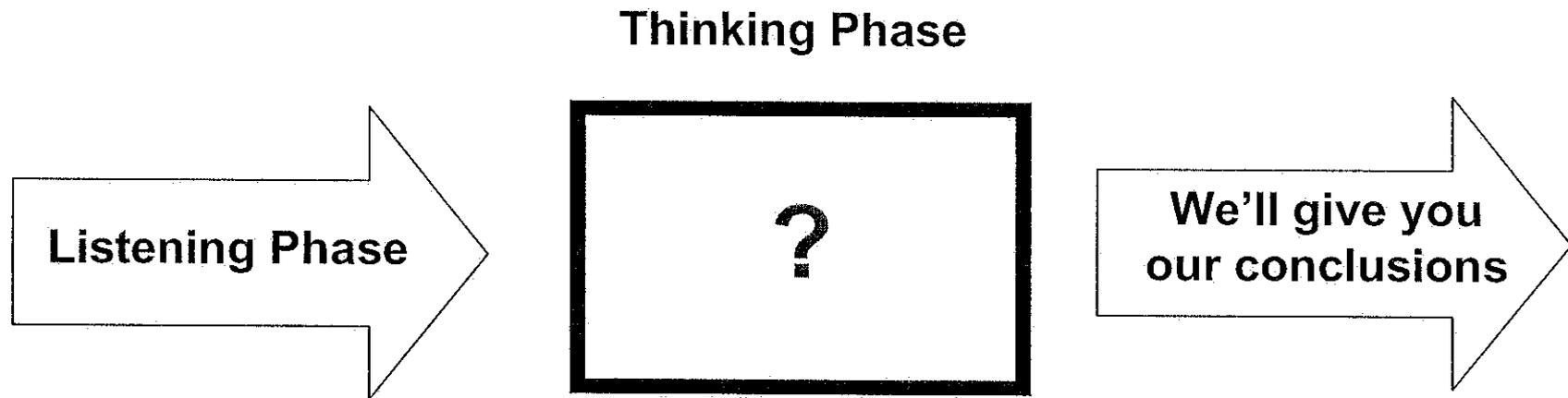
# Royal Dutch Shell's response - actions

The Group also points to certain actions which it has taken:

- Divisional CFOs now to report to the Group CFO
- Non-Executive Chairman at Shell Transport

Although these steps are appropriate, a far more radical transformation is required.

# The “Black Box” Approach



- The process is opaque and leaves the market with great uncertainty for several months.
- It is unstructured – the objectives to be achieved are not announced clearly in advance and there is no mechanism for external monitoring.

# What Do Shareholders Want?

Announced

1.	The establishment of a board-level committee comprised of non-executives from Royal Dutch and Shell Transport to undertake a rigorous and wide-ranging re-examination of the Group's "special arrangements" and more generally the way the Group is managed.	?
2.	Publication in advance of the terms of reference of this committee – with precisely stated objectives, the names of the participants, an agreed timetable and regular feedback to the market.	
3.	Access by the committee to independent financial and legal advisers.	Yes
4.	Express provision for regular consultation with representatives of the Group's long-term shareholders during the committee's process.	
5.	Publication of the committee's conclusions and recommendations.	Yes

# What Shareholders are Not Seeking

- We are not seeking to be prescriptive about the structure which achieves our common objectives. i.e.,
  - we are not necessarily seeking a merger of RD and ST&T.
  - we are not necessarily seeking an Anglo-Saxon style combined executive and non-executive board.
- We are also not seeking blind compliance with the Tabaksblat or Combined Codes.

# Terms of Reference - Objectives

As part of its terms of reference the Committee should (at the very least) address the following:

- The role and authority of the chief executive
- Management succession
- Board succession
- The composition of the Group's boards

# Role and Authority of the CEO

- The role of the CMD is described as being that of considering and developing “objectives and long-term plans of the Group” yet neither its status nor its responsibilities are set out in the articles of either parent company nor in the trade register extracts of Royal Dutch or Shell Petroleum NV. Its powers and responsibilities are unclear to the outside world.
- The Chairman of the CMD – often presented as a Group CEO – appears to have no formal powers or responsibilities.
- The absence of a true Group CEO with clearly delineated authority and overall responsibility for management of the Group is of great concern to shareholders.

# Management Succession

- We believe that there should be a transparent board-level process, including external searches, shareholder consultation and a suitable evaluation period, to address management vacancies at the highest executive level.
- Competition is one of the key Business Principles by which the Royal Dutch Shell Group conducts its affairs; it is important that this also be seen to apply to the selection of the Group's most senior executives.
- Recent and forthcoming management changes need to reflect this.

# Board Succession

- There is a lack of mechanisms for meaningful shareholder involvement in the selection of the Group's directors, including the CEO.
- In particular, the rights of Royal Dutch's priority shareholders need to be re-examined, both in light of best practice and as a practical matter.
- We believe that the Group does not need protections of this nature and, given its aspirations, should be prepared to accept nominations from 1% shareholders as a matter of principle.

# Composition of the Group's Boards

- The fact that the Group's two main boards are composed of different individuals makes it difficult for any Group CEO to know where his allegiance and accountability truly lie.
- Reed Elsevier – also a complex, Anglo-Dutch Group – resolved this issue by making its two Boards identical.
- No solution is ideal, but the Conference, which is both too large and unaccountable directly to shareholders, has clearly demonstrated its limitations.
- Ideally, the Group CEO should be accountable to a unified Group Board, headed by a non-executive chairman. The composition of this Board could reflect the 60/40 split of assets.

# Conclusion

- Royal Dutch Shell is going through an unprecedented crisis of confidence related to the reclassification of its reserves. Its reputation for integrity and conservatism have been badly dented.
- With the regulators focusing on what happened in the past, the Group's long term shareholders need (and want) to look to a better future.
- Governance changes are a vital part of this forward-looking exercise and Royal Dutch Shell needs to go beyond minimum standards imposed by regulators to restore the market's confidence. A radical transformation is required.
- The "Black Box" approach goes against the grain of what shareholders are seeking – and is inconsistent with the high governance standards to which the Group aspires.
- A more transparent, structured approach to the Group's transformation is a necessary part of this process.