

Member States providing for management and control functions

EU Company Law

Exam question

Examine the laws of the Member States providing for management and control functions.

Introduction

UK

General considerations

- **One-Tier Board Model** in the United Kingdom
- Public & private companies → same rules
- The Companies Act 2006
 - **Requires** every company **to have a director** or directors.
 - Attributes certain powers to and imposes certain general duties on them.
 - Many rules derived from case law (principles of common law).
- Wide powers of directors <> limited control of shareholders
- Large companies:
 - Effective control → extra-legal bodies
 - E.g. investor protection committees, codes of practices
 - Role of Stock Exchange and City Panel on takeovers and mergers.
- Smaller companies:
 - Majority shareholders often directors.

The Role of the Board of Directors

- Management and control to the hands of the board of directors.
- Unless the articles confer power on the board to delegate its functions, directors must exercise their managerial powers collectively as a board.
- A **distinction** has to be made between:
 - **executive directors** who are employed as managers parallel to their directorate; and
 - **non-executive directors** who are not involved in the running of the day-to-day business of the company.
- All directors owe the same duties to the company.
 - Fiduciary duties
 - Exercise their powers in a bona fide (tillidsfuld) manner.
 - For the benefit of the company and its stakeholders.
 - They must make *no* unauthorized profit from a corporate transaction.
 - Even if the company did suffer any loss, and could not have made any profit itself.
 - Any such profit must be paid back to the company.

- They may not place themselves in a position in which their personal interests may conflict with those of the company.
 - → Directors must disclose all interests in corporate transactions.
- Exercise reasonable care, skill and diligence
 - Directors are liable if they are negligent (uagtsomme) in managing the company's affairs in the ordinary course of events.
- Specific duties
 - e.g. to convene (indkalde) the general meeting
- What the role of the board vis-à-vis management and shareholders is and how exactly this function shall be exercised is as a matter left to be determined by the company's articles.

Directors

- Relations between the company and its directors to authorities and the general public is heavily regulated.
 - A director of a company must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred.
- The board of directors are hardly mentioned and thus not intensively regulated.
- Size of the board
 - Public companies → min. 2 directors
 - Private → min. 1 director
- Directors are regarded as agents of the company
 - May bind the company to any transaction within their authority. (Actual, implied and apparant)

Combined Code:

- Expects “comply or explain”
 - If a company does not comply with the code, it is expected to explain why and then what.
- the number of board meetings (“sufficiently regularly”);
- the separation of decision-making between the board and management;
- the role of each director (chairman and so forth);
- the number of meetings shall be disclosed in the annual report;
- the relation between the chairman and non-executive;
- the proper procedure if a director disagrees with the board’s policies;
- the separation of functions between chairman and chief executive and the question of the chairman’s independence;

Remuneration of Directors

- Lively debated topic!
- Directors are not employees of the company and do not receive any remuneration (løn)
 - that is not authorized by the company, that is!
 - They may be employed under a service contract.
 - Must be open to inspection by the members. - according to the act.
- Companies Act 2006 on director remuneration focus on its disclosure
 - including the requirement to move at the accounts meeting a resolution approving the directors' remuneration report;
 - directors' service contracts with a term of longer than two years require members' approval.
- Combined Code’s provisions

- establishment of a remuneration committee and its role as the safeguard for adequate remuneration agreements.

Shareholders – General meeting

- Division of powers between GM and the board is stated in the articles.
 - Private companies:
 - Optional to hold an AGM (unless its articles of association specifically require it to do so).
 - Public companies:
 - Required to hold an annual general meeting (AGM).
- Limited powers → articles normally vest managerial powers in the board.
 - Approve the annual accounts (monitoring role).
 - Empowered to dismiss directors.
 - → not necessarily the power to appoint directors.
- Reserved powers
 - Reduction of capital
 - Alteration of articles.
 - Approval of certain transactions.

Minority protection

- Minorities can bring a ‘derivative action’ (on behalf of themselves and all the other shareholders (except the wrongdoer)) against the wrongdoers, joining also the company as a defendant.
 - One of such exceptions is where there is allegedly fraud on the minority and the wrongdoers are in control of the company.
- Two-stage procedure for derivative claims.
 - The applicant presents a prima facie case for their claim and the court considers the issues on the basis of the evidence filed by the applicant only.
 - At this stage courts can dismiss applications if the applicant cannot establish a prima facie case.
 - If a prima facie case is established then the court shall consider a range of other matters before giving permission for a substantive claim.

Germany – GmbH

Management and control

- GmbH: the German **private limited liability company** (Gesellschaft mit beschränkter Haftung).
- Powers of management:
 - Divided between the manager(s) and the GM (acc. to provisions of GmbH Gesetz).
 - Managing directors (Geschäftsführer):
 - Powers to bind the company, (if more than one) joint signatories (unless articles state otherwise).
 - Restrictions in articles do not bind 3rd parties (unless they knew).
- Authorized representative (Prokurist) – appointed by managing director
 - Must be registered.
 - Authority to sign for any transactions within their competence.
- Company with few members:
 - Members = managers

- Shareholder may be able to take decisions.
- GM **may** be exercised by a **supervisory board** (control function).
 - Powers of the board are left to the discretion(skøn) of the company.
- Company with **more than 500 employees**.
 - A supervisory board (Aufsichtsrat) is required.
 - Employee participation in the supervisory board.
 - Rules that apply to public (AG) applies without choice.
 - Two-tier system under criticism. Why?

Supervisory board

- If voluntarily
 - Powers of the board + relationship with GM are left to the company's discretion.
- If compulsory (more than 500 employees)
 - The rules applicable to an AG apply without any choice!

Managers

- Appointment:
 - By shareholders/supervisory board.
 - Any change must be registered.
 - If more than 2000 employees the power to appoint is compulsory given to supervisory board.
- Removal
 - May be dismissed at *any time* by members in GM (unless restricted by articles).
 - Service agreement are not dismissed! (Notification periods, exit sums, etc)
- Duties of managing directors
 - Ordinary, prudent businessman.
 - Duties stated in the articles or service agreement.
 - Collectively entrusted with the management and in transactions with 3rd parties.
- Liability
 - Jointly and severally liable to the company in damages for any violation of their duties.
- A company may not grant loans to managers, authorized representative or managing agents, out of its assets.

The GM

- Members of GM exercise general control over managing directors
 - GM may issue binding instructions on the managers.
 - Incl. their appointment, dismissal and terms of appointment.
 - Specific functions stated in articles.
- Unless the article provide otherwise, shareholders competencies are:
 - Approval of annual accounts
 - Application of profits
 - Calling up of contributions on shares
 - Repayment of additional contributions
 - Division and cancellation of shares

- Appointment, dismissal release from liability of managers
- Appointment of authorized representatives and other 3rd parties
- Assertion of claims for damages against managers or the members
- Shareholders cannot vote where they have a personal interest in the resolution. (Except appointment of directors)
- Resolutions
 - Passes by simple majority.
 - Alteration of articles and capital → 2/3 majority.
 - If written resolution as alternative to formal meeting → unanimous.

Germany – AG

Management and supervisory board – the Two-tier system

- Aktiengesellschaft (AG) refers to a corporation that is limited by shares, i.e. owned by shareholders, and may be traded on a stock market.
- The two-tier board system (dual board system)
 - Supervisory board (Aufsichtsrat)
 - Controlling function
 - No instructions on management.
 - The members of the supervisory board are elected at the shareholders' meeting.
 - Appointed for 4 years. (Renewable)
 - More than 500 employees
 - → 1/3 employee participation on the supervisory board is compulsory.
 - More than 2000 employees
 - → 50% of the supervisory board consists of labour representatives.
 - Management board (Vorstand).
 - One or more individuals – no legal persons on the board.
 - Appointed and dismissed by supervisory board.
 - Dismissal only on limited grounds. → stronger position than in GmbH.
 - (Gross breach of duty or incapability. GM's vote of no confidence.)
 - Appointment for up to 5 years. (Renewable)
 - Determines their remuneration.
 - Directly runs the company – exclusive right to management
 - Consent of the supervisory board might be needed on certain transactions.
 - Power to bind 3rd parties can not be restricted.
- Corporation between management and supervisory board.
- German Corporate Governance Code
 - Recommendations for supervisory board.

Role of the shareholders

- Power:
 - Appoint + dismiss members of supervisory board
 - Appoint auditors

- Approve accounts
- Consent to allocation of profits
- Effect alteration of articles and the company's capital (3/4 majority required, else simple majority)
- Meetings are called by management board or in request of shareholders (min. 5%)
- Additional issues on agenda of GM if 5% or shareholders representing € 500.000.
- Voting rights attached to shares, except if not listed at stock exchange.
- No voting rights if it relates to his/her liabilities toward the company.

Minority protection

- Request of calling a meeting
- Right of 10% to apply to the court for a special audit (Sonderprüfung)
 - The appointment of auditors to investigate breaches of the act or the articles.
- Right of 10% to require actions of directors being approved.
- The right to be given information during meeting to any issue on agenda.
 - If management board does not answer questions → subsequent resolutions may be voidable by the court.
- Resolutions contrary to the articles is voidable and may be challenged by each individual shareholder
 - If he attended the meeting and voted against it.

France

SARL – basic management structure

- A form of private limited liability corporate entity that has commerce as its purpose.
- Leaders of a SARL are called managers (gérants).
 - Placed under the direction and control of shareholders.
 - Need not to be shareholders.
 - Managers frequently have service contracts with the company.
- Duties of managers
 - May act on behalf of company on all matters. - Not contrary to the articles.
 - More than 1 manager:
 - Separate power to represent the company without any restrictions to 3rd parties.
 - Even without consent of other manager(s).
 - Statutory restrictions on the power based on avoidance of conflict of personal interests.

SARL – control of the managers

- Members' power to dismiss manager(s)
 - Managers are liable to the company for any damages caused to it resulting from any breach of the law relating to SARL, any infringement of the articles and any negligent or deliberate mismanagement.
 - Individual or jointly liable for damages acc. To the circumstances
 - Both towards company, its members and 3rd parties
 - If company does not bring action against the managers, 1 or more of the members may bring derivative action against them.
- To approve the company's accounts in GM
 - Consist of managers' reports, inventories of assets, trading accounts, profit and loss accounts and

balance sheets no more than 6 months after the end of the financial year.

SA – different management structure

- Société Anonyme (SA): a public limited company
- Single board of directors v. dual board of directors:
 - Distinction between management and controlling function under both.
- Single board system (one-tier):
 - Management sometimes carried out by the chairman of the board (PDG) + a number of delegated executive officers.
 - Other members of the board (administrators) → controlling function (only theoretical right to manage).
- Dual board system (two-tiers):
 - Supervisory board → controlling functions
 - Executive board → management
- GM under both systems
 - Certain controlling rights: account, management report, allocation of profits.

SA – the single board system

- Board = supreme management organ of the company:
 - Proper functioning of the company.
 - But duty of chief executive!
- Natural & legal persons may be board members (directors) of a public company.
- Duties:
 - Board of directors acts collectively – meetings, resolutions.
 - Preparing annual accounts, calling GM, etc.
- Chairman
 - Has the widest powers – within the limits of the company's objectives.
 - Acts of chairman are binding to company.
 - Has the controlling function.
 - Chief executive & executive officers (assistant managing directors): max. 5
 - May be nominated to be chief executive.
 - No right to damages even if dismissal was not justified.

SA – the dual board system

- Must be opted for in company's articles.
- Management board (directoire)
 - Managing company
- Supervisory board (conseil de surveillance)
 - Controlling functions but retroactively.
 - But prior consent for important transactions.
 - May carry out checks and controls if appropriate.
 - 3-18 members can include employee representatives.
 - Apart from e.r. must be shareholders; first 3 years + subsequently up to 6 years.

SA – directors' liability

- Directors, executive officers and members of s.b. → subject to a number of statutory controls (both systems).
 - Purpose: avoidance of conflict of interest
 - Strict rules on agreements between directors and a company.
 - Loans and guarantees are prohibited and void.
- Directors, etc. are required to act within their statutory powers and in acc. with the articles.
 - In best interest of the company.
 - Liability of members of s.b. restricted to personal fault, excl. any liability for management decisions.
 - Damages are the only remedy. → no remedy for unjust enrichment.
 - Only liable during their duties as directors.
 - Self-interested behavior = criminal offence.
 - Company may bring actions against directors.
 - Minority protection derivative actions against directors.
 - Damages paid by company.

SA – position of shareholders

- Members acting in GM → supreme body of company
 - Role: general control
 - Consent required for certain transactions, e.g. reduction of capital.
 - Residual power: appointment and removal of directors & ultimate financial control in approval of accounts and reports and distribution of profits.
- GM
 - Starting point: each share = 1 vote but articles...
 - Ordinary:
 - Annual meeting and other meetings to pass ordinary resolution.
 - E.g. dismissal of directors.
 - quorum: $\frac{1}{4}$ of shares issued:
 - resolutions require simple majority of those present.
 - Extraordinary
 - Required to pass special resolutions.
 - E.g. alteration of the articles.
 - Quorum: 1st call → one-half of the issued share capital, 2nd call → $\frac{1}{4}$
 - $\frac{2}{3}$ majority of those being present.
 - In exercising their votes, majority shareholders must act in interest of the shareholders as a whole .
 - Else court intervention possible.
 - Called by board of directors, board of management or supervisory board.
 - But right of minority shareholders of min. 5%.

The Netherlands

- Naamloze vennootschap (NV): public limited liability company
- Besloten Vennootschap (BV): private limited liability company
- Governed by identical statutory provisions

- Management structure, supervisory board (if any), powers of shareholders.
- 3 systems:
 - One-tier regime
 - Voluntarily two-tier regime
 - Compulsory two-tier regime (structure regime)
- 1. + 2.: traditional division of powers between management and the members acting in a GM.
- 3.: shift of powers to the supervisory board.
- Day-to-day management (1 or more directors)
 - Composition:
 - Management board: directors and maybe non-executive-members.
 - Supervisory board: 1 or more individuals.
 - Appointed and dismissed by shareholders in GM, but articles...
 - Duty: to supervise and advise.
 - Duties of board of directors:
 - Manage affairs of companies, represent company toward 3rd parties.
 - Power of representation → applies to every single director (but articles).
 - Controlling:
 - Either by supervisory board as stated in the articles or GM.
- Structure regime: applicable to “large” companies.
 - Employs on a regular basis 100 ppl.
 - Legally obliged to establish a work council.
 - Issued share capital + reserves = € 16,000,000.
- The mandatory supervisory board has more powers than the supervisory board voluntarily installed.
 - The power to appoint, suspend and dismiss members of the management board, adopt the annual accounts, and prevent certain management board decisions.
 - Appointment: appointed (for a maximum term of four years) by the shareholders’ meeting.

Duties of directors

- Responsible for proper performance of their duties.
 - Act in interest of the company.
- Liability of directors:
 - E.g. in case of ‘mismanagement’ → board members are liable towards the corporation.
 - E.g. in case of bankruptcy of the corporation as to the amount of the liabilities.
 - If improperly performance.
 - Conflict of interests:
 - All directors lose their power to represent the company. → supervisory board takes over.

Role of shareholders

- GM
 - at least once a year: within 6 months after the end of the financial year or at shorter notice , c.f. articles.
 - All powers that are not attributed to the management board or others.
 - powers to:

- Appoint supervisory board, suspend and dismiss members of the management and supervisory board;
- Amend the articles of association;
- Adopt the annual accounts;
- Decide on the dissolution, change of legal form, merger and split-up of the corporation.

Belgium

NV/SA – management

- Unitary board system
 - Management of company entrusted to its board of directors.
 - Main decision-making body of the Company and has the power to perform all acts that are necessary or useful to accomplish the Company's objects.
 - Members of GM exercise control and other functions.
- Directors
 - Minimum 3 directors.
 - Can be legal persons! → must nominate a permanent representative.
 - Duties:
 - Represent company in relation to 3rd parties, and in court.
 - Day-to-day management: Jointly or individually.
 - Statutes might allow for transfer of powers to executive committee.
 - May also be delegated to individual persons → who needs to be shareholders.
 - Board of directors treated as forming a collegiate body:
 - Acts by majority decision
 - Minority bound by majority.
 - Normally in meetings: exceptional cases: in written.
 - Company is bound by acts done by the board of directors.

NV/SA – directors' liability

- Conflict of personal interest and duties to companies:
 - Transparency requirements → directors' report, auditors' report
 - Interested director cannot take any part in any discussion of the proposed transactions or vote on it.
 - If company suffers losses → damages from director.
- In more general terms:
 - Directors are jointly and severally liable to the company and 3rd parties for damages.
 - For negligence in their management of the company.

NV/SA – shareholders' role

- Most extensive power to ratify acts which affect the company.
- Called by directors and auditors, and at request of 5% minority of the shareholders.
 - Ordinary meetings: once a year.
 - Approval of annual accounts and directors and auditors reports.
 - Extraordinary meetings:

- E.g. proposal to alter the articles, major changes to company's capital or structure.
- 1st call: Quorum of at least 50% of the share capital.
- Resolutions passed by simple majority of those being present.
 - Certain quorum and special majority requirements for certain transactions.
- Voting rights
 - May be restricted by the articles.

The BVBA/SPRL

- Management system: quite similar
 - BUT: only required to have 1 director.
 - Nominated by the members.
 - Authority to bind the company individually and jointly (NO collective requirement) + represent in relation to 3rd parties.
 - Articles may state limitations re the latter + effect on 3rd parties.
 - Dismissal: only for serious reason.
- Directors' liability
 - Shareholders:
 - Only if shareholders represent 10% of issued capital may sue directors at company's expenses.
 - In case of breach leads to insolvency:
 - No liability of directors to creditors, if:
 - Average turnover of less than € 620,000 (excl. VAT) in the 3 preceding years, and
 - total balance sheet was more than € 370,000 in the last year

EU corporate governance – harmonization

2 opposite governance systems

- The two-tier system → basic structure to the German tradition
- One-tier system → derives from the Anglo-American tradition.
- Strengths and Weaknesses of these systems?
- Differences in the MS:
 - Liability?
 - Also effect re 3rd parties?
 - Service contract v. employee contract?
 - Legal v. natural persons?
 - Jointly v. separate representation of directors re 3rd parties?
 - Employee representation?

The EU and Company Law

- "...our action has been based on two key objectives:
 - bringing more transparency in the way companies operate; and
 - empowering shareholders". - Commissioner McCreevey
- National company law still provides the basic legal framework.
- The EU framework harmonizes parts of the national company law of Member States through directives.

- The key criteria for bringing a subject matter area within the scope of harmonization are:
 - material impact on single market integration and EU cross-border investment,
 - subsidiarity and better regulation objectives.

Board of Directors

- The draft fifth Directive (the structure of companies within Europe)
 - Encompasses the participation of workers in the management of the company;
 - touches upon the structure of the company, the role of the directors and auditors as well as the rights of shareholders.
 - Relates only to the internal structure of a company.
 - Two-tier system and one-tier system.
- Reason for withdrawal:
 - importance decreased
 - Introduction of SE
- Recommendation on the Role of Nonexecutive/Supervisory Directors and Supervisory Board Committees (2004)
 - To reinforce the presence and role of independent non-executive directors on listed companies' boards.
 - Protecting shareholders, employees, and the public against potential conflicts of interest through an independent check on management decisions.
 - It includes minimum standards for the qualifications, commitment, and independence of non-executive or supervisory directors.
 - Board Director Criteria and Codes of Best Practice
 - to encourage further convergence.
- Recommendation on the Remuneration of Directors (2005)
 - Remuneration is one of the main areas of potential conflicts of interest for executive directors.
 - MS should ensure that listed companies disclose their policy on directors' remuneration and tell shareholders how much individual directors are earning and in what form.
 - adequate control to shareholders over these matters.
 - => improving governance standards!

Disclosure

- Directive on Company Law, Accounting and Auditing Rules (2007)
 - clarifies the duties of auditors and provides for their oversight, independence, and adherence to ethical standards;
 - requires "public interest entities" (essentially listed companies, credit institutions and insurance companies) to have audit committees;
 - at least one member must be independent and be competent in accounting and/or auditing.
 - => to enhance confidence in financial statements and annual reports.
- The Transparency Directive (2005)
 - designed to improve the quality of information available to investors on companies' performance, their financial position, and changes in major shareholdings.
 - Periodic financial reporting: quarterly reports or an interim management statement, that:
 - gives a general description of its financial position and performance during the relevant period; and,
 - explains material events and transactions and their impact on the financial position.

- Disclosure of major shareholdings for issuers whose securities are admitted to trading on a regulated market in the EU.
- => May increase the liability of a listed company and its directors and auditors for the accuracy of the company's financial reports.

Shareholder rights

- Most fundamental shareholder rights are still sourced in national law rather than in EU directives:
 - Claims to residuals: approval of dividends.
 - Empowerment: voting rights, electing board members at the AGM.
 - Protection
 - Most minority rights (including EGM convocation, special information / investigation rights).
 - Approval of major (and some related party) transactions.
- Capital Changes (2nd Company Law Directive)
 - Decisions requiring shareholder approval:
 - Increase and reduction of share capital. Where there are several classes of shares, shareholder of each class whose rights are affected by the transaction have right to a separate vote.
 - Waiver of pre-emption rights for shareholders.
 - Acquisition by company of its own shares. Shareholders determine the terms and conditions of acquisitions: the maximum number of shares to be acquired, the duration of the period for which the authorisation is given.
 - Certain related party capital transactions.
 - Financial assistance (funds, loans, security) by company for acquisition of its shares by a third party.
- Changes in Corporate Structure through mergers and divisions (3rd and 6th Company Law Directives and Directive on Cross Border Mergers):
 - Right to become shareholders of the acquiring/merging company.
 - Right to approve the draft terms of merger and any alterations to the Memorandum and Articles necessitated by the merger.
 - Right to approve the terms of a division.
 - => Protecting shareholders from agent abuse and inequitable treatment!
- Changes in Corporate Control (13th Company Law Directive)
 - Mandatory Bid
 - Breakthrough clause
 - Shareholder approval of post-bid defences
 - Sell out rights
 - => Protecting shareholders from agent abuse and inequitable treatment
- Directive on the Exercise of Shareholders' Rights (2007)
 - Minimum notice period of 21 days for most GM
 - can be reduced to 14 days where shareholders can vote by electronic means and the GM agrees to the shortened convocation period.
 - Internet publication of the convocation and of the documents to be submitted to the general meeting at least 21 days before it convenes;
 - Abolition of share blocking and introduction of a record date in all MS which may not be more than 30 days before the general meeting;
 - Abolition of obstacles on electronic participation to the GM, including electronic voting;
 - Right to ask questions and the company's obligation to answer questions;

- Abolition of existing constraints on the eligibility of people to act as proxy holder and of for the appointment of the proxy holder; and, excessive formal requirements
- Disclosure of the voting results on the issuer's Internet site.
- External Auditors (8th Company Law Directive)
 - Right to appoint external auditor
 - Empowering shareholders' participation in decision-making