

**THE ROLES OF THE BOARD OF DIRECTORS:
THE UNRESOLVED RIDDLE***

**LOS ROLES DE LA JUNTA DIRECTIVA:
EL ACERTIJO SIN RESOLVER**

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ABSTRACT

The board of directors is a highly complex organ considering its origin and reasons for existence, board members' relation to the corporation, shareholders and officers, and board's functioning and models. The corporate governance movement has defined the board's main activities and responsibilities under a prism that includes three main roles: the decision-making role, the monitoring role and the relational role. However, when analyzing two of the most important jurisdictions (the United States and the United Kingdom) it seems that the board of directors has problems to perform its functions properly. The analysis shows the board as an imperfect and limited organ subject to a variety of tensions and interests. Thus, it would be of great help if the board could be analyzed under a new outlook in which the first role is to be a manager of tensions.

Key words author: Board of Directors, Roles, Corporate Governance, One-tier board, Two-tier board.

RESUMEN

La junta directiva es un órgano de gran complejidad, si consideramos su origen histórico, las razones que justifican su existencia, la relación de los miembros de la junta con la sociedad, los accionistas y los administradores, así como su funcionamiento y modelos que hay de la misma. En el mundo del gobierno corporativo se han definido las actividades y responsabilidades de la junta con un prisma que incluye tres roles, a saber: el rol de la toma de decisiones, el rol de la supervisión y el rol de las relaciones. Sin embargo, si analizamos dos de las jurisdicciones más importantes en estos temas (Estados Unidos y el Reino Unido), parece ser que la junta directiva tiene problemas para desempeñar sus funciones de manera adecuada. Este documento describe la junta como un órgano imperfecto y limitado sujeto a una variedad de tensiones e intereses. Por tanto, sería de gran ayuda si la junta pudiera ser entendida desde una nueva perspectiva en la cual su primer rol consistiría en administrar el conjunto de tensiones al cual está sometida.

Palabras clave autor: Junta directiva, roles, gobierno corporativo, sistema monista (órgano de administración), sistema dual (órgano de control y órgano de dirección).

SUMMARY

INTRODUCTION.- I. INTRODUCTORY IDEAS.- *A. Concept.*- *B. Origin.*- *C. Why a Board: Reasons for its existence.*- 1. Board of Directors as an instrument of political legitimacy.- 2. Board of Directors as a specialized body to solve agency problems.- 3. Board of Directors as an explanation of organizational behavior.- *D. Relation to the Corporation.*- 1. Civil Law.- 2. Common Law.- *E. To whom the board is responsible.*- *F. Duties.*- 1. Duty of care.- 2. Duty of Loyalty.- II. FUNCTIONING OF THE BOARD AND MODELS.- *A. Selection.*- 1. Classified Board.- 2. Regular Voting.- 3. Cumulative Voting.- 4. Staggered Board.- 5. Co-option.- *B. Group Decision-making.*- *C. Models.*- 1. One-tier board.- 2. Two-tier board.- III. THE ROLES.- *A. The Different Roles of the Board of Directors.*- 1. The decision-making role.- 2. The monitoring role.- 3. The relational role.- *B. The roles in different legal systems.*- 1. The United States.- 2. The United Kingdom.- *C. Critical Approach.*- 1. Conflicting Roles.- 2. Fetishization of Independence and Committees.- 3. Check List approach.- 4. Board at the Crossroads.- CONCLUSION.- BIBLIOGRAPHY.

INTRODUCTION

Corporations have increased in size and complexity and they require more complex organizational structures and a more diverse workforce possessing various levels and areas of expertise.¹ In this context, the board of directors is required to perform various roles and activities and to function as a highly professional body. The board plays a key role in the corporate governance structure and it has been at the center of the most important developments in company law.

Back in history, the traditional duty of a corporate board of directors was to manage the corporation.² However, the theory of corporate governance abandoned the paradigm that a public corporation is managed by its board of directors and considered a new model in which the board of directors focuses on the monitoring of management's performance.³ This shift in mentality has implied for the board to undergo a process of transformation in its roles and structure.

At the same time, this "new board" has been tested under real life circumstances and has left in some important cases a bitter taste about its performance, like in the financial scandals (WorldCom and Enron) at the turn of the millennium and the financial crisis that started in 2007. As an example, the Organisation for Economic Cooperation and Development (OECD) in its most recent study about Corporate Governance and the Financial Crisis has concluded as follows: "*The above sections have documented how negative assessments about both remuneration and risk management continually point back to boards as being both a cause of the problems as well as a potential solution (...). The financial crisis has also pointed in a large number of cases to boards of financial companies that were ineffective and certainly not capable of objective, independent judgment (...)*".⁴

In view of the circumstances just mentioned, the purpose of this document is twofold: on the one hand, the idea is to understand the basic functioning of the board of directors and the different roles that it has to perform according to the current developments in corporate governance and, on the other hand, to make a critical assessment about the problems that these roles are facing in practice with emphasis on the Anglo-Saxon model, which has been

1 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

2 Arthur W. Hahn & Carol B. Manzoni, *The Monitoring Committee and Outside Directors' Evolving Duty of Care*, 9 *Loyola University Chicago Law Journal*, 587, 587 (1977-1978).

3 George W. Dent, Jr., *The Revolution in Corporate Governance, The Monitoring Board, and the Director's Duty of Care*, 61 *Boston University Law Review*, 623, 623 (1981).

4 Organisation for Economic Co-Operation and Development, OECD, Steering Group on Corporate Governance, *Corporate Governance and the Financial Crisis: Key Findings and Main Messages*, 41 (June 2009). Available at: <http://www.oecd.org/dataoecd/3/10/43056196.pdf>. [Hereinafter *Corporate Governance and Crisis*].

leading the corporate governance debate in the last 30 years and has been hit very hard by the current financial crisis.

This document proceeds as follows. In Part I, some introductory ideas will be explained which are useful to understand the board of directors. This part includes concept, origin and reasons for the existence of the board of directors. Also, it will explain the relation of the board members to the corporation, to whom they are responsible and the principle duties under the Anglo-Saxon model. In Part II, the basic functioning of the board and the two board models will be analyzed: the one-tier board and the two-tier board. In Part III, the different roles of the board of directors will be considered how they are organized in the United States and the United Kingdom and some preliminary thoughts will be presented regarding the problems that have been evidenced in their implementation.

Finally, it is important to point out that this document in principle refers to the public limited liability company. However, it includes some references and comments about the private limited liability company having in mind that it is useful to stress some differences in the corporate governance structure. Also, the document includes some references to the German board having in mind its significance as a point of comparison regarding the debate about the ideal model for a board of directors.

I. INTRODUCTORY IDEAS

A. Concept

Before beginning this work, it is very important to determine what a board of directors is. Primarily, it should be noted that it is really difficult to find a whole-purpose definition for this concept. Nevertheless, for the purpose of this paper the board will be understood as a team at the top of the corporate hierarchy responsible for the formulation of broad policy and the oversight of the subordinates who actually conduct the business day-to-day⁵ in which is possible to find three underlying relations:⁶ i) relation directors-shareholders; (ii) relation director-director; and (iii) relation directors-corporation's executives. The first relation is based in the fact that shareholders entrust directors with some key responsibilities concerning the functioning of the company. The second relation considers the board as a group-decision making body in which all the members (directors) have the same responsibilities and func-

5 Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 4-5 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

6 Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 *Stetson Law Review*, 925, 928 (2004). Available at: <http://justice.law.stetson.edu/lawrev/abstracts/PDF/33-3Gevurtz.pdf>.

tions. Besides, decisions are made by the group under certain requirements and formalities so individuals by themselves do not have the power to act but as a group. The third relation considers the board as hierarchical group over the corporation's executives.

B. Origin

The origin of the corporate board could be traced to Europe in the seventeenth century.⁷ This institution could be found in England in what has been called the East India Company⁸ and in the Netherlands in what has been called the Dutch East India Company.⁹ Initially, the board performed two main functions. On the one hand, the board was a legislative body which regulated the membership to the company by passing ordinances.¹⁰ On the other hand, the board was an adjudicative body which heard and resolved disputes involving the members of the company.¹¹

Nevertheless, the board had to face an early metamorphosis in its functions while keeping the same structure as a group-decision making body.¹² The board turned from a regulatory and adjudicative body into an organ which

7 "Most corporations formed around the world today have boards of directors. However, if we look back to the seventeenth century, large European companies had boards of directors, but fairly large businesses owned and operated by non-Europeans did not. This suggests that the corporate board of directors originated in Europe". Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 *Stetson Law Review*, 925, 929 (2004). Available at: <http://justice.law.stetson.edu/lawrev/abstracts/PDF/33-3Gevurtz.pdf>.

8 "For example, at the outset of the seventeenth century, Queen Elizabeth I granted a charter to 216 knights, aldermen and merchants to become 'a body politic and corporate' by the name the 'Governor and Company of Merchants of London, trading into the East Indies'. The result was to create what came to be known as the East India Company. The East India Company's charter committed the director of the voyages, and the management of all things belonging to the company, to a governor and twenty-four persons called 'committees'". Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 115 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33nol.pdf.

9 "Many of the VOC's [Vereenigde Oost-Indische Compagnie] features are still characteristic for modern companies. Legal personality, limited liability, listing, and tradable share (...). With its incorporation in 1602, the VOC had an internal structure comparable to what we describe today as a one-tier board model". Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe, Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy, in VOC [Vereenigde Oost-Indische Compagnie, The Dutch East India Company] 1602-2002 400 Years of Company Law*, 281-316, 283 (Ella Gepken-Jager, Gerard van Solinge & Levinus Timmerman, ed., Kluwer Legal Publishers, The Hague, 2005).

10 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 169 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33nol.pdf.

11 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 169 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33nol.pdf.

12 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 119 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33nol.pdf.

had the responsibility of running the business of the company.¹³ Besides, other important governance mechanisms, such as the power of the governing board to elect the corporation's governor, the existence of a chairman (different from the governor) to preside the meetings of the board and the staggered terms to the company's board, were all part of the evolution process of the trading companies.¹⁴

Historically, corporate boards developed in England as well as in continental Europe¹⁵ and they were spread by European companies in their colonies, considering that one of the purposes of the trading companies was to establish colonies.¹⁶ As a result of this expansionist process, the US incorporated this organ as part of its business institutions and has always recognized its crucial role in the affairs and management of the company in the corporation statutes.¹⁷ Thus, it is possible to conclude that the board of directors (and its changing functions) has been a protagonist since the beginning of company law and, for more than four hundred years, the separation of ownership and control has been a core problem in corporate governance.¹⁸ However, it is important to mention that only in the past century the academic interest started to focus on this fundamental problem which was set out by Berle and Means in the 1930s in the United States.¹⁹

13 "The board developed the business strategy, set the shipping routes, and issued resolutions that were binding for the chambers. In the course of further business expansion in 1648, an executive committee of the board (The Hague Committee) helped to organize the work of the directors. Committees formed for accounting or specific business matters, were also found at the chamber level". Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe, Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, in *VOC [Vereenigde Oost-Indische Compagnie, The Dutch East India Company] 1602-2002 400 Years of Company Law*, 281-316, 284 (Ella Gepken-Jager, Gerard van Solinge & Levinus Timmerman, ed., Kluwer Legal Publishers, The Hague, 2005).

14 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 118-119 (2004). Available at: http://www.hofstra.edu/PDF/law_rev_gevurtz_vol33nol.pdf.

15 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 126-127 (2004). Available at: http://www.hofstra.edu/PDF/law_rev_gevurtz_vol33nol.pdf.

16 Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 *Stetson Law Review*, 925, 935 (2004). Available at: <http://justice.law.stetson.edu/lawrev/abstracts/PDF/33-3Gevurtz.pdf>.

17 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 108 (2004). Available at: http://www.hofstra.edu/PDF/law_rev_gevurtz_vol33nol.pdf.

18 Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe, Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, in *VOC [Vereenigde Oost-Indische Compagnie, The Dutch East India Company] 1602-2002 400 Years of Company Law*, 281-316, 283 (Ella Gepken-Jager, Gerard van Solinge & Levinus Timmerman, ed., Kluwer Legal Publishers, The Hague, 2005).

19 Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property*, 84-90 (Mac-Millan, London, 1932).

C. Why a Board: Reasons for its existence

The existence of the board of directors, as a crucial axis in the governance structure of a company, has become the prominent model around the world.²⁰ The board of directors is considered a universal characteristic of large companies regardless of whether they have a large shareholder or a disperse group of shareholders.²¹ Nevertheless, the board model is not an essential corporate governance structure for all types of companies. In the case of smaller companies, the convenience and efficiency of a board structure will vary from case to case.²²

To understand the existence of the board of directors it is possible to find some historical, economic and psychological justifications. This part will refer briefly to some of these explanations. However, the idea is not to qualify the reasons as right or wrong but to see how from different perspectives the board has been justified.

1. Board of Directors as an instrument of political legitimacy

The first explanation is built on a historical perspective by Franklin Gevurtz. Franklin Gevurtz searched the historical roots of the board of directors around the world, starting with the US, continuing with the UK, and then continental Europe.²³ In his analysis he started with modern times and he finished in medieval times, using what he called an “*archeological dig*” approach.²⁴ The main conclusion of his research is that the origin and existence of the board of directors is justified by “*political legitimacy*”.²⁵ Gevurtz has explained it in the following terms:

20 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 92 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33no1.pdf.

21 Paul L. Davies, *Introduction to Company Law*, 114 (Oxford University Press, New York, 2002).

22 Paul L. Davies, *Introduction to Company Law*, 114 (Oxford University Press, New York, 2002).

23 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33no1.pdf.

Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 *Stetson Law Review*, 925, 925 (2004). Available at: <http://justice.law.stetson.edu/lawrev/abstracts/PDF/33-3Gevurtz.pdf>. Some of the ideas express in this articles have been mention in this document when referring to the origin of the board of directors.

24 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 108 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33no1.pdf.

25 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 170 (2004). Available at: http://www.hofstra.edu/PDF/law_lawrev_gevurtz_vol33no1.pdf.

While the historical and political origins of the corporate board of directors provide conflicting evidence regarding the various purposes modern commentators claim for the board, these origins suggest a critical function which modern commentators seem to have overlooked. This function is providing political legitimacy. The unifying theme behind medieval parliaments, town councils, guild councils, councils of the church, and the boards of trading companies, is that they provide the means to comply with the 'corporate law' rule that 'what touches all shall be consented to by all', in circumstances when consent by assembly of the entire group was impractical.²⁶

(...) the reason the board of directors endures is because human beings, even in the business context, do not divorce their notions of how to run a business from their broader political and cultural ideas, and the idea of consent through elected representatives is so ingrained in our culture that shareholders expect it even if they do not take advantage of it.²⁷

2. Board of Directors as a specialized body to solve agency problems

The second explanation has been justified from the corporate finance perspective. In this approach, the board existence has been justified in an environment (normally big companies with fragmented shareholdings) where capital risk and management of the company are in different hands.²⁸ Therefore, in a context with large and fluctuating shareholders, it has been considered that decision-making by shareholders about management is inefficient (the process would be very slow having in mind for instance what is required for a convocation of a large number of people), inexpert (there is a difference between investing in a company and managing a company) and uncommitted (not having an important financial stake in the company would constitute an incentive for fragmented shareholders not to invest substantial time and effort in what is the best path for the company).²⁹

26 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 170 (2004). Available at: http://www.hofstra.edu/PDF/law_law_rev_gevurtz_vol33nol.pdf.

27 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 170-173 (2004). Available at: http://www.hofstra.edu/PDF/law_law_rev_gevurtz_vol33nol.pdf.

28 "Berle and Means [Adolf Berle and Gardiner Means] noting that venturing capital in business and controlling or managing the business are two different functions, both of which need to be encourage if economic activity is to be promoted". Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 409 (25th ed., Oxford University Press, Oxford, 2008-2009). "Delegated management is an attribute of nearly all large firms with numerous fractional owners". Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 11 (Oxford University Press, New York, 2004).

29 Paul L. Davies, *Introduction to Company Law*, 112 (Oxford University Press, New York, 2002).

To solve the problem of inefficient, inexpert, and uncommitted management authority is centralized in the managers of the corporation. Nevertheless, in this solution a new problem arises: *agency cost*.³⁰ Under this new problem, it is considered that the *agent (manager)* normally will have better information than the *principal (shareholders)* about the activities and facts of the company and the agent will have an incentive to act opportunistically reducing his performance or shifting to himself some of the benefits of the principal.³¹ In this reasoning, it is also expressed that the more complex the task of the agent is, the more discretion he will receive in his performance and in consequence the agency problems will be greater.³²

Therefore, the board of directors constitutes an important mechanism to face agency costs in the shareholders-managers relation.³³ In fact, the board of directors is an instrument to reduce agency costs because this body is established to *guarantee* that management acts in the interest of shareholders rather than in its own interest.³⁴ In the two-tier model, one of the boards (the supervisory board) is expected to monitor and supervise company's management assuring that managers are responsive to the owner's interest and in the one-tier model, the board has to combine strategic decision making and oversight.

In the case of companies with concentrated ownership the board still is an important instrument to reduce agency costs but with emphasis on a different agency problem: the relation between controlling and non-controlling shareholders. In this case, the minority shareholders are considered to be principals and the majority shareholders are agents, and the problem lies in the fact that the controlling owner could exploit the non-controlling owner.³⁵ Therefore, the board could be a way to guarantee a balance between the majority and minority interests in the company assuring that the controlling shareholders do not expropriate the minority shareholder. The same "guar-

30 "For readers unfamiliar with the jargon of economist, an 'agency problem' –in the most general sense of the term– arises whenever the welfare of one party, termed the 'principal', depend upon actions taken by another party, termed the 'agent'". Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 21 (Oxford University Press, New York, 2004).

31 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 21 (Oxford University Press, New York, 2004).

32 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 22 (Oxford University Press, New York, 2004).

33 This is particularly important in countries where there is a widespread system of companies with dispersed ownership and non controlling shareholder like United States and United Kingdom.

34 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 801 (2003).

35 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 22 (Oxford University Press, New York, 2004).

antee” could be extended to the conflicting relation between the shareholders and the stakeholders because the board has to watch over the interest of the company as whole without favoring an unjustified interest of the shareholders to the detriment of the stakeholders.

3. Board of Directors as an explanation of organizational behavior

The third explanation is related to organizational behavior and psychology of groups and individuals. The analysis was made by Stephen Bainbridge and the idea behind is that group-decision making is preferable to that of individuals because groups outperform their best member.³⁶ His analysis recognizes that team production is imperfect,³⁷ but with respect to the exercise of critical evaluative judgment, groups have more advantages than individuals.³⁸

To support this statement, Bainbridge presents a set of mini-theories of behavior which he considers more useful than a single unified theory like the traditional rational choice model. In sum, some of the mini-theories support that: i) group decision making creates a system for aggregating the inputs of multiple individuals with different knowledge, interest and skills (in the corporate context, this means that the board of directors may have emerged as institutional governance mechanism to limit the negative effect of bounded rationality in the organizational decision making process);³⁹ ii) group decision making may counteract individual biases as, for example, herding⁴⁰ and

36 Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

37 “The most significant group bias for our purposes, however, is the ‘groupthink’ phenomenon. Highly cohesive groups with strong civility and cooperation norms value consensus more than they do a realistic appraisal of alternatives. In such groups, groupthink is an adaptive response to the stress generated by challenges to group solidarity. To avoid those stresses, groups may strive for unanimity even at the expense of quality decisionmaking. (...)

Boardroom culture encourages groupthink. Boards emphasize politeness and courtesy at the expense of oversight. CEOs foster and channel groupthink through the exercise of their powers to control information flows, reward consensus, and discourage reelection of troublemakers. The groupthink phenomenon therefore demands close attention with respect to a variety of corporate governance issues”. Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 32 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

38 Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 54 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

39 Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 21 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

40 “Herding also can be a response to bounded rationality and information asymmetries. Under conditions of complexity and uncertainty, actors who perceived themselves as having limited information and who can observe the actions of presumptively better-informed persons may attempt to free ride by following the latter’s decisions. Importantly, this explanation for herding suggests that the introduction of new

overconfidence;⁴¹ and iii) group decision making may help constrain agency costs by vertical monitoring⁴² (board members to management) and horizontal monitoring⁴³ (board member to board member).

D. Relation to the Corporation

A corporation is an artificial entity which can not act by itself. It requires others (real individuals) to represent it and act on its behalf.⁴⁴ Having this in mind, one question to be answered relates to the nature of the relationship between a corporation and its directors. Civil and common law have had different approaches for explaining this relation. Next, this document will refer briefly to the two systems.

information may alter the equation". Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 21 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

41 "Although individuals may well be better at devising a brilliant plan, individual often become wedded to their plans and fail to see flaws that others might to identify. As with all decisionmakers, corporate managers likewise become heavily invested in their beliefs, which makes them unable to recognize that those beliefs may be biased". Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 21 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

42 "As we have seen, hierarchy is an adaptive governance response to the agency cost problem. Yet that explanation raises the question of 'who watches the watchers'? Because all members of the hierarchy are themselves agents of the firm with incentives to shrink, a mechanism to monitor their productivity and reduce their incentive to shirk must also be created, or one ends up with a never-ending series of monitors monitoring lower-level monitors. (...)

Corporate law therefore provides a series of alternative accountability mechanisms designed to constrain agency cost without the need for an unending series of monitors. Chief among them is the board of directors. Putting a group at the apex of the corporate hierarchy turns out to be a highly effective alternative solution to the problem of another unending chain of monitors". Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 33 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

43 "A hierarchy of individuals whose governance structures contemplate only vertical monitoring cannot resolve the problem of who watches the watchers. Instead, it seems the vicious circle can be broken by placing a group at the apex of the hierarchy. Where an individual autocrat would have substantial freedom to shirk or self-deal, the internal dynamics of a group governance may constrain self-dealing and shrinking by individual team members and, perhaps, even by the group as a whole. Within a production team, for example, mutual monitoring and peer pressure provide a coercive back-stop for a set of interpersonal relationships founded on trust and other non-contractual social norms. Of particular relevance here are effort and cooperation norms". Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 *Vanderbilt Law Review*, 1, 1-55, 35-36 (2002). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-55-number-1-january-2002/index.aspx>.

44 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 409 (25th ed., Oxford University Press, Oxford, 2008-2009).

1. Civil Law

The traditional basis for explaining the nature of the relation of board members with the company is the civil law of mandate which refers to a contract with two parties being one the *mandator (principal)* and the other the *mandatary (agent)*. Under this contract, the mandatary could represent the mandator in such a way that any legal act or agreement entered into will be imputed to the mandator as if it were his own.⁴⁵

Nevertheless, this traditional approach based on a contractual relation has faced some problems having in mind the particularities of the company. In fact, on the one hand, directors are elected by the shareholders of the corporation but they act on behalf of the corporation (the corporation is a separate legal entity) not the shareholders and, on the other hand, directors duties and functions are determined by law and the articles of incorporation and shareholders could not normally impose specific actions and behavior on directors while they perform their duties and functions.

As a response to these problems, the theory of organs emerged. The theory was taken by company law from other areas of law and sociology which explained society and different institutions as a whole establishing relations between the 'social' body and its different organs.⁴⁶ In the case of company law, the relation is between the corporation (being the body) and its different organs (being the board of directors one of them). This theory puts the emphasis in the relation between the company and the board (body-organ) in a way that the acts of the organ (board of directors) could be attributed directly to the company.⁴⁷ Also, this conception finds in the law and articles of incorporation the sources for the functions and duties of directors which are triggered by the fact that board members are elected and not just in the will of some individuals (shareholders).⁴⁸

However, it is important to point out that the theory of organs does not imply that the law of mandate is not applicable anymore under civil law sys-

45 Ejan Mackaay, *An Economic Analysis of the Civil Law of Mandate*, 2. Available at: <http://mle.economia.unibo.it/Papers%20MTM/Workshop%20in%20Law%20and%20Economics%20-%202007/Economic%20Analysis%20Civil%20Law%20of%20Mandate%20-%20Mackaay.pdf>.

46 Manuel Andrino Hernández, *Los Órganos de las Sociedades de Capital, Parte Primera: La Junta General*, in *Instituciones de Derecho Privado*, Tomo VI, Volumen 2 (Ana Fernández-Tresguerres García, coord., Mercantil, Derecho de Sociedades, Parte Especial I), 322-438, 326 (Juan Francisco Delgado de Miguel, coord., Civitas Ediciones, Madrid, 2004).

47 Francisco José Aranguren-Urriza, *Los Órganos de las Sociedades de Capital, Parte Segunda: El Administrador, el Consejo de Administración*, in *Instituciones de Derecho Privado*, Tomo VI, Volumen 2 (Ana Fernández-Tresguerres García, coord., Mercantil, Derecho de Sociedades, Parte Especial I), 439-631, 440 (Juan Francisco Delgado de Miguel, coord., Civitas Ediciones, Madrid, 2004).

48 Francisco José Aranguren-Urriza, *Los Órganos de las Sociedades de Capital, Parte Segunda: El Administrador, el Consejo de Administración*, in *Instituciones de Derecho Privado*, Tomo VI, Volumen 2 (Ana Fernández-Tresguerres García, coord., Mercantil, Derecho de Sociedades, Parte Especial I), 439-631, 440 (Juan Francisco Delgado de Miguel, coord., Civitas Ediciones, Madrid, 2004).

tems. Directors' duties and functions are still rooted in the law of mandate.⁴⁹ Nevertheless, the mixed source of authority (election by shareholders and functions defined by law), the existence of duties with special content and specific regulation (like loyalty and care) and the application of the theory of organs which attributes the acts of the directors directly to the company, make the relation somewhat of a *sui generis* nature, requiring a broader and creative approach beyond the traditional rules of mandate.

2. Common Law

Initially, directors were considered to be trustees of the company's property.⁵⁰ Nevertheless, this approach became too limited having in mind that ownership of property was shifted to the company (the corporation was recognized as a separate legal entity) and the fact that directors had to face different risks and decide whether they were worth taking instead of carefully protecting trust property and avoiding exposure to unnecessary risk.⁵¹ As a result, it is considered nowadays that directors occupy a fiduciary position towards the company.⁵²

The fiduciary theory has been built in English law by judicial decisions.⁵³ The expression 'fiduciary' refers to a relation that involves trust and confidence.⁵⁴ The idea is that the fiduciary has some additional duties which constrain the exercise of lawful activities and legal rights.⁵⁵ According to this view agents are fiduciaries but not all fiduciaries are agents.⁵⁶

49 Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, 1 *European Company and Financial Law Review*, *ECFR*, 2, 135-168, 142 (2004). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

50 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 452 (25th ed., Oxford University Press, Oxford, 2008-2009).

51 Holger Fleischer, *Legal Transplants in European Company Law – The Case of Fiduciary Duties*, 2 *European Company and Financial Law Review*, *ECFR*, 3, 378-397, 381 (2005). Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1034062.

52 Holger Fleischer, *Legal Transplants in European Company Law – The Case of Fiduciary Duties*, 2 *European Company and Financial Law Review*, *ECFR*, 3, 378-397, 381 (2005). Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1034062.

53 William T. Allen, *The Corporate Director's Fiduciary Duty of Care and the Business Judgment Rule under US Corporate Law*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 307-338, 314 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

54 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 457 (25th ed., Oxford University Press, Oxford, 2008-2009).

55 William T. Allen, *The Corporate Director's Fiduciary Duty of Care and the Business Judgment Rule under US Corporate Law*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 307-338, 314 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

56 Thomas Earl Geu, *A Selective Overview of Agency, Good Faith and Delaware Entity Law*, 10 *Delaware Law Review*, 17, 19 (2008).

Therefore, in company law, directors are not considered agents (from the legal point of view) because their powers are not conferred or delegated by shareholders,⁵⁷ on the one hand, and shareholders normally do not have the right to control directors by giving binding instructions to them while they perform their functions, on the other.⁵⁸ Paul L. Davies gives a good explanation to understand the common law approach about fiduciary duties, in the following terms:

*The judges contributed to the recognition of management as a separate function by abandoning at the beginning of the twentieth century the view that directors were the agents of the shareholders (who could instruct the board by ordinary majority vote at any time what to do or not to do) and adopted instead a constitutional view of the board. The articles of association were now regarded as dividing up the powers of the company as between the shareholders' meeting and the board, each body being supreme in its own sphere, so that the shareholders by ordinary resolution could not impugn the constitutional position of the board. The board cannot interfere with the shareholders' meeting nor the shareholders' meeting with the board so long as they are exercising their respective powers conferred upon them by the articles.*⁵⁹

In this context, directors are just fiduciaries.⁶⁰ This is a consequence of the fact that directors agree to accept a broad legal power over the company but their powers originate as the legal consequence of their election.⁶¹ Besides, the degree of dependency (to shareholders, stakeholders and the company) in directors' performance is somewhat different from the activities of a trustee or agent.⁶² However, even if directors are fiduciaries it is recognized that the law of agency not being directly applicable, it can be used to fill the gaps of fiduciary duties.⁶³

57 "Although a corporation's shareholders elect its directors and may have the right to remove directors once elected, the directors are neither the shareholders' nor the corporation's agents as defined in this section, given the treatment of directors within contemporary corporation law in the United States". Restatement (Third) of Agency § 1.01, comment f(2). *According to the Restatement (Third) of Agency.*

58 Restatement (Third) of Agency § 1.01, comment f(2). Nevertheless, it is important to consider the unanimous consent doctrine which has been used to state the shareholders' supremacy in the corporation. "The unanimous consent doctrine is not just a rule permitting informal decision-making by shareholders, but constitutes also an expression of shareholders' control of the company, whether they act formally or informally. A company can take decisions either through the body which that decision has been allocated by the company's constitution or by unanimous agreement among shareholders". Paul L. Davies, *Introduction to Company Law*, 116-117 (Oxford University Press, New York, 2002).

59 Paul L. Davies, *Introduction to Company Law*, 115 (Oxford University Press, New York, 2002).

60 Victor M. Earle, III, *Corporate Governance and the Outside Director – A Modest Proposal*, 36 *Washington & Lee Law Review*, *W&L Law*, 787, 792 (1979).

61 Restatement (Third) of Agency § 1.01, comment f(2).

62 William T. Allen, *The Corporate Director's Fiduciary Duty of Care and the Business Judgment Rule under US Corporate Law*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 307-338, 314 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

63 Thomas Earl Geu, *A Selective Overview of Agency, Good Faith and Delaware Entity Law*, 10 *Delaware*

In conclusion, the two systems (civil and common law) made an initial different approach in defining the relation between the company and its directors. In fact, under civil law directors were considered *mandataries* (covered by the law of mandate) and under common law directors were considered trustees. Nevertheless, each system evolved in the analysis on the nature of this relation with new ideas and concepts rooted in their traditions and institutions. In this process, while lawyers could discuss and write extensively about different terms and concepts, it seems that the approaches are converging in practice if we consider how the two legal systems refer to the functions and duties of the board of directors.

E. To whom the board is responsible

The question to whom the board of directors is responsible in the fulfillment of its functions could be considered very important from the corporate governance perspective. A general answer to this question it is that the board owes its duties to the company.⁶⁴ As a first step, this is a reasonable statement if we consider that the company is a separate legal entity.⁶⁵ But as one tries to go further, a new problem arises: what is the company and which are its interests. Initially, it is possible to find the shareholders of the company, those who are bearing the risk of the enterprise and have a direct and inseparable interest with the activity and success of the corporation. But what about the interest of other groups which are related to the economic interest of the company like employees, creditors, customers or even the community related to the business activity.

There can be endless discussions about what should be understood as the company's interest. Besides, to give a definite answer would be too difficult and short-sighted. The discussion suggests that for determining company's interest the answer should be found in the legal system (and its own conception about company law) under review. In any event, we could refer to different perspectives when facing this question about the company's interest ranging from pro-shareholder to pro-stakeholder approaches.⁶⁶

One, the *pro-shareholder approach*, considers generally that the board responsibility is owed exclusively to the company and its shareholders.⁶⁷ The

Law Review, 17, 31 (2008).

64 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 275 (8th ed., Oxford University Press, Oxford, 2008).

65 "The notion that the company is a legal person separate from its shareholders, directors, creditors, employees, indeed from anyone else involved in it, is fundamental to the conceptual structure of company law". Paul L. Davies, *Introduction to Company Law*, 9 (Oxford University Press, New York, 2002).

66 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 276 (8th ed., Oxford University Press, Oxford, 2008).

67 Franklin Gevurtz, *Corporation Law*, 305 (West Group, Saint Paul, Minnesota, 2000).

second, the *inclusive pro-shareholder* approach, considers that the board should promote the success of the company for the shareholders' benefit, but directors should take into account the interest of stakeholders, as long as acting in good faith they consider that they are relevant. The third, the *pro-stakeholder* approach, states that directors have to consider the interest of all stakeholders of the enterprise.⁶⁸

Let us start by looking at the pro-shareholder approach. Under this perspective, directors should maximize the profits of the corporation having in consideration the interest of the shareholders of the company.⁶⁹ Therefore, company law does not impose special duties to directors regarding the interest of others groups and directors' standard of conduct should be weighted looking exclusively at the interest of shareholders.⁷⁰ The analysis under this approach suggests that interests of other stakeholders could conflict with those of the company's shareholders⁷¹ and this conflict should be solved always in favor of the shareholders. In addition, the concept of shareholders should be understood to apply to shareholders collectively (the interest of shareholders as a whole) and not to a majority or minority group.⁷² This is the general approach under the US system.⁷³

Next is the inclusive pro-shareholder approach. Under this view, there is still an emphasis in shareholders' interest but it is also recognized that it is possible to consider the interests of other stakeholders (and others such like the environment) as long as directors consider, in good faith, that this is relevant for the company's success.⁷⁴ To be more precise, it is recognized that the main purpose of the corporation is to make a profit for shareholders. Nevertheless, the existence of good and successful relations with stakeholders is a key issue to guarantee a stable and long-term performance for the company and to generate shareholder value.⁷⁵ This approach tries to keep a

68 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 276 (8th ed., Oxford University Press, Oxford, 2008).

69 Franklin Gevurtz, *Corporation Law*, 304 (West Group, Saint Paul, Minnesota, 2000).

70 Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 *Journal of Corporation Law*, 2, 351, 353 (2001).

71 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 11 (Oxford University Press, New York, 2004).

72 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 275 (8th ed., Oxford University Press, Oxford, 2008).

73 "Despite periodic challenges to business in the face of political and social events at various times over the years, the formal system of corporate governance embodied in the laws of the United States has unwaveringly and clearly stated that the objective of the corporation is to maximize profits for shareholders". Jeswald W. Salacuse, *Corporate Governance in the New Century*, 25 *Company Lawyer* 3, 69-83, 74-75 (2004).

74 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 276 (8th ed., Oxford University Press, Oxford, 2008).

75 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 276 (8th ed., Oxford University Press, Oxford, 2008).

reasonable balance between shareholders and stakeholders interests through the company's success concept.⁷⁶ In any event, this approach is far from the pro-stakeholder approach because the stakeholder interest does not have an independent value, the non-shareholder interest is valued not as end in itself but as an end to promoting shareholder value.⁷⁷ This is the approach under *UK Companies Act (2006)*.⁷⁸

Third, there is the pro-stakeholder approach. The idea under this view is that directors should have in mind the interests of all stakeholders in the enterprise and even when appropriate give priority to the interest of the stakeholders ahead of those of the shareholders.⁷⁹ This approach could be found in Germany under the Two-Tier System. In fact, the interest of the company in this case are considered to be composed of a varied set of interests which include shareholders, employees, creditors and the general public.⁸⁰ So, when facing decisions related to the existence and long-term (plans, strategies and development) of the company directors should consider the interest of shareholders and stakeholders.⁸¹

As a manner to support this approach, the following reasoning has been presented: “*Stakeholder advocates, (...), argue that the corporation, deriving special benefits and privileges from the community, for example limited liability of shareholders, legal personality, perpetual existence and access to public capital must as a result take account of community interest in its decisions*”.⁸²

Finally, it is worth mentioning that even the pro-shareholder approach recognizes a case in which directors should focus on the interest of a group of stakeholders (creditors) instead of the interest of shareholders.⁸³ To explain

“*Enlightened shareholder value does not require the directors to prefer the short term over the long term, in promoting the success of the company*”. Paul L. Davies, *Introduction to Company Law*, 277 (Oxford University Press, New York, 2002).

76 “*It is difficult to imagine a successful business with disaffected employees, reluctant suppliers, and customers who doubt the quality of the product which the company provides. This, again rather obvious point, has been recognized by the common law, by means of permission to directors to take account of the interest of stakeholders group when promoting the interest of the company*”. Paul L. Davies, *Introduction to Company Law*, 278 (Oxford University Press, New York, 2002).

77 Paul L. Davies, *Introduction to Company Law*, 279 (Oxford University Press, New York, 2002).

78 Commenting that *CA 2006 S 172*: “*Imposing on directors a duty to promote the success of the company, adopts the enlightened shareholder value approach*”. Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 276 (8th ed., Oxford University Press, Oxford, 2008).

United Kingdom, *Companies Act 2006*. Available at: http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf.

79 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 276 (8th ed., Oxford University Press, Oxford, 2008).

80 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 453 (July 2005).

81 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 453 (July 2005).

82 Jeswald W. Salacuse, *Corporate Governance in the New Century*, 25 *Company Lawyer* 3, 69-83, 75 (2004).

83 Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26

this concept, initially, it is important to understand that a creditor is not allowed to intervene in matters related to the functioning of the company so long as the corporation meets its obligations towards him or the company is solvent.⁸⁴ Nevertheless, directors should take primarily into account the interest of creditors instead of shareholders when the company is facing insolvency.⁸⁵ In case of insolvency, the shareholders are in a situation where they have nothing to lose and this could mean that they are willing to use the assets of the corporation in a very risky manner, where the losers will be the creditors.⁸⁶ Therefore, directors' actions should intent to protect creditors (the entire body of creditors and not a particular creditor) when the corporation finds itself in serious financial difficulties.⁸⁷

F. Duties

Duties are a very important instrument for regulating directors' behavior. Duties could constrain directors' actions either by determining specific *rules* for decision-making by the board or establishing *standards* by which board decisions could be reviewed in the future.⁸⁸ In the case of rules, they require or prohibit specific actions from board members.⁸⁹ In the case of standards, they ask for a broad parameter of proper behavior leaving enough room to judge directors' actions (or omissions) by adjudicators after facts and circumstances have occurred.⁹⁰

Journal of Corporation Law, 2, 351 (2001).

84 "It would be contrary to all reason to burden directors with any duty towards creditor when the company is solvent: their function is to make judgements about business risk, and to take those risk –and usually, when negotiating with outside parties, to drive as hard a bargain as they can. Similarly, creditors cannot expect their business with a solvent company to be preferred over other stakeholders– or, in the limit, to be risk free". Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 276 (8th ed., Oxford University Press, Oxford, 2008).

Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 *Journal of Corporation Law*, 2, 351, 358-359 (2001).

85 "The picture changes when the corporation becomes insolvent. In such a case the residual risk in the corporation shifts from the shareholders to the creditors. In cases of insolvency the shareholders lose their equity interest, they fall into a situation where they have nothing to lose, and this makes them willing to use the assets of the corporation in a highly risky manner, where the only possible losers will be the creditors". Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 *Journal of Corporation Law*, 2, 351, 376-377 (2001).

86 Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 *Journal of Corporation Law*, 2, 377 (2001).

87 Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 *Journal of Corporation Law*, 2, 379 (2001).

88 Paul L. Davies, *Introduction to Company Law*, 151 (Oxford University Press, New York, 2002).

89 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 23 (Oxford University Press, New York, 2004).

90 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 23 (Oxford University Press, New York, 2004).

The list of duties could be varied and detailed depending on the legal system or academic approach.⁹¹ In any event, having in mind the scope of this paper, it is not the idea to describe and compare all the duties laid down in the different legal systems. The document will comment on two duties which have become part of the corporate legal jargon in the world: the duty of care and the duty of loyalty.⁹² This selection involves two major standards (one relating to competence and the other loyalty) which are normally expected from directors and they will be applied in general terms to judge their actions independently of the name given in a legal system.

1. Duty of Care

The duty of care imposes a standard of conduct for directors concerning the interest of the corporation. The duty of care is composed by two core elements: diligence and rationality.⁹³ First, the idea is that directors have the duty to act diligently and prudently in managing the corporation's affairs.⁹⁴ In this manner, this duty requires directors to make decisions on the basis of reasonable diligence in gathering and analyzing all material information. Second, it is required that directors act in a way that they reasonable believe to be in the best interest of the corporation.⁹⁵ In this manner, there must be a rational relationship between the decision made and the best interest of the company.

The general rules is somewhat clear but things get more complicated if one tries to determine the degree of competence required under the duty of care. In this regard, national laws and courts have established different

91 "With respect to directors, they may be chargeable with a number of obligations some of which are fiduciary and some of which may not be, including: (a) duty to be competent; (b) duty to be reasonably informed; (c) duty to provide adequate supervision; (d) duty to disclose conflicts of interest; (e) duty to reveal to the corporation information material to its operation; (f) duty to avoid intentional misconduct; (g) duty to avoid negligent misconduct; (h) duty to act primarily for the benefit of the corporation; (i) duty to be fair in all dealings that involve the corporation; (k) duty to avoid seizure of corporate opportunities; (l) duty to be loyal, and honest and to act in good faith, (m) duty to devote reasonable time and effort to the performance of directional duties; (n) duty to keep abreast of the financial status of the corporation; (o) duty to investigate suspicious circumstances in the affairs of the corporation". Stanley A. Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 *Business Lawyer*, 883, 887-888 (1976).

92 Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 488 (8th ed., Sweet & Maxwell, London, 2008).

93 Melvin A. Eisenberg, *The Duty of Good Faith in American Corporate Law*, 3 *European Company and Financial Law Review*, ECFR, 1, 10 (2006). Available at: Available at Social Science Research Network, SSRN: <http://ssrn.com/abstract=981443>.

94 William E. Knepper & Dan A. Bailey, *Liability of Corporate Officers and Directors*, Volume 1, 77 (6th Edition, Lexis Law Publishing, Charlottesville, Virginia, 1998).

95 Melvin A. Eisenberg, *The Duty of Good Faith in American Corporate Law*, 3 *European Company and Financial Law Review*, ECFR, 1, 4 (2006). Available at: Available at Social Science Research Network, SSRN: <http://ssrn.com/abstract=981443>.

standards for the duty of care, ranging from stricter to less strict approaches. For instance, under the German model, board members (either of the management or supervisory boards) are subject to the standard of skill and care of a prudent and conscientious businessman.⁹⁶ When referring to a “*prudent and conscientious businessman*” the rule establishes an objective parameter which imposes a specific test for directors, having in mind that the reference implies ideas like professionalism, specific knowledge, skills and experience.

Another example is the English model. Historically, this model was considered very subjective.⁹⁷ The standard basically imposed to any director the duty to act in what he thought was the best interest of the company according to his knowledge and experience.⁹⁸ Since 2006, the model has a dual standard for the duty of care involving objective and subjective criteria.⁹⁹ The duty has been explained in the following terms:

*It is now clear under S 174(2) that a director must display the care, skill and diligence that would be exercised by a reasonably diligent person with both (a) the general knowledge, skill and experience that may reasonable be expected of a person carrying out the same functions as the director in relation to the company and (b) the general knowledge, skill and experience that the director actually has.*¹⁰⁰

The double standard of the duty of care implies an objective standard that all directors must meet (a *reasonable*) person carrying out the same functions as the director in relation to company) and a subjective standard that the specific director has to take into account (the *director himself*). The two standards interplay in a way that the objective standard (*reasonable person*) is in the base of the duty and the subjective standard (the *directors himself*) is used to build on or to add to the attributes of the reasonable person.¹⁰¹ The effects of this new parameter is to be determined but it is clear at the end that courts have a greater role in defining the activities of the board.¹⁰²

96 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 459 (July 2005).

97 Paul L. Davies & Jonathan Rickford, *An Introduction to the New UK Companies Act: Part I*, 5 *European Company and Financial Law Review, ECFR*, 1, 48-71, 66 (2008). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.5.1.48?journalCode=ecfr>.

98 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 476 (25th ed., Oxford University Press, Oxford, 2008-2009).

99 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 476 (25th ed., Oxford University Press, Oxford, 2008-2009).

100 Anthony J. Boyle & John Birds, *Boyle and Birds' Company Law*, 622 (6th ed., Jordan Publishing, London, 2007).

101 Paul L. Davies & Jonathan Rickford, *An Introduction to the New UK Companies Act: Part I*, 5 *European Company and Financial Law Review, ECFR*, 1, 48-71, 66 (2008). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.5.1.48?journalCode=ecfr>.

102 Paul L. Davies & Jonathan Rickford, *An Introduction to the New UK Companies Act: Part I*, 5 *European Company and Financial Law Review, ECFR*, 1, 48-71, 67 (2008). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.5.1.48?journalCode=ecfr>.

At this point, it is important to mention that the *ex post* review by courts could hinder the decision-making process of boards and affect normal business activity by creating an incentive for excessive risk avoidance.¹⁰³ To avoid this danger, the US case law has developed what has been called “*the business judgment rule*”.¹⁰⁴ The business judgment rule is based on a principle of judicial non-interference in the business decisions. In other words, courts will not second-guess from an *ex post* perspective what could have been the best business decision for the company when directors acted in good faith.¹⁰⁵ This is a task for businessmen and not for judges. Therefore, courts will focus on the decision-making process of the board to scrutinize if the members took reasonable steps to inform themselves about the issues and circumstances concerning the decision but they will not try to find which could have been the best solution.¹⁰⁶ Judges focus more on the procedures the company applied for a specific decision and whether the procedures are sound.¹⁰⁷ The responsibility for defining this process lies with the board of directors. Therefore, the board is not asked to be right about the business decision but it is asked to be careful in the decision-making process.

2 Duty of Loyalty

It is important to consider that the authority of directors is granted for specific purposes.¹⁰⁸ In this manner, if a director exercises his powers for other purposes than the interest of the company, the director will be liable for abusing his functions and authority.¹⁰⁹ Having this in mind, directors are forbidden to enter in unfair or illicit self-dealing transactions.¹¹⁰ In this context, the duty of

103 Paul L. Davies, *Introduction to Company Law*, 156 (Oxford University Press, New York, 2002).

104 Paul L. Davies, *Introduction to Company Law*, 156 (Oxford University Press, New York, 2002).

105 “*The rule’s [the business judgment rule] presumption of good faith does not state a standard of liability but rather establishes a presumption against judicial review of duty of care claims. The court therefore abstains from reviewing the substantive merits of the directors’ conduct unless the plaintiff can rebut the business judgment rule’s presumption of good faith*”. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 *Vanderbilt Law Review*, 1, 83-130, 90 (2004). Available at: <http://law.vanderbilt.edu/publications/vanderbilt-law-review/archive/volume-57-number-1-january-2004/index.aspx>.

106 Paul L. Davies, *Introduction to Company Law*, 157 (Oxford University Press, New York, 2002).

107 Bernard S. Black, *The Core Fiduciary Duties of Outside Directors*, *Asia Business Law Review*, 3-16, 4 (July 2001). Available at: <http://ssrn.com/abstract=270749>.

108 Koen Geens & Marieke Wyckaert, *Conflicts of Interest: Can a Director Serve Himself or his Kin?*, in *VOC [Vereenigde Oost-Indische Compagnie, The Dutch East India Company] 1602-2002 400 Years of Company Law*, 387-426, 393 (Ella Gepken-Jager, Gerard van Solinge & Levinus Timmerman, ed., Kluwer Legal Publishers, The Hague, 2005).

109 Koen Geens & Marieke Wyckaert, *Conflicts of Interest: Can a Director Serve Himself or his Kin?*, in *VOC [Vereenigde Oost-Indische Compagnie, The Dutch East India Company] 1602-2002 400 Years of Company Law*, 387-426, 393 (Ella Gepken-Jager, Gerard van Solinge & Levinus Timmerman, ed., Kluwer Legal Publishers, The Hague, 2005).

110 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*,

loyalty imposes a standard of conduct for directors concerning the self-interest of directors. The purpose of this duty is that directors may not benefit their own interest if this interest conflicts with the interest of the corporation.¹¹¹

At present, the main concern in the duty of loyalty is that insiders when dealing with themselves, normally do so in terms that are not fair to the corporation.¹¹² The conflicts of interest could be present in self-dealing transactions¹¹³ and in business opportunities (when directors take for themselves business opportunities which could be of use to the corporation).¹¹⁴ As an example, self-dealing could include two types of transactions: (a) one in which the insider benefits directly from the company, e.g. a contract between the company and a director's family business; or (b) one in which the relation is between affiliate companies and the director is a shareholder of the beneficiary company, e.g. one company transferring value to an affiliate company which is less successful to benefit the latter.¹¹⁵

As an example of the problem related to corporate opportunities Franklin Gevurtz explained one of the most famous cases in the following terms:

The most frequently cited corporate opportunity case, Guth v. Loft, Inc., illustrates the typical scenario. Guth was the president of a corporation (Loft) which operated a candy store chain. The person in control of the company producing Pepsi-Cola informed Guth of the opportunity to buy the assets of the Pepsi-Cola Company, which was then in bankruptcy. Shrewdly sensing that Pepsi would be 'the taste of a new generation', Guth joined this individual to start up a new company to buy the bankrupt Pepsi-Cola company's assets (essentially the formula for the syrup and the trademark), and to produce and market Pepsi. The problem was, instead of undertaking this activity for the candy store corporation, Guth bought into the new

114 (Oxford University Press, New York, 2004).

111 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 230 (4th ed., Aspen Publishers, New York, 2003).

112 The duty of loyalty has been very well described Professor Bernard S. Black as follows: "When a company's director, senior managers, or controlling shareholders (collectively, 'insiders') propose a 'self-dealing' transaction in which their interests conflict with the company's (read: the shareholders') interests, the insiders should act in the company's interests and not in their own interests". Bernard S. Black, *The Core Fiduciary Duties of Outside Directors*, *Asia Business Law Review*, 3-16, 4 (July 2001). Available at: <http://ssrn.com/abstract=270749>.

113 "These are were the director contracts with his or her company and where the company enters into a contract with a third party in which the director has an interest". Paul L. Davies, *Introduction to Company Law*, 170 (Oxford University Press, New York, 2002).

114 "The most obvious danger that directors or officers will favor themselves at the expense of the corporation exits when directors or officers enter into a contract with their corporation. A second common problem occurs when directors or officers learn of a business opportunity which may be of use to their corporation, but take the opportunity for themselves". Franklin Gevurtz, *Corporation Law*, 321 (West Group, Saint Paul, Minnesota, 2000).

115 Bernard S. Black, *The Core Fiduciary Duties of Outside Directors*, *Asia Business Law Review*, 3-16, 4 (July 2001). Available at: <http://ssrn.com/abstract=270749>.

*Pepsi company for himself. The court held this breached Guth's fiduciary duty to Loft and ordered him to transfer his stock in to the new Pepsi company to Loft.*¹¹⁶

In conclusion, to avoid the breach of the duty of loyalty, directors must act in good faith and demonstrate scrupulous and inherent fairness in transactions in which they have an interest different from the best interest of the corporation.¹¹⁷ The idea is that directors should be able to show that transactions are fair to the corporation or that if there is a conflict of interest, the problem was disclosed to the board or the general meeting and the transaction has been approved by the disinterested directors or shareholders.¹¹⁸

II. FUNCTIONING OF THE BOARD AND MODELS

A. Selection

The board of directors is made up of persons selected normally by shareholders (united in a general meeting) of the corporation.¹¹⁹ The allocation of the selection power could be found in the articles of incorporation and if nothing is provided then company law usually provides some specific rules in this regard. The person appointed should be permitted by law to act in such position¹²⁰ and should fulfill all the requirements imposed by the company's articles and the law.¹²¹ Once the person is appointed as a director of the company he should agree to the appointment in order for it to take effect unless he had already accepted to be a candidate in the case of some jurisdictions.¹²²

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- 116 Franklin Gevurtz, *Corporation Law*, 362 (West Group, Saint Paul, Minnesota, 2000).
Guth et al. v. Loft Inc., Supreme Court of Delaware, April 11, 1939. Available at: <http://www.sba.pdx.edu/faculty/maggief/GuthLoft.pdf>.
- 117 William E. Knepper & Dan A. Bailey, *Liability of Corporate Officers and Directors*, Volume 1, 121 (6th Edition, Lexis Law Publishing, Charlottesville, Virginia, 1998).
 "If a transaction by a director with the corporation involves a possible conflict of interest, its fairness to the corporation should be a primary concern for both the interested director and those disinterested directors entertaining a request for favorable action". The American Law Institute, ALI, *Principles of Corporate Governance: Analysis and Recommendations*, Volume 1 §3.02, 206 (American Law Institute, ALI, American Bar Association, ABA, New York, 1994).
- 118 "The manner in which courts have interpreted the duty of loyalty has evolved over the years from the position that transactions were voidable without regard to fairness to the modern view that if transactions are fair they will be allowed to stand, even in the absence of approval by disinterested directors, and if transactions are approved by disinterested directors under fair procedures, they will normally be subject to a much lighter level of scrutiny". The American Law Institute, ALI, *Principles of Corporate Governance: Analysis and Recommendations*, Volume 1 §3.02, 207 (American Law Institute, ALI, American Bar Association, ABA, New York, 1994).
- 119 Florence Shu-Acuquay, *The Independent Board of Directors and Governance in the United States: Where is this Heading?*, 27 *Whittier Law Review*, 725-753, 728-729 (2006).
- 120 For instance bankrupts are not allowed to act as directors according to UK general law.
- 121 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 420 (25th ed., Oxford University Press, Oxford, 2008-2009).
- 122 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*,

Nevertheless, while there is normally a body (shareholders' general meeting) responsible for the selection of board members it is important to distinguish in reality who is behind the election of the board members. There are two main perspectives on this issue. The first corresponds to companies with major shareholdings where the majority shareholder is very active on the board and, therefore, it has a great influence over management.¹²³ In this case, the majority shareholder normally has a great influence in the composition of the board.

Under the second model, we are under a disperse group of shareholders where there is not a prevalent majority group of shareholders. In this case, the management of the company plays a key role in determining the structure and composition of the board.¹²⁴ In this structure, management picks in practice the members of the board. In fact, shareholders at the end vote for a list of board members prepared and agreed by company's management.

There are different ways to organize the election of board members and this is determined by law, the articles of incorporation, corporate governance rules or shareholders' agreements. Some examples:

1. Classified Board

In this case, only certain shareholders can vote for specified director positions.¹²⁵ In this manner, a group of shareholders (e.g. minority shareholders) guarantee that they will have a representative in the board of directors.¹²⁶

2. Regular Voting

Directors are elected by the shareholders of the company by majority decision.¹²⁷ Under this system, the minority shareholders do not have any special

419 (25th ed., Oxford University Press, Oxford, 2008-2009).

123 Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 227-258, 231 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

124 "Though formally elected by shareholders' general assembly, the supervisory board members were chosen by the management". Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 227-258, 231 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

125 "A company's articles may legitimately confer the right to appoint the directors (or one or more of them) on a third party, such as a majority member, or the sole trader whose business was incorporated. This power may be given directly, or attached to a special class of shares". Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 273 (8th ed., Oxford University Press, Oxford, 2008).

126 Alexander Loos, *Directors' Liability: A Worldwide Review*, 97 (Kluwer Law International and International Bar Association, Alphen aan den Rijn, 2006).

127 Alexander Loos, *Directors' Liability: A Worldwide Review*, 261 (Kluwer Law International and International Bar Association, Alphen aan den Rijn, 2006).

right or mechanism to elect a board member. Normally, each share will give a right for one vote and therefore, board members will be the persons who get the majority of votes.

3. Cumulative Voting

This is also known as proportional voting and the idea is to promote minority representation in the board.¹²⁸ In this case, the positions are split and votes are considered in different proportions which could help minority shareholder to get represented in the board.

4. Staggered Board

Directors are elected for a determined period of time but in such a way that the terms overlap. So, in this structure only part of the board (some of the members) could be replaced each year.¹²⁹

5. Co-option

This mechanism could be used to fill casual vacancies of board members.¹³⁰ The idea is that the remaining directors appoint a replacement to fill the vacancy on a temporal basis until a new member is elected by the competent body, person or group according to the articles of incorporation, in the next general annual meeting.

B. Group Decision-making

The bottom line is that the board of directors is a group decision-making body. In this manner, directors' power is to be exercised collectively¹³¹ and board members only will have authority when acting as a group through board meetings.¹³² On the contrary, directors as individuals do not have any agency power to deal with people outside of the corporation.¹³³ If directors exercise

128 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 54 (Oxford University Press, New York, 2004).

129 Alexander Loos, *Directors' Liability: A Worldwide Review*, 97 (Kluwer Law International and International Bar Association, Alphen aan den Rijn, 2006).

130 Len Sealy & Sarah Worthington, *Cases and Materials in Company Law*, 245 (8th ed., Oxford University Press, Oxford, 2008).

131 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 136 (4th ed., Aspen Publishers, New York, 2003).

132 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 133 (2004). Available at: http://www.hofstra.edu/PDF/law_law-rev_gevurtz_vol33no1.pdf.

133 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations*:

their powers outside of the competence granted as a group decision-making body they will be abusing their authority.

Furthermore, directors' power is to be exercised by majority rule.¹³⁴ For this purpose, directors have an equal vote which they should exercise when making decisions during board meetings.¹³⁵ If differences arise among the board members the majority rule will prevail. Therefore, the binding decision for the corporation will be the one which has been supported by the majority of the board members. The dissenting and minority opinion will not have any legal consequence for the activities and functioning of the company, although it could be important if any future dispute arises on directors' duties and responsibilities.

C. Models

The two predominant models for board structure are the one-tier board system and the two-tier board system.¹³⁶ These models have been a central theme in the corporate governance debate about good governance. Next in this section, the most important characteristics of each model will be explained.

1. One-Tier Board

This is the prevailing model in the United States, the United Kingdom, Italy, Spain and Portugal.¹³⁷ However, for the purpose of this document, the analysis will focus on the Anglo-saxon model. Under the one-tier model, board members have two main functions, one, participating in defining the company's strategy and, second, monitoring the company's management.¹³⁸ Both functions (strategy-setting and management-monitoring) have the same importance from a legal and business point of view and are considered to

Cases and Materials, 155 (4th ed., Aspen Publishers, New York, 2003).

134 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 136 (4th ed., Aspen Publishers, New York, 2003).

135 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 92 (2004). Available at: http://www.hofstra.edu/PDF/law_rev_gevurtz_vol33nol.pdf.

136 Carsten Jungmann, *The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems*, 3 *European Company and Financial Law Review*, *ECFR*, 4, 426-474, 427 (2006). Available at: <http://related.springerprotocols.com/lp/de-gruyter/the-effectiveness-of-corporate-governance-in-one-tier-and-two-tier-hfxIKqJI7g>.

137 Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 227-258, 228 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

138 Paul Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 14. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

be complementary.¹³⁹ Thus, the board simultaneously has to fulfill these two activities with the same group of persons acting as a single unity.

The system guarantees that the members have the same level of information when defining the strategy and monitoring its execution while this could be different in structures that divide strategy and monitoring in different boards.¹⁴⁰ But most importantly, under this system non-executive directors (or independent directors) and executive directors participate jointly in regular board meetings where decisions are made.¹⁴¹

In addition, corporate governance commentators (specially in the US and the UK) reach some degree of consensus about what they call 'best practices' for the board of directors in the one-tier system and they are very useful to understand its functioning and structure. These practices include the following ideas:¹⁴² i) small boards are better (in this regard the optimal board should not exceed 10 members); ii) the use of board committees; iii) meetings should be more frequent; and iv) the majority of the board should be composed of non executive members (independent directors). Having in mind the importance of committees and independent directors in the context of the one-tier system, this document will elaborate on an additional explanation about these two aspects.

a. Committees of the Board

In recent years, boards have experienced some modifications in their structure, composition and practices. One of the most important issues in corporate governance is related to boards' structure by creating specialized board committees.¹⁴³ Committees are the product of delegation by the board of directors in defined areas.¹⁴⁴ Nevertheless, it has to be understood that committees serve for decision-shaping and decision taking but the board remains collective responsible for its role.

Management literature supports the organization of committees for effective board functioning.¹⁴⁵ The concepts of division of labor and delegation

139 Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 14. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

140 Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 16. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

141 Dereck French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law*, 412 (25th ed., Oxford University Press, Oxford, 2008-2009).

142 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 38 (Oxford University Press, New York, 2004).

143 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

144 William C. Greenough & Peter C. Clapman, *The Role of Independent Directors in Corporate Governance*, 56 *Notre Dame Law Review*, 916, 920 (1980-1981).

145 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 789 (2003).

of responsibility were retained from the traditional corporate governance model as a reasonable way to manage the modern corporation.¹⁴⁶ Committees enhance board effectiveness by permitting directors to use and develop expertise in specialized areas and to focus their energies on a subset of issues confronting the corporation.¹⁴⁷

The most prevalent view considers that the role of monitoring must be done by committees made up by independent directors. For this purpose, four committees (audit, compensation, nominating and corporate governance) have become part of a standard corporate governance structure, especially under the one-tier system.

Board audit committees are intended to implement and support the boards' manager-monitoring functions by periodically reviewing the corporations' processes for compiling financial data, their internal controls, and the independence of the corporations' external auditors.¹⁴⁸ Another important committee is the compensation committee which is responsible for setting and reviewing executive compensation.¹⁴⁹ The third most popular manager-monitoring committee is the nominating committee, which is responsible for recommending board members to shareholders.¹⁵⁰ In recent years, some corporations have established the corporate governance committee and its main goal is to review corporate governance processes.¹⁵¹

Finally, the Korn/Ferry Institute,¹⁵² in a recent study, has stressed that committees remain crucial but the subject areas they cover are in flux.¹⁵³ In fact, the study stress that some of the board committees have been established to deal with current trends which incentives the existence of diversified committees. Today's standard board committees for the world's largest companies often include: audit, compensation, nominating, executive, corporate governance,

146 Arthur W. Hahn & Carol B. Manzoni, *The Monitoring Committee and Outside Directors' Evolving Duty of Care*, 9 *Loyola University Chicago Law Journal*, 587, 587 (1977-1978).

147 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

148 The American Law Institute, ALI, *Principles of Corporate Governance: Analysis and Recommendations*, Volume 1 §3.02, 3A.03 (American Law Institute, ALI, American Bar Association, ABA, New York, 1994).

149 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

150 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

151 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 783 (2003).

152 The Korn/Ferry Institute is a private entity focused on management and executives issues. Since 1973, it has conducted the *Board of Directors Study* that includes analysis of the worldwide evolution of governance in general and boards in particular.

153 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 9 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

The 34th Study includes quantitative analysis from 891 *Fortune 1000* organizations from different regions in the world.

finance, investment and corporate responsibility.¹⁵⁴ Additionally, environment, sustainability and risk management committees are a new concern.¹⁵⁵

b. Participation of Non-executive (Independent) Directors

The most significant trend in board composition under the one-tier system has been the increase in the number and proportion of independent (non-executive) directors on corporate boards. An independent director is someone who will be seen as such only if one is non-management director free of any family relationship or any material business or professional relationship with the corporation or its management.¹⁵⁶ Normally, most outside directors are present presidents, managing partners, corporate executives and board chairmen of other companies¹⁵⁷ or lawyers, investment and commercial bankers and academicians.¹⁵⁸

Under the Anglo-saxon model (with dispersed ownership), outside directors elected by shareholders have been the answer to the accountability problem of managers under the separation of ownership from management (control).¹⁵⁹ The commonly accepted idea is that outside directors act as shareholder surrogates to monitor that the company is ran in accordance with the interest of the shareholders because these directors do not have a personal or financial interest in keeping management.¹⁶⁰

Under the continental model (with concentrated ownership), outside directors could be seen as an instrument to solve agency problems between majority and minority shareholders. Therefore, independent board members monitor that the company is managed in a way that coincides with the interest of the company as a separate legal entity and in this manner satisfies the interest of the shareholders as a whole. Also, they are considered crucial in the agency problems between shareholders and stakeholders. In fact, outside directors when making decisions are supposed to take into consideration the interest of other important actors that are directly linked to the company's interest.

154 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 9 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

155 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 9 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

156 American Bar Association, Business Law Section, Committee on Corporate Laws, *Corporate Director's Guidebook*, 27 (4th ed., 2004). [Hereinafter *Corporate Director's Guidebook*].

157 Spencer Stuart: *2006 Board Diversity Report*, 13 (2006). The data for this report were collected from the 200 largest S&P 500 companies, ranked by revenue, as of September 30, 2005. Available at: http://content.spencerstuart.com/sswebsite/pdf/lib/Board_Diversity_Report_2006.pdf.

158 Larry D. Soderquist, *Toward a More Effective Corporate Board: Reexamining Roles of Outside Directors*, 52 *New York University Law Review*, 1341, 1350 (1977).

159 Florence Shu-Acquaye, *The Independent Board of Directors and Governance in the United States: Where is this Heading?*, 27 *Whittier Law Review*, 725-753, 736 (2006).

160 Florence Shu-Acquaye, *The Independent Board of Directors and Governance in the United States: Where is this Heading?*, 27 *Whittier Law Review*, 725-753, 736 (2006).

Today, numerous codes of best practices proposed and adopted around the world by national stock exchanges or authorities, academicians, legal practitioners and business leaders recommend independent outside directors on corporate boards for more effective manager monitoring.¹⁶¹ More specifically, it has been emphasized that independent directors are important to review self-dealing transactions having in mind their independence from the management of the corporation.¹⁶² Also, it has been considered that Courts would apply a more deferential standard of review when analyzing corporate decisions made with the intervention of independent directors.¹⁶³

2. Two-Tier Board

This is the prevailing model in Germany, Switzerland, Austria, the Netherlands and the Scandinavian Countries. For the purpose of this document, the analysis will emphasize on the German model. Generally, this model gives stakeholders (in particular employees) a “voice” in the way the firm is managed and management seeks to accommodate their interest in deciding about corporate action.¹⁶⁴ Under the two-tier model, it is mandatory to have two boards: the management board (*Vorstand*) and the supervisory board (*Aufsichtsrat*).¹⁶⁵ The two boards are organized in a vertical relation being the supervisory board responsible for the appointment of the management board.¹⁶⁶

161 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

162 Bernard S. Black, *The Core Fiduciary Duties of Outside Directors*, *Asia Business Law Review*, 3-16, 11 (July 2001). Available at: <http://ssrn.com/abstract=270749>.

163 “This trend toward utilizing disinterested and independent directors is based upon, among other things, the great deference courts give to decision makers who are capable of making an impartial business decision. Indeed, where courts decide that such decision makers who are capable of making an impartial decision because of a disabling conflict of interest or lack of independence from a party suffering from such a conflict, judicial scrutiny is more demanding and courts review the merits of the business decision to determine whether it was fair to, and in the best interest of the corporation”. Grover C. Brown, Michael J. Maimone & Joseph C. Schoell, *Director and Advisor Disinterestedness and Independence under Delaware Law*, 23 *Delaware Journal of Corporate Law*, 1157, 1157 (1998).

164 Jeswald W. Salacuse, *Corporate Governance in the New Century*, 25 *Company Lawyer* 3, 69-83, 75 (2004).

165 Carsten Jungmann, *The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems*, 3 *European Company and Financial Law Review*, ECFR, 4, 426-474, 432 (2006). Available at: <http://related.springerprotocols.com/lp/de-gruyter/the-effectiveness-of-corporate-governance-in-one-tier-and-two-tier-hfxIKqJ17g>.

166 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 35 (Oxford University Press, New York, 2004).

a. The Management Board

The management board is responsible for the day-to-day management of the company.¹⁶⁷ In principle, the management issues are part of the autonomous decision process of this board without shareholders or supervisory board intervention.¹⁶⁸ In fact, the management board can not be removed by the supervisory board without cause and some decisions are exclusive part of its competence.¹⁶⁹

The management board may consist of one or more natural persons, if they are two or more they have to act jointly, unless it is provided otherwise.¹⁷⁰ The members have equal rights and there is not a Chief Executive Officer (CEO) like in the Anglo-Saxon model.¹⁷¹ Nevertheless, in practice the board has a spokesman or chairman who has a casting vote but can not give instructions to the other members.¹⁷²

Moreover, the existence of rules of internal procedure for the management board referring, among other things, to internal decision-making process and allocation of powers and duties among the board members, is very common.¹⁷³ The allocation of powers and duties among members of management and the board's collective responsibility has been explained in the following terms:

Any allocation of duties and responsibilities, as laid down in the bylaws, de facto has an effect on the responsibilities of any individual manager. The primary responsibility of managing a certain area or sector of business (for example, R&D [research and development]) is imposed on the particular manager for this area. His/her colleagues perform, concerning his/her primary tasks (R&D), only supervising and monitoring tasks. In other words: the primary duty of managing transforms into a secondary duty of controlling and monitoring. Thus, every manager has a primary responsibility for his or her area of business and a secondary duty of monitoring for

167 Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 227-258, 229 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

168 Carsten Jungmann, *The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems*, 3 *European Company and Financial Law Review*, ECFR, 4, 426-474, 433 (2006). Available at: <http://related.springerprotocols.com/lp/de-gruyter/the-effectiveness-of-corporate-governance-in-one-tier-and-two-tier-hfxIKqJ17g>.

169 Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 35 (Oxford University Press, New York, 2004).

170 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 451 (July 2005).

171 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 452 (July 2005).

172 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 458 (July 2005).

173 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 453 (July 2005).

*the management of the company as a whole. Furthermore, there exist certain core decisions, those of exceptional importance, which can only be taken collectively. In order to control other managers, every manager has a right to information and intervention concerning the area of business of his/her colleague. Furthermore, every manager has a right to call a management board meeting and to discuss a matter which he/she regards as exceptionally important. This principle of mutual control, thus, justifies the principle of collective responsibility of the members of the management board.*¹⁷⁴

Furthermore, the members of the management board can not be members of the supervisory board.¹⁷⁵ Neither, the management board could delegate any of the executive functions on the supervisory board.¹⁷⁶

b. The Supervisory Board

The supervisory board nominates, controls, advises and dismisses the management board.¹⁷⁷ Also, the board co-participates in some basic company's decisions, for example, the annual report and other transactions which may be subject to its approval according to the bylaws of the company or by decision of the board itself.¹⁷⁸ In short, the supervisory board functions are mainly related to monitoring and advising the management board.

In this context, the supervisory board controls the management board (not the company) in issues related to compliance with the law and bylaws

174 Alice Belcher & Till Naruich, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 455 (July 2005).

175 "Membership in the supervisory board is incompatible to simultaneous membership in the management board". Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, 1 *European Company and Financial Law Review*, ECFR, 2, 135-168, 141 (2004). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

176 Thomas J. André, Jr., *Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards*, 70 *Tulane Law Review*, 1819, 1824 (1995-1996).

177 Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 227-258, 229 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

Manuel R. Theisen, *Empirical Evidence and Economic Comments on Board Structure in Germany*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 259-266, 259 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

178 "In addition, the supervisory board must approve the annual accounts and can intervene in cases where the company's interest are seriously affected. For certain extensive and fundamental decisions, the by-laws must impose that authorization by the supervisory board is required". Carsten Jungmann, *The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems*, 3 *European Company and Financial Law Review*, ECFR, 4, 426-474, 432 (2006). Available at: <http://related.springerprotocols.com/lp/de-gruyter/the-effectiveness-of-corporate-governance-in-one-tier-and-two-tier-hfxIKqJI7g>.

and the business strategies as well.¹⁷⁹ All members of the board have the same rights and responsibilities¹⁸⁰ and only a natural person with complete legal capacity could be a member of the supervisory board.¹⁸¹ The board members have no right to represent the company, except when, acting on behalf of the company, they assert claims against former and present members of the management board.¹⁸²

The supervisory board is normally chosen by the shareholders but in large companies employees could select up to one half of the seats in the board.¹⁸³ Therefore, the presence of labour in the supervisory board is very important under the two-tier structure, keeping a balance between the interests of shareholders and an important group of stakeholders.¹⁸⁴ Nevertheless, it is worth mentioning that the chairman casting vote gives the shareholders the final word in case of discrepancies among board members.¹⁸⁵ The chairman fulfills administrative tasks (co-ordinates the work in the supervisory board) and he is the link between the management and supervisory boards, nevertheless, from the legal perspective he does not have a right to give instructions to his colleagues in neither of the boards.¹⁸⁶

179 Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, 1 *European Company and Financial Law Review*, *ECFR*, 2, 135-168, 141 (2004). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

180 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 457 (July 2005).

181 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 456 (July 2005).

182 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 455 (July 2005).

183 “This composition of the supervisory board is due to the German laws of co-determination in companies with more than 500 employees: depending on the size and the business of the corporation, up to 50% if the members of the supervisory board are labour representatives. They are elected in a rather complicated procedure governed by the applicable co-determination act, while the representatives of the shareholders are elected in the general meeting by the shareholders”. Carsten Jungmann, *The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems*, 3 *European Company and Financial Law Review*, *ECFR*, 4, 426-474, 432 (2006). Available at: <http://related.springerprotocols.com/lp/de-gruyter/the-effectiveness-of-corporate-governance-in-one-tier-and-two-tier-hfxIKqJI7g>.

184 “Labour participation is at the heart of industrial democracy, and it is not surprising that German co-determination finds its roots mainly in the difficult times after World Wars I and II”. Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, 1 *European Company and Financial Law Review*, *ECFR*, 2, 135-168, 144 (2004). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

185 “On a strictly technical level, even if a dispute would divide the board equally precisely along labor and shareholder lines, the chairman of the supervisory board, who is always elected by the shareholders, has a so-called casting vote, whereby he or she may cast a second vote in order to break the deadlock. Although the situations in which the casting vote have been used are quite rare, the shareholder representatives will ultimately prevail over any unified objection of the labor representatives”. Thomas J. André, Jr., *Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards*, 70 *Tulane Law Review*, 1819, 1826-1827 (1995-1996).

186 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 457 (July 2005).

Another important characteristic of the monitoring board is that it provides an important space for networking and the participation of stakeholders in the company. Paul L. Davies has commented on this issue in the following terms:

*Appointments to the supervisory board were a method of establishing and maintaining links between the company and other financial and non-financial institutions whose co-operation was important for the company's success. This might be viewed as an early form of stakeholding, where the stakeholders are defined as those who have a long-term interest in the economic success of the company.*¹⁸⁷

Additionally, Committees (audit, remuneration and nomination) are now playing a more important role in the supervisory board structure, without affecting the collective responsibility of the supervisory board as whole.¹⁸⁸ Also, it is common to have committees between the chairmen of the two boards.¹⁸⁹

III. THE ROLES

A. The Different Roles of the Board of Directors

The Board is a central institution in the corporate governance structure. But having a main place in company's government, what should be a board's role? In this part, the purpose is to describe the different roles that the board of directors should perform for the company.

Initially, and before jumping to the analysis of the different roles it is important to mention some general considerations. First, the board is multi-tasking in nature. It is an organ which is in charge of a varied set of activities. Nevertheless, the purpose of this document is not to analyze each activity in detail but to describe the core functions performed by this body. Second, the analysis brings together the one-tier board and the two-tier board systems. Although the structure of the two systems is different, the roles can be examined together. In this context, the analysis of roles is not a defense of any of the systems but an attempt to gather the common features and to gain a common understanding of the main concepts. Third, the different activities are regulated in a very widespread manner. It is possible to find some of the

187 Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 18. Available at Social Science Research Network, SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

188 Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, 1 *European Company and Financial Law Review, ECFR*, 2, 135-168, 141 (2004). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

189 Alice Belcher & Till Naruisch, *The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures*, 4 *Journal of Business Law*, 443-472, 458 (July 2005).

activities in laws; others are in the constitution of the company¹⁹⁰ or in special codes of corporate governance adopted by the company; or some of them are just part of the practice of an industry or company in particular. However, in this document the approach will be more conceptual than normative.

Next, three different roles will be explained having in mind their relevance from the normative point of view and corporate governance practice. The roles are: i) the decision-making role; ii) the supervisory role; and iii) the relational role.¹⁹¹

1. The decision-making role

The decision-making role is based on the idea that the board of directors is the cornerstone of all legal power and authority in the corporation.¹⁹² Although shareholders in general meeting have the ultimate control of the company,¹⁹³ they do not intervene in management of the company and their functions and rights are exercised only occasionally.¹⁹⁴ Then, the idea is that the shareholders have given to the board the main responsibilities concerning the strategy and functioning of the company. This level of authority makes the corporation boards the most important decision-making body within the company.¹⁹⁵

Some of the main activities concerning the decision-making role are:

- a. Formulating strategic goals and missions with management.
- b. Formulating corporate strategy with management.
- c. Taking actions with respect to specific matters, such as election of officers, approving important transactions involving the company's assets, etc.
- d. Appointing senior executives and officers according to the articles of the corporation.

190 "By the constitution, the shareholders determine the division of powers between themselves and the board, so that the directors are beholden to the shareholders for the formal grant of their functions". Paul L. Davies, *Introduction to Company Law*, 255 (Oxford University Press, New York, 2002).

191 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

192 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 136 (4th ed., Aspen Publishers, New York, 2003).

193 "The primary of these is the annual general meeting, a forum at which the board presents to the members its conduct of the affairs of the company for their questioning and approval. The normal business at an annual general meeting includes reappointment of retiring directors, the appointment of auditors, and the approval of directors' reports, the accounts, and any recommended dividend. The other specific power of the general meeting, whether at annual general meeting or an extraordinary general meeting is changing the constitution by special resolution". Andrew Hicks & S. H. Goo, *Cases and Materials of Company Law*, 190 (5th ed., Oxford University Press, 2004).

194 Andrew Hicks & S. H. Goo, *Cases and Materials of Company Law*, 190 (5th ed., Oxford University Press, 2004).

195 Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 365 (8th ed., Sweet & Maxwell, London, 2008).

Normally, in corporations with disperse shareholding directors are not very active when performing these activities; instead it is assumed that they behave in a more passive manner. Constraints of time and lack of information would not allow directors to formulate much of the strategic decisions and policy.¹⁹⁶ In fact, boards in reality just approve the policies and strategies that company' executives bring before them.¹⁹⁷ This leaves directors subject to the influence of management and limits the way in which directors could participate in defining the strategy of the company.

On the other hand, in companies where shareholdings are concentrated in large-blocks, directors are subject to the influence of the major shareholder. The reason is that the controlling shareholder will always have access to the top management because he controls the board or through other mechanisms.¹⁹⁸ In this manner, no matter the structure of the company the controlling shareholder will have an important say in the decision-making process of the company. This could dilute the decision making role of the board in practice.

Nevertheless, it is very important to stress that from a legal point of view and corporate governance practice the authority for strategic management is a board's task. Therefore, board members are responsible and accountable for the fulfillment of the decision-making role. It does not matter that board members are subject to influence and pressure either by management or major shareholders, they are at the top of the strategic decision-making role and they will be judged accordingly.

Finally, it is worth mentioning that this is one of the roles performed by the board in the one-tier structure. Under the two-tier structure, the supervisory board is not in contact with the decision-making role which is left completely to the management board, except when naming the members of the latter.

2. The monitoring role

The traditional duty of a corporate board of directors was to manage the corporation.¹⁹⁹ Nevertheless, since 1970's under US influence, the theory of corporate governance abandoned the myth that a public corporation is

196 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 105 (2004). Available at: http://www.hofstra.edu/PDF/law_law-rev_gevurtz_vol33no1.pdf.

197 Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 105 (2004). Available at: http://www.hofstra.edu/PDF/law_law-rev_gevurtz_vol33no1.pdf.

198 Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 21. Available at Social Science Research Network, SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

199 Arthur W. Hahn & Carol B. Manzoni, *The Monitoring Committee and Outside Directors' Evolving Duty of Care*, 9 *Loyola University Chicago Law Journal*, 587, 587 (1977-1978).

managed by its board of directors and considered a new model in which the management role is performed by its executive officers.²⁰⁰ At the same time, the new role for the board of directors was focused on the monitoring of management's performance.²⁰¹

The oversight function has been described as follows in the *Corporate Director's Guidebook*:

*The oversight function concern ongoing monitoring of the corporation's business and affairs and, in particular, attention to corporate business performance, plan and strategies, risk assessment and management, compliance with legal obligations and corporate policies, and the quality of financial and other reports to shareholders, as well as attention to matters suggesting a need for inquiry or investigation.*²⁰²

At the base of the monitoring role, it is possible to find that the main objective is to avoid conducts like self-dealing, negligence, and lack of professionalism on the part of management of the company.²⁰³ In this manner, boards oversee the activities of officers and they are responsible for providing the right incentives in the best interest of the company.²⁰⁴ As an example of some of the activities which should be performed by the "monitoring board" the *Corporate Director's Guidebook* includes the following tasks:²⁰⁵

- Reviewing and monitoring performance of the corporation's business and its operating, financial and other corporate plans, strategies and objectives, and changing plans and strategies as appropriate.
- Adopting policies of ethical conduct and monitoring compliance with those policies and with applicable laws and regulations.
- Understanding the risk profile of the corporation and reviewing and overseeing risk management programs.
- Understanding the corporation's financial statements and monitoring the adequacy of its financial and other internal controls as well as its disclosure control and procedures.

200 George W. Dent, Jr., *The Revolution in Corporate Governance, The Monitoring Board, and the Director's Duty of Care*, 61 *Boston University Law Review*, 623, 623 (1981).

201 George W. Dent, Jr., *The Revolution in Corporate Governance, The Monitoring Board, and the Director's Duty of Care*, 61 *Boston University Law Review*, 623, 623 (1981).

202 American Bar Association, Business Law Section, Committee on Corporate Laws, *Corporate Director's Guidebook*, 5 (4th ed., 2004).

203 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

204 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

205 American Bar Association, Business Law Section, Committee on Corporate Laws, *Corporate Director's Guidebook*, 6 (4th ed., 2004).

- Choosing, setting goals for, regularly evaluating and establishing the compensation of the chief executive officer and the most senior executives, and making changes in senior management when appropriate.
- Developing, approving and implementing succession plans for the chief executive officer and the most senior executives.
- Reviewing the process for providing adequate and timely financial and operational information to the corporation's decision makers (including directors) and shareholders.
- Evaluating the procedures, operation and overall effectiveness of the board and its committees.
- Establishing the composition of the board and its committees, including choosing director nominees who will bring appropriate expertise and perspectives to the board, recognizing the important role of independent directors.

If we consider the variety and importance of the activities just mentioned this role requires for directors to be very active in the company. First, directors should understand the business of the corporation. Directors should know about the different strategies, business opportunities, strengths and weaknesses of the firm and the market in which it is involved as well as the different risks the company could face, among other things. Second, directors should determine a process to monitor all these different issues and establish some policies and parameters for management of the company. Third, directors should monitor management and performance of the company. However, while all these requirements are very logic and coherent in theory things could get very tricky when it is time to apply them.

The problem with this role has been described as a trade-off between proximity monitoring and objectivity monitoring.²⁰⁶ On the one hand, proximity allows monitors to have close contact with management and they could make better-informed decisions on real-time basis and, on the other hand, objectivity allows monitors to be completely independent from management and to evaluate management's performance without management interference.²⁰⁷ The problem is that if a monitor has proximity to management he

206 Arnoud W. A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 *Cornell Law Review*, 356, 357 (2004). Available at: http://digitalcommons.law.yale.edu/fss_papers/1420/.

207 Arnoud W. A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 *Cornell Law Review*, 356, 357 (2004). Available at: http://digitalcommons.law.yale.edu/fss_papers/1420/.

loses objectivity²⁰⁸ but if a monitor wants to be objective he loses proximity with the management and the company, and the advantages this implies.²⁰⁹

At the end, the monitoring role will depend on the legal requirements and the corporate governance structure of the company. The monitoring role in companies with disperse shareholdings have been entrusted to independent and professional directors. The idea is that non-executive directors increase the quality of objective monitoring²¹⁰ and they could act considering the interest of shareholders as a whole. In companies where shareholdings are concentrated in large-blocks, large shareholders are able to monitor management independently of the functions of the board.²¹¹ In fact, the major shareholder will have the opportunity to act as an outside monitor because in this case the information gap is much more limited. Also, the major shareholder will have inside control through the board of directors which is under his control. In this case, the non-executive directors are really important in considering the interest of minority shareholders and the company in the long-term involving the interest of other stakeholders.

Finally, it is important to mention that the distinction between executive and non executive directors is relevant in the one-tier structure. In the case of the two-tier structure the supervisory board is completely independent from management and its core activity is to monitor the former. So while the problem of objectivity monitoring and proximity monitoring exists the existence of non-executive directors is not an issue or it could be proper to say it has been resolved long ago.

208 “Public choice and psychology research illustrates that boards with close proximity to management are likely to become captured by management. Psychologists, for example, have observed a ‘foot-in-the-door’ phenomenon, which predicts that individuals will agree to a series of escalating commitments once they make an initial commitment. Thus, earlier decisions, once made and defended, affect future decisions such that later decisions comport with earlier decisions. As applied to board members, this phenomenon suggests that board members begin to identify strongly with management after some agreement with management’s decisions”. Arnoud W. A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 *Cornell Law Review*, 356, 368 (2004). Available at: http://digitalcommons.law.yale.edu/fss_papers/1420/.

209 Arnoud W. A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 *Cornell Law Review*, 356, 368 (2004). Available at: http://digitalcommons.law.yale.edu/fss_papers/1420/.

210 Arnoud W. A. Boot & Jonathan R. Macey, *Monitoring Corporate Performance: The Role of Objectivity, Proximity, and Adaptability in Corporate Governance*, 89 *Cornell Law Review*, 356, 368 (2004). Available at: http://digitalcommons.law.yale.edu/fss_papers/1420/.

211 Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 24. Available at Social Science Research Network, SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

3. The relational role

In recent years, the business community has focused in having more diverse boards.²¹² The idea is that the board is an instrument which provides a set of networks²¹³ and advice for the benefit of the company.²¹⁴ Under this approach, the company reduces uncertainties about the resources (credit, workforce, clients) needed to operate and increases chances of survival through board membership.²¹⁵ Board membership is used as a bridging strategy to link the company with the stakeholders of the company and its social environment.²¹⁶ This is called the relational role of the board of directors.²¹⁷

The company, as a legal person, is not at self-sufficient entity. It requires of others to achieve its goals and objectives. As an example, in the internal environment it requires a well motivated workforce to function properly. Also, in the external environment it requires a proper understanding of its market (clients) and access to funding in the capital markets (investors or banks). For this reason, it is suggested that the company could articulate its internal and external environment by giving active participation to different stakeholders in the board of directors.

The relational role could bring the company some of the following benefits:²¹⁸ i) coordination of its external environment; ii) advice and access to information from directors with different backgrounds, skills and networks; iii) support, status and legitimacy of the corporation in front of different audiences; and iv) understanding of the company's role in the long-run.

The idea is not to shift the power in the company to outsiders or employees but to have some important contact points with them for the benefit of the company. This has been somehow the experience under the two-tier board

212 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 783 (2003).

213 "Networking with stakeholders and business partners and the balancing of interest within the corporation have been rated as indispensably valuable, particularly for resolving desperate situations". Klaus J. Hopt & Patrick C. Leyens, *Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, 1 *European Company and Financial Law Review*, *ECFR*, 2, 135-168, 141 (2004). Available at: <http://www.reference-global.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

214 Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, in *Comparative Corporate Governance - The State of the Art and Emerging Research*, 227-258, 233-235 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

215 Lynne L. Dallas, *Proposal for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudspersons*, 54 *Washington & Lee Law Review*, 91, 101 (1997).

216 Lynne L. Dallas, *Proposal for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudspersons*, 54 *Washington & Lee Law Review*, 91, 101 (1997).

217 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 783 (2003).

218 Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 801 (2003).

system through the supervisory board.²¹⁹ Also, this role has become more important under the one-tier board which is trying to get its benefits.²²⁰

B. The roles in different legal systems

This document will analyze the roles performed by the board of directors under the US and UK legal systems. The idea is to understand the actors involved in the regulation process, the instruments used to regulate the board of directors and the roles attached to the board.

1. The United States

Initially, back in the 1950's, the role of the board of directors was not considered in practice of great importance in the US corporate governance system.²²¹ It was said that normally key corporate decisions were made by management without asking board review or approval and companies were controlled by a powerful CEO who subjected the board to his will.²²² Nevertheless, some significant forces caused important changes in the system in the following years:²²³ i) the growth of institutional investors (meaning a more active, organized and professional group of shareholders); ii) the development and decline of take-over bids; iii) scandals involving the corporations and destroying the image of large and public companies as a law-abiding corporate citizen per definition; and iv) proposals for improved corporate governance, especially by private bodies and organizations.

As a result, there have been important changes in the governance of public companies, especially in the last thirty years.²²⁴ In this development the private actors have played a very important role introducing voluntary best practices with the idea of strengthening board functioning.²²⁵ Also,

219 "The supervisory board thus was and has remained a relationship board". Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms, in Comparative Corporate Governance - The State of the Art and Emerging Research*, 227-258, 228 (Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch & Stefan Prigge, eds., Oxford University Press, New York, 1998).

220 "In addition, there is increasing interest by US public corporations in having corporate boards represent the interests of a diverse society". Lynne L. Dallas, *The Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 797 (2003).

221 Robert W. Hamilton, *Corporate Governance in America 1950-2000: Major Changes But Uncertain Benefits*, 25 *Journal of Corporation Law*, 349, 352 (2000).

222 Robert W. Hamilton, *Corporate Governance in America 1950-2000: Major Changes But Uncertain Benefits*, 25 *Journal of Corporation Law*, 349, 352 (2000).

223 Robert W. Hamilton, *Corporate Governance in America 1950-2000: Major Changes But Uncertain Benefits*, 25 *Journal of Corporation Law*, 349, 353-6 (2000).

224 Grover C. Brown, Michael J. Maimone & Joseph C. Schoell, *Director and Advisor Disinterestedness and Independence under Delaware Law*, 23 *Delaware Journal of Corporate Law*, 1157, 1157 (1998).

225 E. Norman Veasey, *Counseling Directors in the New Corporate Culture*, 59 *Business Lawyer*, 1447, 1450 (2003-2004). Available at: <http://business.highbeam.com/127/article-1G1-128972109/counseling-directors-new-corporate-culture>.

other public-oriented actors have played an important role, like the federal legislator through the Sarbanes-Oxley Act, the Securities and Exchange Commission (SEC) through its different rules for the securities market and the self-regulatory organizations (SRO's) with their listing requirements, providing a more rigid approach ("one size fits all").²²⁶

In this context, it has been said that modern corporate governance in US has been driven by three difference forces:²²⁷ i) state corporations law; ii) federal securities regulation; and iii) self-regulatory organizations such as the stock exchanges. Next, this document will explain how these different actors have regulated board's roles.

The American corporate system is state-centered.²²⁸ Every state offers a specific set of rules for the business interested in incorporation.²²⁹ This system creates a competition among the states to get the companies and, consequently the fees and taxes which come with incorporation.²³⁰ This document will make initial reference to two statutes in the United States: The Model Business Corporation Act (MBCA) and the Delaware General Corporation Law (DGCL). The MBCA was developed by the American Bar Association, Section of Business Law, Committee on Corporate Law; most states based their rules on this statute.²³¹ On the other hand, the DGCL has become the preminent American corporate law jurisdiction, playing a dominant role in the United States corporations system.²³²

226 E. Norman Veasey, *Counseling Directors in the New Corporate Culture*, 59 *Business Lawyer*, 1447, 1451 (2003-2004). Available at: <http://business.highbeam.com/127/article-1G1-128972109/counseling-directors-new-corporate-culture>.

227 Robert Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 *Wake Forest Law Review*, 961, 961 (2003).

228 Roberta Romano, *Foundations of Corporate Law*, 84 (Foundation Press, New York, 1993).

229 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 140 (4th ed., Aspen Publishers, New York, 2003).

230 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 140 (4th ed., Aspen Publishers, New York, 2003).

231 Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 141 (4th ed., Aspen Publishers, New York, 2003).

"The Model Act serves as the primary basis for the corporation statutes in approximately half of the states, and many of its provisions have been adopted in almost all of the other states". American Bar Association, ABA, Committee on Corporate Law, ABA Section of Business, *Managing Closely Held Corporations: A Legal Guidebook*, preface vii (2003).

232 "Differences among the states are not as great as they once were. Successful Delaware innovations are quickly copied by the MBCA, and vice versa. In addition, there is substantial uniformity in the so-called common law of corporations. Courts in one state may borrow freely from the jurisprudence developed by courts in other states. Delaware, as the home of so many publicly traded corporations, again played a dominant role. Delaware courts are frequently called on to decide major questions of corporate law and have developed a large body of judicial rules and precedent on major corporate law issues, and courts in other jurisdictions routinely cite their decisions. Indeed, Delaware case law frames much of the debate about the structure of corporate law". Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 141 (4th ed., Aspen Publishers, New York, 2003).

If we analyze the legal rules it might be said that director's functions are not clearly defined in state corporation statutes.²³³ They are described in a very general manner providing the general skeleton in the corporate governance context.²³⁴ The Delaware statute establishes: "*The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors*".²³⁵ On the other hand, the Model Business Corporation Act establishes: "*All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of its board of directors, subject to any limitation set forth in the articles of incorporation or in an agreement authorized under section 7.32*".²³⁶

Summarizing, the general description is that "*the business and affairs of the corporation... shall be managed (or exercised) by or under the direction (or authority) of a board of directors*". As a result, the idea is that state corporate law puts all corporate power in the board of directors.²³⁷ This legal formula is not self-explaining and it is necessary to find its scope in a complementary source. In US, private actors have always made an important effort to give meaning to this general mandate and to have a better understanding of the statutes. In this manner, the *Principles of Corporate Governance*, prepared by the American Law Institute in 1994, could be of significant help.

The *Principles* establish the following concerning functions and powers of the board of directors:²³⁸

233 Larry D. Soderquist, *Toward a More Effective Corporate Board: Reexamining Roles of Outside Directors*, 52 *New York University Law Review*, 1341, 1344 (1977).

234 Robert Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 *Wake Forest Law Review*, 961, 963 (2003).

235 Delaware Code Annotated Title 8, § 141 (a). Available at: <http://delcode.delaware.gov/>, <http://delcode.delaware.gov/title8/c001/sc04/index.shtml>.

Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 219 (4th ed., Aspen Publishers, New York, 2003).

236 ABA-ALI Model Business Corporation Act, § 8.01 (b). American Bar Association, *Model Business Corporation Act*, MBCA (2005). Available at: <http://apps.americanbar.org/buslaw/committees/CL270000pub/nosearch/mbca/home.shtml>.

Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 63 (4th ed., Aspen Publishers, New York, 2003).

237 Robert Thompson, *Collaborative Corporate Governance: Listing Standards, State Law, and Federal Regulation*, 38 *Wake Forest Law Review*, 961, 963 (2003).

238 "Section 3.02 is not intended, (...), to enlarge the scope of a director's legal obligations and liability, the performance expected from directors to comply with the duty of care, or the role and accountability of directors concerning the corporation's compliance with law. Rather, §3.02 is intended to clarify the applicable concepts that are relevant to delineating, in particular cases, the scope, performance and role of directors". [Hereinafter *Principles of Corporate Governance*]. The American Law Institute, ALI, *Principles of Corporate Governance: Analysis and Recommendations*, Volume 1 §3.02, 88 (American Law Institute, ALI, American Bar Association, ABA, New York, 1994).

§ 3.02 *Functions and Powers of the Board of Directors*

Except as otherwise provided by statute:

a. *The board of directors of a publicly held corporation should perform the following functions:*

1. *Select, regularly evaluate, fix the compensation of, and where appropriate, replace the principal senior executives.*
2. *Oversee the conduct of the corporation's business to evaluate whether the business is properly managed.*
3. *Review and, where appropriate, approve the corporation's financial objectives and major corporate plans and actions.*
4. *Review and, where appropriate, approve major changes in, and determinations of other major questions of choice respecting, the appropriate auditing and accounting principles and practices to be used in the preparation of the corporation's financial statements.*
5. *Perform such other functions as are prescribed by law, or assigned to the board under a standard of the corporation.*

b. *A board of directors also has the power to:*

1. *Initiate and adopt corporate plans, commitments, and actions.*
2. *Initiate and adopt changes in accounting principles and practices.*
3. *Provide advice and counsel to the principal senior executives.*
4. *Instruct any committee, principal senior executive, or other officer, and review the actions of any committee, principal senior executive, of other officer.*
5. *Make recommendations to shareholders.*
6. *Manage the business of the corporation.*
7. *Act as to all other corporate matters not requiring shareholders approval.*²³⁹

Considering the *ALI Principles*, the board could either manage the corporation or direct management by overseeing its performance and keeping the decisive voice on major corporate actions.²⁴⁰ However, the activities of a board of directors (at least in the large companies) do not involve day-to-day operation of the corporations, but a more general decision-making power.²⁴¹ In this manner, it is considered that the board does not manage the company

239 The American Law Institute, ALI, *Principles of Corporate Governance: Analysis and Recommendations*, Volume 1 §3.02, 86-87 (American Law Institute, ALI, American Bar Association, ABA, New York, 1994).

240 The American Law Institute, ALI, *Principles of Corporate Governance: Analysis and Recommendations*, Volume 1 §3.02, 88 (American Law Institute, ALI, American Bar Association, ABA, New York, 1994).

241 Larry D. Soderquist, *Toward a More Effective Corporate Board: Reexamining Roles of Outside Directors*, 52 *New York University Law Review*, 1341, 1344 (1977).

but it sets qualitative and quantitative standards defining classes of decisions which should be reserved for board decision or submitted for board review.²⁴²

The other important role is the oversight function of the board of directors. This role is present –according to the *ALI Principles*– in activities like reviewing the adequacy of systems to comply with applicable rules, review of accounting matters and evaluating performance of senior executives. It is important to mention that this has been one of the favorite topics in the corporate governance debate in the last three decades and the US has regulated this role not through state law but federal intervention and self-regulatory organizations.

The most important federal intervention in board issues has been the Sarbanes-Oxley Act of 2002. This federal intervention was justified in the wake of corporate scandals involving accounting irregularities in some important public companies in the US.²⁴³ The Sarbanes-Oxley was enacted to restore investor confidence on the strength of US financial markets and the integrity of corporate executives.²⁴⁴

This Act incorporated aspects that had been previously regulated through self-regulatory bodies (like the NYSE or NASDAQ) or professional standards.²⁴⁵ Therefore, it could not be said that Sarbanes-Oxley was very conservative in its board-related reforms. Nevertheless, Sarbanes-Oxley meant a great intervention at the Federal level in the US altering the pre-existing equilibrium between federal law's and state law's regarding oversight functions in corporate governance.²⁴⁶ It mandated that the audit committee must be composed exclusively of independent directors²⁴⁷ and it charged the Securities and Exchange Commission (SEC) with overseeing upgrades regarding corporate governance in the listing standards.²⁴⁸

242 The American Law Institute, ALI, *Principles of Corporate Governance: Analysis and Recommendations*, Volume 1 §3.02, 92 (American Law Institute, ALI, American Bar Association, ABA, New York, 1994).

243 Irwin H. Steinhorn & William M. Lewis, *Corporate Compliance under the Regulation Implementing Sarbanes-Oxley*, 60 *Consumer Finance Law, Quarterly Report*, 1, 30, 30 (2006).

244 *Sarbanes-Oxley Act of 2002*, come into force in July 2002, Senator Paul Sarbanes & Representative Michael Oxley. Available at: <http://www.soxlaw.com/>.

Faith Stevelman, *Foreword*, Symposium *Corporate Governance Five Years After Sarbanes-Oxley: Is there Real Change?*, 52 *New York Law School Law Review*, 4, 475-500, 483 (2007-2008). Available at: http://www.nyls.edu/user_files/1/3/4/17/49/LR524-1.pdf.

245 Faith Stevelman, *Foreword*, Symposium *Corporate Governance Five Years After Sarbanes-Oxley: Is there Real Change?*, 52 *New York Law School Law Review*, 4, 475-500, 486 (2007-2008). Available at: http://www.nyls.edu/user_files/1/3/4/17/49/LR524-1.pdf.

246 Faith Stevelman, *Foreword*, Symposium *Corporate Governance Five Years After Sarbanes-Oxley: Is there Real Change?*, 52 *New York Law School Law Review*, 4, 475-500, 487 (2007-2008). Available at: http://www.nyls.edu/user_files/1/3/4/17/49/LR524-1.pdf.

247 *Sarbanes-Oxley Act of 2002*, § 301 (3), come into force in July 2002, Senator Paul Sarbanes & Representative Michael Oxley. Available at: <http://www.soxlaw.com/>.

248 Faith Stevelman, *Foreword*, Symposium *Corporate Governance Five Years After Sarbanes-Oxley: Is there Real Change?*, 52 *New York Law School Law Review*, 4, 475-500, 488 (2007-2008). Available

In addition, the listing standards approved by SRO's have gone further than the federal legislator.²⁴⁹ For instance, the NYSE and NASDAQ require, at a minimum, a majority of the board of directors to be independent.²⁵⁰ Also, the SROs have imposed listing standards requiring companies to have the nominating and compensation committees composed by or with an important intervention of independent directors.²⁵¹ Moreover, the new trend in listing standards requires that independent directors must meet to discuss company business in regularly-scheduled executive sessions.²⁵² All these requirements are a clear evidence that the US system has considered that committees and independent directors are an essential component to guarantee the fulfillment of functions by board members.²⁵³

In conclusion, the US board of directors has two main roles from the regulatory perspective: i) a general decision-making power and ii) a supervisory role.²⁵⁴ The board has to balance these two different sides at the same time, the promotional side with its decision-making role and the preventive side with its monitoring role. In any event, it is possible to see in some of the language used in the *ALI Principles* and in the *MBCA*, as well as in the federal and stock market regulatory intervention, that the major developments and concerns have been put in the oversight function.²⁵⁵

The relational role is not regulated from the legal point of view, probably; the only close reference to this issue is the fact that the board should have non-executive members. However, there has been an effort to introduce diversity in the boardroom through diversity-gender and ethnicity. For example, while in 1973 only about 10 percent of the companies in the United States had a female director on their board, the number of companies (*Fortune 1000 companies*) with at least one woman was 85 percent in 2007.²⁵⁶ Also, while in 1973 the representation of ethnic minorities in the boardroom was only 9%,

at: http://www.nyls.edu/user_files/11/3/4/17/49/LR524-1.pdf.

249 Irwin H. Steinhorn & William M. Lewis, *Corporate Compliance under the Regulation Implementing Sarbanes-Oxley*, 60 *Consumer Finance Law, Quarterly Report*, 1, 30, 31 (2006).

250 Irwin H. Steinhorn & William M. Lewis, *Corporate Compliance under the Regulation Implementing Sarbanes-Oxley*, 60 *Consumer Finance Law, Quarterly Report*, 1, 30, 31 (2006).

251 Irwin H. Steinhorn & William M. Lewis, *Corporate Compliance under the Regulation Implementing Sarbanes-Oxley*, 60 *Consumer Finance Law, Quarterly Report*, 1, 30, 31 (2006).

252 Irwin H. Steinhorn & William M. Lewis, *Corporate Compliance under the Regulation Implementing Sarbanes-Oxley*, 60 *Consumer Finance Law, Quarterly Report*, 1, 30, 31 (2006).

253 Grover C. Brown, Michael J. Maimone & Joseph C. Schoell, *Director and Advisor Disinterestedness and Independence under Delaware Law*, 23 *Delaware Journal of Corporate Law*, 1157, 1157 (1998).

254 Larry D. Soderquist, *Toward a More Effective Corporate Board: Reexamining Roles of Outside Directors*, 52 *New York University Law Review*, 1341, 1344 (1977).

255 American Bar Association, Business Law Section, Committee on Corporate Laws, *Corporate Director's Guidebook*, 6 (4th ed., 2004).

256 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 6 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

the number of companies (*Fortune 1000 companies*) that have at least one director from an ethnic minority has risen to 78% in 2007.²⁵⁷

It is clear today that women and members of ethnic minorities are not strangers to board services but in recent years the numbers have been rising only slowly.²⁵⁸ However, the possibility to increase the importance of the relation role and its strategic benefits will depend on the future advantages that these members could bring to the boardroom and the implementation of corporate governance standards by private agents.

2. The United Kingdom

UK has the *Companies Act 2006* which applies to all companies, public or private, large or small.²⁵⁹ This regulation puts an important emphasis on shareholder autonomy and structure²⁶⁰ and adopts three core policies: i) think small first (a way to approach law solutions asking the questions from the needs of small and new companies); ii) an inclusive, open and flexible scheme of company governance; and iii) a flexible, responsive institutional structure for regulation.²⁶¹

The *Companies Act 2006* does not regulate directors' role. In this regard, the legal rules provide little guidance on composition, structure and function leaving to the companies the main responsibility to develop their own government structure, building on from the single board structure which is required under British law.²⁶² At the end, it leaves the determination of the role of the board of directors to the shareholders in the company's constitution.²⁶³

257 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 7 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

258 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 6 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

259 Paul L. Davies & Jonathan Rickford, *An Introduction to the New UK Companies Act: Part II, 5 European Company and Financial Law Review*, ECFR, 3, 239-279, 259 (2008). Available at: <http://www.reference-global.com/doi/abs/10.1515/ECFR.2008.239>.

United Kingdom, *Companies Act 2006*. Available at: http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf.

260 "UK law attaches great prominence to the role of shareholders as the appropriate controller and monitors of the operation of the company's business by the board and confers on them wide powers to control the governance, operation and structure of the company. The philosophy of the new Act places even more emphasis on this. The most dramatic expression of this established approach are the long-standing provisions empowering a simple majority vote of the shareholders to remove all or any of the directors, at any time, and for any or no reason". Paul L. Davies & Jonathan Rickford, *An Introduction to the New UK Companies Act: Part II, 5 European Company and Financial Law Review*, ECFR, 3, 239-279, 240 (2008). Available at: <http://www.reference-global.com/doi/abs/10.1515/ECFR.2008.239>.

261 Paul L. Davies & Jonathan Rickford, *An Introduction to the New UK Companies Act: Part II, 5 European Company and Financial Law Review*, ECFR, 3, 239-279, 251-252 (2008). Available at: <http://www.reference-global.com/doi/abs/10.1515/ECFR.2008.239>.

262 Paul L. Davies, *Introduction to Company Law*, 115 (Oxford University Press, New York, 2002).

263 Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 366 (8th ed., Sweet & Maxwell, London, 2008).

In any event, some initial light could be found in the model²⁶⁴ sets of articles for public or private companies which apply unless excluded by incorporators.²⁶⁵ The model set of articles provide for public and private companies that: “*Subject to the articles, the directors are responsible for the management of the company’s business, for which purpose they may exercise all the powers of the company*”.²⁶⁶ This broad description has been criticized either for public²⁶⁷ and private companies²⁶⁸ and has reinforced the idea that the division of powers (and roles) is an issue of private ordering where variations from the default rule could be many and varied.²⁶⁹

In UK, the regulation of board functioning and activities has been more the result of professional and private actors than the conscious effort of government regulators.²⁷⁰ In this context, a more complete analysis and definition of a board’s role, especially for large companies, is found in the *Combined Code of Corporate Governance*.²⁷¹ The *Combined Code* has been built on the

264 Section 19 of the *Companies Act 2006* provides that “*the Secretary of State may by regulations prescribe model articles of association for companies*”. The regulations were drawn up by the Secretary of State in December 2008 and they are identified as Regulation 2008 No. 3229. United Kingdom, *The Companies (Model Articles) Regulation 2008, No. 3229*, come into force on 1st October 2009. Available at: http://www.legislation.gov.uk/uksi/2008/3229/pdfs/uksi_20083229_en.pdf.

265 Section 20 of the *Companies Act 2006* provides for the application of model articles in specific circumstances: i) if articles not registered or ii) if articles are registered, in so far as they do not exclude or modify the relevant model articles.

Noting in regard to section 20 that “*this provision, according to the Explanatory Notes, acts as a safety net which will provide for decision-making in the event that, on registration, a company fails to register articles or to include articles which do not deal with any particular matter*”. Geoffrey Morse & Sarah Worthington, eds., *Palmer’s Company Law: Annotated Guide to the Companies Act 2006*, 71 (Thomson, Sweet & Maxwell, London, 2007).

266 Article 2 of the draft model articles for public and private companies.

267 “*It is clear that, in a large company, the totality of its management is something quite beyond the grasp of even the most talented set of directors*”. Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 367 (8th ed., Sweet & Maxwell, London, 2008).

268 “*Turning to private companies, here discharge of the full management function by the board is often in fact possible, but it is equally possible in small companies for the shareholders to play a larger role in decision-making than in large companies. Often in such companies important shareholders who are not also directors will expect to have such a role*”. Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 367 (8th ed., Sweet & Maxwell, London, 2008).

269 Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 367 (8th ed., Sweet & Maxwell, London, 2008).

270 Paul L. Davies, *Introduction to Company Law*, 115 (Oxford University Press, New York, 2002).

271 Paul L. Davies, *Introduction to Company Law*, 131 (Oxford University Press, New York, 2002).

“*The combined code contains main and supporting principles and provisions of corporate governance. It focuses on directors, remuneration of directors, accountability and audit and relations with shareholders. The specific role of institutional investors is also covered. The aim of the Combined Code is to allow companies to create and establish their own governance policies in the light of the main and supporting principles set out in the Code. This seeks to offer flexibility for companies in order to take account of their diversity but within a broad framework of requirements*”. Anthony J. Boyle & John Birds, *Boyle and Birds’ Company Law*, 391 (6th ed., Jordan Publishing, London, 2007).

Financial Reporting Council, FRC, *Combined Code of Corporate Governance* (2008). Available at: [http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008\(2\).pdf](http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf).

work of three main committees: the Cadbury Committee,²⁷² the Greenbury Committee²⁷³ and the Hampel Committee.²⁷⁴

The principles contained in the *Combined Code* apply to listed companies but considering its flexibility and self-regulatory approach unlisted and private companies have been encouraged to adopt it.²⁷⁵ The Combined Code is annexed to the listing rules and all listed companies must state in their annual reports if they have complied with the rules during the preceding year and if not, why not (comply or explain principle).²⁷⁶ The statement is composed of two parts: i) In Part I, the company should define and explain its own governance policies in light of the principles; and ii) In Part II, the company must confirm whether complies with the Code provisions or explain why it does not.²⁷⁷ It is for shareholders and others to evaluate this information and explanations and to take any action for non-compliance, not for the London Stock Exchange or the Financial Services Authority (FSA).²⁷⁸ Any action concerning the non-compliance is for the shareholders to take.

The *Combined Code* (2008) in its main and supporting principles express a view about board's role in the following terms:²⁷⁹

272 “The Cadbury Committee was set up as a private initiative in response to a number of corporate collapses (...). The Cadbury Committee regarded the public attention on its work as an opportunity to raise standards of financial reporting and accountability. It sought to ensure that boards would be free to drive their companies forward in a competitive environment but they would exercise that freedom within an effective framework of accountability”. Anthony J. Boyle & John Birds, *Boyle and Birds' Company Law*, 388 (6th ed., Jordan Publishing, London, 2007).

“The single most important achievement of the Cadbury Committee was its successful advocacy of the introduction (or, perhaps better, re-introduction) of the monitoring function to the boards of large British companies, and its elevation to equal status with the strategy-setting function”. Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 14. Available at Social Science Research Network, SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

273 “The Greenbury Committee was established (...) in response to public and shareholder concerns about directors' remuneration. The terms of reference were to identify good practice in determining directors' remuneration and prepare a code of such practice for use by public companies”. Anthony J. Boyle & John Birds, *Boyle and Birds' Company Law*, 389 (6th ed., Jordan Publishing, London, 2007).

274 Paul L. Davies, *Introduction to Company Law*, 131 (Oxford University Press, New York, 2002).

“The Hampel Committee built on the recommendations of the Cadbury and Greenbury Committees and had a broader remit, covering the most general aspects of corporate governance. The Report covered corporate governance, principles of corporate governance, the role of directors, directors' remuneration, the role of shareholders and accountability and audit”. Anthony J. Boyle & John Birds, *Boyle and Birds' Company Law*, 390 (6th ed., Jordan Publishing, London, 2007).

275 Anthony J. Boyle & John Birds, *Boyle and Birds' Company Law*, 393 (6th ed., Jordan Publishing, London, 2007).

276 Paul L. Davies, *Introduction to Company Law*, 131 (Oxford University Press, New York, 2002).

277 Anthony J. Boyle & John Birds, *Boyle and Birds' Company Law*, 391-392 (6th ed., Jordan Publishing, London, 2007).

278 Anthony J. Boyle & John Birds, *Boyle and Birds' Company Law*, 392 (6th ed., Jordan Publishing, London, 2007).

Paul L. Davies, *Introduction to Company Law*, 131 (Oxford University Press, New York, 2002).

279 Financial Reporting Council, FRC, *Combined Code of Corporate Governance*, Section 1 A (A.1.) 5 (2008). Available at: [http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008\(2\).pdf](http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf).

A.1. The Board

Main Principle

Every company should be headed by an effective board, which is collectively responsible for the success of the company.

Supporting Principles

The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met.

The UK model is a typical example of the one-tier board. The Combined Code Principles describes activities which are proper for the board in large companies like setting corporate strategy and reviewing management performance.²⁸⁰ In short, the board has a dual function to lead and control the company.²⁸¹ Therefore, the main focus of the Combined Code is on the (strategic) decision-making and the monitoring roles. Also, it is worth mentioning that the Combined Code puts emphasis on the importance of non-executive and independent directors and the idea of balance between insiders and outsiders in a way that no individual or small group of individuals can dominate the board's decision taking.²⁸²

Concerning the relational role, nothing is established in the Combined Code. The decision is up to shareholders of the company which are the one responsible for defining the composition of the board. In any event, normally the idea of network and employee representation could find resistance from the shareholders' perspective.²⁸³ For instance, there are 24 companies among the 100 in the FTSE100 leading stock market index that still do not have a single female director.²⁸⁴

280 Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 367 (8th ed., Sweet & Maxwell, London, 2008).

281 Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 6. Available at Social Science Research Network, SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

282 Financial Reporting Council, FRC, *Combined Code of Corporate Governance*, Section 1 A (A.1.) 7 (2008). Available at: [http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008\(2\).pdf](http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf).

283 Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?*, 20. Available at Social Science Research Network, SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

284 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 6 (2008). Available in: <http://www.kornferry.com>.

C. Critical Approach

This document has gathered important information regarding the board of directors and its roles. In this manner, it is possible to have a fair picture about this body including origin and possible reasons for its existence, relation to the corporation and responsibility of the board members, as well as functioning and models. Furthermore, the roles attributed to this organ under the modern corporate law were described, on the one hand, and how they are conceived in two leading jurisdictions, like the United States and the United Kingdom, on the other hand.

It is possible to say that the board of directors is an institution of a complex nature and its functioning and the articulation of its activities have been the object of endless discussions in corporate governance land. However, the interest of the final part of this document is to understand why this organ seems to be at the center of the storm in times of crises because it has not been able to perform its functions properly.

With this purpose in mind, this document will try to give some reasons that could help to understand board's underperformance. Next, this paper will refer to four different aspects that may be critical taking into consideration the Anglo-Saxon experience and some of the issues mentioned in previous chapters. However, it is of great importance to make clear that this study is not a defense of the two-tier system. In fact, anyone familiar with the news should have noticed that the two-tier board is subject to similar criticisms²⁸⁵ and probably some of the reasons that will be given hereunder could apply, *mutatis mutandis*, to explain these circumstances.

1. Conflicting Roles

According to the Anglo-Saxon model the board of directors has two main roles which have been called the strategic decision-making role and the monitoring role. In this manner, the board initially formulates goals and strategies for the company, in other words, the board defines the path the company should follow and also appoints the team responsible for this task. In addition, the board must evaluate performance, compliance and make a risk assessment of the company, meaning that the board should evaluate what and how the company is doing to achieve the goals that have been fixed.

In principle, the two roles have a different scope and they could be divided from an intellectual perspective. However, when the board is functioning, in

kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

285 *Germany's flawed corporate governance – Boards behaving badly, Why the leading citizens of corporate Germany are so scandal-prone*, *The Economist*, Berlin, August 6th, 2009. Available at: <http://www.economist.com/node/14183029>.

practice, the two roles are interconnected. Interestingly, while in theory it would be possible to say that the two roles are complementary, once they are applied they end up being conflicting. Therefore, there is a natural inconsistency between the board's monitoring and managing functions.²⁸⁶ If the board participates in the corporate decision-making it could sacrifice the capacity to monitor those decisions independently.²⁸⁷ But, if the board maintains a significant distance there is a risk of not understanding the company which is supposed to monitor.²⁸⁸

For instance, once the board gets involved in a decision, either by acting or no acting, it could be more difficult for the board to judge objectively future actions concerning that decision. The board is already involved in the path chosen and changing the way or even the team could be understood as a mistake in the initial decision. In this case, board members are not subject to a traditional conflict of interest involving the duty of loyalty but to a clash of functions which are imposed by the normative structure with no clear tools to manage the existing conflict.

This could explain why in some cases the board is not able to perform properly one of the roles or all of them at the same time. In principle, the idea is to stress the fact that the different roles could be conflicting and they will always interact in one way or another. Then, more than a redefinition of roles or activities it would be important to find the best way to manage the conflicts that the board has to face when dealing with its functions in the tension between proximity and objectivity.

2. Fetishization of Independence and Committees

The corporate governance movement has relieved most –if not all– of the responsibility of good governance at the board level in independent directors and committees. In the US case, the two most important regulatory requirements for public-listed companies are related to these two icons. In the UK case, while is not mandatory to have independent board members and committees it is common practice to have them in listed companies. For example, the 34th Board of Directors Study concluded that in 2007 the average board consisted of 10 directors, two of them full-time employees of the company (insiders) and eight of them from outside the organization.²⁸⁹ Also,

286 Florence Shu-Acquaye, *The Independent Board of Directors and Governance in the United States: Where is this Heading?*, 27 *Whittier Law Review*, 725-753, 733 (2006).

287 Florence Shu-Acquaye, *The Independent Board of Directors and Governance in the United States: Where is this Heading?*, 27 *Whittier Law Review*, 725-753, 733 (2006).

288 Florence Shu-Acquaye, *The Independent Board of Directors and Governance in the United States: Where is this Heading?*, 27 *Whittier Law Review*, 725-753, 733 (2006).

289 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 6 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

the study concluded that committees are vital and the variety and specialization is quite significant.²⁹⁰

Nevertheless, if we analyze the recent financial crises that started in 2007 it is possible to see that independent directors and committees have not been sufficient to avoid the governance problems in some of the most sophisticated institutions. It would be impossible to deny that independent members and committees are an essential and natural part of good corporate governance²⁹¹ but they are not enough to restrain the problems in the boardroom. The problem is that modern corporate law has treated independence and committees as ends in themselves²⁹² and companies have forgotten that they are only (very important) means to govern the firm. As a result, this misconception has created the fetishization of independence and committees and they have been understood as the answer to the problems in the board.

Furthermore, the independent director paradigm has been subject to important criticism considering aspects such as scarcity of time²⁹³ and lack of information²⁹⁴ when analyzing and making decisions. In the case of committees, there is an important discussion about how far they could keep growing in number and specialized issues without affecting the integral functioning of the board, as well as the best way to distribute responsibilities between the board and its committees.

The purpose of this comment is not to dismantle the idea of independence and committees as instruments for the board of directors to function properly. The objective is to point out some of the problems they are facing and suggest a new way to approach the problem. In this context, it would be of great help to understand the best way for the board to manage the tension between means and goals from the normative perspective.

3. Check List approach

While in theory it has been stressed that each company should make its own assessments about how to organize the government of the entity, having in mind specific circumstances and realities, in practice companies have imple-

290 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 9 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

291 Usha Rodrigues, *The Fetishization of Independence*, 7 *University of Georgia Legal Studies Research Paper*, 3-4 (2007); 33 *Journal of Corporation Law*, 447-496 (2008). http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968513.

292 Usha Rodrigues, *The Fetishization of Independence*, 7 *University of Georgia Legal Studies Research Paper*, 53 (2007); 33 *Journal of Corporation Law*, 447-496 (2008). http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968513.

293 Larry D. Soderquist, *Toward a More Effective Corporate Board: Reexamining Roles of Outside Directors*, 52 *New York University Law Review*, 1341, 1351 (1977).

294 Larry D. Soderquist, *Toward a More Effective Corporate Board: Reexamining Roles of Outside Directors*, 52 *New York University Law Review*, 1341, 1360 (1977).

mented, without major discussion, the common standards suggested by the corporate governance movement assuming a “*one size fits all*” approach. This has been in part the result of the regulatory approach that in the US case has been somewhat mandatory through the Sarbanes-Oxley and listing standards of SROs and in UK with the “*comply or explain*” principle.

If we go back to the ‘best practices’ for the board of directors in the one-tier system mentioned before in this document, it is possible to find that all of them have been implemented by most of the world largest companies. In the case of small boards, it is clear that the size has decreased over time if we consider that in 1973 one in every five boards had between 16 and 25 members and in 2007 the average size consisted of 10 members.²⁹⁵ Now, if the case of use of board’ committees is considered, as this document has already mentioned, companies are full of specialized committees at the board level. Today’s standard board committees for large companies often include: audit, compensation, nominating, executive, corporate governance, finance, investment and corporate and environmental responsibility.²⁹⁶ About having more frequent meetings, there is evidence showing that while 20 years ago a member used to spend 9.5 hours a month working in board business they spend 16 hours a month in US and 18 in the United Kingdom in 2007.²⁹⁷ Finally, the requirement for a majority of the board composed by non executive members (independent directors) is fulfilled with the present numbers that suggest that 8 out of 10 members come from outside the organization.²⁹⁸

However, the problem is that even though the numbers and information evidence a good deal of compliance with the standards, board performance is under scrutiny again. According to the OECD, in a recent report about Corporate Governance and Financial Crises, one important conclusion is that “*The major failures among policy makers and corporations appear to be due to lack of implementation*”.²⁹⁹ Thus, it has become evident that some of the most important instruments in corporate governance have been used as a way to comply formally with normative standards but not a real mechanism to introduce changes at the interior of some organizations.

Therefore, the corporate governance movement is facing a real challenge at this moment about how to pass from a check list approach to a substan-

295 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 6 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

296 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 9 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

297 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 10 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

298 The Korn/Ferry Institute, *34th Annual Board of Directors Study*, 6 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

299 Organisation for Economic Co-Operation and Development, OECD, Steering Group on Corporate Governance, *Corporate Governance and the Financial Crisis: Key Findings and Main Messages*, 55 (June 2009). Available at: <http://www.oecd.org/dataoecd/3/10/43056196.pdf>.

tive implementation approach. In this context, it would be very interesting to research about new ideas and practical solutions regarding the best way to manage the tension between form and substance in the implementation of good governance practices.

4. Board at the Crossroads

The board of directors is at the crossroads of all the different actors of the company. The board has a direct relation with the shareholders of the company and the managers of the company. Furthermore, the board has to make strategic decisions concerning the interest of the company which involves at the same time the interest of shareholders as a group, management and the interest of a very diverse group of stakeholders. Additionally, each board member is an individual universe with diverse ideas and interests and the board in its interior has to manage all these differences. To make things most complicated, the board has to manage the normative interest and the duties (care and loyalty) that are imposed by law or case law and the limitations that board members have as human beings. All this set of interests makes the board functioning and decision-making very complicated because each interest involves its own conflicts and to make things more difficult they interact with each other, like everything in real life.

The problem that this document wants to stress is that the board is at the crossroads when performing its activities but this circumstance seems to be oversimplified under current corporate governance regulation. This is due to the fact that most of the analysis of board interest and its conflicts is based on economic analysis, principally the agency problems theory, and as any model it is useful but incomplete. In fact, models are merely intellectual constructions and they do not capture reality and all its complexity.³⁰⁰ Thus, the models stress some important problems and relations but at the same time they oversimplify the interaction of different factors in real life.

The purpose is not to abandon the agency problems perspective because it is clear that it has been an incredible breakthrough in the study and analysis of company law. Besides, it will be impossible from the regulatory point of view to find the silver bullet that will guarantee the perfect functioning of the board. However, the idea is to move one step further searching for new answers to articulate in practice these diverse interests that the board has to face in reality. In this purpose, it would be very interesting to find the best way to manage the tension among the different interests as a way to achieve a better result in board performance.

300 Jeswald W. Salacuse, *Corporate Governance in the New Century*, 25 *Company Lawyer* 3, 69-83, 82 (2004).

CONCLUSION

The board of directors is clearly a limited and imperfect organ. There are problems that always will exist and there is not a magic formula to solve all the different conflicts that the board of directors has to face. However, it is clear that further research is needed in order to decode the riddle for the right performance of roles by the board of directors. Initially, it could be of great help to start thinking about board's first role as a "*manager of tensions*". In this manner, the focus of academic and regulatory interest could concentrate in a theory of tensions in the boardroom. The purpose would be to identify the different tensions (beyond the agency problem perspective) that are involved in board functioning, like proximity and objectivity, aims and means, form and substance, conflicting interest, and the best way to manage them.

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