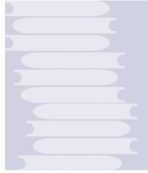

*Roles, Powers and Interests: A Glance Inside the Board of a Listed Company**

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Abstract

Relazione svolta presso la School of Law di Harvard il 17 settembre 2019 nell'ambito del XVII Seminario Harvard - Universidad Complutense di Madrid dedicato a profili attuali di diritto societario. Il lavoro mira a individuare le particolarità del consiglio di amministrazione delle società quotate rispetto alla figura generale dell'organo amministrativo societario generale. Vengono individuate, preliminarmente, le ragioni per le quali non è possibile ridurre il consiglio di una società quotata entro gli schemi tradizionali dell'organo collegiale, in cui tutti i membri sono dotati di identici poteri e autoorganizzano l'attività collegiale attraverso la delega. Viene evidenziata la necessità, che si riflette nella disciplina, di una collegialità diversa, articolata in funzioni distinte e variamente ripartite tra i componenti del consiglio, dal cui diverso e armonico interagire scaturisce una collegialità asimmetrica funzionale alle esigenze di gestione e di controllo richieste dalla quotazione.

1. The legal concept of the administrative body of a joint stock company in Civil Law jurisdictions first emerged in times long past (19th century and first decades of the 20th century), when a highly personalistic idea of the company prevailed.

In two respects.

First: the proprietorship was largely concentrated in the hands of natural or legal persons (in the latter case, with pervasive state ownership in some countries), and they made decisions in matters concerning strategy and business.

Second: the business was conceived as a product of human organisation and endeavour, where the link between invested capital and profit is left to elementary systems based on a hierarchical relational structure and on a ramified distribution of skills and flows among various persons.

At the top of the hierarchical structure, a legal fiction was used to set in place a corporate body - the Board of Directors - formed by one or more natural persons, charged by the Shareholder-owners with running the business in order to make a profit.

2. This markedly personalistic aspect has also typified the legal specificities of the Board in Civil Law countries.

Civil Law found two very ancient instruments in Roman Law, and it used them to ensure that the actions of the various members of the Board became a single action from a legal angle, attributable to the Board as a whole.

These two instruments are collegiality and power of attorney.

Collegiality is to be intended as a set of rules for regulating the procedures required to facilitate the joint action of all the members gathered in meetings, at which the decisions are passed on a majority rule basis. In this manner, the will of many is made to become the will of "one", creating, thanks to a legal fiction, the same result as that of the decision of a single natural person acting as director.

The power of attorney rests on the premise that all powers pertaining to business decisions rest, in exactly the same way, with the board's members, who can organise their work in a more flexible and efficient manner, arranging for it to be carried out by one or more Directors and confining themselves to monitoring what they do. This, again, is a legal fiction used to attribute the actions of one or some Directors to the entire Board, which nonetheless remains free to take the power back and exercise it in place of the delegated Director.

3. To a large extent, these long-standing concepts are still at the basis of doctrinal studies on Boards of Directors in Europe. But they are no longer suitable for, or coherent with, the dimensional and organisational changes that have come about in major companies today or with the financial structure of the invested capital. The corporate governance model expressed by those theories has come to be less and less suitable as a stimulus for professional investment in listed companies.

First of all, today's major company undermines the preconception that the hierarchical architecture is sufficient to guarantee the unity and efficiency of the

organisation and hence its economic and industrial performance. In particular, it undermines the illusion of a decision-making venue - i.e., a venue formed by the members of the highest body - set up to encapsulate technical, commercial and financial inputs and adopt informed decisions for concrete action.

The development of wide-ranging and complex technostructures - based on broadly automated procedures, often applying analysis and process algorithms with no human mediation - reduces the scope for assessment (and for discretionary decisions), modifying the structure of business management "power", which no longer rests with the Board alone. This will be so if the listed company is particularly large, if it is a multinational, or if it operates in several economic areas; and even more so, if it spearheads a group of controlled companies that operate in different places and are organised and financed in different ways.

4. The business operations of complex structures call for differently structured roles and responsibilities both within the board and also between the various levels of the operating structures. Consequently, they are not compatible with a Board organisation model based on the premise that all its members are involved in adopting decisions in the same manner.

The typical functions of the decision-making process (collecting data, processing the data collected, planning action, implementation, checking results) instead call for a specialisation of functions and, correlatively, for a distribution of power consistent with the type of process.

So, it will first be necessary to leave behind the "holistic" idea of the board of directors as the highest corporate body, whose members are vested with all functions and powers, exercised, generally, with equal responsibility.

The Board's members:

- do not have equal access to crucial information;

- do not have equal powers to consult the employees responsible for the various business functions;

- are not in a position to evaluate complex components of risk on a primary basis, but are forced to receive the assessments of others in this respect;

- do not have the same professional profiles, the same categories of knowledge, psychology and experience or even the same capacity to assess whether their actions comply with rules of law;

- do not dedicate the same time to working for the company;

- are thus unable to process the information - which they receive asymmetrically - in a truly contextual manner;

- do not all dispose, in the same way, of the necessary instruments of analysis, which are often highly technical, mathematical and legal.

Likewise, from a business efficiency angle, the fact that they have to decide everything together slows the procedures down and consequently fails to meet the real needs.

In this context, the power of attorney granted by the Board of Directors to the Executive Director is, too, a somewhat inflexible instrument for a company whose shares are exchanged on one or more stock markets.

5. The personalistic concepts of the Board rest on the premise that it alone is responsible for managing and tackling the business risk, if this, too, is to be seen as a part of the “agency” constraint: the administrative body is accountable for management and it is also responsible for risk control; or we could say that risk control is one of many aspects for which it is responsible, just as it is accountable for the management choices adopted. This lays bare the inadequacy of the personalistic system and its fundamental lack of reliability in the eyes of potential investors who are asked to risk their money in the company.

In point of fact, the business generates risk as it develops, in every area, in every relationship and in every decision. Business “is” risk; otherwise, it is not business. Managing business means managing risk. The Board of Directors is not the right place to adopt all the company’s decisions because it is unable to

control and neutralise all the business risks. To achieve this, an even more extensive organisation will be required, depending on the importance of the business and the risk inherent in it.

The evolution of management power - of which risk control is a vital component - from power in the hands of a small group of persons into an interconnected power within a complex organisation, will thus enhance the reliability of the company, safeguard the invested capital and improve the chances of success - a vital element in gaining the confidence of the capital market.

6. So, it is reasonable to assume that the CEO and the Executive Directors should have exclusive business management powers. It is unrealistic to imagine that the powers can rest in exactly the same way with all the board's members, in view of the aforesaid information asymmetries, shortcomings of analysis, differences in receiving and processing information and different levels of commitment and skill.

Whereas the varied expertise of the Board's members - with their diverse experience, curricula, education, independence and gender - can be best exploited by dividing up the various duties that are in any case necessary to ensure that the CEO and the Executive Directors can run the business efficiently and legally, i.e., such duties as:

- selecting the Executive Directors;
- remuneration policies;
- averting and resolving conflicts of interest;
- strategic decisions;
- monitoring the actions of the CEO and the Executive Directors;
- monitoring compliance with rules of law;
- monitoring the adequacy of the company's organisational structure and the risk control system.

7. For the above reasons, the Board of Directors of a listed company is, despite appearances, substantially different from that of a non-listed company.

In terms of composition, the board continues to be a corporate body formed by several persons, which is responsible for making decisions on how to proceed and act. In a nutshell, this can be defined as running the company.

But, in listed companies, the directors are not appointed on a totally free basis by the majority of votes formed at the shareholders' meeting.

In the main European jurisdictions, as indeed in the voluntary codes of corporate governance adopted by associations of listed companies or by (private or public) entities responsible for the organisation and management of respective national stock exchange, the board of a listed company must include:

- persons with different professional and gender requisites;

- directors who are independent in relation to the shareholders that appoint them;

- in certain jurisdictions, such as Italy, it is even contemplated that part of the board should be appointed not by the majority, but by minorities, of shareholders.

8. As to the duties of the board of directors, we again find significant differences between a listed company and a non-listed company.

The everyday running of the company is, in fact, just one significant aspect. Equally significant is any behaviour that could affect the investors' assessments prior to risking their money in the company or disinvesting, a constant feature of the markets on which listed securities are traded. Acts of management and acts that affect the price of shares are two areas involving the duties of the board, which is judged not only according to the results of the business but also on the basis of how the share price performs on the markets. These two aspects are not necessarily always in harmony; on the contrary, their asymmetry generates specific conflicts of interest, which disrupt "from within", as it were, the unity of the administrative body and its relationship with the centres of interest that appointed its members.

This leads to a direct consequence.

In a non-listed company, everything hinges on the relative strengths of the majority and the minority, with the former imposing on the latter (compliance with the law being the only limit) the entire set of objectives, pathways and solutions. These are freely made individual decisions, for which no justification or coherence is necessary: all the majority has to do is decide.

This is not so in a listed company.

Generally speaking, here there is no “majority”, even though there will be more than one minority and there will be one minority that prevails over the others (Italy is somewhat atypical in this respect, because in most listed companies there is a controlling shareholder or coalition, unlike other countries, including in Europe).

But that is not all. In this case, the situation is “open”, in so far as the shares are continuously changing hands and this tends to modify the original majorities (or important minorities).

And this has two particular implications.

The first implication is that it is not possible to ensure *a priori*, and assume to be firm and stable, the objectives, pathways and business issues of a certain majority, which may not be a real majority and may change in the course of time. It must therefore be accepted that the board of directors may not be able to establish one set only of objectives, pathways and business issues. The board is not an expression of a one-to-one relationship with a specific majority; inside the board, the wide range of interests involved in the listed company have to be reconciled (in a non-listed company, on the other hand, there is just one prevailing interest, i.e., that of the majority of shareholders that appoint the board, which is charged with pursuing it, and there is no possibility for the board to pursue different interests or objectives).

The second implication - and this applies also in cases where the listed company has a controlling shareholder - is that the objectives of the majority that appointed the board in the past have to be reconciled with the other interests affected by the company’s actions. These interests exist irrespective of

the original majority, given that the majority may change, and given also that the company’s management involves diverging interests (the interests of financial shareholders vs. the interests of industrial shareholders; the interests of creditors vs. the interests of proprietors; the interests of small investors vs. the interests of professional investors; the interests of speculative professional investors, e.g., Hedge Funds, vs. the interests of long-term investors, e.g., Pension Funds, Insurance Companies, etc.; the interests of workers vs. the interests of management; and so on).

9. In a nutshell, the board of a listed company is characterised by a diversification of persons, which in its turn reflects the diversification of roles and functions assigned to each one; this is not so in the case of the board of an ordinary non-listed company.

The role of reconciling the shareholders’ interests with the interacting interests of a listed company must therefore be attributed to the board (as we all know, in August this view was aired in the US by the Business Roundtable, which updated the traditional concept of the company’s interest of maximising the shareholders’ value in favour of reconciling diverse interests, including the social interests of the workforce, the community and the environment, following the pattern adopted years ago by the corporate social responsibility doctrines that have already led to highly significant developments in traditional company law in Europe).

In reconciling such diverse interests, specific importance is attached, at the legal level, to the “diversity” of its members.

Diversity in the source of the appointment, diversity in terms of dependence on the shareholder that appoints the board member or on the company and its management, and professional and gender diversity. The board’s action is the result of the joint action of persons who have such diversities and who, thanks to this, reflect differently, but simultaneously, all the interests affected by the actions of the listed company.

10. This is the hard core of the legal difference between the board of directors of a listed company and that of a non-listed company.

Board Collegiality:

- in non-listed companies, this means the procedural rules whereby the members of the board divide up the work, while however all maintaining the same duties and powers; and whereby, when operating, they have (or should have) the same information at their disposal. It follows that the various activities assigned to each member are legally ascribable to all of them and that, generally speaking, they all share the same responsibility for the actions decided by the board. In this perspective, the duties and powers of a board formed by several persons are the same as those of the sole director: the function and the responsibility of the sole director are exactly the same as those of the board;

- in listed companies, the situation is precisely the opposite. The management duties have to be assigned to specific members of the board, who are required to implement them while making sure that all the other members can, for their part, operate in their specific sphere of functional responsibility. But in so doing, it will no longer be possible to theorise that they are all doing the same thing and that they should all dispose - at the same time and to the same extent - of the information and means required to do it. All the members must carry out their respective duties, exercising different powers and following strict procedural steps, in accordance with mandatory disclosure requirements and a strict control system. In this manner, the decision-making process of the board of directors is the outcome of an asymmetrical contribution of roles, and the management of the company's business is possible thanks to, and on the basis of, this very same asymmetry.

In listed companies, the management, and the scrutiny of management, thus become two elements that coexist, but are legally autonomous and distributed differently among the board's members. The fact of acting jointly no longer means that we have to attribute to all the members of the board - in an

identical and contextual manner - the paternity of, and hence responsibility for, the actions.

11. In this perspective, the board of directors model that has now established itself on the basis of experience in Europe, has the following role structure:

- the Chairman,
- the CEO,
- the Executive Directors,
- the Non-executive Directors,
- the Independent Directors and
- the Internal Board Committees.

In many jurisdictions, including Italy, these roles are laid down by the law or, in any case, by the voluntary Codes of Corporate Governance.

12. The Chair. The duties of the Chair have been substantially enhanced in all jurisdictions (often having been introduced for the first time in very important sectors of economic regulation, such as banking law, and then extended to companies of larger dimensions such as listed companies). The Chair must ensure that the Board operates in an efficient and proper manner, having particular regard to the need to provide the various board members with sufficient information, offer a point of reference for the supervisory authorities, the market and the Shareholders and ensure that the various corporate bodies liaise efficiently.

The Chair necessarily plays a key role in the actions of the Board of a listed company, which depend upon a distribution of roles and functions geared to balancing the multiple interests involved. Above all, the Chair's role consists of organising activities inherent in ensuring the proper functioning of the Board, but not the business, which should be entrusted to the Executive Directors alone. According to a number of best practice principles, the counterbalance between the power of the Executive Directors and the guarantee of the Board's

proper functioning would be at risk if the chairman were also to be vested with powers of attorney in business matters or if he himself were the CEO or a member of the committee of Executive Directors. See, for example, the OECD Principles of Corporate Governance, chapter V, A, 9, which provide that "*companies should clearly disclose the different roles and responsibilities of the CEO and/or Chair and, where a single person combines both roles, the rationale for this arrangement*". Likewise, the 2013/36/EU Directive of the European Parliament and the Council of 26 June 2013, art. 88, paragraph 1, letter e), is against the chairman having combined roles.

The Chair's role should instead be that of conductor of the board orchestra.

This role is fulfilled, above all, by ensuring a proper and complete flow of information between the various ramifications of the board.

Indeed, if there is to be a functional distribution of responsibilities, the guarantee of information will be both a keystone of the board's proper functioning and a precondition for the board's non-executive component to perform its strategic function of monitoring and administration, in so far as it does not have powers of its own to obtain information by directly consulting the executive directors and the company's employees responsible for the specific subject-matter.

European voluntary codes of corporate governance broadly acknowledge the chair's role in circulating information. See the FINANCIAL REPORTING COUNCIL, *UK Corporate Governance Code 2018*, Principle F ("*the chair facilitates constructive board relations and the effective contribution of all non-executive directors, and ensures that directors receive accurate, timely and clear information*"); in Germany, the REGIERUNGSKOMMISSION, *Deutscher Corporate Governance Kodex*, point 5.2 ("*the Management Board Chair or Spokesperson informs the Supervisory Board Chair without undue delay of major events that are of material importance for the assessment of the company's status and performance, and for the management of the company. The Supervisory Board Chair subsequently informs the Supervisory Board and, if required, shall*

convene an extraordinary Supervisory Board meeting"). In Spain, the CNMV, *Good Governance Code of Listed Companies*, Recommendation 33: "*The chairman, as the person charged with the efficient functioning of the board of directors, in addition to the functions assigned by law and the company's bylaws, should prepare and submit to the board a schedule of meeting dates and agendas; organise and coordinate regular evaluations of the board and, where appropriate, the company's chief executive officer; exercise leadership of the board and be accountable for its proper functioning; ensure that sufficient time is given to the discussion of strategic issues, and approve and review refresher courses for each director, when circumstances so advise*".

The chairman's instruments to stimulate collegiality include:

- the power to arrange for meetings to be held only with the non-executive directors (see, for instance, *UK Corporate Governance Code 2018*, Provision 13: "*the Chair should hold meetings with the non-executive directors without the executive directors present*");

- the power to ask the executive directors to invite the senior managers of the issuer, and those of group companies in charge of corporate functions responsible for the subject-matter, to take part in joint meetings, in order to furnish due clarifications on the matters placed on the agenda (see the Code of Self Discipline of Borsa Italiana s.p.a., *Criterion 1*.C.6).

But there does not appear to be any justification for giving the Chair of a listed company the power (which some jurisdictions give the Chair of the board of non-listed companies) to make a proposal to the board to "take back" the decision on matters covered by powers of attorney granted to the executive directors. As said, this power is based on the idea that the board is vested, by nature, with all powers of management and that it can always exercise them in place of the executive director, who received them under the power of attorney. For the reasons explained above, this cannot apply to a listed company. So, it is perfectly reasonable to assume that - apart from serious situations of malfunctioning, inertia, unlawfulness or, at any rate, situations in which the markets' reaction to matters involving the executive directors, or to undesirable

decisions or policies on their part, so require - it is not possible to allow the board, at the chair's initiative, to withdraw the executive director's power to decide on matters assigned to him.

13. The Executive Directors (according to the term traditionally used in Civil Law countries, these are directors who receive a power of attorney from the board to carry out specific business management duties). They have the duty to carry out the company's business in a transparent context, in such a way that the board can control their actions (in this respect, the term used is monitoring board). The powers assigned to the Executive Directors may concern areas of varying scope (there are no differences here in relation to the general company law applicable also to non-listed companies). They may be assigned either to one Director only or to several members of the board, on a joint or individual basis.

The Non-executive Directors do not have business management powers; instead, they watch over the efficiency, propriety and legality of the company's organisational system, monitor the actions of the Executive Directors and take part in decisions relating to strategy and in any decisions of particular importance which, by law or under the company's bylaws, cannot be entrusted to individual Directors.

In jurisdictions where it is envisaged that some directors are to be appointed by minorities, such directors usually have non-executive status.

The special feature of the law on listed companies is not so much the extension or content of the powers of the CEO and the Executive Directors, but the role of the remaining part of the board, which is not, strictly speaking, involved in running the business.

The non-executive component is made responsible for contributing to strategic planning (proposed by the CEO and decided together); adopting suitable rules of governance; verifying step-by-step the functionality and efficiency of the system of rules; analysing the information provided by the CEO and the Executive Directors; continuously monitoring operations; and providing

information to the market. In this respect, see the Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC), Annex II. See also "Whereas" no. 57 of Directive 2013/36/UE of the European Parliament and the Council ("*The role of non-executive members of the management body within an institution should include constructively challenging the strategy of the institution and thereby contributing to its development, scrutinising the performance of management in achieving agreed objectives, satisfying themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible, scrutinising*").

In its various ramifications and stratifications, the monitoring function thus becomes the defining element of the board's non-executive component.

14. The main jurisdictions provide that some Non-executive Directors should be defined Independent Directors.

These directors are expected to meet specific requirements of independence in relation to the shareholders and also in relation to the other Directors of the company and other companies belonging to the same group of companies.

They are assigned - in some cases by law, in some cases by the voluntary codes of corporate governance, and in other cases by the articles of association of the companies concerned - specific roles in the decision-making process relating to operations of particular importance, such as related parties transactions, operations between group companies, approving operations in which an Executive Director has disclosed a conflict of interest, the emoluments of the Executive Directors, and so forth.

The role of the independent directors in related parties transactions has now been adopted by art. 9-*quater*, par. 3, letter c) of Directive 2007/36/EC, introduced by the Second Shareholders' Rights Directive: the European system of law thus acknowledges the importance of their intervention in "*procedures*

that prevent the related party from taking advantage of its position and provide adequate protection for the interests of the company and of the shareholders who are not a related party, including minority shareholders" (see Recital 42 of the Second Shareholders' Rights Directive).

We have asked ourselves how the independent directors differ from the non-executive directors and whether there is any point in providing for a particular category of independent non-executive directors.

In point of fact, non-executive directors who have significant ties with the company, the shareholders or the executive directors (and who cannot therefore be defined independent), can indeed contribute particular potential interests to the debate and the decision, but this does not necessarily mean that they are in conflict with the company's interest or liable to compromise other overriding interests. It is only fitting that diverse opinions, views, interests and objectives should contribute to the debate: the joint stock company, and even more so the listed company, is by nature a place where such diversities meet, compete and confront each other; they are all legitimate provided they do not surpass the limit of breaking the law or acting in a conflict of interest.

So, it is reasonable to assume that the function of the independent directors has a meaning, precisely because the board is an expression of diversified interests, not only in running the business - the domain of the executive directors - but also in the sphere of strategic decisions, "high level administration" and scrutiny entrusted to the board's non-executive component. Consequently, the independence of one or more directors is important because it can contribute, with the added benefit of unbiased reflection, to both the debate and the decision.

15. A final consideration concerns the practice of many listed European companies of creating Internal Board Committees formed by only some board members, who are entrusted with business duties (as in the case of committees formed by Executive Directors) or other duties involving such matters as defining strategy, selecting Executive Directors and establishing their

remuneration, monitoring, authorising operations in which conflicts of interest may arise, and so forth.

Even though these committees do not, strictly speaking, have business management powers, they can be of great importance in the board's concrete actions and hence in the company's destiny.

Depending on the circumstances, the committee may be entrusted with recommending important board decisions, delivering opinions on specific situations or operations, and advising and/or suggesting that the board should vote on a certain matter based on a particular content.

The approach adopted by a Committee - albeit non-binding (the committee in fact has no autonomous powers of its own to pass decisions) - may nonetheless carry significant weight by virtue of: the prestige of the committee's members; the degree of analysis and scrutiny which the board does not have due to insufficient time or competence; the greater level of information at the disposal of committees compared with the other Directors; and the tendency of Directors extraneous to the Committee to hide behind the responsibility of others and follow suit rather than go against the position of a better informed committee.

But the basic weight of the committee's resolutions may also depend on the board's requirement - imposed by various voluntary codes of corporate governance or best practices (which could also be contemplated by the articles of associations and become mandatory) - of having to publicly justify the reasons that induced it not to set up a particular committee or not to comply with its proposals, opinions or recommendations. In even more intense cases, the committee's intervention may be imposed by the law (as in the case of operations with related parties).

16. Some committees are particularly important.

The Nomination Committee is responsible for releasing opinions on such matters as: the composition or size of the board; the professional characteristics considered advisable in selecting directors; the maximum number of external

assignments permitted for each board member; putting forward possible names for new board appointments; and selecting employees to be engaged with strategic functions. This is an extremely important committee. For this reason, the voluntary codes of self governance often seek to protect its objectivity and neutrality of assessment, requiring that in it there should be a majority of independent directors.

The Remuneration Committee is expected to be even more impartial. It is vested with duties in terms of assessing the adequacy, coherence and concrete application of remuneration policies. In various codes of corporate governance or rules of best practice, this committee must be formed, wholly or mainly, by independent directors or, alternatively, by non-executive directors only, the majority of whom are independent directors.

A pivotal role in the system of risk management is played by the Monitoring and Risk Control Committee. It is responsible for evaluating, averting and scrutinising corporate risks as they evolve. It is an essential committee in order to achieve an efficient system of corporate governance and a fair balance between administration and control. It wields substantial influence also at a *de facto* level. It in fact contributes towards strategic choices in controlling risks; it verifies their sustainability; it verifies the adequacy of the system of internal controls; and it acquires information in cases where irregularities are detected by the auditors. Here again, a significant number of independent directors, and in any case, non-executive directors, is usually required.

The fact that the committees do not have a mandate cannot obscure the importance their actions and resolutions (whether they be opinions or whether they be proposals or recommendations) can actually have on the board's decision-making process, on the destiny of the listed company and on the prices of the shares on the market.

This has led several scholars to consider that the committee's members should be accountable for their actions just as the executive directors are. This further proves the fact that, as we already find in Common Law systems, Civil Law systems are now also tending to adopt a substantial approach, in which

relevance is no longer attached to the formal fact that one or more directors have received a power of attorney from the board; and it also proves that Directors who do not have business management powers can also be held responsible in accordance with the rules that apply in matters involving wrongful trading and fraud on the part of the Executive Directors.

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