

## **Corporate Governance Update**

Response to Requests from Storm Real Estate ASA

**17 June 2011**

Storm Real Estate ASA ('Storm Real Estate'), a significant shareholder in Eastern Property Holdings Limited ('EPH'), has recently made a number of statements in relation to EPH's corporate governance. EPH welcomes the active involvement of shareholders and EPH management has engaged in a detailed dialogue with Storm Real Estate about their requests and concerns through face-to-face meetings, calls and written correspondence over several months. The purpose of this Corporate Governance Update is to enable all shareholders to benefit from this dialogue by addressing the issues raised. We look forward to also discussing a number of these issues with our shareholders at this year's Annual General Meeting which will be held in London on 21 June.

Storm Real Estate is a Norwegian company which, like Eastern Property Holdings, is focused on property and property-related investments in Russia. It has accumulated a significant stake in Eastern Property Holdings (EPH). On 14 April 2011, Storm Real Estate announced that their holding was in excess of 10%.

### **1. Inclusion of Items on the AGM Agenda**

- Shareholders holding 10% or more of EPH's voting shares may request additions to the agenda of the EPH's Annual General Meeting ('AGM'), as stated in our Articles of Association and the Corporate Governance sections of our Annual and Semi-Annual Reports.
- Storm Real Estate demanded that a wide range of items be added to the agenda of this year's AGM.
- The board of directors should consider requests from minority shareholders to add items to the AGM agenda, (the 'AGM Agenda'), but, contrary to a statement in a Storm Real Estate press release dated 1 June 2011, is under no obligation to accept the requests and put items on the agenda exactly as written, or at all. The board of directors has considered each of Storm Real Estate's requests in good faith.
- Some of Storm Real Estate's proposed agenda items have been reflected in the AGM Agenda. A further series of requests were deemed more appropriately dealt with as questions to the AGM.
- Other requests specifically relate to the day-to-day management and operation of EPH. While these matters may be discussed at the AGM, they fall properly within the competence of the executive management rather than of the shareholders and the directors.

## **2. Board of Directors**

Storm Real Estate proposed a number of amendments to EPH's Articles of Association which concern the composition, term, eligibility, election, remuneration, voting, removal and activities of the board. A number of these matters will be addressed at the AGM (Agenda Items 5, 6,7, 9 and 10).

### **Conflicts of Interest**

- Given EPH's structure – EPH is managed by a subsidiary of Valartis Group, which is also the largest shareholder – it is particularly important that conflicts of interest are recognized and managed.
- Item 7) of the AGM Agenda proposes that directors with an interest in a transaction be precluded from voting on the matter.
- A number of other proposals from Storm Real Estate seem to address the risk that a decision might be made in favor of Valartis Group because executive board members are in the majority, or have the casting vote at a particular board meeting. We believe that preventing directors with an interest in a transaction from voting on the matter and electing additional independent non-executive directors to the board effectively addresses this concern.

### **Board Composition**

- The Board of Directors of EPH currently consists of two executive board members from our largest shareholder, Valartis Group, and two independent non-executive directors.
- Storm Real Estate has recommended that “the majority of shareholder elected members of the Board of Directors must be independent of the EPH's major shareholder/management company”.
- Items 9) and 10) of the AGM Agenda propose that two new independent non-executive directors be appointed to the board. The board will then have a majority of independent directors.
- Both proposed independent non-executive directors – Bernard Sucher and Kirill Rubinsky – are well-known and respected business leaders with relevant experience and deep knowledge of our market. Their candidacy statements are available on the EPH website.

### **Term of Board Members**

- Currently, EPH's Articles of Association do not impose a maximum term for board members.
- A three-year limit with the potential for re-election is now proposed. The term limitation would also apply to the current board.
- Storm Real Estate further proposed that half of the directors should retire by rotation at each AGM. EPH believes that it and the shareholders benefit from the continuity of the board of directors in a business characterized by long lead times and complex multi-year commitments.
- The term limit for directors is raised in Items 5) and 6) of the AGM Agenda.

## **Election of Board Members**

- Directors are currently elected by the shareholders. Storm Real Estate proposes that directors should also be able to appoint other directors provided that the appointment is approved by shareholders at an EGM within 3 weeks of the appointment.
- We believe that since a shareholder meeting is required in either case, the proposal has limited practical impact.
- Storm Real Estate further proposed that EPH create a Nomination Committee, composed of representatives of each of the five largest shareholders. This Nomination Committee would propose candidates for director and their remuneration.
- Nomination and Remuneration Committees are generally composed of board members. While our board may choose to appoint committees amongst themselves, we do not believe it is detrimental to EPH if they address these matters as a body that recognizes and managed potential conflicts of interest.

## **Removal of Directors**

- Storm Real Estate stated in their press release of 1 June 2011 that a 75% shareholder resolution is needed to change an elected board member.
- That is incorrect. As per the EPH's Articles of Association, a director may be removed, with or without cause, by a simple majority at a shareholders' meeting called for purposes including the removal of the director, or without a shareholder's meeting by a written shareholder resolution passed by at least seventy-five percent of the shareholders of EPH entitled to vote.
- Storm Real Estate has proposed amendments to our Articles on the subject of removing directors, seemingly based on an incorrect understanding of the current Articles. The proposed wording is more lengthy and detailed than the wording of the current provision and at present, the board does not believe these amendments would have any practical impact.

## **Quorum for Board of Directors**

- Currently, the quorum is not less than half the total number of directors. If there are only two directors, the quorum is two. The Chairman has a casting vote in the case of any equality of votes.
- Storm Real Estate proposed that the quorum be a majority of independent directors, or an equal number of independent and non-independent directors plus the Chairman (who, under Storm's proposals, is assumed to be independent).
- Having considered Storm's proposal, the board believes it is in EPH's best interests not to make the convening of board meetings unnecessarily onerous.

## **Chairman of the Board**

- Currently, the Chairman of the Board can be either independent or non-independent. The Chairman has a casting vote in the case of any equality of votes.
- Storm Real Estate proposes that the Chairman must be an independent director.
- EPH's view is that, given a) the plan to add two further independent directors to the board, and b) that board members, including the Chairman, cannot vote on transactions in which they have an interest, it is not necessary for the Chairman also to be independent.

## **Written Resolutions of the Directors**

- Currently, a written resolution must be signed by a majority of the directors. In the case of a committee decision, all members of the committee must sign.
- Storm Real Estate proposed that, in addition to the requirement that a majority of the directors sign, a majority of those signatories must be independent directors.
- Agenda item 7) prohibits a director from voting on any matter in which he is interested. As a result, the board's view is that the proposed resolution would have no material effect.

## **Directors' Remuneration**

- Currently, the remuneration of directors is decided by a resolution of the directors. Storm Real Estate proposes that remuneration of directors be decided by a resolution of the shareholders.
- Directors who are also officers of Valartis Group are not eligible for any compensation as board members. The board as a whole will agree upon remuneration for independent board members.

## **Eligibility of Directors**

- As per EPH's Articles, a competitor, or person directly or indirectly employed by a competitor, cannot be appointed to the board of directors. A "competitor" is defined as any entity competing for properties, projects or tenants with EPH, or engaged in substantially the same business in the same geographic region as EPH.
- Storm Real Estate, a competitor which is in substantially the same business in exactly the same geographic area, proposed the removal of this restriction.
- The board of directors decided that this proposal was not in the best interest of EPH or its shareholders.

### **3. Introduction of SESTA corporate takeover rules**

- Storm Real Estate requested that EPH adopt the rules on corporate takeovers of the Swiss Federal Act on Stock Exchange and Securities Trading (SESTA). The Swiss takeover rules contain three key elements:
  1. A regime mandating disclosure of significant shareholdings;
  2. A regime regarding voluntary takeover offers; and
  3. A mandatory offer regime.
- EPH is incorporated in BVI and listed on SIX as a foreign company. As such, it does not generally fall under SESTA. Regulation by request is not possible.
- An alternative approach is to introduce similar rules via EPH's Articles of Association.
- Of the three SESTA takeover elements, the rules mandating disclosure of significant shareholders are most easily implemented by amendment to the Articles. The AGM Agenda proposes reporting by shareholders as certain thresholds are crossed, either due to buying or selling of shares. Patterned after SESTA rules, failure to report would be enforced by denial of voting rights for a period of up to the SESTA standard of five years.
- EPH's ability to enforce rules regarding voluntary or mandatory takeover would be limited as the Articles of Association are only enforceable against shareholders. While it would be possible to withhold rights on shares, it is not necessary, for example to a shareholder to make a voluntary takeover offer. As such, we have not proposed rules which could only be enforced against shareholders, while being potentially ignored by non-shareholders.
- Based on our conversations with investors, we understand that they are primarily concerned with the risk that, without warning, an investor could acquire control of EPH and, depending on the investor, potentially change EPH's risk profile. Proposed Notification rules requiring disclosure of dealings in shares are found in Item 8 of the AGM Agenda.

### **4. Quarterly Reporting**

- Storm Real Estate requested that EPH publish its results quarterly, rather than semi-annually.
- EPH welcomes this proposal and proposes to start publishing results on a quarterly basis. The first quarterly report, covering Q1 2011, will be presented at the AGM. Subsequent quarterly reports are expected to be published within 60 days of the end of the quarter. The quarterly reports will include updates on construction progress, rental receipts and any other significant news.

## **5. Valuation of assets**

- Assets held at fair value will continue to be re-valued twice per year.
- EPH has always used appraisals of its real estate assets prepared by international property consultants. The assumptions and methodologies used by the appraisers are also checked by our auditors. We will engage a different international consultant to perform appraisals starting 30 June 2011. As such, two different international appraisers will have opined on each of EPH's real estate assets within a six month period.

## **6. Management Agreement**

- Storm Real Estate requested that the Management Agreement between EPH and Valartis International Ltd be made public before the AGM.
- All material commercial terms of EPH's Management Agreement are publically available on page 34 of EPH's 2011 Annual Report, in accordance with the SIX Listing Rules.

## **7. Management Fee**

- The management of EPH has been delegated to Valartis International, a wholly owned subsidiary of Valartis Group AG.
- Valartis International is currently entitled to fees as follows:
  - Management Fee of 2 % of EPH's adjusted Net Asset Value ("NAV"). The Management Fee includes the remuneration for the Management Committee.
  - Performance Fee equal to 15 % of the value appreciation of EPH's properties and property developments.
- If Valartis Group provides any other services not included in the Management Fee, for example property management, they are provided at cost.
- Fees paid or provisioned under the Management Agreement are verified as being correctly calculated by EPH's auditors.
- Storm Real Estate has proposed that the Performance Fee should be aligned to EPH's share price rather than NAV.
- EPH believes that management's primary focus should be creation of value, which is reflected in the NAV. Focusing management's attention on share price – a short term indicator of market sentiment – would seem to be especially inappropriate for a company in the inherently long-term business of owning and developing real estate.

## **8. Disclosure and Transparency**

- Storm Real Estate has made a number of helpful proposals in relation to EPH's communication with shareholders and the public. EPH welcomes these suggestions and, in response, is introducing the steps below.
- In addition to quarterly reporting, EPH proposes to organise a quarterly conference call for shareholders with management. This will create at least two extra opportunities each year for investors to interact with management.
- A link to the SIX page detailing management transactions will be added to the EPH website, so that recent and historical transactions can easily be reviewed.
- Dividend policy – EPH's dividend policy remains unchanged: we will pay up to 90% of disposable net rental income as a dividend each year. In recent years, when equity and debt financing were largely unavailable, and construction of Geneva House underway, it has not been possible to consider any of EPH's net rental income to be disposable.

## **9. Share Dealing**

- The SIX Listing Rules require directors and management to report any transactions in EPH shares, whether on their own account, or in relation to accounts over which they may reasonably be expected to have an influence.
- Storm Real Estate has proposed additional information and timing requirements on EPH.
- EPH's directors believe that the SIX Listing Rules requirements are reasonable, and provide the key information as to whether management or entities related to management are actively buying or selling shares.

## **10. Treasury Shares**

- Storm Real Estate has proposed that all issued treasury shares are cancelled once they exceed 5% of total issued shares.
- Treasury shares provide flexibility in terms of financing possible acquisitions and other transactions, making them a potentially useful asset of EPH. The rationale for the proposed cancellation is arbitrary and unclear.
- EPH can only buy its own shares or sell its treasury shares by decision of the board of directors.

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**Eastern Property Holdings Ltd.** is an SIX Swiss Exchange-listed real estate development company focusing on Russia. EPH holds interests in office, residential, retail and parking properties and developments, principally in Moscow and St. Petersburg. EPH is managed by Valartis International Ltd. a wholly-owned subsidiary of Valartis Group AG. Additional information on Eastern Property Holdings is available by contacting Terry Olin, Tel: +41 22 716 3222.

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