

The two-tier system in Italy and Germany

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The remuneration of the members of the Supervisory Board

1. Preface

From a first analysis, the remuneration to which the members of the Supervisory Board are entitled to appears to be an easily re-constructible issue.

There are, in fact, two rules which governs such topic; the first one, paragraph 1 of Article 2409-*quaterdecies* of the Italian civil code (ICC), and the second one, in more general terms, paragraph 1 of Article 223-*septies* disp. att. ICC.

Paragraph 1 of Article 223-*septies*, accomplishment provisions of the ICC, provides for a general reference with respect to the supervisory board, following the relevant compatibility assessment, to the rules concerning the board of auditors in the Italian traditional system. Pursuant to paragraph 1 of Article 223-*septies*, disp. att. ICC : “*If not otherwise foreseen, the rules of the civil code which refer to [...] auditors are applicable, if consistent, also to the members [...] of the supervisory board [...]*”.

Paragraph 1 of Article 2409-*quaterdecies*, ICC, with specific respect of the subject-matter, provides for a direct reference to Article 2402 ICC. The said rule, within the framework of the board of auditors, under the heading “*Remuneration*”, provides that: “*The annual remuneration of the auditors, if not established in the by-law, shall be determined by the shareholders’ meeting at the moment of appointment thereof for the entire term of the office*”.

The scope of the aforesaid rules, with respect to the matter at issue, is significant but not comprehensive in order to derive the remuneration rules to which the members of the supervisory board are entitled to. As a matter of fact, it is worth underlying, on the one side, the fact that the applicability of the referred rules, in both cases, is subject to the fact that their respective provisions are “compatible” and, on the other side, to the fact that the duties allocated to both bodies, within the framework of operation of their respective corporate governance systems are, from numerous points of view, significantly different.

The two tier model is characterized by the prominent role of the supervisory board that, on the one hand, perform the same monitoring functions carried out by the board of auditors in the Italian traditional system¹ and, on the other hand, borrows duties from the shareholders’ meeting and has power unknown to the board of auditors in the Italian traditional system.

In this respect, pursuant to Article 2409-*terdecies*, paragraph 1, “*the supervisory board : a) appoints and revokes the members of the management board and fixes their compensation, save for the specific powers attributed by the by-laws to the meeting; b) approve the balance sheet for the fiscal year and if drafted, the consolidated accounts; [...] d) promotes liability actions against the members of the management board; [...] f-bis) if provided in the by-laws, resolves on strategic transactions and industrial*

¹ The reference is made to the functions set forth in: Article 2403 ICC, “*Duties of the board of auditors*” (referenced by paragraph 1, lett. c) of Article 2409-*terdecies* ICC), Article 2408 ICC, “*Complaint to board of auditors*” (referenced by paragraph 1, Article 2409-*quaterdecies* ICC), Article 2409, paragraph 7, ICC, “*Report to tribunal*” (referenced by paragraph 1, lett. e), Article 2409-*terdecies*), Article 2406 ICC, “*Omission by directors*” (referenced by paragraph 1, Article 2409-*quaterdecies*), Article 2403-*bis*, paragraph 2, ICC, “*Powers of the board of auditors*” (referenced by paragraph 1, Article 2409-*quaterdecies*, ICC). Furthermore, (i) the supervisory board “*report in writing at least once a year to the meeting on the supervisory activity made, on censurable omissions and facts found*” (Article 2409-*terdecies*, paragraph 1, lett. f), ICC); (ii) the members of the supervisory board “*may attend the meetings of the management board and must attend meeting*” (Article 2409-*terdecies*, paragraph 4, ICC).

and financial plans of the company drafted by the management board, without prejudice to the liability of the management board for its acts”.

The foregoing explains the rationale of the legislator when having recourse in the law provisions to the term the “management and control” systems and not, for instance, to that one of “systems of administration and systems of control” the same, in fact, when establishing the framework of the three models of corporate governance currently in force (*i.e.*, the traditional model, the monistic model and the two-tier model), aimed at balancing the allocation of management powers and of control powers in different ways amongst the various corporate bodies.

2. The role of Article 2402 ICC

In light of the above, we hereby draw our attention to the provisions set forth in Article 2402 of the ICC, in view of ascertaining the consequences which may arise from the direct reference made by paragraph 1 of Article 2409-*quaterdecies* ICC with specific respect to the remuneration rules to which the members of the supervisory board are entitled.

Article 2402 ICC sets forth three fundamental principles: *a)* the onerousness of the office of statutory auditor; *b)* the predetermination of the relevant remuneration and *c)* the invariability of the same.

The onerousness requirement is deemed to be a necessary element of the safeguarded relation of the professionalism of the auditors and of the independence and impartiality of the control office with respect to the potential pressure which the majority shareholding may enforce.

With reference to the predetermination and the invariability of the remuneration of the member of the supervisory board, the aforementioned principles prevents the control activity from being influenced both from the prospective reduction of the relevant amount and by the expectancy of an increase thereof. According to the prominent scholars and authorities, only changes linked to objective and predetermined criteria are feasible.

Summing it up, in accordance with Article 2402 ICC, the determination of the remuneration of the auditors, if not provided in the by-laws, shall be determined by the ordinary shareholders’ meeting at the moment of their appointment. Moreover, it is undisputed that the failure to determine the relevant remuneration does not jeopardize the appointment of the members of the board of auditors; in these cases, if compensation has not been agreed upon by the parties (*i.e.* the ordinary general meeting and the auditors) it is determined by the court pursuant to Article 2233 ICC.

With regard to the extent of this study, it must be held that the same requirements pointed out for the board of auditors arise, reinforced, in respect of the supervisory board, corporate body entrusted with the internal control of the company management; in fact, this latter functions are carried out, within the framework of the two-tier system, by the management body that, pursuant to Article 2409-*teredecies*, paragraph 1, lett. *a)*, ICC, is an expression of the same supervisory board not consistent with the traditional system in which directors are appointed directly by the shareholders’ meeting.

Therefore, provided that the shareholders’ meeting, when resolving upon the determination of the remuneration to be granted to the members of the supervisory board, abides by the principles set forth under Article 2402 ICC, there are no particular concerns. The remuneration shall be fixed at the moment of the appointment; at this latter stage the shareholders’ meeting shall predetermine an objective criteria for the determination thereof.

In view of the above, *quid iuris* in the event in which the shareholders’ meeting does not resolve upon the remuneration and the by-laws do not contain any provision to such extent? Furthermore, *quid iuris* in the hypothesis in which the shareholders’ meeting has duly established the remuneration to be granted to the members of the supervisory board and, subsequently, the shareholders’ decide, amending the by-laws, to grant to the supervisory board new functions (such as, the power set forth pursuant to Article 2409-

terdecies, paragraph 1, lett. f-*bis*), ICC, namely, the possibility to resolve on strategic transactions and industrial and financial plans of the company drafted by the management board)?

In the above mentioned events, it must be held that the members of the Supervisory Board are entitled to request the determination of the remuneration to the Court. The principle of onerosness of the office of member of the Supervisory Board enables to affirm that all members of the said body, at the moment of acceptance of the office, have the right to receive such remuneration.

Having ascertained, from a subjective point of view, the competent authority in view of the hearing of any disputes on the remuneration of the members of the supervisory board in the envisaged circumstances, it is necessary to investigate a further profile, namely, the criteria based on which, in practice, any such authority proceeds to the quantification of the remuneration.

In this respect, the judge called to establish the *quantum* owed to the members of the supervisory board shall take into consideration the specific duties carried out by the corporate body pursuant to an express law provision or as vested pursuant to the By-laws.

To this extent, the partial coincidence of duties between the board of auditors and the supervisory board may become significant.

More specifically, it appears reasonable to hold that for the determination of the remuneration to be granted to the member of the supervisory board connected to the monitoring functions – carried out by the board of auditors in the Italian traditional system – the relevant authority should make reference to the criteria identified by the case law in view of the determination of the remuneration of the auditors in the framework of the Italian traditional system.

The supervisory board should, nonetheless, be entitled to a greater remuneration connected to the carrying out of the specific activities that the law grants to the body (see Article 2409-*terdecies*, paragraph 1, lett. a), b), d) and f-*bis*).

The idea that, in connection to the carrying out of any such further duties, the supervisory board is entitled to a greater remuneration, may find a confirmation, though indirect, with respect to the board of auditors of the Italian traditional system. With respect to this latter body, the recognition of a greater remuneration, in the event in which the same must carry out further duties other than those of control, may be derived from the observations raised with respect to paragraph 5 of Article 2386 ICC. In any such event, in fact, the prominent scholars and the case law deem that the auditors shall be entitled to a greater remuneration, compared to that established at the moment of appointment, in respect of the carrying out of the ordinary course of business duties throughout the period falling within the vacancy of the directors and the resolution of the shareholders' meeting appointing the new directors.

In view of the assessment on the feasibility to recognise to the members of the supervisory board a greater remuneration connected to the carrying out of such specific activities, it shall be necessary to carry out a stand-alone analysis which studies such duties individually.

3. Criteria for the determination of the remuneration connected to the carrying out of control duties

In order to ascertain a criteria for the determination of the remuneration to be paid to the members of the supervisory board in consideration for the control duties, as stated, it is worth taking into consideration the criteria used in the case law in order to solve the same issues with respect to the traditional system's control body. The partial coincidence of the duties carried out by the board of auditors, on the one side, and by the supervisory board, on the other side, offers in fact the possibility of carrying out an assessment on the applicability, *mutatis mutandis*, of the solutions reached for the former with respect to the latter.

Insofar as the determination of the remuneration to which the auditors are entitled, the Italian civil code does not include any provisions whatsoever and does not provide for any principle in order to calculate the relevant amount.

Reference point, pursuant to the theory which appears to prevail, shall be the professional fees of certified public accountants and accountants and commercial experts (Article 37, decree No. 645/94 and Article 37 decree No. 100/97), which indicate in a rather detailed manner the remuneration of those recorded into the respective registers carrying out auditing activities, clarifying, depending on the type of

activity entrusted to the auditors, the due fees, which vary from a minimum to a maximum range depending on certain thresholds regarding the economic and business value situation of the company.

Before carrying out an in-depth analysis of the parameters to which it is possible to make reference in view of the determination of the remuneration to which the certified public accountant carrying out auditor duties is entitled and prior to ascertaining the incidence with respect to the issue subject to our analysis, a premise is necessary.

As at the date hereof, the criteria of the reference to a professional fees appears to be less reliable than in the past, in view of the fact that the binding effect of professional fees was jeopardised as a result of the issuance of the “Bersani decree” (paragraph 1, letter a) of decree by law No. 223 dated 4 August 2006; conversion law No. 248 dated 4 August 2006). Moreover, any such doubts should apply with respect to the members of the supervisory board, whose composition goes beyond the scope of professionals recorded into the relevant registers (the reference is made to Article 2409-*duodecies*, paragraph 4, ICC: “*at least one regular member of the supervisory board must be selected among those registered in the register of the examiners of account held at the Ministry of Justice*”).

In view of the above necessary premise, it appears to be adequate to take into consideration the provisions of certified public accountants’ current fees (approved the Decree No. 645/94). The same, in fact, due to historical reasons, provides for a series of specific reference elements with respect to the activity carried out by those recorded into the relevant registers within the scope of the board of auditors.

In particular, with respect to auditors, paragraph 1 of Article 37 of the abovementioned Decree specifies the services in consideration for which, within the scope of the aforesaid duty, the relevant fees are due: “a) *the carrying out of the quarterly verifications; b) the control of the fiscal year’s financial statements and the drafting and execution of the relevant report to be submitted to the shareholders’ meeting; c) the participation to each meeting of the board of directors or shareholders’ meeting, not including in the relevant agenda the approval of the relevant fiscal year’s financial statements, and of the executive committee, along with the participation to each meeting of the board of auditors, save for those in view of the relevant quarterly verifications, aimed at the control of the extraordinary corporate activities, to the examination of the claims set forth under Article 2408 of the Italian civil code or, in any event, requested by a member of the management body*”.

The rule, subsequently, continues setting forth under paragraphs 2, 3 and 4, the parameters to take into consideration in view of the determination of the remuneration to which the certified public accountant carrying out the office of auditor is entitled; to this extent, we shall consider the parameters in order for the determination of the remuneration regarding any auditing activities carried out (*i.e.* the carrying out of the quarterly verifications and of the control of the financial statements pursuant to letters a) and b) of Article 2409-*ter* of the Italian civil code), in light of the fact that the legislator has established the obligation, for those companies having implemented the two-tier system, to entrust the said duty to an external auditor (paragraph 1 of Article 2409-*bis* ICC, referenced by Article 2409-*quinquiesdecies* ICC) and, consequently, the problem of the potential determination of a remuneration regarding this type of activity with respect to the members of the supervisory board does not arise.

Pursuant to paragraph 4 of article 37 of the Decree No. 645/94, with reference to the determination of the fees set forth under letter c), it must be considered to the maximum fees foreseen under letter d), point I, of the chart included under article 26 of the relevant fee, whereby the value of the assignment is calculated in an amount equal to the share capital of the company.

Lastly, paragraph 5 of the same Decree states the rule of the different remuneration to the remuneration of the Chairman of the board setting forth that “*in the event that the certified public accountant holds the office of chairman of the board, the remunerations set forth under paragraphs 2 and 3 shall be increased by 50%*”.

4. Criteria for the determination of the remuneration connected to the carrying out of specific duties by the supervisory board

As for the criteria which, most likely, shall apply in view of the determination of the remuneration concerning the carrying out of control duties with respect to “*the observance of the law and with the by-*

laws, compliance with the principles of proper management and [...] adequacy of the organisational, administrative and accounting structure adopted by the company” (see Article 2403 ICC referenced by paragraph 1, letter c) of Article 2409-*quinquiesdecies*, ICC) by the members of the supervisory board, in the event in which any such remuneration has not been determined by the shareholders’ meeting and there are no by-laws provisions whatsoever to such extent, or in the event of an amendment to the by-laws which assigns new duties to the same corporate body, compared to those originally assigned to the same and with respect to which the remuneration was determined, it is now worth analysing each specific duty which characterise the activities which the said body is called to carry out within the scope of the two-tier system.

The reference is made, in particular, to the activities of:

- i) promotion of the issuance of the liability action against the members of the management board (paragraph 1, letter d) of Article 2409-*quaterdecies* ICC);
- ii) approval of the balance sheet for the fiscal year and, if drafted, the consolidated accounts (paragraph 1, letter b) of Article 2409-*quaterdecies* ICC);
- iii) appointment and revocation of the members of the management board and determination of their remuneration (paragraph 1, letter a) of Article 2409-*quaterdecies* ICC);
- iv) if provided by the by-laws, resolution on strategic transactions and on industrial and financial plans of the company drafted by the management board (paragraph 1, letter f-*bis* of Article 2409-*quaterdecies* ICC).

i) Promotion of the issuance of the liability action against the members of the management board

With respect to the carrying out of this duty, it is not deemed that the supervisory board shall be granted with a specific remuneration.

In fact, notwithstanding paragraph 1, letter d) of Article 2409-*terdecies* ICC allocates the same, on an exclusive basis, to the supervisory board, paragraph 3 of Article 2393 ICC (as amended by lett. a), No. 1 of Article 3.1, law No. 262/05) sets forth, as already foreseen for listed companies, that “*the liability action may also be issued following the relevant resolution of the board of auditors, reached by the majority of two-thirds of its members*”.

The remuneration for the carrying out of this duty, therefore, appears to fall within the scope of those control duties for which, pursuant to what already stated, the remuneration should be determined by taking into consideration those criteria used with respect to the board of auditors.

ii) Approval of the balance sheet for the fiscal year and, if drafted, the consolidated accounts

The supervisory board is the corporate body entitled to, within the framework of the two-tier system, the approval of the balance sheet. The carrying out of any such duty is linked to the duty of the shareholders’ meeting of resolving upon the distribution of profits.

To the said extent, it is worth laying stress on the fact that, pursuant to paragraph 2 of Article 2409-*terdecies* ICC, “*the by-laws may provide that, in the event of non-approval of the accounts or should at least one third of the members of the managing board or the supervisory board require the powers for the approval of the balance sheet be attributed to the meeting*”.

In any event, the supervisory board is entrusted, with respect to the balance sheet, with a different and specific duty compared to those entrusted to the same body in light of the fact that, this latter, carries, with respect to the subject-matter, the same duties carried out by the board of auditors.

The substantial traditional duties regarding the balance sheets are, as a matter of fact, those established by paragraph 2 of Article 2429 ICC (report to the balance sheets by the board of auditors, which shall include any observations and proposals of the control body to be submitted to the shareholders’ meeting).

Duties which entail the undertaking of own liabilities (Articles 2407 and 2434 ICC), but which are independent of a resolution activity by the control board.

The approval of the financial statements is an essential competence in view of the operation of the company (failure to approve the same could amount to dissolution cause inherent to the failed operation of

the shareholders' meeting – paragraph 1, No. 3 of Article 2484 ICC – and is, therefore, surrounded, with respect to the traditional and one-tier management/control systems, by especial safeguarding techniques, - paragraph 4 of Article 2369 ICC).

Therefore, the above approach, it may be held that the assignment of the duty of approving the balance sheet to the supervisory board is not only a specification of the particularity of the operation of the corporate organisation of Italian joint-stock companies having adopted the two-tier system, but also an instrument by means of which it is possible to expedite and render the examination and the discussion of the balance sheets by the corporate bodies more secure.

Notwithstanding the foregoing, the issue which appears to be significant in order to establish whether, by way of consideration for the exercise of any such duty, it may be possible to recognise and/or it shall be recognised a further remuneration to the benefit of the supervisory board, is the fact that the balance sheets, even though approved by the members of the supervisory board, is an action of the directors. From approval thereof, hence, it does not appear, at least to date, to be possible to derive a specific resolution liability by the members of the supervisory board.

If this is the case when imagining that the carrying out of an action, on the one side, necessary for the operation of the corporate organisation and, therefore, for the survival of the corporate enterprise and, on the other side, not adequate in order to allocate a specific liability to the members of the body having carried out the same, may justify the claim by the said members of a specific greater remuneration.

iii) Appointment and revocation of the members of the management board and determination of their remuneration

Activities which, also in this case (reference is made to the financial statements), imply the exercise of a duty which, within the scope of the Italian traditional system, is allocated to the shareholders' meeting.

The exercise of such duty, nonetheless, also implies the allocation of a directors' liability; liability which, pursuant to the provisions of paragraph 3 of Article 2409-*terdecies* ICC is proportional to the “*due diligence requested by the nature of the office*”. By way of specific reference to this duty, in fact, the member of the supervisory board, may face a possible liability for *culpa in eligendo*, namely, the same could be called to compensate for all damages caused to the corporate value (see Articles 2393 and 2394 ICC) for the determination of an inadequate remuneration compared to the capacities and duties of the appointed individual to the office of management director. It is due to this liability directly linked to the carrying out of the office, that it appears to be reasonable to taking into account this function as for the determination of the remuneration of the member of the supervisory board.

It is fully evident that the amount of the greater remuneration may solely be proportional to the technical difficulty of the choice, the corporate value and volume of business of the company, in one word, to the risk.

iv) Resolution on strategic transactions and on industrial and financial plans of the company drafted by the management board (a specific By-law provision to this extent is necessary)

This is the so-called top management duty, whereby the entrustment to the supervisory board is subject to an express by-laws provision. Despite the fact that the same does not amount to a managerial activity in a strict sense, it is certainly not possible to find a similar competence with respect to the board of auditors in the Italian traditional system.

The absolute inexistence of the referred to duty in the case of the duties carried out by the board of auditors and in light of the fact that the allocation to the supervisory board is merely incidental, are both elements which enable to deem that for the exercise of any such duty a specific remuneration to the benefit of the members of the supervisory board should be established.

The fact that the referred to duty allocates to the supervisory board the exercise of a top management duty, enables us to carry out an analysis on the feasibility of having recourse, in the subject-matter, to the provisions of paragraphs 2 and 3 of Article 2389 ICC applicable, by way of analogy, to the management board.

With respect to the provision included under paragraph 3, it is deemed that the same may not be applied to the subject-matter. On the one hand, in fact, it must be stressed that – pursuant to the provisions of paragraph 1 of Article 223-*septies* disp att. ICC (which statues, if not otherwise foreseen and if consistent, the applicability of the provisions set forth for the board of auditors to the supervisory board), on the one side, and of the reference made by paragraph 1 of Article 2409-*quaterdecies* to Article 2402 ICC, on the other side – in order to redefine the rules of the supervisory board, it is necessary to make reference to the provisions set forth for the board of auditors and not to those foreseen for directors; on the other hand, Article 2402 ICC is a mandatory provision, therefore, reference must be made to the same and not to the other provisions.

Insofar as the provisions of paragraph 2 of Article 2389 ICC are concerned, it is necessary to stress as follows. The provision of a remuneration linked to the participation in the profits does not appear to be consistent with the duties and nature of the supervisory board. In fact, the participation in the profits is certainly linked to the preparation of the industrial plans which, should a remuneration of this nature be foreseen, could be aimed at the achievement of profits on a short/medium term basis, causing an evident prejudice to the corporate activity on a long term. The same problems arises reinforced with respect to stock option plans. Stock option plans entail the payment of a consideration, the amount of which is directly linked to the amount of the premium over the shares at the moment of the allocation of the same. We deem, therefore, that enabling the recognition to the members of the supervisory board of a consideration, the significance of which is, from a certain point of view, linked to corporate value shown in the balance sheet may cause a negative effect on the exercise of the control duties, on the side of the supervisory, with respect to the balance sheet.

The aforesaid duties, in fact, are those typical of the board of auditors, prior to the approval of the financial statements, with the aggravating circumstance that, with respect to the *de quo* body, in the two-tier system the approval of the said financial statements is added to the said duties.

It is worth noting the provision set forth under paragraph 2 of Article 2365 ICC, pursuant to which “*the By-laws may attribute [...] the supervisory board [...] with the resolutions concerning the merger in the events foreseen under articles 2505 and 2505-bis [ICC]*”.

Also the entrustment of this duty to the supervisory board is incidental and is subject to the amendment to the by-laws.

The said provision, furthermore, entails the reaching of resolutions concerning the strategic management of the company, not differently to what occurs provided that the provisions set forth under paragraph 1, letter f-*bis* of Article 2409-*terdecies* ICC may be exercised.

In this event, as in the previous one, it appears feasible to state that the liability linked to the reaching of these resolutions may be a sufficient reason to allocate to the members of the supervisory board a specific remuneration, in the footsteps of the what provided for with respect to the duties set forth under paragraph 1, letter f-*bis* of Article 2409-*terdecies* ICC.

It remains pending to assess, with respect to the two foregoing analysed events, the criteria regarding the determination of the amount to be recognised in the event of failure of determination on the side of the shareholders’ meeting.

It is, as obvious, an assessment upon the merits. The said assessment, nonetheless, should have as reference criteria that of the correlative advisory professional services.

The foregoing appears to be consistent in view of the fact that (a) it is the case of duties entrusted to the body and, therefore, undertaken upon the agreement of the members thereof; (b) it is the case of duties which must be exercised with professional competence and (c) correlative liability *vis-à-vis* the company, - following the relevant resolution of the shareholders’ meeting, pursuant to Article 2364-*bis* ICC, and of the corporate creditors – Article 2394 of the ICC.