



## **Foundation of Hearts**

### **Building a Framework of Good Governance**

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Consultation on the long-term governance arrangements for Foundation of Hearts and  
Heart of Midlothian Football Club

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**April 2017**

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## **INTRODUCTION**

As the Foundation progresses towards becoming the major shareholder in the Club, one of our important tasks is to map out the governance framework which will be put in place when the shares in the Club change hands.

Governance is concerned with the way companies and other organisations are managed and run. It involves a set of relationships between the entity's owners, its board of directors, its senior management and other stakeholders. A governance framework seeks to ensure that responsibilities and powers sit in the right place, and decisions are made in the right way. In a broader sense, governance is also about having the right people, behaviours and organisational culture in place.

Our governance model will encompass two distinct legal entities – the Foundation and the Club. These entities will be in a group relationship, with the Club sitting immediately below the Foundation – see the diagram on page 3. Our model must create a balanced and cohesive governance system for that group as a whole, with consistent policies, processes and values in place at each level. In any governance model for a group, it is of central importance to have the right balance between, on the one hand, operational independence for the subsidiary, and, on the other hand, oversight by the “parent” shareholder.

There is no ready-made governance template available to us. There is a range of options we could adopt. As we examine the different options, we want to listen to the views of our members and make sure they are given proper consideration. This paper therefore sets out the primary areas we have been working on, and outlines the options we are provisionally minded to adopt.

We would draw your attention not only to the main body of our proposals, which is set out in chapter 3, but also to chapter 6. This is a section on “frequently asked questions”, which is intended to provide answers, in straightforward language, to a number of questions that members may understandably have on their minds.

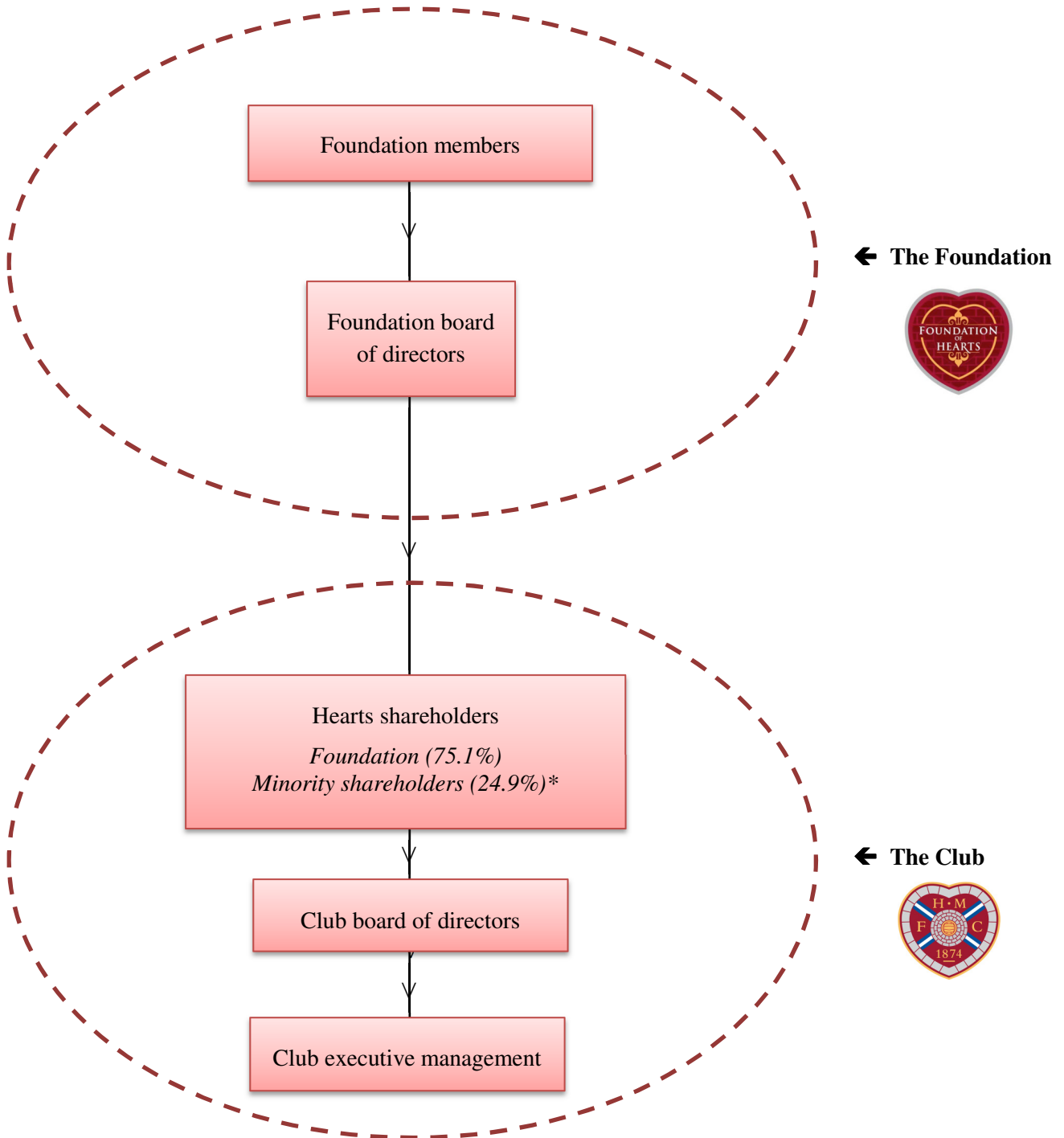
During the consultation period, we may circulate supplementary notes on particular topics of interest. Once the consultation period ends, we will firm up on our proposals in light of the responses to the consultation, and then present these to the members. There will be a further opportunity for member engagement at that stage.

Creating a sound governance model for adoption when the Foundation assumes majority ownership of the Club will be a key building block in the long term success and stability of the Club. It will reduce risk, and it will maintain Hearts' reputation and good standing. We encourage anyone who wants to help to shape the model to respond to our consultation.

### **Acknowledgments**

Various people have helped us to develop the governance proposals, and we would like to express our thanks to them. Members of the executive team at the Club, in particular Martin Jesper (Head of Stakeholder Management) and Jacqui Duncan (Head of Finance), have been generous with their time and support. We have also received valuable input from Professor Andrew Adams of Heriot-Watt University, Marcia Campbell, formerly a group executive at Standard Life plc, and Alex Mackie, one of the founders, and the first chairman, of the Foundation. The views expressed in this consultation document are those of the Foundation directors, and not necessarily those of the people who have worked with us.

**Group structure once the Foundation acquires a 75.1% majority shareholding in the Club**



\* The largest minority shareholder will be Bidco, which is expected to hold approximately 17.4%

## CHAPTER 1

### SUMMARY OF THE GOVERNANCE PROPOSALS

1.1 We are consulting our members on the corporate governance arrangements which will be established for the Foundation and the Club at the stage when the Foundation acquires a 75.1% shareholding in the Club from Bidco and becomes the controlling shareholder.

1.2 Both the Club and the Foundation currently have governance processes in place, and in developing our proposals for the long-term model, we have sought to avoid unnecessary change and to maintain a high degree of continuity and stability.

1.3 One of the cornerstones of the governance framework is the principle that it is the directors of the Club – not the shareholders, the Foundation or the Foundation’s members – that are charged with managing and directing the affairs of the Club. The Foundation will not interfere in the day-to-day operation of the Club. The framework also recognises, however, that at all levels of the governance structure, the exercise of powers must be associated with meaningful accountability, and it therefore seeks to build in appropriate “checks and balances” that subject the actions of relevant individuals to scrutiny.

1.4 The proposals in relation to the Foundation include the following:

- membership of the Foundation should continue to be based primarily on the making of monthly financial contributions, so that the Foundation can continue as an important source of funding for the Club. But our flexible membership rules will provide scope for us to introduce other categories of membership;
- the process for appointment of directors with specific business or professional expertise to the Foundation board should be modified;
- one of our directors will be designated as Director of Members’ Affairs, with specific responsibility for maintaining effective engagement and communication with members; and
- the future sale of shares in the Club by the Foundation will be restricted by entrenched provisions in our articles.

1.5 The proposals in relation to the Club include the following:

- as at present, the board structure of the Club will include two non-executive directors from within the board of the Foundation. The other directors will be a combination of executive and non-executive directors, as appropriate. The board of the Club will choose its chairman from among the directors;
- to ensure that due care is taken over the choice of board members and senior management, a nomination and governance committee will be established. Its primary role will be to make recommendations to the board on the appointment of new directors and senior executives. The committee will also monitor the governance framework to ensure that it remains effective and is being adhered to;

- certain matters will be reserved for decision by the Club’s shareholders. These will be matters, such as a potential sale of the Stadium or a change of the team’s name, which are important and emotive issues for supporters;
- certain other matters, such as the Club’s business plans and budgets, would be subject to consultation with the Foundation board; and
- the Foundation and the Club will put in place a “working together” document which will set out guidance, procedures and processes governing the relationship between them.

**1.6** The consultation period will end on 31 August 2017. Once we have considered the responses and firmed up the proposals, it is our intention to submit the proposed framework to our AGM late in 2017.

## CHAPTER 2

### CURRENT GOVERNANCE STRUCTURE

2.1 At present, the Foundation and the Club each has its own corporate governance regime, which governs its operation and control. This chapter explains the key components of those regimes.

2.2 Certain features are common to both the Foundation and the Club. For example:

- they are both companies<sup>1</sup> incorporated in Scotland under the Companies Acts - the Foundation as a company “limited by guarantee”<sup>2</sup> and the Club as a public company “limited by shares”<sup>3</sup>;
- the constitution of each company is set out in its articles;
- each company must comply with the 2006 Act;
- the two basic organs of governance of each company are, like all UK companies, *the members voting in general meeting* and *the board of directors*. The governance regime is concerned primarily with the balance of power between those two bodies;
- in each company, the appointment of directors is controlled by the members, and the 2006 Act confers an entrenched right on the members to remove directors by ordinary resolution; and
- both companies publish annual accounts made up to 30 June.

#### *The Foundation*

2.3 The *members* consist of the pledgers who make monetary contributions to the Foundation. So when a supporter signs up as a pledger, he or she becomes a member of the Foundation for as long as the pledges continue. Under the articles, additional classes of membership may be created, with different rights or obligations.

2.4 A member can resign at any time by giving notice to the Foundation, and in a limited number of situations (such as serious misconduct), the rules permit individual memberships to be revoked.

2.5 The membership body transacts business in *general meeting*. General meetings may be annual general meetings or non-routine meetings called for a specific purpose. They are usually called by the directors, but members with support of at least 5% of the total votes can also do so.

2.6 If a vote is held at a general meeting, each member is entitled to one vote.

2.7 The members in general meeting have the right to change the articles of the Foundation by special resolution. Any decision to wind up the Foundation would also be reserved exclusively for the members.

2.8 The *board of directors* is appointed by the members in general meeting. If a vacancy arises unexpectedly, the remaining directors may co-opt a new director temporarily, but the appointment must be confirmed by the members in general meeting as soon as possible.

2.9 Each director must be a member of the Foundation. The maximum number of directors is six.

<sup>1</sup> This means they each have a legal identity which is distinct from the members who collectively constitute the company.

<sup>2</sup> This means that if the Foundation owes more debts than it can pay, the guarantors’ personal liability will be limited to the extent of the money they elect to guarantee. Each member of the Foundation is a guarantor for £1.

<sup>3</sup> This means a shareholder’s personal liability for the debts of the Club is limited to the amount subscribed to acquire shares.

2.10 Each appointment comes up for regular renewal – the term of office is generally three years. No director should serve for more than nine years in total.

2.11 Under the process for electing directors, a candidate must be nominated by at least 25 members. For some vacancies, the directors may, in order to maintain an appropriate balance of skills on the board, restrict the candidates to members with specific professional or business expertise, but no more than half the places on the board may be filled in this way.

2.12 The method of electing directors is either a vote at the annual general meeting or a ballot of members in advance of the meeting. In a contested election, the voting system is “first past the post” (i.e. the winner is the candidate with the highest number of votes (not necessarily a majority)).

2.13 The articles vest a general power of management in the board of directors, subject to a reserve power for a general meeting, acting by a three-quarters majority, to give specific directions to the board.

2.14 The directors have a number of specific duties set out in the 2006 Act. They must manage the business, in their best judgement, for the benefit of the Foundation (which effectively means for the benefit of the members as a whole). Directors must exercise the powers conferred on them for their proper purposes, and are subject to duties of care and skill.

2.15 Directors are subject to a strict rule which forbids any conflict of interest without disclosure to the board or seeking approval from members. Directors must also declare to the board any interest in a proposed transaction or arrangement with the Foundation.

2.16 The quorum at a board meeting is three. Resolutions are passed by a simple majority vote, with each director having one vote. The chairman (who is chosen by the directors from among their number) has a casting vote.

2.17 No directors’ fees are payable, but a director may receive reasonable remuneration for professional or other services provided to the Foundation, and be repaid reasonable expenses properly incurred on Foundation business.

### *The Club*

2.18 The *members* consist of the individuals and companies who hold the share capital of the Club<sup>4</sup>. The share capital is currently made up of approximately 156 million ordinary shares. Those shares are freely transferable, and are not listed or traded on any stock market.

2.19 Decisions of the shareholders are taken at general meetings. General meetings are usually called by the board of directors, but shareholders representing at least 5% of the voting rights have the ability to request that the directors call a general meeting.

2.20 Most decisions at a general meeting only require an ordinary resolution, but a special resolution is required for certain corporate actions, including changing the Club’s articles. An ordinary resolution is required to sanction any borrowing by the Club in excess of a limit prescribed in the Club’s articles<sup>5</sup>.

2.21 On any resolution at a general meeting, a shareholder has one vote for each share held.

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<sup>4</sup> In relation to the Club, the expressions “*shareholders*” and “*members*” can be used interchangeably.

<sup>5</sup> The current borrowing limit is an amount equal to the greater of £40m and 2.5 x Adjusted Capital and Reserves (as defined).

2.22 The *board of directors* is appointed by the shareholders in general meeting. The board may also co-opt directors, either to fill a vacancy or as an addition to the board. All directors must resign and stand for re-appointment by shareholders on a periodic basis.

2.23 The Club must have at least two directors but no upper limit is set. The current board of six consists of two executive directors and four non-executive directors. Two of the non-executive directors are representatives of the Foundation<sup>6</sup>.

2.24 Every member of the board must satisfy the SFA's "fit and proper" eligibility test. The criteria used when applying the test are open-ended, but the key indicators of potential unfitness include unlawful conduct, personal bankruptcy, or involvement in a business which became insolvent.

2.25 The quorum at a board meeting is two. Resolutions are passed by a simple majority vote, with each director having one vote. The chairman has a casting vote.

2.26 The board of directors is responsible for the *management* of the Club's business and affairs, with full power to delegate tasks to employees and board committees. In carrying out their functions, the directors (including the Foundation representatives) owe duties to the Club (including a no-conflict rule) which are similar to those of the Foundation directors described in paragraphs 2.14 and 2.15.

2.27 Like its counterpart in most commercial organisations, the board has delegated responsibility for the running of the Club's business to the executive management team. The key governance role of the board is to exercise proper oversight of the executive management. Notwithstanding the delegation of decision-making to management, the board is ultimately collectively accountable for the performance of the Club.

2.28 As a professional football club, the Club is a member of the SFA. This status is a prerequisite for playing in the SPFL. The Club is bound to comply with the requirements of the SFA and UEFA club licensing system. The licensing criteria define minimum standards which must be fulfilled by a club in areas such as the development of young players, safe stadium facilities, suitable internal administration, and legal and financial benchmarking. The system provides important assurance about the level of professionalism and financial stability within a licensed club.

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<sup>6</sup> During the transitional period under the Bidco Agreement, the Foundation may nominate as directors the chairman of the Foundation, and one other representative acceptable to Bidco.



## CHAPTER 3

### PROPOSED GOVERNANCE STRUCTURE

#### *Section 1: Introduction*

3.1 In reviewing the current governance framework and discussing possible changes, we have sought to follow two basic tenets:

- (1) **we should avoid change for its own sake.** Many elements of the existing governance framework will continue to function effectively, and these should be retained. There should be no gratuitous or unnecessary change. For the Club in particular, it is important to maintain a high degree of continuity and stability. We should also “keep it simple”, and avoid unnecessarily complicated structures;
- (2) **the long-term governance model must respect and acknowledge the independence and authority of the board of directors of the Club.** The directors of the Club should be entrusted with responsibility and power over the Club’s activities.

Performance of this role would be subject to meaningful oversight and accountability, since every good governance system incorporates “checks and balances”. But the board of directors of the Foundation would not interfere directly in the operation of the Club. There has to be clear separation between the responsibilities of the two boards.

If we fail to adhere to this basic tenet, tensions and operational problems would arise and, crucially, the governance model would not command the trust and respect of those charged with delivering success for the Club.

3.2 It may also be worth re-emphasizing that the model we are developing **does not relate to the period when the Club is in the ownership of Bidco.** It would come into effect only when the Foundation fulfils its obligations under the Bidco Agreement and assumes majority ownership of the Club.

3.3 We should also stress that it is inherent in our proposals that the Foundation should remain a long-term shareholder in the Club, acting as a collective vehicle for supporter ownership. The objectives of the Foundation do not include the distribution of its shares in the Club to Foundation members – indeed the distribution of any assets to members is currently prohibited by the articles. This prohibition would also rule out the payment of a dividend by the Foundation to members.

#### *Section 2: The Foundation’s governance model*

(a) *Our “membership model”*

3.4 Although it does not involve making formal changes to our constitution, it is appropriate to start with our long-term “membership model”.

3.5 In theory, once the Foundation becomes majority shareholder in the Club, it would be possible to base membership on payment of a nominal – perhaps even a one-off – membership fee<sup>7</sup>. We strongly believe, however, that **membership of the Foundation should continue to be based on**

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<sup>7</sup> For example, millions of UK consumers pay a fee of £1 for membership of “the Co-op”, and, once conferred, membership is valid forever.

**the contribution of meaningful amounts by way of monthly pledges, so that the Foundation can continue to be an important source of funding for the Club.** We would like contributing to the Club, through the Foundation, to become a natural incident of following Hearts, part of the DNA of everyone who can afford to help. That is what underlies our “pledge for life” message. As majority shareholder in the Club, a large part of your board’s time and energy will be dedicated to attracting new members from the wider body of supporters<sup>8</sup>.

3.6 As we indicated in paragraph 2.3, our membership rules are flexible, and different classes of membership can be accommodated within them. We would not preclude the possibility of creating some form of “associate” membership for supporters who, for whatever reason, were unable to afford monthly contributions.

(b) *Specialist directors*

3.7 The current constitution recognises the importance of having a suitable blend of skills and expertise on the board. It specifies that up to half the directors can be individuals with specific professional or business expertise (“specialist directors”). If the board decides that a specialist director should be appointed, it spells out the expertise it is looking for, and then invites suitably-qualified candidates to come forward for election by the members. If more than one candidate comes forward, there will be a competitive election.

3.8 We perceive two potential drawbacks in this system. Firstly, we believe it gives the board insufficient say in the appointment of specialist directors. The outcome of the appointment process is unpredictable, as the final choice is left to a “democratic lottery”. Secondly, we believe the possibility of having to undergo a competitive election could make it difficult to attract high calibre individuals to the board.

3.9 We therefore recommend that **specialist directors will be selected and appointed by the board**. Selection will be in accordance with a Board Membership Policy to be developed and published by the board, and selection will purely be on the basis of the individual’s skills and expertise. The selection would be made in consultation with the Club board. A specialist director must be a member of the Foundation.

3.10 A specialist director appointed by the board would have to **submit to a members’ vote** at the first AGM after appointment by the board, and would be subject to removal by a majority vote. But this election process would not be competitive, and the specialist director could not be opposed by another candidate.

3.11 Directors who are not specialist directors would continue to be elected by the members, as at present.

(c) *Nomination of candidates for election as directors*

3.12 Currently, a candidate for election to the board must be nominated by a minimum of 25 members. We recommend that the directors should have discretion to **reduce the number of nominations required**, provided the number is the same for all candidates.

3.13 Business acumen on the board should not be confined to the specialist directors, and the overall skills balance of the board is important. We have considered whether, as part of the proposed

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<sup>8</sup> The role of the Foundation board will include setting a strategy for future funding from members and forecasting the likely levels of contribution on a rolling basis. This planning ahead will form part of the information flow between the Foundation board and the Club board, and will assist the Club in its own financial planning. We propose that the “working together” document referred to in section 4 of this chapter will stipulate that all Foundation funding is provided to the Club for general working capital purposes, unless a particular use is agreed between the Foundation and the Club.

changes, we should create a **nominations committee**, which would screen candidates for election, and would have authority to reject any candidate who did not meet prescribed ability-based eligibility criteria. We feel, however, that, on balance, a nominations committee should not be created. We believe the process of screening candidates drawn from our membership could become over-cumbersome and also potentially divisive. In practice, the board of directors will keep the balance of the board, both in terms of skills mix and diversity, under review, and can actively encourage candidates with a particular profile to come forward. If the board has concerns about the quality of a particular candidate, it may express them to members. Conversely, if the board rates a particular candidate highly, it can recommend that candidate for election.

*(d) Requirements of regulatory authorities*

**3.14** We propose one final change regarding board membership. The appointment or election of every director should be subject to **meeting any requirements of a relevant regulatory authority**. This change is intended to allow the introduction of eligibility criteria reflecting the fit and proper test applied by the Scottish football authorities (see paragraph 2.24). A director of the Foundation could potentially serve on the board of the Club, so it is appropriate to factor the regulatory test into the eligibility criteria at Foundation level. If a candidate for election as a director did not satisfy applicable regulatory requirements, he would not be eligible to stand.

*(e) Chairman*

**3.15** We do not propose any change in the present rules governing the appointment of a chairman. **The chairman will continue to be selected by the board from among the directors**. The chairman of the Foundation may or may not be the same person as the chairman of the Club, although, from a governance perspective, we would expect them, normally, *not* to be the same.

*(f) Director of Members' Affairs*

**3.16** One of the crucial tasks of the board is to keep in touch with the members, listen to their issues and concerns, find out what they want from their membership, and share information about the Foundation and the Club. We propose that **one of the directors will be designated as Director of Members' Affairs**, and this director will have primary responsibility for ensuring that an effective dialogue with members takes place. If the level of interest justifies it, we would expect the engagement activities to include **open meetings** at which members can provide feedback on matters relating to the Foundation. Over time, we would seek to extend that engagement and dialogue to the wider community of Hearts followers. The Director of Members' Affairs would work closely with the Club to ensure consistent and accurate messages to supporters.

**3.17** The Director of Members' Affairs will be the principal contact person with whom members may freely discuss any issues relating to the Club. As part of the governance framework, there will be ongoing communication and dialogue between the Club and the Foundation, and part of the Director of Members' Affairs' role will be to provide a sounding-board for members where direct contact with the Club is not appropriate.

*(g) Director's letter of appointment*

**3.18** We propose that each director will sign a **letter of appointment** on joining the board. This will cover various matters. It will highlight the duties which the director owes to the Foundation as a director. It will impose an express obligation of confidentiality, both during and after appointment. Each director will agree to conduct themselves in a way which upholds the values of the Foundation and the Club, and to act with the highest standards of fairness and integrity. Each director will also

acknowledge that the Club has a separate board of directors, and that, as a director of the Foundation, the director will not seek to influence, directly or indirectly, the running of the Club at an operational level<sup>9</sup>.

*(h) Restriction on sale of shareholding in Club*

**3.19** As part of the development of a long-term governance model, we have considered a future scenario in which the Foundation might need to decide whether or not to sell its shareholding interest in the Club to a third party. At the present time we cannot envisage the circumstances in which such a scenario would arise, but we nevertheless believe it would be remiss if we did not address this particular matter in the governance framework and seek members' views on our proposal.

**3.20** In our view, a transfer of the Foundation's shareholding interest to a third party would be such a fundamental step that it should require **the prior sanction of a super-majority** of the Foundation membership. Using mechanisms available under the 2006 Act, this super-majority would be "entrenched" in the articles, so that it could not be changed or removed by a simple special resolution (75%) at a shareholders meeting. Our current thinking is that the appropriate super-majority requirement would be a 90% majority in favour of a resolution. To encourage as many members as possible to vote, we would put in place procedures to allow advance voting by members unable to attend the meeting of members in person.

*Section 3: The Club's governance model*

**3.21** Changes in governance of the Club may be a necessary part of defining the new relationship between the Foundation and the Club, but, as we explained in section 1 above, certain constraints should be recognised when drawing up proposals for change. Firstly, stability and continuity should be a key priority. Secondly, the board of directors of the Club must remain the primary decision-making body. In addition, the Club's processes and procedures should not become so formalised and inflexible that they impose an unnecessary bureaucratic burden.

**3.22** It should also be noted that, while the Foundation will have the largest shareholding in the Club, it will not be the sole shareholder. The rights and interests of the other shareholders (many of whom will be members of the Foundation) will need to be recognised and respected in the governance framework.

*(a) Size and composition of the Club board*

**3.23** We believe a board of 5-6 members is likely to remain the right size to make decisions and exercise proper scrutiny. The board should also continue to consist of both non-executive directors and executive directors.

**3.24** The Foundation will have a formal right to nominate two of its directors to be non-executive directors to the Club board. The exercise of this nomination right will be subject to prior consultation with the nomination and governance committee of the Club (see below). . If we wished to appoint someone who was not a Foundation director, this would be subject to prior consultation with the nomination and governance committee and approval by the Club board (excluding the Foundation representatives).

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<sup>9</sup> The requirement for each director to respect the separate responsibilities of the Club directors would not impede the appropriate oversight of the Club by the Foundation board collectively, nor would it prevent a Foundation representative acting as a director of the Club.

3.25 As at present, at least one of the non-executive directors will be an **external independent director**. Appointments will be made, on merit, against objective criteria. The aim will be to maintain an appropriate balance of skills and experience and recruit the best possible people to the board. With no allegiance to any single shareholder, independent directors will bring a fresh perspective to the Club's business.

3.26 In this context, mention should be made of the statutory duty on directors to promote the success of the company. Under the 2006 Act, each director must apply independent judgment and act in the way he believes most likely to promote the success of the company "*for the benefit of the members as a whole*". The words in italics are important where a director is associated with a particular shareholder – for example, the directors on the Club board who are identified with the Foundation. They do not prevent a director communicating the views of a particular shareholder to the board as a whole, or taking a particular sectional interest into account in any decision or action as a director. But the director must also consider - and ultimately give priority to - the wider interests of shareholders as a collective group. Decisions of the Club board must be taken in the interests of the Club as a whole.

(b) *Board committees*

3.27 A **nomination and governance committee** will be established to identify the best possible candidates to fill positions on the board, and to ensure that the board has an appropriate balance in terms of its skills base. Its remit would extend to screening and proposing candidates for senior executive positions, and identifying the best-qualified director to be chairman of the Club. The board of the Foundation would consult the committee when nominating its two representatives to the Club board, and when selecting the Foundation's chairman.

3.28 The committee would work in a completely impartial and objective manner, and would recommend candidates to fill a vacancy on the basis of strictly meritocratic criteria. All appointments to the Club board would, as at present, be subject to ultimate approval by the shareholders as a whole.

3.29 The committee would also review and monitor the effectiveness of the Club's governance arrangements and make recommendations to the board in respect of any amendments to the governance framework.

3.30 The members of the nomination and governance committee would include the independent non-executive director and one of the non-executive directors nominated by the Foundation.

3.31 As part of the governance framework, the Club board might, if required in the circumstances, establish other committees that are commonly found in large commercial organisations. An **audit and risk committee** would be charged with overseeing the preparation of accounts and monitoring financial performance and control systems. A **remuneration committee** would make recommendations on the remuneration of the Club's senior executives.

3.32 The Club is taking steps to roll out a nomination and governance committee, audit and risk committee and remuneration committee *before* the transfer of majority ownership of the Club. In that event, we would retain these committees in place.

(c) *Chairman*

3.33 The Club directors will appoint the chairman of the Club from among their number (based on a recommendation from the nomination and governance committee). If the chairman of the Club and the chairman of the Foundation are not the same person, the two individuals will need to have a good working relationship, as both will have public-facing duties.

(d) *Day-to-day operational management*

3.34 The Club board will decide the strategy of the Club and its business, but it will not conduct the day-to-day operational management of the Club. As with most medium-sized or large companies, managerial authority will be delegated by the board to the executive management team, headed by the chief executive. The chief executive will report to the board, and the board will oversee the executive team as they carry out their roles. The chief executive will be given extensive authority, but important matters on which the board's decision is necessary will be clearly delineated.

3.35 Although the executive team will be responsible for running the Club on a day-to-day basis, ultimate responsibility for the success of the Club will lie with the board as a whole.

**Section 4: A “working together” document**

3.36 A key proposal in creating a harmonious governance system across the Foundation and the Club is that the Club and the Foundation should put in place a **“working together” document**. This would set out policies, processes, guidance and protocols governing the relationship between the Foundation and the Club.

3.37 The basic approach of the document would be to confirm the board's authority to manage the Club's operational affairs, but to also include the Foundation (or the Club's shareholders in general meeting) in certain important decisions. A correct balancing of these elements is crucial, along with a clear definition of roles and responsibilities at each level.

3.38 Within that overall framework, the document could cover a wide range of specific matters relating to governance. The topics might include:

- (1) a clear definition of the roles and responsibilities of the two boards (which recognises the independent responsibilities of the Club Board);
- (2) matters reserved for approval by Hearts shareholders at a shareholders' meeting. For example:
  - (a) borrowing or raising money which would result in the Club's aggregate borrowing exceeding a specified amount;
  - (b) any issue of shares in the Club;
  - (c) any change in the name of the football team, the design of the Club badge, the name of the Stadium or the Club colours; or
  - (d) sale of the Stadium.

At the shareholders' meeting, some of these decisions might require a “super-majority” – for (d) above, the required majority might, for example, be 90%;

Those “shareholder reserved matters” would be in addition to the constitutional or formal matters which require shareholder approval under the 2006 Act (e.g. changes to the articles). Best practice in governance might make it appropriate to include some or all of the reserved matters in the articles for additional transparency;

- (3) certain actions of the Club board which would be subject to prior consultation with the Foundation board. These matters would be agreed when the governance structure is established (and would be kept under periodic review). Possible items might include

business plans, budgets, capital expenditure, borrowings and key management appointments. Over time, other items might be added to the list, and, for some of these items, it might be appropriate for the Foundation to have a consenting role rather than a consultative one. We would establish an orderly consultation procedure which allowed the Foundation board to receive accurate, timely and clear information about each matter referred to it;

- (4) a process for selection of the two Foundation representatives to the Club board;
- (5) a requirement for an independent non-executive director on the Club board;
- (6) the Club board's policy on delegation to management (see paragraph 3.34);
- (7) clear rules governing how the Foundation's representatives on the Club board will report back to the Foundation board, given that some of the information may be confidential or sensitive; and
- (8) appropriate arrangements for regular communication and dialogue between the Club and the Foundation, including reporting mechanisms.

**3.39** The "working together" document would be reviewed, and its fitness for purpose evaluated, at appropriate intervals, as the governance framework should evolve to meet the changing needs of the Club and the Foundation.

## CHAPTER 4

### HOW TO BE INVOLVED IN THE CONSULTATION

4.1 The directors of the Foundation invite comments on the proposals contained in this document. You can give us your views in a number of ways:

- **online:** you can complete our online response form, which will be available on our website [www.foundationofhearts.org](http://www.foundationofhearts.org) from 29 April 2017;
- **by e-mail:** you can e-mail us at [consultationresponses@foundationofhearts.org](mailto:consultationresponses@foundationofhearts.org);
- **by post:** alternatively you can write to us at FoH Consultation, c/o HMFC, Tynecastle Stadium, Gorgie Road, Edinburgh EH11 2NL;
- **in person:** depending on the level of interest, we intend to hold one or more open meetings which members can attend. Details will be provided on our website.

4.2 If responding by e-mail or post, please include your name and an address (e-mail or postal) at which we may contact you.

4.3 Please note that we will not routinely acknowledge receipt of responses.

4.4 If you disagree with any of the proposals, it would be helpful if you could propose an alternative and provide concise analysis or reasons to support your position.

4.5 We may make consultation responses public. All comments will be treated as non-confidential unless you state that all or a specified part of your response is confidential and should not be disclosed.

4.6 The consultation period closes on 31 August 2017.

4.7 If you have any questions about the Consultation Document or need advice on the form of response, please e-mail us at [consultationresponses@foundationofhearts.org](mailto:consultationresponses@foundationofhearts.org).



**CHAPTER 5****FINALISATION AND IMPLEMENTATION OF THE GOVERNANCE STRUCTURE**

**5.1** Once the consultation ends on 31 August 2017, we will spend time considering the full range of members' views on the proposals in the Consultation Document. We will then firm up on the design of the governance framework and put our revised proposals forward for consideration. It is our intention to seek approval of these proposals at the AGM in late 2017.

**5.2** The new governance model would need to be formally put in place by the time the Foundation acquires the 75.1% shareholding in the Club. This is due to take place at the end of the transitional period under the Bidco Agreement, and at a suitable juncture in that period, appropriate resolutions would need to be passed at separate general meetings of the Club shareholders and the Foundation members.

**5.3** The duration of the transitional period is not certain at this stage – it depends on how quickly the Foundation is able to meet in full its financial obligations under the Bidco Agreement, and that target could be achieved some time in 2019, 2020 or 2021. It is not feasible, therefore, to set at the outset a definitive timetable for formal implementation of the governance plan.

## CHAPTER 6

### FREQUENTLY ASKED QUESTIONS (FAQS)

#### A. CONTEXT

##### 1. What is the governance framework aiming to achieve, and why is it important?

The main objectives of the proposed governance structure are:

- first, to protect the Club against recurrence of the financial recklessness and failures of governance which drove it into insolvency in 2012, and ensure its long term continuity and success;
- second, rather than effecting wholesale changes, to create a framework for the Club which evolves from, and builds on, the current framework; and
- third, without compromising the Club’s future success, to embed genuine supporter values in the governance architecture.

Effective governance will ensure that the right people hold the key roles in the running of the Club’s affairs. Those individuals will be suitably skilled, experienced and “fit and proper” in accordance with regulatory requirements. They will have clearly defined roles and responsibilities and will operate within clear and transparent processes.

##### 2. When will the governance framework be in place?

The framework will be in place when majority ownership of the Club is transferred from Bidco to the Foundation. This is due to occur when the Foundation completes the final phase of the Bidco Agreement by buying out in full the £2.4m loan made by Bidco to the Club. See chapter 5 (*finalisation and implementation of the governance structure*) of the Consultation Document.

When the shares change hands, ongoing stability and continuity within the Club will be crucial. The Foundation, Bidco and the Club will seek to ensure that the passing of control will be seamless, and changes in processes and procedures will be kept to a minimum. It is not intended that there will be any changes to the strategic direction or prudent business model of the Club, simply as a result of a transfer of controlling interest from Bidco to the Foundation.

#### B. THE CLUB

##### 3. Who will own the Club?

The Club will be owned by its shareholders. With 75.1% of the shares, the Foundation will be the controlling shareholder, and its shares will carry 75.1% of the voting rights. This means that any special or ordinary resolution put to the shareholders of the Club in a general meeting will be determined solely by the votes of the Foundation. Our percentage holding will also give us certain ancillary rights, including the right to call general meetings and to circulate suggestions for resolutions.

Although the Foundation will be the controlling shareholder, it is important to remember that there will be other shareholders in the Club, holding 24.9% of the shares, and they will have the right not to be treated unfairly by the majority shareholder. Currently there are around 8000 individual shareholders in Hearts.

**4. Who will run the Club?**

The board will be responsible for the management of the business of the Club. Responsibility for the day-to-day operation and running of the Club will be delegated to an executive management team, in the same way as it is at present. Notwithstanding this delegation, the Club's board will remain ultimately accountable to the shareholders for the Club's performance.

As controlling shareholder, the Foundation will be able to ensure the right people hold the key roles in the running of the Club, and also ensure that the strategic direction being taken is appropriate. But companies are not run by the shareholders, and the Foundation will not interfere directly in the Club's operations. This principle lies at the heart of the proposed governance framework.

**5. What business model will the Club follow? How will it fund its operations?**

There will be no material change of direction from the business model currently followed by Ann Budge and her executive team at the Club.

There will continue to be a prudent and sustainable approach to financial management. The Club will operate within the financial requirements set out in the UEFA and domestic club licensing systems. These rules encourage good financial management and are designed to ensure that clubs live within their means. They also promote long term investment in youth development and sporting infrastructure, so that clubs build for success.

The Club's revenue will be generated by three principal income streams – Commercial, Broadcasting and Matchday. There will be ongoing initiatives to exploit the commercial growth potential of the stadium redevelopment plan. Additional funding for the Club will come from the continuing pledges of our members.

**6. How will the directors of the Club be appointed?**

The board will be appointed by the shareholders at annual general meetings, and directors will be subject to annual re-election. They will also be subject to the statutory provisions relating to the removal of a director by ordinary resolution.

A nomination and governance committee of the board will lead the process for new board appointments and make recommendations to the board (see paragraphs 3.27 - 3.32). Two of the non-executive directors will be individuals nominated from the Foundation's board.

**7. Will some decisions and actions of the Club require shareholder approval?**

Under the articles of the Club, certain matters will be reserved for approval by Hearts shareholders. Assuming the percentage approval required is no greater than 75.1%, the giving or withholding of approval will fall to be determined by the Foundation as the controlling shareholder.

The detailed list of matters is not finalized at this stage, as we want our members to have their say on this during the consultation, but the Club and the Foundation have been working on identifying matters which are considered to be the most important and emotive issues in the longer-term interest of all supporters and the wider community. These include the sale of the Stadium or other Club tangible or intangible assets, changes to the Club colours, and changes to the Club name, nicknames, etc..

In addition to matters reserved for approval by the shareholders, we envisage that certain matters would be subject to prior consultation with the Foundation board. These would be set out in a “working together” document between the Foundation and the Club. This document will set out how the relationship between the Club and the Foundation should be organised, and will be an important element in the governance framework (see paragraphs 3.36 – 3.39).

**8. Who will ensure that behaviour and practices within the Club are consistent with good governance?**

The Club’s board will have a responsibility to maintain effective governance (as it does at present). Under the scrutiny of the Foundation (as controlling shareholder and also participating on the Club’s board in two non-executive positions), appropriate checks and balances across financial, operational and constitutional behaviour will be in place and regularly reviewed.

It is envisaged that the Club’s board will establish committees with delegated authority to apply, review and appraise particular internal controls (see paragraphs 3.27 - 3.32). One of these committees – the nomination and governance committee – will monitor the Club’s governance arrangements to ensure that good governance standards and practices are upheld.

**C. THE FOUNDATION**

**9. Who will be the members of the Foundation in the proposed governance framework?**

Our current membership structure is based on the making of financial contributions. Going forward, as controlling shareholder we will want to remain an important source of funding for the Club. We believe, therefore, that our long-term membership structure should continue to be based on monthly pledging.

But we also want the Foundation to represent a large and diverse cross-section of the supporter community, and to foster a genuine sense of ownership and identity. So we will look at other forms of membership. We will seek in particular for a way to recognise the contribution of those who, through their contributions, helped to save the Club when it was on the brink of extinction in 2012-13. Our membership rules are flexible, and they can accommodate different categories of membership, including non-voting members and associate members. However, while looking at different forms of membership, we would not anticipate any departure from the principle of “one man one vote”, and would not expect any extension of voting rights beyond members who are active pledgers.

**10. Will the Foundation distribute its shares in the Club?**

The Foundation is a legal entity distinct from its members. We do not envisage the Foundation distributing its shares in the Club to the members, as we are strongly committed to the Foundation continuing as a long-term collective vehicle for supporter share ownership. Any such distribution to members would require a change to the Foundation’s articles. Similarly, we do not envisage circumstances in which the Foundation would pay a dividend to members.

**11. Will there be any restriction on the Foundation selling its shares in the Club?**

In theory, the Foundation could, at some point in the future, have to consider such a sale, although we cannot today envisage what the circumstances might be. In paragraph 3.20, we

propose that the articles of the Foundation will provide that any sale would require the prior approval of our members by a super-majority of 90%.

**12. How will the directors of the Foundation be appointed?**

As with any company, the members of the Foundation will be able (as at present) to appoint and dismiss the board of directors of the Foundation. The only material change we are proposing to the current rules for nomination and appointment of directors relates to specialist directors. We are recommending that specialist directors are initially selected and appointed by the board and their appointment is then submitted for approval at the next AGM of the Foundation (see paragraphs 3.7 – 3.11).

**13. How will members' views be taken into account by the Foundation board?**

To flourish as a member-owned organisation, we must engage effectively with the membership and provide opportunities for all members to voice their opinions. As a member, you will be able, as at present, to participate at general meetings of the Foundation, either in person or by proxy. You will be permitted to submit questions in advance of general meetings. Under the articles, members in general meeting will have direct say in various key decisions, such as changes to the constitution. If the Foundation is required to vote its shareholding in the Club for or against a matter which is important to supporters (see question 7 above), the directors will consult with the members.

One of the directors will be designated as a Director of Members Affairs, with primary responsibility for connecting with the membership. We will hold “town hall” meetings for members. Given we are in the digital age, we will also seek to use modern technology such as social media and electronic meetings to conduct discussion and debate, and to share information.

**14. Who will ensure that good governance is upheld within the Foundation?**

The Foundation's board will have a responsibility to maintain effective governance. The directors will each have legal duties and responsibilities under the 2006 Act, and they will undertake in their letters of appointment to conduct themselves in a way which upholds the values of the Foundation and the Club, and to act with the highest standards of fairness and integrity. The “working together” document between the Foundation and the Club will also regulate behaviour and practices within the Foundation.

**15. There is a perception in some quarters that supporter ownership of a club inevitably leads to instability and interference in on-pitch matters. What do you think? Will the Club be able to attract sufficiently good quality coaching staff?**

We do not agree with this perception, and in designing the proposed governance framework, we have sought to refute it. The Club will be well-run, with a strong governance model and an unrelenting focus on financial and operational stability. Majority ownership of the Club will be through a properly governed supporter organisation, with checks and balances to ensure decisions are made in the right way by the right people at the right level. The governance structure will not give the Foundation and its members any direct power over the operations of the Club (although the Foundation representatives who sit on the Club board will obviously participate in board discussions and decisions). What the governance structure will do, however,

is offer a proper sense of ownership to supporters who have demonstrated great loyalty and commitment to the Club and who want it to flourish. This will be healthy for the Club.

Given this, we are confident the Club will be an attractive option for potential coaches, and we do not believe supporter ownership will erode in any way the Club's ability to recruit and retain talented individuals.

**APPENDIX****GLOSSARY OF TERMS**

This glossary explains some of the key terms we have use in the Consultation Document.

<b>Term</b>	<b>Definition</b>
<b>2006 Act</b>	the Companies Act 2006, the main statutory source of company law in the UK
<b>articles</b>	the articles of association of the Club or the Foundation (as the case may be). Articles of association are the constitutional document of a company which sets out the basic management and administrative structure of the company. They regulate the internal affairs of the company. Changes to the articles can only be made by special resolution
<b>Bidco</b>	Bidco (1874) Limited. Bidco is wholly owned by Ann Budge and she holds her shareholding in the Club through the company
<b>Bidco Agreement</b>	the agreement between Bidco and the Foundation, dated 9 May 2014 (as amended), under which the Foundation, subject to complying with various conditions regarding cash injections into the Club and payments to Bidco, is to acquire a majority shareholding in the Club from Bidco
<b>board</b>	the board of directors of the Club or the Foundation (as the case may be)
<b>Club or Hearts</b>	Heart of Midlothian plc. The Club is a public company limited by shares, governed by the 2006 Act
<b>Consultation Document</b>	the consultation document of which this glossary forms part
<b>Foundation</b>	Foundation of Hearts Limited. The Foundation is a private company limited by guarantee, governed by the 2006 Act
<b>ordinary resolution</b>	a resolution of a company's shareholders (or members) which may be passed with a simple majority – more than 50% – of the votes cast
<b>paragraph</b>	a paragraph in the Consultation Document
<b>SFA</b>	The Scottish Football Association

<b>special resolution</b>	a resolution of a company's shareholders (or members) which, to be passed, requires a majority of not less than 75% of the votes cast
<b>SPFL</b>	The Scottish Professional Football League
<b>Stadium</b>	Tynecastle stadium