

# Corporate Governance: a Challenge to Company Law

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The contributions to this issue of ECL show that corporate governance codes affect the development of company law in many ways. The requirements set by corporate governance, also affect the structure and, thus, the nature of the legal entity as a central unit in company law. Although *formally* the codes focus on listed legal entities, in fact, they intend to affect the course of affairs of and within the entire business associated with that entity, for the benefit of investors. Directors of the holding company must warrant, by issuing “in control statements”, the quality of the flow of financial information throughout the organisation, including consolidated subsidiaries,<sup>1</sup> also sometimes involving the course of operations and risk management.<sup>2</sup> In other words, corporate governance drives the responsibilities of holding company Directors beyond the borders of that legal entity. However, this may easily lead to friction, because important parts of the business are operated by subsidiaries with their own legal personality, bodies, competencies and responsibilities.

For Dutch company law I have recently argued in my inaugural address that this friction regards the positions of the board, the supervisory board and the shareholders of listed companies.<sup>3</sup> Under Dutch company law the powers of the bodies of the holding company do not stretch beyond that legal entity. As a consequence, from a company law perspective, there is no hierarchical relationship between a parent company and its subsidiary. However, if the board of the holding company cannot give its subsidiaries mandatory instructions, then what is the legal significance of an in control statement as required by the applicable corporate governance code or law?

As stated, similar reasoning holds for the positions of the supervisory board and the shareholders under Dutch law. Subsidiary Directors are under no mandatory obligation to submit information to supervisory Directors of the holding on the specifics and whereabouts of their group company. And

finally, shareholders/investors in the holding do not have a right to approve material resolutions to be made on a subsidiary level, even where it may be evident that such resolutions will affect the entire business of the group.

One may conclude that Dutch company law is not yet fully equipped to meet the requirements set for businesses by modern corporate governance. I suspect that this conclusion will also hold true for many other jurisdictions both inside and outside the EU. Corporate governance requires the relationship between listed public companies and dependent private (group) companies to be reconsidered. Many disclosure and accountability provisions are not relevant to the latter and, consequently, they should not be burdened with them. Also a separate legal status for listed companies is needed, in which not only holding Directors but also key officers, such as the group controller and the internal group auditor, should be able directly and mandatorily to exercise powers on a subsidiary level for corporate governance ends. Corporate governance asks for a certain “breakthrough of powers” within the group.

The developments in Europe also advocate an integrated and coherent legal system of regulations for listed companies. I refer to the 13th Directive on takeover bids which was the topic of ECL’s April issue. Such regulations will also be able to implement the recently expressed desire of the European Commission, caused by the Parmalat affair, to make the group auditor working on holding company level fully responsible for the contents of the consolidated accounts,<sup>4</sup> while at the same time defining the newly introduced term “public interest entity”, as used in the relevant draft Directive in further detail.<sup>5</sup> This initiative could be considered as the start of an adequate response to the challenge that corporate governance offers to have company law meet the demands of the 21st century.

1 Sarbanes-Oxley Act, Sec. 302(a) (4) (B)

2 See the Dutch Tabaksblat Code, Article II.1.4

3 Steef M. Bartman, *Voorbij NV en BV*, Kluwer-Deventer, 2004

4 See Art. 27 in conjunction with Art. 2 (4) Proposal for a Directive of the European Parliament and of the Council on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC, Brussels, 16 March 2004, COM(2004) 177 final, 2004/0065 (COM), as discussed in further detail by Gert-Jan Vossestein in his column, under par. 4 in this issue of ECL.

5 See Chapter XI, in conjunction with Art. 2 (11) of the Draft Directive cited to in the foregoing note.