Corporate and Financial Markets Law

The Evolving Role of the Board: Board Nomination and the Management of Dissenting Opinions

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Abstract

In recent years, significant steps ahead have been taken in Italy to enhance corporate governance standards. The traditional commonplace, describing the Italian system as hostile to investors' activism, is no longer accurate. This paper aims at (re)starting a discussion about the issues of board nomination and the management of dissenting opinions, looking at the current legal and factual framework through the lens of the evolving role of boards of directors and advocating for a larger room for private ordering and self-regulation.

I. Introduction

The purpose of this paper is to start a discussion about the evolving role of the board of directors and to jointly consider two quite problematic issues: on the one hand, the board nomination and, on the other hand, the management of dissenting opinions within the board.

A discussion about the role of the board of directors requires answers to the following questions:

- Which functions does a board perform?
- Are these functions always the same in every jurisdiction?
- Are these functions always the same in every corporation?

According to the reasoning of a prominent Oxford Corporate Law Professor,[1] boards of directors perform five main functions:

- First, they act as a marketing tool to sell the corporation;
- Second, they engage in periodic self-evaluation;
- Third, they manage (more precisely, boards set the business strategy);
- Fourth, boards monitor; and
- Finally, boards mediate between shareholders and other constituencies and between different groups and kinds of shareholders.

Are these different functions always the same in every jurisdiction? And are

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[1] L. Enriques, 'The Role of Italian Companies' Boards in the Age of Disruptive Innovation', available at https://tinyurl.com/zavt627 (last visited 27 December 2018).

they really performed in every single corporation?

The answer may be yes and no at the same time.

It may be yes, considering the strong convergence of the different jurisdictions in the global economy: it is indeed very well known that the basic principles of corporate governance have achieved a high degree of uniformity across developed markets' jurisdictions.

It may be no, considering that much depends on the ownership structure of the corporation or, at least, on the ownership structure that the specific law-maker had in mind when she conceived and laid down the rules concerning the structure and composition of the board as well as the nomination and election of the single directors. Depending on the features of the country's typical ownership structure and on the agency problems that consequently need be addressed, each country's corporate law enacts a somehow different regime for the board's nomination and election.

From this viewpoint, the Italian experience and the development of Italian legislation are quite interesting.

II. The Italian Rules on Board Composition and the Issue of Majorities that Become Minorities

Before 2005 there were no special provisions concerning the composition, nomination and election of the boards of Italian listed companies. The civil code applied and, at least theoretically, a listed corporation could have been managed even by a sole director.

However, this scenario has since changed. As corporate governance issues met with increasing awareness and consideration, we witnessed a proliferation of rules. The result is that the Italian model has ultimately become way too intricate and that the current regime governing the composition of the board is overly complex and stiff.

These days, the formation of a board has become the product of an 'alchemy', which must include at least the following components: executive and non-executive directors; independent and non-independent directors; 'majority' and 'minority' directors; female and male directors.

Other requirements in terms of diversity, international experience and professional background and qualifications are added by corporate governance recommendations, provisions of bylaws, as well as by special regulations applying to specific business sectors.

Because of the excessive rigidity of the current system, we currently face increasing difficulties in dealing with changing economic realities.

As a matter of fact, the slate voting mechanism was originally designed for companies controlled by a single shareholder or a group of shareholders. However,

also in Italy, such kind of ownership structure is progressively fading away.[2]

In addition, it happens with increasing frequency that slates which are filed and considered as 'majority' ones turn out to be, after the actual vote, 'minority' slates, and that the slates filed as 'minority' turn out to be 'majority' slates, since they bring together most of the market's votes. However, since the slate that actually wins often comprises a number of candidates lower than the one needed to fill the vacant board seats, there is an issue of 'majorities' that become 'minorities' which has led, with the current election system, to paradoxical results.

III. The Outgoing Board's Proposal: A Possible Solution?

The issue of majorities that become minorities is just one of the many signs which suggest that the system needs to be reshaped in a more general and flexible way.

In many foreign jurisdictions, the candidates for the role of director are or may be selected by the outgoing board, sometimes through a procedure involving a special committee. This solution might prove appropriate also for the Italian reality, at least in a number of cases.

Indeed, it duly values the function of the management body in selecting the best possible candidates for the advancement of the corporate interests. For instance, as the recent amendments to the Consolidated Financial Act concerning the adoption of board diversity policies suggest,[3] directors in charge are those in the best position to give consistency to the otherwise elusive notion of diversity.

Moreover, proposals coming from the outgoing board of directors would be welcomed by foreign institutional investors, who are pretty much accustomed to this practice.

According to the last available Assonime report, twenty-seven listed companies (about ten percent of all Italian listed companies) include a clause in their bylaws which allows the outgoing board to file a slate for the election of future directors, and so far five companies have made use of such clause.

After the publication of the abovementioned report, two other important corporations (ie Unicredit and Mediaset) decided to do the same at their annual general meetings.

The trend is clear and a more significant use of this sort of bylaws provisions is

[2] Consob, 'Report on corporate governance of Italian listed companies (2017)', available at https://tinyurl.com/y6v4gnf2 (last visited 27 December 2018), 9. The available data shows that, as of the end of 2016, Italian widely held companies were fourteen, and together accounted for almost twenty-one percent of the overall market capitalization (therefore, for more than a fifth). Moreover, weakly controlled companies (which are companies neither controlled by a shareholders' agreement nor majority controlled) were forty-three, and together accounted for around forty-four percent of the overall market capitalization.

[3] Art 123-*bis*, decreto legislativo 24 February 1998 no 58 (hereinafter referred to as 'Consolidated Financial Act').

foreseeable in the future, and probably every corporation should consider the opportunity to introduce bylaws provisions that allow the outgoing board of directors to submit a slate for the election of the incoming directors.

IV. The Renewed Need for Private Ordering and Self-Regulation

Introducing bylaws provisions of the kind described above is something that can be done, of course, also without changing the law. However, the Italian legislator should seriously consider the opportunities for simplification and for restoring an adequate space for self-regulation.

First, self-regulation as regards the system of gender quotas[4] must be prioritised. Such a system will soon cease to be compulsory. This is a discipline that has proven very effective and has given a significant contribution to the understanding of the importance of diversity within corporate bodies. As long as the temptation to extend the duration of the provisional regime is resisted, then, eventually, self-regulation will have a chance of building on this useful experience, laying down the necessary recommendations.[5]

Second, self-regulation should be restored also with regard to the appointment of independent directors. The safeguard represented by independent directors is a typical expression of the corporate governance codes worldwide. It is now commonly established in the culture and practice of Italian listed companies as well. Regardless of the binding provisions, the reality of listed companies usually shows a number of independent directors greater than that strictly required by the Consolidated Financial Act.[6]

Nowadays, it seems counterproductive rather than useful to keep on having rules like these in binding statutory provisions.[7] Repealing such rules would solve a number of problems; for example, the one determined by the dual notion of independence according, respectively, to the Consolidated Financial Act and to the Italian Corporate Governance Code.

Finally, the rule – also binding and basically representing the peculiar feature of the Italian model – which reserves at least one board seat for the minority slate[8] needs to be looked at.

It is commonly agreed that such a rule has been beneficial in companies where institutional investors hold a stable and significant portion of the share capital. Minority slates get filed in about a half of Italian listed companies, but only in a number of cases (always involving blue chips) these slates can be said

[4] Introduced in Italy with legge 12 July 2011 no 120 (so-called 'Golfo-Mosca') and whose effects are limited to the first three renewals of the relevant corporate body.

[5] See, in this regard, the new recommendations of the Italian Corporate Governance Code concerning diversity introduced in July 2018.

[6] Consob, 'Report on corporate governance of Italian listed companies (2017)' n 2 above, 15.

[7] Arts 147-*ter* and 147-*quater*, Consolidated Financial Act.

[8] Art 147-*ter*, Consolidated Financial Act.

to come from the market.

As noted by one of the most extensive empirical investigations on the matter,[9] the activism of institutional investors – which arguably represents the necessary basis for the proper operation of the slate voting mechanism – is largely affected by the ownership structure and the size of companies. In other terms, institutional investors (and particularly mutual funds) usually concentrate their Italian investments on a limited number of blue chip companies.

To sum up, the point is that there are good reasons to design a less rigid statutory system, possibly providing for different regimes applying to the different market segments and finally doing away with a 'one-size-fits-all' approach.

The matter needs to be further investigated. The goal, here, is just to express the opinion that listed companies do certainly need their boards to be expert, independent, plural and diverse, but also that much larger room for self-regulation and for private ordering is necessary.

V. The Dissenting Opinion Inside (and, Unfortunately, also Outside) the Boardroom

The other subject to be considered – as anticipated at the beginning of this article – is that of the *dissenting opinion* within the boardroom.

Only ten or twenty years ago the dissenting opinion within a corporate body was something that existed in Italy only in the books. As a matter of fact, boards of directors decided unanimously almost without exception; and there were plenty of anecdotes about that.

Independent and minority directors contributed to changing such a reality. In Italy, the culture of corporate governance improved impressively in quite a short period of time. The corporate practice has changed since the introduction of the Italian Corporate Governance Code, the implementation of the slate voting system, of the record date mechanism and of other significant innovations.

The phenomenon has attracted attention also in academia: three leading scholars have published an important empirical study concerning dissenting directors in Italy.[10] Their study takes into account various issues such as: (i) the topics on which directors dissent more frequently; (ii) the personal characteristics of dissenting directors; (iii) the consequences of dissent in terms of returns and volatility of the shares; etc.

As the study points out, directors' dissent is

[9] M. Belcredi et al, 'Board election and shareholder activism: the Italian experiment', in Id and G. Ferrarini eds, *Boards and Shareholders in European Listed Companies* (Cambridge: Cambridge University Press, 2013).

[10] P. Marchetti et al, 'Dissenting Directors', *European Corporate Governance Institute (ECGI) - Law Working Paper no 332/2016*, available at SSRN https://tinyurl.com/ybgcv5j3 (last visited 27 December 2018).

> 'a valuable, indeed vital, attribute of good corporate governance. Vocal opposition might help correct a good-faith mistake or, in more serious and extreme circumstances, warn the market of possible abuse and other risks for investors'.[11]

However, there is also a dark side of the moon. A dissenting opinion is not *per se* a sign of actual independence, good faith and integrity.

Of course, there is still the risk that boards are quite too ready to rubberstamp the decisions of executive directors. However, this is not a trait unique to the Italian corporate governance. Instead, what is becoming typical and peculiar of some Italian companies is, unfortunately, an atmosphere of distress and even of quasi-permanent conflict within the corporate bodies.

This is a problem we should not underestimate.

There is already anecdotal evidence of boards steadily engaged in legal disputes, employing permanent legal counsellors and receiving a non-stop flow of legal opinions (which is something indeed very advantageous for corporate lawyers and corporate law professors, but not necessarily for the corporation and its stakeholders as well). Discussions held within a corporate body (or between different corporate bodies) often give rise to complaints and disputes, which in some cases are even taken to court. Moreover, derivative actions have been brought against single directors for their filibustering and biased or interested behavior.

This way the duty of confidentiality is jeopardized, and we often read in the papers about dissenting votes expressed within the boardroom, something which – to be precise – represents a violation of the confidentiality duty and would not be allowed under Italian corporate law.

As a matter of fact, there are kinds of systematic dissent that are either used as a recurring cautionary measure (in order to avoid liability) or motivated by selfish goals or even by an unhealthy desire for protagonism.

VI. Conclusions

While the efforts to give a proper board representation to minorities are more than welcome, a warning should be issued about: (i) the consequences resulting from a significant change in the ownership structure of Italian listed companies; (ii) the dangers of the distortions in the system.

In a nutshell, significant steps have been taken in Italy to enhance corporate governance standards. The traditional commonplace, describing the Italian system as hostile to investors' activism, is no longer accurate. Especially foreign investors, venture capitalists and hedge funds are as much active towards Italian listed

[11] ibi, 2.

corporations as they are abroad. However, now it is time to take care of the distortions. We have the duty to ensure that conflicts and systematic dissent do not become the hallmark of Italian corporate governance. To that effect, further analysis is needed in order to achieve a comprehensive solution.