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Working and composition of supervisory and management boards in Italian Two – Tier System

Lorenzo Guadagni

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1.Introduction.

An analysis of the Italian two tier system is complicated since the regulation given by the 2003 law reform presents a number of unclear aspects; this is the result of the specific regulatory technique used by our legislator: few norms directly govern some aspects of supervisory and administrative boards, and for the rest our Civil Code makes various references to the discipline laid down for the traditional system**.**

This problem has repercussions on the regulation of the composition and working of the supervisory and management boards: our Civil Code expressly fixes only the composition of corporate bodies and their building up procedures, while, as far as the functioning of the boards is concerned (frequency of meetings, powers of the chairman, call for the meeting, appointment of executive directors etc.) we have to look to norms ruling the same aspects in the Traditional corporate governance system; these norms are not completely compatible with the dual board System and, notwithstanding the great number of references, in the regulation of the supervisory and management boards some normative voids remain that must be filled in**.**

2.Composition of management and supervisory board.

On the grounds of the analysis of the norms directly ruling the composition of the two tier system bodies we can easily understand that the structure of both boards is flexible: articles of the Civil Code simply provide for a minimum number of members, the management board is composed of, at least 2 members (art. 2409 novies, second paragraph c.c.) and the minimum number of supervisory board persons is three (art. 2409 duodecies, first paragraph, c.c.).

In compliance with these limits it will be possible to shape these bodies on the bases of the specific needs of the company, regardless of any numeric parameters. This improves the level of efficiency of the bodies, and, mainly,

the functionality of the supervisory board' s work: it is not a coincidence that that the semi-rigid composition of the board of auditors is considered, by legal authors, one of the principal causes of ineffectiveness of this body; this problem seems to be resolved in the two tier system.

The structural adaptability of the supervisory board is one of the principal characteristics that makes the two tier system really different from the traditional one, but, naturally, has its drawbacks: in case of a body made up of an even number of members, it may become impossible to get the majority of votes necessary to pass a resolution, in other words there is the risk of deadlock. It is to be hoped that, in such circumstances, the by-laws of the company provides mechanisms suitable for breaking the stalemate of the decision-making process. In some of the by-laws of public companies adopting the two tier system the chairman of the management or supervisory board is endowed with the casting vote: this represents a valid solution to prevent dangerous deadlock.

3.Eligibility and disqualification requirements of the member of management and supervisory board.

Analysing the eligibility and disqualification requirements of the supervisory board we realize that this board, at least in unlisted companies, is not a professionally qualified body: in fact, on the grounds of the art. 2409 duodecies, fourth paragraph c.c., only one member shall be selected from the official list of auditors, while the other members do not have to satisfy particular requirements, moreover, on the contrary of what happens in the traditional system of corporate governance, members of the supervisory board may be relatives of directors.

This particular regulation aims to achieve a precise goal: our legislator wants to make the two tier system a corporate lay out suitable for family firms, and, from this perspective, we can also understand why the supervisory board is not a professionally qualified body. This is a reason for choosing the two tier system.

Naturally this solution may create problems and negative repercussions on the minority shareholders since the majority shareholder is practically able to control both management and supervisory bodies. This is the default set up in theme of independence and professional requirements of the members of the supervisory board. Naturally the by-law of the company may introduce further requirements to select certain types of supervisors:, which will increase the degree of protection of minorities and will enhance the appeal of the company and the trust of the market.

The situation changes radically in the listed company: first, all the members of the supervisory board shall satisfy particular requirements to be elected: on the grounds of article 148 of the financial intermediation consolidated act all the persons who perform a control role must satisfy the integrity and experience requirements laid down in a regulation adopted in agreement with the Minister of Economy and Finance; secondly, independence requirements are stricter in listed companies than in close corporations. These requirements are the same in the three different corporate governance model, so, even if the differences between the models are reduced, the degree of protection of market and savers is increased.

As far as the management board of listed companies is concerned, it is important to point out that the presence of a minority director is not required, on the contrary of what happens in the other management bodies of

the traditional and one tier system. This particular solution has been judged, in any case, consistent with the specific and particular nature of the management board: this organ is or should be, in the view of our lawmaker, a quick and agile, entirely engaged in the day to day running of the business.

However, on the grounds of art. 147 quater t.u.f: if the management board is made up of more than four members, at least one of them must satisfy the independence requirements establish for the members of the controlling bodies in the art. 148 t.u.f.

4.Working of the management board.

In theme of two tier system no disposal governs expressly the working of the management board, this profile is object of a reference to art. 2388 c.c. governing the traditional system of corporate governance. This article fixes only few aspects of the working of the board of auditors: the quorums and the prohibition to vote by proxy. If we want to understand how the management board works and which is the development of the decision-making process of this organ we have to go by practices of the by-laws and legal scholars' studies.

First of all, we have to understand which is the nature of this body: even in the case of a two members body, it would seem possible to say that the nature of the management board is collective, on the grounds of dispositions of the Civil Code: the management board shall have its chairman and as we will see, the role of the chairman is strictly linked with the collective method so it would not make sense to provide the figure of the chairman if the management board was not a collective organ. the rules applying to the management board are the same as the directors' board's norms and these take for granted the collective nature of the board of directors so that also the management board must adopt the collective decision making process.

Having resolved the problem of the nature of the management body and understanding that it is a collective one, going by the general theory of collective bodies, it's possible to divide its decision making process into different phases: the call, the constitution of the meeting, the debate and finally the resolution.

Every single phase of the decision making process is carried out by the chairman, so, the study of the development of the meeting should not put aside the analysis of the role of the president: with the 2003 law reform the functions of this particular subject has been clarified, at least as far as the traditional system of corporate governance is concerned. The chairman of the board of directors is the engine of the board itself and must supervise the development of the meeting of the board. Added to this, the chairman has another fundamental duty in modern corporate governance: he has to supervise and to control the regularity of the management board's information flow.

These duties are laid down only in the norms governing the traditional system and nothing, concerning this subject, is said regarding the dual tier system: this omission is not emphasized by our scholars; also in the two tiers system the chairman of the management board has to set in order the functioning of this body and, above all, has to take on the role of information gatherer of the chairman in the traditional corporate lay out.

Regarding the call for meetings we have to underline that no dispositions set a precise frequency of the meeting: In any case the management board shall be called every time its chairman, and other subjects entitled

to call, want and above all, every time the call is required by the needs of the running of the business.

The chairman has naturally the power to call meetings; it is also possible that the meeting is called by the supervisory board or by each embers of this organ. As far as the single members of the management board is concerned it is a commonly understood that they may ask the chairman to call meetings.

Looking at quorums we see that for the validity of the resolution, the presence of the majority of members in office is required; the majority required is referred to the real number of directors, not to not the legal, so even an incomplete management body is able to pass resolutions, however the supervisory board shall replace the directors vacating office without delay. The resolution of the management board is passed by an absolute majority of these presents.

The article of association may provides different (higher) quorums and is disputed whether is possible to introduce the unanimity. No dispositions prevent the shareholders from introducing this type of clause, but such clauses may bring the work of the meeting to a standstill.

5.Working of the supervisory board.

Understanding the working of the supervisory board presents the same problems of the management board functioning: the regulation of the board of auditors in the traditional system, which norms ruling the supervisory body refers to, does not clarify all the aspect linked to the decision making process.

In any case the entire discipline seems more detailed compared to that of the management board: first of all, a minimum frequency for meeting has been established : the supervisory board shall meet every ninety days. Also in this case is possible for the by-laws to provide for an higher frequency: indeed when the supervisory board is given administrative tasks this is advantageous to allow regular updates of the business progress.

The chairman is given the power to call for meetings, and with regard to listed companies, every single member may request the chairman to call a meeting; in such case the meeting must be called without delay, unless this is prevented by specific reasons (art. 151 bis t.u.f.). These reasons shall be promptly notified to the person who requested the call, and explained to the next meeting of supervisory board.

Also the supervisory board is obliged to work as a collective body, and this is for two reasons: first, the rules governing the working of the supervisory board make a reference to the norms governing the board of auditor, which is a collective body; secondly the supervisory board must have its chairman and, we've seen, the role of chairman is linked to the collective process. The powers of chairman are not expressly set by the norm ruling the board of auditors, but on the grounds of art. 2409 duodecies, ninth paragraph, the by-laws shall precisely establish them. In any case, even in absence of precise by-laws disposals, the chairman of the supervisory board shall manage the running of the meeting, taking care that any single phase of the decision making process is carried out correctly.

During the voting phase a series of problem connected with the overlapping of quorums laid down in the civil code may arise: art. 2409 quaterdecies c.c., make a reference to both art. 2404 c.c., which governs the quorums of the board of auditors, and art. 2388, that disciplines the quorums of the board of directors. The problem arises because these norms provide different quorum, so becomes necessary to understand which disposal to apply.

Legal scholars have tied to resolve the problem considering the nature of the resolution: Supervisory board, apart from carrying out control tasks, has also managerial functions, therefore its resolutions could be of both control and managerial nature. Depending on the type of resolution, or better, on their nature, which norm to apply must be chosen: art. 2388 c.c. for managerial resolutions; art. 2404 c.c. for the control ones.

This problem, at least as far as listed companies are concerned, is often solved setting a single quorum suitable for all types of resolutions; this option is useful but it is not clear whether it is completely compatible, or not, with the norms of the Civil Code.