Lasák, J. Kontrola řízení a správy akciové společnosti a postavení dozorčí rady (*Control over the management of a joint stock company and the position of a Supervisory Board*). Prague: Wolters Kluwer, 2023, 416 p. ISBN: 978-80-7676-566-5

Abstract:

Contemporary joint-stock companies exist on the basis of certain pillars that shape their function and form. First of all, modern joint-stock companies could not exist without a state-recognised and guaranteed legal personality which is distinct from the legal personality of its founders or shareholders and allows the corporation to own assets that are separate from the ownership of individual shareholders. The principle of separate ownership, together with the limited liability of shareholders, represent cornerstone of modern joint-stock companies, together with the principle of free transferability of shares, which could not meaningfully exist without limited liability of shareholders.

Large number of shareholders and legal separation of a joint-stock company's assets and the assets of the company's shareholders predetermine the existence of another basic element of modern corporations, which is the delegation of managing the company to professional management. This leads to so-called "separation of residual ownership and management", which in modern joint-stock companies is carried out by the board of directors (in two-tier systems) or the management board (in one-tier systems). However, the separation of ownership and management can lead to inefficiencies within the corporate governance framework (including inefficient related party transactions or various forms of looting). Therefore, for a long time, corporate governance has sought supervision & control mechanisms to curb the negative consequences of the separation of ownership and management. Historically, one of these control mechanisms in a two-tier joint-stock company has become the supervisory board, whose position in corporate governance is analysed in this monograph.

This publication first comprehensively places the supervisory board together with other institutional instruments of supervision & control over the management of a joint-stock company within the framework of different ownership systems in which joint-stock companies operate. In "managerial" systems, the basic axis of corporate governance is the cleavage line between professional management and shareholders. In systems with a concentrated shareholder structure, the controlling shareholder exercises ultimate control over the management of the company. In these concentrated systems, professional management (including members of the supervisory board) tends to be an extension of a particular residual owner (the controlling shareholder). This brings to the fore the cleavage (conflict) line between the controlling shareholder and the minority shareholders.

This monograph outlines a general structural taxonomy of the control mechanisms of a modern joint-stock company's governance, which is based on two basic variables: (i) the company's ownership structure; and (ii) the public tradability of the company's shares. These parameters predetermine corporate governance methods, the basic frictional surfaces between the various actors operating in the corporate arena, and the scope and effectiveness of the various instruments of corporate governance supervision & control. At the same time, the instruments of supervision & control work in symbiosis with each other and are, or can be, to some extent substitutable. If supervision & control of a company's management is not sufficiently effective under the law (and its enforceability), i.e. if it does not sufficiently and effectively prevent undesirable behaviour by those who are in control over the company's management, social

standards or a combination of other supervision & control instruments, can compensate for the partial lack of a legal or institutional environment. Therefore, in the next part of the monograph, I focus on the basic internal and external institutional instruments of supervision & control in the Czech Republic in terms of their importance for corporate governance.

Instruments of an organisational nature shall be distinguished from instruments of a shareholder (ownership) nature within the corporate governance framework. The basic organisational instruments of supervision & control are: (i) the existence of supervisory units within the executive management (usually an internal audit unit or a compliance unit), (ii) the existence of a non-executive supervision body, which may be of a mandatory nature (supervisory board in a joint-stock company with a two-tier management system), or its organisational anchoring is based on a facultative basis (non-executive members of the management board, or a facultative supervisory body). An additional organisational instrument of supervision & control is the requirement to establish an audit committee in the case of public-interest entities. On the other hand, shareholder (investor) instruments of supervision & control include namely the right to participate in the management and supervision of the company (including, where applicable, the right to request a review of certain reports concerning the company's operations, including the conditional right to request a review of the performance of the board of directors in a two-tier joint-stock company), or a litigation instrument in the form of the existence of a so-called "shareholder lawsuit" (*pro socio* lawsuit).

In addition to the internal supervision & control tools, external tools are also available in the corporate governance toolkit. Where ineffective corporate governance may lead to a systemic risk to society, more vigorous instruments of supervision & control are applied, with the aim of preventing, as much as possible, systemic negative externalities. The external supervision & control instruments depend on the nature of the business operations that the entities concerned are engaged in. "Enhanced" supervision may also result from capital market protection (in the case of companies whose securities or other investment instruments have been admitted to trading on a regulated market). From a corporate governance perspective, the regulation of insider trading or transparency requirements are of particular importance in this respect. Selected external instruments of supervision & control are present even in companies which are not a source of systemic risk. These may include, for instance, "gatekeepers" verifying, confirming or supplementing financial or non-financial information (e.g., statutory auditors or audit firms, rating agencies or attorneys and other advisors who provide professional advice and services to joint-stock companies).

The existence of a supervisory board represents the basic institutional instrument of supervision & control which distinguishes a two-tier joint-stock company's management system from a one-tier system. In the Czech legal environment, the existence of the supervisory board as a basic distinguishing feature of the two-tier system is emphasised by the fact that, in one-tier companies, Czech law does not, generally, distinguish between executive and non-executive members of the administrative board. However, looking at modern trends in corporate governance, one can observe certain convergence of one-tier and two-tier internal governance systems of joint-stock companies. Under the modern one-tier system, the supervisory board members' supervisory role is substituted by independent members of the management board who have no direct involvement in managing the company. On the other hand, as a result of the adoption of modern corporate governance codes, we can observe in two-tier systems an increased importance of the advisory role of the supervisory board in strategic decisions, or in matters of internal supervision and risk management, which, in the one-tier system, is performed by the management board, or its independent members (outside directors).

The increasing complexity of the social and regulatory environment in which joint-stock companies operate these days, as well as the complexity of certain business operations, the geopolitical situation with regard to the ongoing or threatened war conflicts, environmental issues and the continuing development of digitalisation, the deepening obligations regarding statutory auditing, the remuneration of directors, as well as the changes in the structure of investors in joint-stock companies whose securities are admitted to trading on a regulated market, all continuously increase the demands on properly performing the duties associated with service on a supervisory board and also predetermine the requirements for the scope and quality of the supervisory board’s supervisory responsibilities.

As a result, the main part of this monograph analyses the supervisory board’s key powers, which include supervising the board of directors’ performance and the company’s operations. Historically, the supervisory board’s supervisory powers have been perceived primarily retrospectively. In addition to the retrospective exercise of the supervisory function, however, modern corporate governance also emphasises the preventive supervisory function, consisting in particular of the supervisory board's approval right in respect of certain transactions to be undertaken by the company management. At the same time, as part of the supervisory board's preventive supervisory function, the advisory role of the supervisory board as a partner of the board of directors in making strategic decisions, most importantly in times of crisis, is becoming increasingly significant in the corporate arena.

In two-tier management systems, the supervisory board’s position is based on a natural information asymmetry or information deficit on the part of the supervisory board members, who are not directly involved in the company management, do not participate in the decision-making process of the board of directors and are largely dependent on the board of directors in terms of obtaining the necessary information. The proper control of the management by the supervisory board, however, presupposes that supervisory board members have sufficient information about what is going on in the company (for the purposes of exercising general supervision) or about the matters under scrutiny (in cases of individual supervision).

The basic building block which compensates for the natural information asymmetry between the supervisory board (and its individual members) on the one hand and the board of directors (individual directors) on the other, is the supervisory board’s statutory power to “inspect files”. The existence of the power to inspect files stems from the fact that the supervisory board would not be able to properly exercise its supervisory role in all cases (in all circumstances) if it relied solely on information or reports that the board of directors would disclose and make available to it. At the same time, the existence of the power to inspect files prevents supervisory board members from getting rid of their responsibility for its lack of supervision. Therefore, a major part of this monograph is devoted to analysing the supervisory board’s power to inspect files and related powers.

The exercise of the supervisory board’s control powers is also determined by the composition of the supervisory board, i.e. by the individual characteristics of each member. The subsequent part of this monograph, therefore, analyses prerequisites for serving on the supervisory board, the possible ways of establishing and terminating the supervisory board’s office, the nature of the contractual relationship between the supervisory board members and the company, and the scope of the elementary duties performed by the supervisory board members while serving on the board. The monograph then focuses on the supervisory board's decision-making process, reflecting the ownership structure of the joint-stock company in which the supervisory board is established, the coexistence, importance and effectiveness of other institutional (as well as non-institutional) instruments of supervision & control, as well as the personal characteristics of individual supervisory board members. The complexity of these factors then fundamentally influences the way in which the supervisory board exercises its control function in a two-tier joint-stock company. The monograph concludes with a summary of the main aspects of the position of the supervisory board within the Czech corporate governance arena, and outlines proposals that might allow the supervisory board to perform better monitoring in modern Czech joint-stock companies.

* * *