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Main Theme

Corporate Governance and Legal Practice (Concluding Remarks)

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Ladies and Gentlemen, Dear Colleagues,

I. Good afternoon.

I am delighted and very honoured to have the opportunity to attend this Congress, and, specially, to have been able to hear, and benefit from, all the communications made in this section dedicated to Corporate Governance and the Legal Practice.

I am sure we have all learned a lot, and have significantly enhanced our experiences and reflections with such communications.

I personally would like to thank you all who made this possible.

I was not asked, nor will I try, to make a synthesis of what we have heard during our work of today. Besides that it would overlap with the co-ordination made within each section, our time should rather now be used to jointly debate any points you may select for such purpose.

I would therefore take only a few minutes to go over some highlights on the fascinating challenges – but risks also – that today's powerful movement of ideas and initiatives surrounding corporate governance presents to lawyers and, more widely, to the legal world.

II A first delicate issue is, of course, **the issue itself on when and how to consider binding legal regulation** for corporate governance matters.

Being corporate governance not merely a legal discipline, it is indeed crucial that we, lawyers - as well as legislative powers and regulators –, are able at all times to find what are the right legal contributions required, and what type of responses may serve corporate governance key objectives (e.g. *efficiency of corporations and their value enhancement, transparency, accountability*), without going too far or produce overwhelming invasion or disruption.

This is particularly true in what concerns calls for legal regulation, which tend to become stronger not only following corporate scandals, but also as a result of the spreading of more or less "*standardised*" trends of thought.

I believe this is a point that this Congress has - quite correctly - placed at the very heart of its work.

III. In this regard, many of the interventions in this Congress have widely supported four central approaches of the so-called WINTER II Report [(1)]:

- Not recommending an European Code of Corporate Governance, but rather an increased (and non binding) co-ordination at EU level;
- Recommending that key inputs for codes of corporate governance should continue to come from the markets and their participants;
- Recommending that for each national jurisdiction corporate governance disclosure statements are made by reference to a specific Corporate Governance Code, and on a "*comply or explain*" basis;
- Recommending that EU companies should be allowed the choice of the board structure (one tier/two tier) that better suits their particular corporate governance and circumstances.

These central recommendations are combined, in the WINTER II REPORT, with a restricted set of proposed binding rules, mainly centred on selected areas such as disclosure and shareholders' participation.

Again (and without discussing now the detail of the proposed binding norms), it should be noted that communications to this Congress have also agreed that "*transparency*" (which also enhances *accountability*) is the key objective of corporate governance more likely to be pursued through mandatory rules, being "*corporate efficiency and value creation*" the objective in respect to which more freedom of choice and flexibility should normally be left to companies (individually, and within each national legal system) to find their most appropriate solutions themselves.

IV. The above views of the WINTER II Report are in line with the consultation and conclusions of the comparative study performed for the European Commission by the law firm WEIL GOTSHALL & MANGES in January 2002 [(2)], where the inconvenience of a European Union-wide code is expressly justified by "*the need for corporations to retain a degree of flexibility in governance so as to be able to continuously adjust to changing circumstances*" and, furthermore, it was recommended that "*harmonisation of law and securities in the areas of disclosure and shareholder participation should take priority*".

And, although on a different level, it can be mentioned that recent indications on the work in progress for review of the worldwide highly influential 1999 OECD PRINCIPLES OF CORPORATE GOVERNANCE [(3)]appear to show that – after an initial impetus where voices were heard for making the Principles more stringent, more explicit or more binding – there is now a firm resolution of the Steering Group not to reopen the Principles – which are to remain principles – and not try to make them more directive or prescriptive.

I believe all this, besides, showing consistency with the traditional – but sometimes forgotten – principle that in corporate governance "*one size does not fit all*", goes certainly in the right direction, safeguarding the evolutionary and changing nature of "*best practice*" recommendations and enhancing also its important function as a laboratory for mature selection of future legal norms.

In this context, I think also that it should be noted the explicit position taken by the European Commission, in its two recent May, 21 2003 Communications on "*Action Plan for Modernising Company Law and Enhancing Corporate Governance*" [(4)] and on "*Reinforcing Statutory Audit in the EU*" [(5)], in which the Commission expresses a firm determination to move forward, but rejects at the same time "*knee-jerk regulatory reactions*" and puts forward a list of intentions where development of appropriate studies (including in what respects the "*one share/one vote*" principle largely, but not entirely, adopted in the so far unsuccessful proposed take-over bids Directive) clearly outnumber the proposed binding initiatives.

V. As we all know, these mainly recommendatory approaches contrast sharply with the type of intervention recently chosen by the United States, where – albeit with the merits of a quick and energetic reaction to a particularly explosive situation - the option by the Sarbanes-Oxley Act for lengthy and detailed binding rules and implementing measures – accompanied, moreover, by a pretension of extraterritoriality – certainly continues to raise important difficulties, particularly to European and other non US companies and auditors (as noted in the above referred European Commission communications of May 21, 2003) but also to lawyers, who, at US level, are still engaged on ethical debate on issues such as the "*up the ladder*" and "*noisy withdrawal*" impositions.

I would like to express my hope that cross-Atlantic consultations under way may lead to closer and more co-ordinated ways of proceeding, as this is vital for successful improvement of corporate governance on a globalised basis.

VI It is also worthwhile to note – now turning to **corporate governance in the M&A context**, one of the matters of this Congress - that the WINTER II Report's mainly recommendatory approaches on corporate governance also show a significant difference in respect of the rigid binding regulation proposals made, in respect of an EU Directive on take-over bids, by the WINTER I Report, of January 2002 (6), with regard to two important corporate governance issues that remain open at EU level:

- The proposal of the mandatory establishment, through an EU Directive, of "*break-through*" rules imposing, in certain tender offer cases, the mandatory disregard of certain (but not all) otherwise legally allowed corporate constitutional structures or contracts; and

- The proposal of a rigid version of the "*passivity rule*" for board corporate defensive measures that – here in the inverse sense of the more flexible US approach of the "*business judgement rule*" and its modified standards – would completely overshadow the separation of powers and the duty of directors to act in the best interests of the company, by prohibiting any defensive action without shareholders approval.

It is known that, specially the "*break through*" proposals made by the WINTER I Report (largely adopted by the European Commission in its 13th Directive proposal, although with unprecedented internal divisions), are in the centre of the controversy that has so far delayed the approval of an EU Directive on Take-over bids, and this probably shows that the steps proposed have, at least, failed to create consensus on a level playing field for take over bids in Europe.

I would like to note, however, the fact that, by Portuguese initiative, new proposals towards at a compromise have been recently put on the table of the EU Finance Ministers for discussion. Let us also expect that positive and more flexible developments may arise.

VII The second highlight I would like to make today is that **premature or excessive legally binding rules are not, in this field of corporate governance, the only matter of concern**.

We can find a recent example in the business sector reactions, in particular in the May 2003 response of the LONDON STOCK EXCHANGE [(7)] – in its double capacity as listed company and as operator of a stock exchange – in respect of the proposed implementation, in the revision of the UK *Combined Code*, of the recommendations of the HIGGS Report [(8)].

In fact, although fully endorsing the "*comply or explain*" philosophy of the HIGGS Report and its substance, the LSE (as well as other market participants) warned that enlarging the obligations of "*comply or explain*" may - by affecting the practical ability of listed companies to explain to the market in an effective way their own corporate governance specificities - force them, in order to avoid reputational damages, to turn to a "*box-ticking*" attitude of formal compliance, which the LSE refers is already experienced in UK.

And - maybe even more significantly - the LSE also voiced the concern that the new rules on boards of directors and independence of their members (in particular, the lack of recognition of the value of non independent members), although non-binding, would - I quote - "*threaten the unitary nature of the board, in the way that the Sarbanes-Oxley Act threatens this in the US*".

It appears that these concerns have been heard, and the final draft approved by the Financial Reporting Council[(9)] has amended key points, including the appointment as Chairman of former CEO's, the role of the senior non executive director and a warning against box ticking.

But this shows that also "*soft law*" can not be seen as a risk-free field.

These are also concerns that we can find throughout certain communications made to this Congress, and they certainly deserve a lot of thought from all of us.

And furthermore, turning back to the WINTER II Report, I would also like to express doubts on whether the expressed inclination to follow normative procedures inspired by to the so-called "*Lamfalussy approach*", developed for security markets regulations, although with a healthy purpose of flexibility and speed, can indeed be appropriate in such a highly delicate area as corporate governance.

VIII This leads to the third and final remark I would like to share with you, which respects the need to keep at all times present the **distinction between objectives and instruments, and not seeing instruments as an objective in themselves**.

In fact, when, for instance, we all praise the importance of independence of directors, or some defend separation of Chairman and CEO or the implementation of Board appointment, remuneration and audit committees, we should never lose the perspective that what we are effectively trying to achieve is full and proper exercise of the supervisory function, on one side, and full and proper accountability, on the other side, and, again, that "*one size does not fit all*", and that there can be alternative and effective ways of insuring the same objectives.

In Portugal, for example - as we have heard in the Portuguese national reports to this Congress -, directors are, not only elected, but directly appointed by shareholders (upon initiative that may came from almost any shareholder, with non significant limitations), with pre and post-election extensive information requirements, and director remuneration is also by law a shareholders' power, which can only be delegated in a committee of shareholders, directly appointed by the shareholders' meeting.

Also in Portugal, as another example, statutory audit committees directly appointed by shareholders (and in which minority shareholders obtain a seat) are mandatory by law, and enjoy wide powers on the control of soundness of financial reporting, although certain listed companies (such as BCP and BES) combine such statutory boards with special audit committees.

Still in Portugal, all of the three companies with largest capitalisation and liquidity have voting caps in their by-laws.

This illustrates that ensuring proper functioning of existing mechanisms in each environment has - at least - to come always side by side with the analysis on whether to complement or replace them, in the light of the proper achievement of corporate governance objectives.

But it shows also the crucial importance of dedicating attention to the central substantive issues – starting, in the very first place, with the treatment of the duties of directors, which certain corporate governance codes do (like the PRINCIPLES OF CORPORATE GOVERNANCE OF THE *AMERICAN LAW INSTITUTE* (10) and the Spanish ALDAMA Report) but many others do not.

IX In concluding, I wonder now whether my words may have sounded as less optimistic or committed.

Please don't get me wrong.

I fully share with most of you the enthusiasm and excitement that the task of enlarging and developing the powerful movement of ideas on corporate governance represents to the business community as a whole and to lawyers in particular.

And I do believe and hope that, with determination and prudence, it will continue to lead, worldwide, to a better corporate world and to more efficient and trustful capital markets.

Thank you very much.

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