3 April 2006

ICAEW response: 21/06

DG Internal Market - F2
European Commission
B-1049
Brussels

Dear Sir

CONSULTATION ON FUTURE PRIORITIES FOR THE ACTION PLAN ON MODERNISING COMPANY LAW AND ENHANCING CORPORATE GOVERNANCE IN THE EUROPEAN UNION

The Institute of Chartered Accountants in England & Wales (ICAEW) is pleased to submit this letter of comment in response to the European Commission's consultation on the future priorities for the Action Plan on modernising company law and enhancing corporate governance in the EU.

The ICAEW is the largest individual body of professionally qualified accountants in Europe with over 127,000 members who work in many areas in the business and public sectors, as well as practising as accountants and auditors.

The Institute operates under a Royal Charter that requires us to act in the public interest. In preparing this submission we have taken account of the views of members of our Corporate Governance Committee, and of our Company Law Committee which deals with company law and capital maintenance issues. The Corporate Governance Committee comprises individuals who have substantial experience as directors of listed companies, as institutional investors, and as external and internal auditors.

Overall comments

We welcome the EC's consultation on the future priorities for the Action Plan and provide our detailed answers to the 14 questions in the appendix to this letter.

We commend the Commission for implementing the most important measures of the 'short-term' phase of the original Action Plan. These measures will hopefully do much to enhance transparency and restore investor confidence following the corporate scandals which took place at the beginning of the decade.

We strongly support the key themes of promoting competitiveness and better regulation that are proposed in the consultation paper.

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In today's complex and competitive business and investment environment, we believe that it is the detailed knowledge of market participants that should be used not only to help inform the development of corporate governance policy but also to provide robust and innovative solutions to problems. Therefore the full and proper application of better regulation principles aligned to a market-led approach that is responsive to the changing needs of markets is, we believe, the way forward for future EU action in the areas of company law and corporate governance.

We consider that the Commission should:

- use a 'light touch'/least regulatory approach required to meet the stated policy objectives: and
- not create regulation that prevents the development of financial markets that support the future prosperity of European companies, investors and citizens.

We believe that the Commission's main focus in future should be on:

- effective implementation by Member States of the existing measures rather than proposing new regulatory measures; and
- those cross-border issues which cannot be addressed by individual Member States.

We give strong support to the European Corporate Governance Forum as it should play an important role in helping to decide policy as well as disseminating information.

In recent weeks, some Member States have taken, or are seeking to take, protectionist measures, including distorting or disproportionate voting structures, in respect of the potential takeover of companies in their jurisdiction. This is a worrying development for the future of the internal market and for the Takeovers Directive. We trust that the Commission is carefully considering taking action on this matter in the context of Article 56 EC dealing with the free movement of capital.

If you require further information, please contact Jonathan Hunt, Head of Corporate Governance (jonathan.hunt@icaew.co.uk), Liz Cole, Manager, Business Law (liz.cole@icaew.co.uk) or myself.

Yours faithfully

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Section 1 The overall aim and context for future priorities

Question 1

Does the Action Plan address the relevant issues and identify the appropriate tools to enhance the competitiveness of European business? If not, please give your reasons and indicate which measures are not appropriate and/or would be desirable. What are your views on the balance of legislative/non-legislative measures proposed?

Are you facing particular obstacles in the conduct of cross-border activities to which, in your opinion, the Action Plan does not provide any satisfactory remedy? Please give your reasons.

We fully support the approach of the consultation paper that the future drivers for any action at EU level should be improving the competitiveness of EU companies and better regulation.

We believe that:

- the change of focus envisaged towards encouragement of entrepreneurship and better regulation is the correct approach; and
- in an age of globalisation and strong competition from other continents, it is vitally important for the competitiveness of EU companies and capital markets that they should not to be hindered by unnecessary regulatory burdens.

We believe that future regulatory action at the EU level, either referred to in the Action Plan or as a result of a specific failure in the market, must be justified at the outset in the context of:

- improving competitiveness of EU companies;
- the absence of alternative, market-based solutions;
- a minimalist approach to regulation beginning with the least regulatory, lowest cost form that is necessary to achieve the desired objective;
- taking a high-level approach covering essential matters rather than detailed points in legislation; and
- very careful scrutiny of the detailed costs and benefits using better regulation principles and covering both large and small companies.

We strongly believe that the importance of the role played by shareholders in regulating the affairs of their own companies must be acknowledged. Working with a robust regime of rights enshrined in company law, it is shareholders, rather than legislators, who are very often the best custodians of their own interests. We strongly support the emphasis on shareholder rights which, if operating effectively, reduces the need for the type of prescriptive, burdensome and costly legislation that has been introduced in some jurisdictions.

The current Action Plan

In the light of the above comments, we consider that the medium-term phase of the Action Plan contains too many legislative proposals.

We question the need for some of the measures proposed to be addressed at EU level, such as wrongful trading, special investigation rights, general squeeze-out and sell-out rights, groups and pyramids, and additional pan-European entities.

What we do consider to be of importance at the EU level is urgent consideration of the ongoing relevance of the Second Company Law Directive on capital maintenance.

Capital maintenance

We call for an accelerated review of the fundamental reform of the Second Company Law Directive on capital maintenance, with a view to the introduction of an alternative system of creditor protection, such as that based on a solvency test. We believe that operating the current capital maintenance regime, particularly in an IFRS environment, imposes disproportionate burdens and is affecting the competitiveness of some European companies.

Many companies that should only have to deal with one GAAP are now experiencing additional cost in running two sets of GAAP (IFRS in group accounts and domestic GAAP in individual accounts).

We also note that for the few companies who prepare individual accounts under IFRS, there are significant costs in determining which profits should be treated as distributable, and keeping dual records in order to have the information necessary to determine the amount of profits on a realisation basis.

We note that the tender document for a study into such reform has recently been re-issued, but we question the need for this feasibility study, especially if the reform is to be by way of the introduction of an *optional* alternative regime. Further, we note that no such study was conducted before deciding to adopt IFRS and, given the large amount of research already conducted, for instance the BIICL 2004 report, we query whether such a comprehensive study is required as we fear this study will slow down reform in this area unnecessarily.

We also think the problems arising due to the lack of compatibility between the capital maintenance regime and International Accounting Standards illustrate a more general point about the problems created by the inter-relationship between Company Law issued by the EU and accounting standards set by the IASB. This inter-relationship needs to be given particular attention on an ongoing basis to identify and resolve potential difficulties or conflicts.

Question 2

Do you have any comments on the proposed application of better regulation principles in the area of corporate governance and company law? Are there other ways in which, in your view, the Commission should be seeking to improve its actions in this field?

We very much welcome the increased consultation that the Commission is now undertaking and we cite the two consultation exercises on the Shareholder Rights Directive as a good example of this new approach.

Open and transparent, as well as widely-based, consultation processes of three months' duration give the Commission access to market knowledge and experience that can help it to make better, pragmatic, evidence-based regulation.

We support the use of events to be held by the Commission, such as the one planned for May 2006 relating to this consultation paper, to provide information to market participants, thus helping them to understand the Commission's reasoning and current thinking.

We also think that:
- the European Corporate Governance Forum (ECGF) and the Advisory Group are useful; and
- the development of regulatory policy in this area should be undertaken by senior individuals, including those who also have experience working within companies and investment institutions.

Regulatory Impact Assessments (RIA)

We believe that, in order to have credibility, RIAs should thoroughly examine the costs and benefits of a proposed regulation including the impact on all sizes of company.

It is also important to undertake follow-up exercises on previous regulatory actions using the same RIA approach. We recommend that such a follow-up exercise should include actions completed as part of the short-term phase of the Action Plan.

Section 2 Establishing the right priorities for the action plan: medium and long term

Question 3 ***Corporate governance: shareholder democracy – one share/one vote***

What would be the added value of addressing the issue at EU level?
What would be the appropriate form for any EU instrument? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

'One share, one vote' is a well used phrase that is often referred to in the context of removing restrictions to voting rights on equity shares.

We:
- support the overall principle suggested by this phrase; and
- believe that good corporate governance is founded upon shareholder democracy and the rights of shareholders to exercise control over their companies.

Nevertheless, there are practical difficulties. There is a considerable array of financial instruments that, in addition to an equity share, may be used by companies and purchased by investors. Some financial instruments do not attract voting rights, such as non-voting preference shares.

We suggest that, whilst recognising that the voting rights of shareholders in some Member States are not equivalent to the rights afforded to shareholders in other Member States, it is important to go back to basics and determine the problem(s) that need to be addressed. We support the proposed study to be launched by the Commission with the involvement of the ECGF. We hope that the study will be rigorous and consider all the key issues.

Transparency is one the key issues. Investors should be fully informed of any restrictions on their voting rights in respect of particular financial instruments. If there is full

transparency of all the voting rights on all of the relevant financial instruments used by a company, then investors should be aware of distorting or disproportionate voting structures. Armed with this knowledge investors may then act accordingly.

Transparency may however only be part of the solution. There are likely to be other market mechanisms to bring about change. For example:

- encouragement of activist investors to take action and to drive new thinking by the management of a company; and
- investors could state that they will not invest in specified shares in a company because of distorting or disproportionate voting structures. Such actions could have an impact on the company's share price and its cost of capital.

Overall, we do not think that EU legislative requirements should prevent the development of innovative financial instruments as long as there is full transparency of the voting (or non-voting) rights for each instrument. We believe that this issue is primarily a matter for market participants and is not a matter for action at the EU level.

Question 4 ***Corporate governance: rights of shareholders***

What would be the added value of addressing these questions at EU level? Please give your reasons.
Which instrument would be best designed to deal with these matters? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

We believe that key matters have already been addressed in the draft Directive on Shareholder Rights.

Nomination and dismissal of directors

In the UK, shareholders already have the right to nominate and remove directors. We presume that Article 6 of the draft Directive on Shareholder Rights which deals with 'the right to add items to the agenda of the general meeting and to table draft resolutions' will allow shareholders the right to propose resolutions for the nomination and dismissal of directors. We thus believe that this matter should be left to individual Member States, operating within their individual national traditions and cultures.

Special investigations

We believe that there are existing rules and requirements at individual Member State level that are based on their own laws and traditions. We recommend that this matter should be left at the Member State level and that there is thus no need for action at EU level as part of the Action Plan.

Question 5 ***Corporate governance: disclosure by investors of their voting policies***

Is there a need for this issue to be addressed at EU level? What would be the added value of addressing the issue at EU level? Please give reasons for your reply.
What would be the appropriate form for any EU instrument? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

We support the recommendations outlined in the Institutional Shareholders' Committee's (ISC) 'Statement of Principles' which emphasise that institutional investors should set out their policy on how they will discharge their responsibilities. Market forces in the UK have led to an increasing number of institutional investors making disclosures on their voting policies. This is an evolutionary process and good practice continues to develop. We therefore see no need for this matter to be addressed at the EU level.

We believe that going beyond the disclosure of voting policies to disclosure about how institutions have actually voted on each resolution put forward by each company in which they invest is not something that should be considered by the Commission. We consider that such matters are surrounded by complex issues (such as definitions of various parties in the investment chain) as well as being potentially very costly to implement, for example in terms of new systems. Whilst developments in this area will take place as a matter of market 'good practice' we do not think that this area should be subject to regulatory action at the EU level. We would not want to see EU based investment institutions have additional regulatory and cost burdens placed upon them, which could place them at a competitive disadvantage in the global marketplace.

Overall, we consider that voting policy is primarily a matter between institutions, fund managers and their clients or ultimate owners. We are not aware of market failures in this area that would need consideration of a legislative instrument at the EU level.

Question 6 ***Corporate governance: directors' responsibilities / enhanced transparency of legal entities***

Do you consider that
a) the question of the wrongful trading rules and
b) the issue of directors' disqualification
should be addressed at EU level? Please give your reasons.

Which instrument would, in your opinion, be most appropriate? Please give your reasons.
If so, are there, in your view, specific elements which any such instrument should cover?
Do you consider that any additional measures are needed to enhance transparency for legal entities and/or legal arrangements (e.g. trusts)?

We consider that there is no need for legislation at EU level on either of these matters.

Wrongful trading

We have interpreted this in the context of trading whilst insolvent. Whilst we think this is good law, we do not believe that this is a matter for EU level regulation, but that it should continue to be based on the insolvency laws at national level.

Directors' disqualification

We believe that these matters should continue to be dealt with at a national level so that the various regimes in Member States can continue to take account of national traditions and cultures. We see no need for harmonisation at the EU level on this matter.

However what would be useful, at an EU level, is careful consideration of the development of an EU wide register of directors who have been disqualified. Such a register would be helpful to prevent a disqualified director in one Member State establishing a business in a second Member State without the disqualification being known about in the second Member State.

Question 7 ***Company Law: corporate restructuring and mobility***

In the light of existing instruments, is there still a need for a directive on the transfer of registered office? Please give your reasons.
Are there, in your view, specific elements which any such Directive should cover?

We do not believe there is a need for this proposed Directive. This is a complex area that is, in part, driven by regulatory and taxation considerations and we do not consider this matter to be a priority for the Commission at this time.

Question 8 ***Company Law: the choice between the monistic and dualistic types of board structures***

Should the question of the choice of board structure be addressed at EU level? Please give your reasons.
Which instrument would be best designed to deal with this matter? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

We do not consider that the choice of board structures is a matter that needs to be addressed by a legislative instrument at the EU level. We believe that this matter is largely driven by national culture and tradition and should thus be left to market participants (companies in liaison with their shareholders) and/or national law at Member State level.

We recommend that no action be taken at EU level on this matter.

Question 9 ***Company Law: squeeze out and sell out***

Do you think that a squeeze out and a sell out right should be introduced at EU-level? Please give your reasons.
If so, should these rights be limited to companies whose shares are traded on a regulated market ("listed companies")? Please give your reasons.
Which instrument would be best designed to deal with this matter? Please give your reasons.

We note that the Takeovers Directive has already dealt with this issue in relation to takeover and bid situations. Outside a takeover offer there is no obvious share price, and we do not think a contract should be capable of being forced upon the company or minority shareholder based on an appraised value.

We recommend that the matter should not be pursued further and that general squeeze out and sell out rights in legislation should not be introduced at EU level.

Question 10 ***Company Law: groups and pyramids***

Should the issues of framework rules for groups and abusive pyramids, in your view, be addressed at EU-level? Please give your reasons.
Which instrument would be best designed to deal with this matter? Please give your reasons.
Are there, in your view, specific elements which any such instrument should cover?

We are not aware that this is producing any practical difficulties and therefore do not believe that this matter should be addressed at EU-level.

Question 11 ***Company Law: legal forms of enterprises: the European Public Company (the ECS)***

How useful do you judge the ECS to be in practice? Do you consider any modifications are appropriate and desirable? Please give your reasons.

There appears to be little, if any, demand from the market in the UK for the European Public Company (ECS). We thus question whether this type of corporate entity has a use in the context of the UK markets and company law regime. There may however be other Member States where such a corporate entity may be of use.

We see no need to make modifications to the ECS at this early given that the ECS was only introduced in 2004. We suggest that the Commission may wish to consider this matter, in conjunction with market participants, in a few years' time.

Question 12 ***Company Law: the European Private Company***

Do you see value in developing an EPC Statute in addition to the existing European (e.g. Societas Europaea, European Economic Interest Grouping) and national legal forms? Please give your reasons.
If so, are there, in your view, specific elements which any such statute should cover?

From a UK perspective we see no value in, or practical demand for, the development of the European Private Company (EPC).

As noted in question 11, demand for the ECS has been negligible in the UK. At this time, from a UK perspective, we foresee a similar situation for the potential EPC. We recognise however that there may be some other Member States that might find the EPC to be of potential benefit.

Question 13 ***Company Law: the European foundation***

Do you consider it useful to carry out an examination on the feasibility of a European Foundation Statute? Please give your reasons.

We do not consider it useful to carry out an examination on the feasibility of a European Foundation Statute (EFS).

As previously mentioned in question 11, demand for the ECS has been negligible in the UK. As with the EPC, we foresee a similar situation for the potential EFS and thus recommend that no further time and effort be spent on this matter at the current time.

Section 3 Simplification and Modernisation of European Company Law

Question 14

Do you agree that there would be added value in modernising and simplifying European Company Law? Please give your reasons.
Are there, in your view, areas of actual or potential overlap between the Action Plan and other initiatives or measures in related sectors? What, if anything, should be done in order to ensure coherence between the various fields of action? Please give your reasons.
What should be the extent of simplification in the interests of improving the regulatory environment and rendering the text more user-friendly? Please give your reasons.

In theory, we appreciate:

- that there may be some merit in an objective to modernise and simplify European Company Law so that it does not contain redundant or obsolete material or inconsistencies; and
- the reasoning for wishing to attempt a formal codification and recasting exercise.

In practice, however, we do not consider this to be a good idea for the Commission to pursue. We set out our main reasons below:

1. Interpretations of the existing law have been in place for several years. Changes to eliminate actual or perceived inconsistencies and/or redrafting substantive provisions just to make them easier to read could:
   - upset delicate balances that have already been achieved;
   - inadvertently change a meaning, or re-open debates where careful compromises have already been agreed;
   - lead to a prolonged period of uncertainty for market participants whilst the process is being undertaken; and
   - lose sight of the original purpose of the simplification objective as the exercise gets bogged down in matters of process.

   In the absence of a really compelling case for change, such complex and potentially time consuming exercises should be avoided.

2. It is the Member States that have to implement into their own laws the changes to EU Directives. If market participants (such as companies and investors) in Member States are satisfied with the existing laws, we see little or no need to make changes for the purposes of a tidying up exercise. Such alterations could add costs to market participants as well as to Member States without necessarily generating any real benefits. If there is a need for specific change on a specific matter, then that issue should be addressed on an individual basis.

3. Company law does not necessarily remain fixed. A constant and perhaps difficult updating exercise might need to be undertaken that may require permanent resource which could be better used elsewhere in looking at, for example, effective implementation of EU law and regulations in individual Member States.

4. If the main purpose of the codification and recasting is to present EU law all in one place, then it would be far easier, less complicated, less risky and less costly for a specialist provider of reference material to produce the relevant reference works without the law itself being changed. Companies and others could then use such reference material without incurring unnecessary change.

5. Our suggested overall approach on this matter is best illustrated by the well used phrase 'if it ain't broke – don't fix it'.

We suggest that priority should be given to a simplification and modernisation programme that prioritises those elements of EU law that impose unnecessary burdens and focus on whether the existing EU requirements, including those recently introduced as part of the 2003-2005 phase of the Action Plan, are working in practice as originally intended.