

## Book presentation Corporate Boards in Law and Practice

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On 13 February 2014, a seminar around the book *Corporate Boards in Law and Practice, A Comparative Analysis in Europe* (eds. P. Davies, K.J. Hopt, R.G.J. Nowak and G. van Solinge)<sup>[2]</sup>, was hosted by Clifford Chance, Amsterdam. The book consists of two parts. The first part consists of an introduction by the editors on how the cross-country analysis on boards in law and practice in Europe was set up. The following factors were distinguished: authority, accountability, enforcement and drivers of change. The second part contains the national reports. Per country the regulation in law and codes, and their actual functioning was analysed by experts of the respective jurisdictions. The following jurisdictions were analysed: Belgium, France, Germany, Italy, the Netherlands, Poland, Spain, Sweden, Switzerland and the United Kingdom. The issues addressed were enforcement by liability rules, incentive structures, shareholder activism, and lastly board structure and the composition and functioning of boards.

Below follows a brief summary of the presentations and the discussions, which were led by chairman Hans Beerlage of Clifford Chance.

The first session starts with a presentation by *Prof. Hopt*, Professor at the Max Planck Institute for Comparative and Private International Law. Prof. Hopt explains that the study was based on the following triple profile: 1. experts in national company law, 2. board inmate practice and experience; and 3. a European and comparative perspective. The comparative method applied was the modern functional comparative theory; it is about the law in action and the actual daily functioning of company laws. The doctrinal differences played a minor role in this study. In the last decade company law has been subject to pressures of competition. Especially, the pro-shareholder force and the impact of European law (freedom of establishment as applied by the European Court of Justice) create this kind of competitive company law. The focus of this study was on the organisation and internal functioning of boards. One of the conclusions observed by Prof. Hopt are that small boards are more effective because there is more discussion. On average the boards in the Netherlands consist of 8,7 members, in the United Kingdom, 12,4 and in Germany up to 21 members. The last higher figure is mainly due to the German Co-determination Act (*Mitbestimmungsgesetz*) which provides employee representatives a guaranteed number of directors in the supervisory board (*Aufsichtsrat*).

The other factor enhancing the performance, according to Prof. Hopt, is the independence of directors. This study shows that it is not so much the mandatory division between the supervisory board and management board that is crucial for an effective company board; it is the independence. Independence means free from any business or family relations with the company. Furthermore, an independent directors must not be a (representative of a) controlling shareholder (cf. the two KPN supervisory board members designated by América Móvil (Carlos Slim)). Besides the crucial point of director independence, Hopt stresses that first and foremost the competence of the director is crucial. In regard of the director liability issues, Prof. Hopt ends his presentation with a remark that the German business judgment rule is losing its importance, especially in the financial sector. Since duties to inform fall outside the "protection" of the business judgment rule, directors of financial institutions are subject to higher risks of being held liable by the courts. In general, most new (financial) legislation prescribes in detail how directors should behave. Violations of these specific rules fall also outside the business judgment rule.

The topic of the speech of *Prof. Davies*, Professor of Corporate Law at Jesus College, University of Oxford, was the enforcement mechanisms of directors' duties. Enforcement is important because non-enforced rules, known not to be enforced, have no impact at all on behaviour. Because of the increased shareholders activism in the last decades, enforcement is an important subject. The sources of directors' duties are the law, laying down the duties owed by the director to the company,

and the corporate governance codes in the respective jurisdictions. These sources require each a different enforcement mechanism. The first deals with problems of conflict of interests between the company and its director. The problem of under-enforcement is mainly solved by allowing minority shareholders to litigate on behalf of the company against its directors. However, because the benefits of the litigation are for the company, the minority shareholders remain under-incentivised to sue. The enforcement of corporate governance code has been enforced differently. Under Dutch law, there is the possibility to request the Enterprise Court (*Ondernemingskamer*) of the Amsterdam Court of Appeal to start an inquiry (*enquête*). Prof. Davies regards these inquiry proceedings as fascinating as it is so different from the UK backward looking approach and regards it as extremely successful because of its broad powers, including the power to take interim measures which can be forward looking. Another, more commonly used, method to verify compliance of the corporate governance codes is the requirement for directors to apply these rules or explain the chosen deviation to the shareholders and the market. At this moment, the European Commission is studying how the quality and adequacy of these explanations for non-compliance can be improved. Prof. Davies is only in favour of naming and shaming those companies who do not satisfactorily explain their non-compliance in cases of extreme violation of the corporate governance rules. In respect of the board structure, Prof. Davies observes two tendencies in Europe. One tendency is convergence in the freedom to choose board structure given to companies by relaxing mandatory company rules. The other tendency is the divergence between those jurisdictions requiring employee representatives in company boards (50% of Member States). Prof. Davies concludes his speech by observing the high degree of path dependence of board structures in the various jurisdictions in Europe.

*Mr. Storm*, non-executive board member of Unilever, Baxter, Anheuser Busch InBev (chairman) and member of the supervisory board of Aegon, PON and KLM (chair), explains in his presentation why he changed his preference from two-tier to one-tier board structures. His experience as chair of the supervisory board of companies in severe crises is that the chairman is ultimately responsible. Therefore, it is better to have the power and instruments to influence the decisions and seize the power at the moment of crisis. Mr. Storm acknowledges the disadvantages of the one-tier board structure as well, because the division between management and supervision is less clear. Furthermore, the formalities in a one-tier board are often more burdensome. A solution to his problem is delegation of tasks of to the CEO and other executives in the management team who are not members of the board. He concludes that in case of strong winds he prefers to be in a one-tier board.

*Mr. Van der Poel* is chairman of the supervisory board of ASML and member of the board of directors of Gemalto. In order to illustrate the differences between one-tier board structures, Mr. Van der Poel explains that Gemalto has a traditional continental board structure: one CEO and ten non-executive directors. The traditional Anglo-US one-tier board consists of 4 executive directors and 5 non-executive directors. ASML, on the other hand, has a traditional Dutch two-tier board structure. The basic rules are similar, especially, when it comes to appointing management, supervising, advising and being a sparring partner. He notes the difference, however, in so far that the one-tier board "owns the strategy", while in a two-tier structure management prepares the strategy and the supervisory board approves it. Mr. Van der Poel stresses the importance of self evaluation of boards. Mr. Van der Poel's experience is that no superior model can be selected in normal circumstances; it is ultimately the competence of the individual directors and the functioning of the board as a whole that determines the outcome, in particular industry expertise, time commitment, energy, balanced team, stimulating chairman role and active committees.

In the discussion that follows, Ms. Broekhuijsen-Molenaar, judge at the Enterprise Court, states that the hybrid figure of the inquiry proceedings qualifies as an effective export product for protection of minority shareholders. The standard applied by the Enterprise Court is whether there appears to be well-founded reasons to doubt the correct management of the company's affairs. If this is the case, the Enterprise Court can order interim measures. This statement raises the question by Prof. Davies by what criteria the correctness of management is assessed. Ms. Broekhuijsen-Molenaar explains that is a marginal test, in which all relevant circumstances are included in the assessment.

Prof. Lennarts of Utrecht University asks Prof. Hopt how he assesses the liability risks for directors of listed companies in case of failure to disclose ad hoc information as required by (financial) law and whether board structures have an impact on this risk. Prof. Hopt answers that the liability risks for violation of capital market regulations, ad hoc disclosure duties and insider dealing rules, are not the subject of research of this study. However, he explains that in his opinion, there ought to be no difference in liability risks between these two board structures.

Mr. Ouweland, lawyer at Clifford Chance, remarks in addition to Broekhuijsen-Molenaar that the Enterprise Court's strength is the trust and credibility that it embodies. In that regard, he stresses the importance of court's decision to be subject to appeal at the Dutch Supreme Court, which quite regularly overrules the Companies Court's decisions.

The second session starts with a presentation by *Mr. Streppel*, former chairman of the Dutch corporate governance committee, chairman of the supervisory board of KPN, member of the supervisory board of Van Lanschot, non-executive director of RSA Group. The most significant difference between the board structures, according to Mr. Streppel, is the fact that in a one-tier board there is no formal higher authority, the directors are all each other's peers, whereas in a two-tier

board structure, the supervisory board appoints or nominates the management board. Therefore, the latter is subject to formal control by the former. The similarities are, however, overwhelming: the tasks and fiduciary duties are similar. The theoretical disadvantage of a one-tier board can be found in the fact that it does not have independent directors (in the way members of a supervisory board are independent). On the other hand, the oversight of management is more direct in a one-tier board structure, whereas the advisory function is weaker because of the liability and responsibility as a board member. This role is stronger for the supervisory board because the members incur a lower liability risk. In practice, however, Mr. Streppel observes that boards try to mitigate the weaknesses in their board structure by creating (sub)committees. In a one-tier board, a Senior Independent Director is appointed. He calls this phenomenon the one-and-a-half one-tier board. Mr. Streppel: "The jury is out, no judgment is expected soon!"

Mr. Dumoulin, general counsel of Akzo Nobel and former group secretary of Unilever, discusses relevant factors for getting the best contribution from and most value out of non-executive directors. He starts pointing out that there is not a typical one-tier board model or two-tier board model: all boards are different in design, operation and dynamics and these factors influence non-executive directors' roles and effectiveness. He reiterates the flexibility of board structures: board regulations (*bestuursreglementen*) tend to be noticeably different. In terms of effectiveness, it is important to recognise that non-executives are often a diverse group of individuals whose added value lies in part in the fact that they bring a part-time involvement with the company. Furthermore, they have many different backgrounds in regard of experience, capabilities and industries. They are adding value already by merely being present: the company management knows it is supervised. This already helps steer behaviour in the right direction. Mr. Dumoulin ends his presentation by stressing that although compliance with and enforcement of governance rules are essential, the cost of ineffective boards often lies elsewhere namely in underperforming businesses.

Mr. Abma, director of Eumedion and secretary to the former Tabaksblat Committee, discusses the recent trend to reduce the size of the statutory Management Board to just two members – generally the CEO and CFO. The other members of senior management who traditionally have served on the Management Board now join the CEO and CFO on a so-called Executive Committee, the ExCo, to which many decisions are delegated by the Management Board. 44% of all Dutch listed companies have established such an ExCo. Companies now using ExCos motivate the change to this governance model as follows: faster decision making and implementation process and greater flexibility and better responsiveness to market dynamics. Perhaps also the absence of the legal requirement to disclose the remuneration details of the ExCo members may play a role in the increased popularity of an ExCo.

There are, however, serious drawbacks from a governance perspective. The ExCo model in a two-tier environment runs the risk of enlarging the already relatively large 'distance' between the Supervisory Board and the persons responsible for the daily operations. Further, the question arises whether the person who is 'only' an ExCo member is aware that he bears the same burden of responsibility as a statutory executive director. Finally, the opportunities for shareholders to hold senior management individually liable may be diminished. From an investor's point of view, the ExCo structure runs the risk of having insufficient checks and balances. If a company would like to establish an ExCo model, Mr. Abma's preferred way forward is to move from a two-tier to a one-tier board model. If this is a step too far, Mr. Abma proposes a number of clarifications in the rules of procedure for the Management Board, the Supervisory Board and Executive Committee, which should also be incorporated in the next version of the Dutch Corporate Governance Code.

In the discussion that follows, Mr. Streppel, in a response to Mr. Abma's presentation, states that Aegon has mitigated these disadvantages by subjecting every decision of the Executive Committee to approval by the statutory management board. Furthermore, the members of this committee are present at every meeting of Aegon's supervisory board. Mr. Abma retorts that according to the corporate governance report 2012, many two-tier companies with an executive committee have not (yet) mitigated these disadvantages. Mr. Streppel does not see any benefit by introducing new rules in this regard. Mr. Abma wonders whether members of the Executive Committee should be able to pass information to the supervisory board directly and thereby circumventing the management board, so that the supervisory board is better able to perform its role. Mr. Streppel answers that in practice no information can be passed to the supervisory board without knowledge of the management board.

To conclude, the presentations as well as the book *Corporate Boards in Law and Practice, A Comparative Analysis in Europe* provide an in-depth analysis of the functioning of boards. The board takes important decisions that are crucial to the company's performance, and sometimes survival. The conclusion of this study and seminar is that companies use the enhanced flexibility created by the company law reforms in the last decade. Within each structure, one-tier or two-tier, companies are able to adapt so as to maximise the performance of the board. Ultimately, the performance of the board is dependent on their members' critical attitude.

Voetnoten

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