Remiss: Grönboken The corporate governance framework, Com (2011) 164

Question 1: Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

The question whether the EU corporate governance measures should take into account the size of listed companies is as such an idea which is easy to accept and adhere to. However before taking such measure, the EU faces the fundamental empirical issue of identifying the relevant ranges of types and sizes of companies in the different Member States, in particular as regards small and medium-size listed companies. The issue of empirical identification is a prerequisite which must be fulfilled prior to the adoption of any recommendations/regulations by the EU and then against the diversity of economies which exist in the different Member States.

Furthermore, it can be argued that, at least for now, the difference between the Member States as regards the relevant ranges of types and sizes of listed companies and the diversity of economies makes it less likely that the EU can find a generally accepted, differentiated and proportionate regime which would really enhance corporate governance on the national level in all Member States. Therefore, the Faculty of Law does not believe that at present and in the absence of proper empirical knowledge of similarities and differences between the Member States, it would be appropriate to take
any action. From this follows that, in the absence of relevant data, the Faculty of Law does not believe that any appropriate definitions or thresholds are possible to ascertain.

But at the same time the EU could contribute to the development of corporate governance on the national level, and thus enhance corporate governance for small and medium size listed companies at a lower (but proportionally equal) cost than for the large listed companies. This can be done by requiring the Member States – on the basis of relevant empirical knowledge – to set up a differentiated corporate governance regime of the kind envisaged in the Green Paper.

**Question 2: Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?**

The issue of any corporate governance measures should be taken on EU level for unlisted companies (with the exception of those that would in near future be listed companies) must against the background of the arguments under question 1 be answered in the same way. The problem of identifying the relevant ranges of types and sizes of companies and, at the same time, taking into account the diversity of economies which exist in the Member States is a huge task and may not even in fact result in a notably better corporate governance in such companies. Again the EU could and would possibly better contribute to the development of corporate governance on national level in unlisted companies by requiring Member States to promote corporate governance awareness and work on corporate level. But this does not necessarily need to be by way of corporate governance codes, and may require that Member States each year present to the Commission what, if any, actions have been taken in this regard.

**Question 3: Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?**

The current legislative framework of the EU in the area of company law and corporate governance do not entail any particular legislation in the form of directives or other binding legal norms as to the composition, responsibility and liability of the board of directors either in the one tier system or two tier system (the regulation of the SE company form is no exception in this regard since it basically depends on national company law). In the absence of such coherent EU legislation (which is not an end in itself) it is questionable if and to what extent a EU initiative as to the division of functions and duties of the chairperson of the board of directors and the chief executive
director may contribute to better corporate governance on Member State level. Member States with different legal framework – most notably the difference between the one tier and two tier system – may implement such initiative differently, and even assuming the Member States do implement it in a similar way it may still be understood differently on corporate level. To put it differently, an legislative initiative on EU level in this regard may or may not enhance the division of functions and duties of the chairperson of the board of directors and the chief executive director. Since the benefits are uncertain the EU should instead promote Member State initiatives in this regard and require that Member States to the Commission each year present what, if any, actions has been taken.

**Question 4:** Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

In line with the foregoing question 3 and the answer to that, the Faculty of Law is of the view that initiatives as regards recruitment policies about the profile of directors to ensure that they have the right skills and that the board is suitably diverse should – if at all – be at Member State level and with similar reporting requirements for Member States as stated above.

**Question 5:** Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

**Question 6:** Should listed companies be required to ensure a better gender balance on boards? If so, how?

Both the issue of diversity generally and gender diversity in particular raise many issues and are somewhat controversial, at least in the form of mandatory legislation demanding a certain diversity on the composition of the board, for instance a minimum number of females versus males.

The Faculty of Law adheres to the objective that diversity in the board composition is important for the effectiveness of any company and its performance. Today, it cannot be regarded as overly radical to require that listed companies within the EU both
disclose their diversity policy including gender balance on the composition of boards and otherwise, what measures a particular company in fact has taken to achieve the objectives in the policy document and, especially if no measure has been taken, why and what measure will be taken in the near future.

**Question 7** Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

There are many good reasons for why the number of mandates a non-executive member may hold in listed companies should be limited. There are, however, also some counter arguments. One argument may be that some directors have the capability to hold a high number of different mandates and actually can contribute to the performance of the company even if this is not the case with the “average” director. Another argument is that any limitation is discretionary and therefore never can be a good rule *per se*.

One prior question to any legislation by the EU is to which extent non-executive directors hold too many mandates in the different Member States and to what extent this really is a practical problem. And even if there is a problem in as much as *some directors* hold too many mandates in some or even all Member States, from this fact it does not necessarily follow that this “misuse” of the system by *some directors* necessitates a legal limitation for *all directors*. If the legal limitation typically is counterproductive (although it eliminates the problem of too many mandates) it should not be introduced, at least not on the EU level since any changes of such rules for the better are more difficult on the EU level than on Member State level.

**Question 22:** Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

The Faculty of Law concurs with the opinion that party-related transactions, in particular in companies with a dominant shareholder, is a problem. Therefore, party-related transactions should be subject to approval by the shareholder meeting. Disclosure of party-related transactions is not enough.

From a legal-technical point of view any EU legislation in this regard should leave the details of the rules to be decided by the Member States themselves on national level since any threshold or similar variables must be understood against a national background.
Question 24: Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

Question 25: Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

The principle of comply or explain is a fundamental part of Corporate Governance Codes (CGC). The principle of comply or explain makes it possible to include rules in the CGC on a higher level than (mandatory) corporate law rules. The principle of comply or explain is, yet, not without its drawbacks.

One negative aspect of the comply element in the principle is that it in many cases is difficult to verify whether an individual company actually as a matter of fact does comply with the rules in a CGC even if the company makes a statement to that effect. There is some empirical studies which suggest that of those companies which state that they comply with the rules in CGC a not insignificant number do as a matter of fact deviate from the rules. To what extent this is a widespread problem is unclear and it may be a problem which diminishes over time.

As regards the “explain” component of the principle of comply or explain, there is a compatible problem. The explain component (and for that matter the comply component) is not standardized globally and not even within the EU. The lack of standardization results in a situation where an acceptable explanation in one country may deviate from what is considered as an acceptable explanation in another country. The end result is that it is difficult for the market to set a price on explanations which vary from one country to another and from one company to another even if the companies are similar. Again, however, it is a problem which may diminish over time.

At least within the EU, it ought to be possible to achieve a standardization of the explain element of the principle of comply or explain. In addition, and for the purpose of assessing the value of such explanations, such standardization should possibly be divided into subgroups which apply a different standard to different issues in CGC’s.
Another problem with the principle of comply or explain is that it usually relates to one alternative or a few alternatives in the CGC. The result is that there hypothetically might be an indefinite number of departures from a particular CGC according to the explain component. From a standard point of view – although this is “soft law” – the price setting of an indefinite number of individual deviations is troublesome at best. A better solution would be to have several standards or alternatives in the CGC (which more easily can be priced by the market).

A requirement that companies departing from the recommendations of CGC should be required to provide detailed explanations for such departures and describe the alternative solutions adopted is a good solution. But there are possibly better alternatives.

One disadvantage with a detailed explanation is that it may not be of much more value than no explanation at all if the explanation is complicated and elusive. Because of this, a better solution is that companies departing from the recommendations of CGC should be required to provide a justified and understandable explanation to the departure and the alternative solution adopted. A requirement of justification is better than a detailed explanation in as much as the former, but not the latter, is more precise, should be understood as a quality requirement for the explanation and that just a detailed explanation is not good enough from a quality point of view. A requirement of understandable makes it clear that a (otherwise) justified explanation also to the average reader must be intelligible.

A further problem with the principle of comply or explain is the sanctions available if and when an individual company does not live up to the principle. Depending on the countries, the obligation to comply or explain results from company law, from the regulatory authority or from listing standards. In reality the end result is that in some countries there is a real sanction while in other countries there is hardly any sanction at all.

In a statement from the European Corporate Governance Forum (Forum) it has been expressed that the Forum believes the corporate governance statement which explains the areas of compliance as well as the reasons for non-compliance, is the responsibility of the company’s board(s), for review and discussion with the shareholders. Thus, the responsibility of the regulators and auditors seems to be secondary although the Forum admits that “lessons should be drawn” before any general conclusion can be drawn.

1 Se European Corporate Governance Forum, Statement of the European Corporate Governance Forum on the Comply or-Explain principle, 22/02/2006, p 1.
The Forum therefore is inclined to the view that regulatory authorities should limit their role to checking the existence of the statement, and to reaching to blatant misrepresentation of facts. They should not try to second-guess the judgment of the board(s) or the value of its/their explanations. This is a matter for the company’s shareholders.3

Neither should the auditors be supposed to evaluate the judgment of the board(s), but may within their duties called upon to review some element of facts contained in the statement.4

Ultimately the evaluation of the corporate governance statement should according to the Forum be an element of the shareholders voting decision at the shareholders meeting.5

The Forums opinion is likely to be a popular opinion within the business community. One issue is of course if improved corporate governance only is an issue for the shareholders or an issue for stakeholders at large (in the former case the role of regulatory authorities is questionable). Another if shareholders are both aware and active shareholders which the Forums opinion presupposes.

The Faculty of Law agrees to the proposal that monitoring bodies should be authorized to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary. For CGC reporting this can be regarded as an essential element in standardization within the EU and between the Member states. There is, however, a problem with the cost and bureaucracy associated with such monitoring. Furthermore, the role of the auditors versus the role of the monitoring bodies must also be addressed. A potential and reasonable cost effective solution may be that the auditors within the framework of auditing check the informative quality of the explanations in the corporate governance statements and that the monitoring bodies only act in such cases where the auditors have found a none explanation or a non-acceptable one.

4 Ibid.
5 Ibid.