REPORT

OF

THE HIGH LEVEL GROUP
OF
COMPANY LAW EXPERTS

ON

A MODERN REGULATORY FRAMEWORK
FOR COMPANY LAW
IN EUROPE

Brussels, 4 November 2002

THE HIGH LEVEL GROUP OF
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LETTER FROM THE CHAIRMAN

The High Level Group of Company Law Experts was set up by the European Commission in September 2001 to make recommendations on a modern regulatory framework in the EU for company law. In our First Report of January 2002, we dealt with issues related to the Takeover Bids Directive, which was rejected by the European Parliament in July 2001. Our original mandate was further extended in April 2002 by the Commission following the ECOFIN Council meeting in Oviedo to deal specifically with a number of corporate governance issues. Our Final Report is presented here.

A fundamental review of company law in Europe was certainly due. Many agree that EU company law has not kept up with developments which shape its role and application, in particular the creation of a single EU market which companies and their investors wish to use to the optimum, the development of European securities markets and their regulation, the development of modern information and communication technologies which should be facilitated and could be used to improve company law arrangements and the development of corporate governance practices and standards.

Indeed, we believe company law in Europe must catch up with these developments. We hope that our Report will stimulate this process, which will require concerted actions of many in the EU.

On behalf of the Group, I would like to thank Commissioner Frits Bolkestein who has always shown a genuine interest and support for our work. I would also like to thank his staff, in particular Karel Van Hulle, Dominique Thienpont and Erich Eggenhofer, who have been of tremendous support in the practical organisation of the work of the Group and in the production of our two Reports and the Consultative Document.

Within the limited time available, we have conducted an extensive consultation process, including a hearing in Brussels, which has received wide response. We are grateful for the numerous responses and comments we have received and highly appreciate the efforts made by many to respond in detail within a very short time. The responses were often of high quality and have greatly contributed to the shaping of views within the Group.

Many thanks are also due to the team of researchers of the Erasmus University in Rotterdam, led by professor Jan Berend Wezeman, which, again within a short time frame, has analysed and summarised in an extensive report for the Group the more than 2,500 pages of responses and comments made to our Consultative Document. This has proven immensely valuable for

the Group in its efforts to analyse and take into account these responses.

Finally, I would like to express my personal thanks to all Members of the Group. We have worked closely together for over a year, with usually a very tight time schedule, and with limited resources and facilities for debate within the Group and with outside interested parties. The expertise each of you has brought to the Group, as well as your willingness and ability to identify and develop sound views that we could agree on, have been excellent. The continuous spirit of co-operation and good personal relations throughout the process have been key to our work. I am grateful for having been able to work with you so closely during the last year. It has been my pleasure and great honour to chair this Group.

Amsterdam, October 2002

Jaap Winter

SUMMARY OF THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS' OBSERVATIONS AND RECOMMENDATIONS

CHAPTER I - ***"Introduction"***
This document constitutes the High Level Group of Company Law Experts' Final Report, in conformity with the Group's terms of reference which were defined by the European Commission on 4 September 2001 and subsequently extended as a consequence of the Oviedo ECOFIN Council in April 2002.
The Group was set up by the European Commission to provide independent advice, in the first instance on issues related to pan-European rules for takeover bids, and subsequently on key priorities for modernising company law in the EU.
In pursuing its mandate, the Group has published a Consultative Document on the issues specified in the second part of its mandate, but including also general themes which appeared to be of importance for the future development of company law in Europe.
Based on the responses received in this consultation, on the discussions in the hearing held on 13 May 2002 and on its own discussions, the Group now presents its conclusions and recommendations to the Commission and to the public in this Final Report.

CHAPTER II - *"General Themes"*

In the Consultative Document, we raised a number of general themes that we believed followed from the mandate given to the Group "to provide recommendations for a modern regulatory European company law framework designed to be sufficiently flexible and up-to-date to meet companies' needs, taking into account fully the impact of modern technology". The themes and specific questions we raised triggered a range of responses, in which a number of suggestions have been made. Overall, the Group feels that respondents support the approaches taken, which we continue to regard as valid.

The EU approach to company law harmonisation has focused on the protection of members and third parties. Several instruments have been adopted, with a view to establishing an equivalent level of protection throughout the EU. Company law should primarily concentrate on the efficiency and competitiveness of business.

Proper protection of shareholders and creditors is necessary, but not all existing mechanisms are effective. This Report contains some recommendations to simplify current rules.

Particular attention should be given to the elimination of obstacles for cross-border activities. Responses to the consultation confirm the high importance of cross-border issues.

Responses to the consultation also call for a freedom of choice between alternative forms of organisation and structure, as is offered by the European Company Statute.

EU company law, once harmonised through Directives, is not easy to modify, whereas there is a growing need for continuous adaptation. Fixed rules in primary legislation offer both advantages and disadvantages, and we can see a movement in Member States to use alternatives for primary legislation, which include secondary regulation, standard setting and monitoring, and model laws. Responses to the consultation confirmed that directives should be restricted to setting principles and general rules, and that detailed rules should be left to secondary regulation and mechanisms for standard setting. There was more hesitation with respect to model laws, which seem difficult to use in different legal systems, but model documents and formats may be useful and the model approach may foster convergence of national legal forms.

For both primary legislation and any alternatives, proper consultation is indispensable.

Making use of alternative forms of regulation as suggested requires a new permanent structure to be built, which could provide the Commission with independent advice on future regulatory initiatives and be responsible for organising necessary consultations.

Disclosure can be a powerful regulatory tool : it creates an incentive to comply with best practice, and allows members and third parties to take necessary actions. Disclosure requirements can be more efficient, more flexible and easier to enforce. Information and disclosure requirements are at the intersection of company law and securities regulation, and responses to the consultation confirmed that disclosure was particularly suited in the area of corporate governance.

Company law traditionally distinguished between public and private companies, but this is often not fully relevant in practice. In today's reality, the Group sees three basic types of companies : listed companies (whose shares are regularly traded), open companies (whose shares could be regularly traded), and closed companies. The regulatory approach may vary for each type of companies, taking national differences into account.

Company law should provide a flexible framework for competitive business. Using company lax for other regulatory purposes may lead to an undesirable tightening of rules. Responses to the consultation confirmed that the development and use of efficient company law structures should not be hindered by anti-abuse provisions.

Due to its profound impact on our society, modern technology may require various types of changes to company law. As to the form of legal acts and of shares, most Member States have already implemented, or started processes of implementing, new rules. As to time, generally law should not force citizens to act quicker now that modern technology allows speedier actions and decisions. As to the place where the company is located and the function that existing company law mechanisms perform, the impact of modern technology is discussed in various chapters of the present Report. The impact of modern technology on disclosure and filing is an area where the EU could take initiatives, in addition to the recently published Proposal to amend the First Company Law Directive.

Company information is currently filed an disclosed at various places, which creates efficiency problems for both companies and interested parties. The Consultative Document suggested that companies could be required to maintain a specific section on their website, and/or a link with the register. Responses to the consultation were mixed.

Easy and cheap access to core information stored in public registers and filing systems should be ensured on a cross-border basis.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item II.1 **Facilitating efficient and competitive business in Europe**	Recommendation II.1. (see p. 29) An important focus of the EU policy in the field of company law should be to develop and implement company law mechanisms that enhance the efficiency and competitiveness of business across Europe. Where mechanisms established so far to protect shareholders and creditors appear to be inappropriate impediments, they should be replaced by ones that are at least as – and preferably more – effective, and less cumbersome. In the future, the EU should concentrate primarily on the creation of the facilities necessary to operate and restructure across borders. Where various alternative systems exist in Member States for elements of the company's organisation and structure, the EU should as much as possible facilitate freedom of choice for companies across Europe.
Item II.2 **Modern Company Law making**	Recommendation II.2. (see p. 31) The EU should consider a broader use of alternatives to primary legislation (secondary regulation, standard setting and monitoring, model laws). The Group recommends that wide and expert consultation should be an integral part of any future initiative taken at EU level in the area of company law. There is a case for setting up a permanent structure which could provide the Commission with independent advice on future regulatory initiatives. The Commission, with the support of Member States, should investigate how best to set up such a structure.
Item II.3 **Disclosure of information as a regulatory tool**	Recommendation II.3. (see p. 33) The EU, in considering new – and amending existing – regulation of company law, should carefully consider whether disclosure requirements are better suited to achieve the desired effects than substantive rules. Any disclosure requirement should be based on the obligation to provide fair, relevant and meaningful information.

Item II.4 Distinguishing types of companies	Recommendation II.4. (see p. 34) The regulatory approach should be different for the three types of companies identified by the Group. Listed companies should be subjected to a certain level of uniform and compulsory detailed rules, whereas closed companies should benefit from a much higher degree of autonomy. The balance may be somewhere in between for open companies.
Item II.5 Increased flexibility vs. tightening of rules	Recommendation II.5. (see p. 36) The objective of combating fraud and abuse of companies should be achieved through specific law enforcement instruments outside company law, and should not be allowed to hinder the development and use of efficient company law structures and systems.
Item II.6 Modern technology	Recommendation II.6. (see p. 36) Listed companies should be required to maintain and continuously update a company information section on their websites, and maintain links with public registers and other relevant authorities. Other types of companies could be allowed to fulfil their filing and disclosure obligations by including such information on their websites, if appropriate links with public registers are established. Existing private initiatives to link the various registries that now contain formal company information should be encouraged by the EU. With respect to listed companies, the EU should at the minimum actively support Member States in their efforts to create national central electronic filing systems, and ensure that national systems are properly linked.

CHAPTER III - *"Corporate Governance"*

The original mandate of the Group included a review of whether and, if so, how the EU should actively co-ordinate and strengthen the efforts undertaken by and within Member States to improve corporate governance in Europe. In that light, we raised four general issues in our Consultative Document, together with general issues relating to the processes of shareholders information, communication and decision-taking. In reaction to the Enron case, the Commission and the ECOFIN have agreed to extend the mandate of the Group to review a number of specific issues related to corporate governance and auditing.

In this Chapter, we address the original and newly added issues, under five themes, and we focus primarily on the internal corporate governance elements. Before, we stress that corporate governance is a system, having its foundations partly in company law and partly in wider laws and practices and market structures.

Disclosure has a pivotal role in company law, as we said in Chapter II and as we already underlined in our First Report. The high importance of disclosure for corporate governance was confirmed by responses to the consultation, at least as far as listed companies are concerned. Information should be given by listed companies on at least the key corporate governance items listed in the present Report.

Being the residual claimholders, shareholders are ideally placed to act as a watchdog. This is particularly important in listed companies, where minority's apathy may have harmful effects. Shareholders' influence will highly depend on the costs and difficulties faced. Shareholders' influence was traditionally exercised through the general meeting, which is no longer physically attended by many. Modern technology can be very helpful here, if it is introduced in a balanced way. In order to facilitate the move towards an integrated European capital market, equivalent facilities should be offered across the EU. Facilities developed for shareholders in listed companies are likely to benefit to other companies too.

Pre-meeting communication is frequently a one-way process. The biggest difficulties and costs arise with bearer shares, but registered shares also present some problems. Modern technology may offer a solution to many problems.

Putting meeting materials and proxy forms on the company's website is efficient for both the company and its shareholders. Many responses to the consultation supported the enabling approach, but the Group believes that we should anticipate future normal practice.

Mandatory bulletin boards and chat rooms are not recommended, because of the risks of abuse which require further review of many issues.

Not all shareholders have access to electronic facilities, so that they should not be compelled at EU level to use them.

The rights to ask questions and table resolutions are often difficult to exercise, but responses to the consultation did not call for mandatory provisions at EU level in this area. In practice, the exercise of these important rights may be facilitated by modern technology, but companies should be able to take measures to keep the whole process manageable. The necessary flexibility for companies should be provided for at national level, but annual disclosure of how these rights can be exercised should be required at EU level.

The right to table resolutions is linked to the squeeze-out right, and thresholds should be set consistently.

In view of the difficulties to attend meetings, shareholders should be able to vote in absentia. The necessary facilities should be offered, but not imposed, to shareholders, to the extent that cross-border holding problems have been solved.

Some companies offer participation to general meeting via electronic means, which increase shareholders' influence in an efficient way. Use of electronic means in meetings should be possible for companies, but not yet mandatory.
In cross-border situations, shares are typically held through chains of intermediaries, which make it difficult to identify the person entitled to vote. Cross-border voting is often almost impossible in practice, and the integration of financial markets calls for an urgent solution. A separate Cross-Border Voting Group has issued its own Report in September 2002, and proposed as primary rule that the right to determine how to vote should be recognised to ultimate accountholders, who should be granted all the voting options available in the company's Member State. The issues identified by this Group should be urgently addressed at EU level, in the interests of both European and non European shareholders.
Institutional shareholders have large shareholdings with voting rights, and tend to use them more frequently than before. Responses to the consultation were mixed about a possible formalisation of the institutional investors' role. The Group believes that good governance of institutional investors requires disclosure to their beneficiaries of their investment and voting policies, and a right of their beneficiaries to the voting records showing how voting rights have been exercised in a particular case. Responses to the consultation did not support an obligation to vote, and the Group agrees that there are no convincing reasons for imposing such an obligation.
In many cases, shareholders are inclined not to vote, due to a lack of influence and/or a lack of information. The special investigation procedure offered in several Member States is an important deterrent. A EU rule on special investigation right was supported by responses to the consultation. It should be open to the general meeting or a significant minority, and any authorisation by the court or administrative body should be based on serious suspicion of improper behaviour.
Many difficulties prevent dispersed shareholders from directly monitoring management, which calls for an active role of non-executive or supervisory directors. No particular form of board structure (one-tier/two-tier) is intrinsically superior : each may be the most efficient in particular circumstances.
The presence of (a group of) controlling shareholder(s) is likely to result in closer monitoring of management, but non-executive or supervisory directors then have an important role on behalf of the minority. Their general oversight role is of particular significance in three areas, where conflicts of interests may arise : nomination of directors, remuneration of directors, and audit of the accounting for the company's performance. The need for more independent monitoring is highlighted by the US regulatory response to recent scandals. The Group does not express views on the composition of the full (supervisory) board, but intends to promote the role of non-executive / supervisory directors. Nomination, remuneration and audit committees could be set up, and composed of a majority of independent directors. To qualify as independent, a non-executive or supervisory director, apart from his directorship, must have no further relationship, with the company, from which he derives material value. Certain other relationships with the company, its executive directors or controlling shareholders may also impair independence. Related parties and family relationships should also been taken into account. With respect to the competence expected from non-executive or supervisory directors, existing rules are generally abstract. Competence must be assessed together with the role a director has on the board. Basic financial understanding is always required, but other skills may be of relevance. Competence should be properly explained to shareholders, and they should be able to assess whether sufficient time is available for the director to fulfil his role.

Remuneration of directors is one of key area of conflict of interests. In order to align the interests of executive directors with the interests of the shareholders, remuneration is often linked to the share price, but this potentially has a series of negative effects. The Group considers that there is no need for a prohibition of remuneration in shares and share options, but that appropriate rules should be in place.

Recent corporate scandals and responses highlight the key importance of trust in financial statements. At national level, the board traditionally has a collective responsibility for the probity of financial statements, which avoids undue excessive individual influence. Collective responsibility must cover all statements on the company's financial position, except for ad hoc disclosure (where proper delegation must be organised), and also all statements on key non-financial data.

The introduction of a framework rule on wrongful trading was opposed by some respondents who argued that this is a matter of insolvency law. The Group rejects this view : the responsibility of directors when the company becomes insolvent has its most important effect prior to insolvency and is a key element of an appropriate corporate governance system.

Various existing national rules make directors liable for not reacting when they ought to foresee the company's insolvency. The details of these national rules vary considerably, but they generally apply to group companies and do not interfere with on-going business decisions. The majority of responses to the consultation supported the introduction of a EU rule on wrongful trading. Without overly restricting management's decisions, such a rule would enhance creditors' confidence and introduce an equivalent level of protection across the EU.

Misleading disclosure by directors should be properly sanctioned, and applicable sanctions should be defined by Member States. Criminal and civil sanctions present some weaknesses, and the disqualification of a person from serving as a director of companies across the EU is an alternative sanction which may be easier to effectuate and has a powerful deterrent and longer disabling effect.

A proper audit is fundamental to good corporate governance. Some initiatives have already been taken by the Commission, among which the Recommendation on Auditor Independence. A new Communication on Audit is expected soon. In the present Report, the Group has focused on the internal aspects of auditing practices. As explained above, the Group believes that there is a key role to play for non-executive or supervisory directors who are in the majority independent. The main missions of the audit committee, which in practice is often set up for these purposes, are summarised in the present Report with respect to both the relationship between the executive managers and the external auditor, and the internal aspects of the audit function.

In the Consultative Document, the Group expressed reservations about the establishment of a EU corporate governance code : the adoption of such a code would not achieve full information for investors, and it would not contribute significantly to the improvement of corporate governance in Europe. A clear majority of responses to the Consultative Document rejected the creation of a European corporate governance code.

However, the Group believes that there is an active role for the EU to play in corporate governance, apart from the various initiatives we suggested above. The EU should indeed co-ordinate the efforts of Member States to facilitate convergence, including with respect to enforcement, on a continuous basis and taking account of US developments.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item III.1 **Annual Corporate Governance Statement**	Recommendation III.1. (see p. 45) Listed companies should be required to include in their annual report and accounts a coherent and descriptive statement covering the key elements of the corporate governance rules and practices they apply. This statement should also be separately posted on the company's website. The principles applicable to such an annual corporate governance statement should be set up in a framework Directive. The detailed rules should be set up by Member States in view of their national company laws, but the EU should ensure a certain level of co-ordination. Such a statement should contain a reference to the designated national code of corporate governance and/or company law rules with which the company complies or in relation to which it explains deviations. Responsibility for the annual corporate governance statement should lie with the board as a whole.
Item III.2 **Notice an pre-meeting communication – Use of websites**	Recommendation III.2. (see p. 49) Listed companies should be required to maintain a specific section on their website where they publish all information relevant for their shareholders, as recommended in Chapter II. This section should include all relevant materials relating to shareholders meetings, and should offer facilities for giving proxies or voting instructions on-line or for downloading and electronic transmission of proxy or instruction forms. Member States should however be able to require listed companies to provide hard copies of meeting materials and voting forms to shareholders who specifically request them.
Item III.3 **Notice and pre-meeting communication – Rights to ask questions and to submit proposals for resolution**	Recommendation III.3. (see p. 51) Listed companies should explicitly disclose to their shareholders how they can ask questions, how and to what extent the company intends to answer questions, and how and under what conditions they can submit proposals to the shareholders meeting. This should be an element of their mandatory annual corporate governance statement. With respect to the right to submit proposals for resolution by the shareholders meeting, there is a link with the squeeze-out right of a majority shareholder and sell-out right of minority shareholders. Member States should be required to set the applicable thresholds in a consistent way.
Item III.4 **Voting in absentia –** **Electronic facilities**	Recommendation III.4. (see p. 52) Listed companies should be required to offer all shareholders facilities to vote in absentia – by way of direct vote or proxies – by electronic means, and through hard copy voting instruction or proxy forms at their request. The Group recommends that such a requirement should not apply to cross border situations to the extent that any necessary solutions have not yet been found and implemented for the problems of cross-border holding of securities in Europe.
Item III.5 **General meetings –** **Participation via electronic means**	Recommendation III.5. (see p. 52) Listed companies should be permitted, but not required, to allow absentee shareholders to participate in general meetings via electronic means (such as internet or satellite). The permission to abandon the physical meeting should be a Member State decision, but such a decision should in any event be taken by – or with the consent of – the general meeting of shareholders with an appropriate strong qualified majority.

Item III.6 **Cross-border voting**	Recommendation III.6. (see p. 53) A separate Group of Experts set up in January 2002 by the Dutch Minister of Justice issued its Final Report on cross-border voting in September 2002. In that Report, it is recommended that the rights and obligations of accountholders and securities intermediaries be regulated at EU level, to ensure that accountholders across the EU can effectively exercise the voting rights on shares they hold. The issues identified by that Cross-Border Voting Group, combined with the relevant recommendations of the Group, should be considered by the Commission as a matter of priority, with a view to building a regulatory framework that facilitates the participation of shareholders across the EU and, where possible, outside the EU, in the governance of listed companies.
Item III.7 **Responsibilities of institutional investors**	Recommendation III.7. (see p. 56) Regulation of the relevant types of institutional investors by Member States should include an obligation on those institutional investors to disclose their investment policy and their policy with respect to the exercise of voting rights in companies in which they invest, and to disclose to their beneficial holders at their request how these rights have been used in a particular case.
Item III.8 **Minority shareholders' special investigation right**	Recommendation III.8. (see p. 61) Shareholders, in a general meeting or holding a maximum of at least 5 or 10 per cent of the share capital, should be given the right to apply to a court or appropriate administrative body to order a special investigation. A European framework rule should be adopted to this end, whereby this special investigation right should be guaranteed in all companies and as far as possible on a group-wide basis. Details of the procedure and determination of proper sanctions should be left to Member States.
Item III.9 **Board structures**	Recommendation III.9. (see p. 59) At least listed and other open companies across the EU should have the choice between the two types of board structure (one-tier / two-tier), so as to be able to elect the system which best suits their particular corporate governance needs and circumstances.
Item III.10 **Role of (independent) non-executive and supervisory directors**	Recommendation III.10. (see p. 60) Listed companies should be required to ensure that the nomination and remuneration of directors and the audit of the accounting for the company's performance within the board are decided upon by exclusively non-executive or supervisory directors who are in the majority independent. The Commission should rapidly issue a Recommendation to Member States that they should have effective rules in their company laws or in their national corporate governance codes to this end, which should be enforced on a "comply or explain" basis at the minimum. The Recommendation should include principles on independence, and could include a list of relationships which would lead a non-executive or supervisory director to be considered as not independent. Listed companies should be required to disclose in their annual corporate governance statement which of their directors they consider to be independent and on what grounds. Similar disclosure should be made when a new director is proposed for appointment. Listed companies should include in their annual corporate governance statement a profile of the board's composition, and should explain why individual non-executive or supervisory directors are qualified to serve on the board in their particular roles. Similar disclosure should be made in proposals for initial appointment. Listed companies should also be required to disclose what board positions in other companies their non-executive or supervisory directors hold.

Item III.11 **Remuneration of directors**	Recommendation III.11. (see p. 64) The remuneration policy for directors generally should be disclosed in the financial statements of the company, and should be an explicit item for debate on the agenda of the annual meeting. The individual remuneration of directors of the company, both executive and non-executive or supervisory directors, is to be disclosed in detail in the financial statements of the company. Schemes granting shares and share options and other forms of remuneration of directors linked to the share price should require the prior approval of the shareholders meeting, on the basis of a proper explanation by the remuneration committee of the applicable rules and of their likely costs. The costs of all share incentive schemes should be properly reflected in the annual accounts, and this accounting principle should be recognised in a European framework rule. The Commission should adopt a Recommendation defining an appropriate regulatory regime for directors' remuneration in listed companies, which should include the four elements outlined above.
Item III.12 **Management responsibility for (financial) statements**	Recommendation III.12. (see p. 67) Responsibility for the probity of financial statements should be attributed, as a matter of EU law, to all board members on a collective basis. This responsibility should extend to all statements made about the company's financial position, as well as to all statements on key non-financial data (including the annual corporate governance statement).
Item III.13 **Wrongful trading rule**	Recommendation III.13. (see p. 68) A rule on wrongful trading should be introduced at EU level, which would hold company directors (including shadow directors) accountable for letting the company continue to do business when it should be foreseen that it will not be able to pay its debts.
Item III.14 **Sanctions – Director's disqualification**	Recommendation III.14. (see p. 69) Appropriate sanctions for misleading financial and other key non-financial statements should generally be determined by Member States. The Commission should nevertheless review whether director's disqualification can be imposed at EU level as a sanction, at least for misleading financial and key non-financial disclosures or more generally for misconduct.
Item III.15 **Audit committees**	Recommendation III.15. (see p. 70) The responsibility for supervision of the audit of the company's financial statements should lie with a committee of non-executive or supervisory directors who are at least in the majority independent. Provisions on the role and responsibilities of audit committees (or any equivalent body), with respect to both the external and internal aspects of audit, should be included in the proposed Recommendation on the role of non-executive and supervisory directors.
Item III.16 **Corporate governance codes – Co-ordination**	Recommendation III.16. (see p. 72) The key input for codes of corporate governance should continue to come from the markets and their participants. Each Member State should designate one particular corporate governance code as the code with which companies subject to their jurisdiction have to comply or by reference to which they have to explain how and why their practices are different. A structure should be set up at EU level to facilitate the co-ordination of Member States efforts to improve corporate governance. Co-ordination should not only extend to the making of codes, but also to the procedures Member States have in place to monitor and enforce compliance and disclosure. Member States should be required to participate in the co-ordination process, but the results should be non-binding.

CHAPTER IV - *"Capital Formation and Maintenance"*

The concept of legal capital is seen as one of the cornerstones of European Company Law : its main function is seen to be creditor and shareholder protection. Many responses to the consultation stressed that legal capital is not in practice effective in attaining its objectives.

The European legal capital regime is generally not considered a competitive disadvantage for European companies, but it is no competitive advantage either. Legal capital is criticised for failing to protect creditors : it is a poor indication of the company's ability to pay its debts. The current regime is arguably inflexible and costly. Finally, annual accounts have become an inadequate yardstick for making decisions on distributions and for assessing the company's ability to pay its debts.

Most respondents agree that there is room for improvement of the current regime, although there is controversy on which is the best possible course to reform the present system.

In the Consultative Document, three alternative approaches were considered :
- a first approach based on the SLIM proposals, supplemented by further recommendations ("SLIM-Plus");
- a second approach inspired by the US experience, which would lead to a radical departure from the concept of legal capital, from many rules on capital formation and maintenance, and from the current balance of powers between shareholders and board of directors;
- a third approach based on the elimination of the concept of legal capital, but with retention of shareholders control.

Very few respondents expressed support for the second approach. A substantial number of respondents preferred the first and third approaches, with some of the respondents opting for one of them, but without excluding the other.

Any modernisation of the current capital formation and maintenance regime has to be selective : it should remove, where possible, the defects perceived in it, while maintaining its virtues. The SLIM Group made a number of suggestions for changing the Second Directive, which we discussed together with some other questions.

In considering the modernisation of the current regime ("SLIM-Plus"), the Group noted that :

a) the minimum capital requirement serves only one function, but it is not seen as a significant hurdle to business activity;

b) the introduction of no par value shares is widely demanded;

c) valuations of non-cash contributions by independent experts are expensive and do not offer a total guarantee of the assets' real value; responses to the consultation welcomed the possibility of allowing the provision of services as contribution in kind, with appropriate safeguards;

d) there is a case for simplifying the conditions under which listed companies can restrict or withdraw pre-emption rights when they issue new shares;

e) there is a case for applying the current regime - for creditor protection in the case of capital reduction - in all restructuring transactions; and for re-evaluating the need for such a protection when the capital is reduced to adjust to losses;

f) acquisition of own shares, and taking them as security, should be possible within the limits of the distributable reserves;

g) a majority of respondents believe that the prohibition of financial assistance should be relaxed;

h) the squeeze-out and sell-out rights should be introduced generally (and not only after a takeover bid);

i) the effectiveness of the legal capital regime could be improved by the introduction of rules on wrongful trading, and on subordination of insiders' claims.

Responses to the consultation supported the development of an alternative regime for creditor protection within a framework of shareholder control.

In considering such an alternative regime, the Group noted that :

a) legal capital offers little protection for creditors against unconsidered distribution of assets, and no protection when the capital is reduced to account for, or write off, losses; creditors – and shareholders – can be better protected if an adequate solvency test is developed;

b) the protection of shareholders can be substantially improved without the concept of legal capital.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item IV.1 **Improvement of the current legal capital regime – Two step approach :** **1. SLIM-Plus** **2. Alternative regime**	Recommendation IV.1. (see p. 79) The Group agrees with most of the respondents to the consultation that there is room for improvement of the current legal capital regime, and proposes a two step approach. The Commission should, as a matter of priority, present a proposal for reform of the Second Company Law Directive, along the lines suggested by the SLIM Group, with the modifications and supplementary measures that are suggested in the present Report ("SLIM-plus"). Any modernisation of the current regime should remove, where possible, the defects perceived in it, while maintaining its virtues. The Commission should, at a later stage, conduct a review into the feasibility of an alternative regime, based on the third approach presented in the Consultative Document. The alternative regime need not replace the capital formation and maintenance rules of the Directive as amended according to the "SLIM-plus" proposals. Rather, the new regime could be offered as an alternative option *for Member States*, who should be able to freely decide to change to the new regime and impose it on companies subject to their jurisdiction or to retain the Second Directive rules as modified by the "SLIM-plus" reform. The alternative regime should at least be as effective in achieving the objectives of creditor and shareholder protection as the regime based on legal capital.
Item IV.2 **SLIM-Plus –** **Minimum capital**	Recommendation IV.2. (see p. 82) It is probably wise not to spend much time on minimum capital in a reform to make the current system more efficient, and to direct attention to issues which are more relevant. The minimum capital requirement should not be removed, nor increased.
Item IV.3 **SLIM-Plus –** **No par value shares**	Recommendation IV.3. (see p. 82) The Second Company Law Directive already allows for shares to have a fractional value (also referred to as "accountable par") rather than a nominal value (see for example Article 8 providing that shares cannot be issued below their nominal or fractional value). Such shares would have to include the appropriate fraction or the total number of shares, together with the date in which the fraction or the total number of shares was correct, and a reminder that the correct fraction can be obtained at any time from the company itself, or from the companies Register. It is debatable whether introducing shares without any reference to either nominal or fractional value would constitute a significant change in the system of the Second Company Law Directive. We recommend that, as part of SLIM-Plus, it is reviewed how no par value shares can be accommodated within the Second Company Law Directive.

Item IV.4 **SLIM-Plus – Contributions in kind**	Recommendation IV.4. (see p. 83) With respect to contributions in kind, the requirement for an expert valuation should be eliminated in certain cases where clear and reliable points of reference for valuation already exist (market price, recent evaluation, recent audited accounts). In addition, the Commission should review the possibility of allowing, with appropriate safeguards, the provision of services as contribution in kind.
Item IV.5 **SLIM-Plus – Pre-emption rights**	Recommendation IV.5. (see p. 84) As the SLIM Group has suggested, for listed companies it would be appropriate to allow the general meeting to empower the board to restrict or withdraw pre-emption rights without having to comply with the formalities imposed by Article 29 §4 of the Second Directive, but only where the issue price is at the market price of the securities immediately before the issue or where a small discount to that market price is applied. If real no par value shares are to be introduced, the suppression of pre-emption rights needs to be reconsidered as pre-emption rights may then be the only effective protection left at EU level for shareholders against dilution.
Item IV.6 **SLIM-Plus – Capital reduction**	Recommendation IV.6. (see p. 84) The current regime for creditor protection (right to apply to a court to obtain security for their claims) in the case of capital reduction should be applied in all restructuring transactions. The burden of proof should be on the creditors. In addition, there is a case for re-evaluating whether some safeguards are needed for creditors in the event of capital reduction to adjust legal capital to losses.
Item IV.7 **SLIM-Plus – Acquisition of own shares**	Recommendation IV.7. (see p. 84) Acquisition of own shares should be allowed within the limits of the distributable reserves, and not of an entirely arbitrary percentage of legal capital like the 10% limit of the current Directive. The same should apply to the taking of own shares as security. It should be possible to establish flexible requirements at least for unlisted companies.
Item IV.8 **SLIM-Plus – Financial assistance**	Recommendation IV.8. (see p. 85) Financial assistance should be allowed to the extent of the distributable reserves. A shareholders' resolution should in principle be required. The shareholders meeting should be allowed to authorise the board for a maximum period of time (e.g. five years) to engage the company in financial assistance within the limits of the distributable reserves. If this facility is to be allowed, there should be disclosure.
Item IV.9 **SLIM-Plus – Compulsory withdrawal of shares**	Recommendation IV.9. (see p. 85) The SLIM Group has recommended that a compulsory withdrawal of shares should be possible when a shareholder has acquired 90% of the capital, as an exception to the provision of Article 36 of the Directive that compulsory withdrawal is only possible if this is provided in the deed of incorporation or articles of association. The recommendations made in Chapter VI of this Report on squeeze-out and sell-out rights - for listed and open companies - would effectively deal with the issue addressed by the SLIM Group.
Item IV.10 **SLIM-Plus – Wrongful trading and subordination of insiders' claims**	Recommendation IV.10. (see p. 86) The responsibility of directors when the company becomes insolvent has its most important effect prior to insolvency and this is a key element of an appropriate corporate governance regime. We recommend that as an element of good corporate governance, a European framework rule should be introduced on wrongful trading, combined with the concept of "shadow" directors. The concept of subordination of insiders' claims could be considered as part of the development of an alternative regime for creditor protection (see below).

Item IV.11 Alternative regime – Solvency test	Recommendation IV.11. (see p. 87) In the alternative regime to be considered at a later stage, a proper solvency test should be required for any payment of dividend or other distribution. The solvency test should be based at least on two tests to be performed before making the distribution : a balance sheet test and a liquidity test. Further study is required in order to develop these two tests, as well as the valuation methods to be used. The study should also consider requiring a certain solvency margin and reviewing the relevance of the going concern concept. Directors of the company should issue a solvency certificate, in which they explicitly confirm that the proposed distribution meets the solvency test. Directors are responsible for the correctness of the solvency certificate and Member States should impose proper sanctions, which could be extended to "shadow" directors.
Item IV.12 Alternative regime – Pre-emption rights	Recommendation IV.12. (see p. 89) In the alternative regime to be considered at a later stage, exclusion or limitation of pre-emption rights should only be possible on the basis of an explicit shareholders' resolution, which is based on objective criteria.
Item IV.13 Alternative regime – Issue of new shares	Recommendation IV.13. (see p. 89) In the alternative regime to be considered at a later stage, a company should not be able to issue shares at a price that bears no relation to the real value of the existing shares. The alternative regime should provide that shares must be issued at fair value, which would substantially improve the protection of shareholders as compared to the current legal capital regime. When elaborating the effects of this principle, the case could be considered for making a distinction between listed and unlisted companies.
Item IV.14 Alternative regime – Contributions in kind	Recommendation IV.14. (see p. 89) In the alternative regime to be considered at a later stage, the issue of contributions in kind should be properly addressed. One possibility would be to require a shareholders resolution for any share issue for which a contribution in kind is made (subject to the exceptions already adopted in the Second Directive for such valuations). The directors could be required to certify the appropriateness of the issue in exchange for the contribution in view of the fair value of the shares. There would need to be appropriate protection for minorities.

CHAPTER V - *"Groups and Pyramids"*

Groups of companies today are frequent in most, if not all, Member States. Responses to the consultation supported the view that groups are a legitimate way of doing business, but recognised at the same time that there is a need for protection of some interests. The Group believes that the existence of risks does challenge neither the legitimacy of groups nor the limited liability principle. The Group takes the view that the enactment of an autonomous body of law, specifically dealing with groups, is not recommended at EU level, but that particular problems should be addressed in three areas.

Responses to the consultation have revealed that transparency is felt as the most important area of intervention with regard to groups. The consultation has confirmed that the actual provisions of the Seventh Company Law Directive do not sufficiently address these concerns, and respondents have suggested a number of areas where specific information should be provided.

The Group takes the view that increased disclosure with regard to a group's structure and relations is needed, and indicates areas where mandatory disclosure would be appropriate.

Some Member States do not recognise the interest of the group as such. The acknowledgement of the legitimacy of groups should actually lead to the recognition of the special position created by the membership of a group. In several Member States, a transaction made for the benefit of the group is legitimate, if the prejudice suffered by a particular company is justified by other advantages.

When groups become insolvent, the separate treatment of individual group companies' bankruptcies causes both procedural and substantive problems. In some Member States, a consolidated approach to group bankruptcies is possible under certain circumstances.

A pyramid is a chain of holding companies, with the ultimate control based on a small total investment. Pyramids extensively use minority shareholders, often through a series of separate stock exchange listings. Pyramids are a source of agency costs, and a number of problems stem from their lack of transparency.

Pyramids are difficult to regulate with specific rules, but the disclosure recommendations made in Chapter III are very relevant for dealing with pyramid structures. Pyramidal groups that include listed companies raise particular concerns, which should be properly addressed.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item V.1 **Ninth Company Law Directive**	Recommendation V.1. (see p. 94) No new attempt to enact the Ninth Company Law Directive on group relations should be undertaken, but particular problems should be addressed through modifying existing provisions of corporate law in the following three areas.

Item V.2 **Transparency of group structure and relations**	Recommendation V.2. (see p. 95) Increased disclosure with regard to a group's structure and relations is needed, and the parent company of each group is to be made responsible for disclosing coherent and accurate information. The Commission should review the Seventh Company Law Directive's provisions in the light of the need for better financial disclosure, and consider whether improvements can be made consistent with International Accounting Standards. With respect to non financial disclosure, it should be ensured that – especially where listed companies are involved – a clear picture of the group's governance structure, including cross-holdings and material shareholders' agreements, is given to the market and the public. In addition, companies could be required to provide specific information when they enter into or exit from a group.
Item V.3 **Tensions between the interests of the group and its parts**	Recommendation V.3. (see p. 96) Member States should be required to provide for a framework rule for groups that allows those concerned with the management of a group company to adopt and implement a co-ordinated group policy, provided that the interest of the company's creditors are effectively protected and that there is a fair balance of burdens and advantages over time for the company's shareholders. The Commission should review the possibilities to introduce in Member States rules on procedural and substantive consolidations of bankruptcies of group companies.
Item V.4 **Pyramids**	Recommendation V.4. (see p. 98) The EU should require national authorities, responsible for the admission to trading on regulated markets, not to admit holding companies whose sole or main assets are their shareholding in another listed company, unless the economic value of such admission is clearly demonstrated. Finally, operators of stock indices should properly take into account the free float in determining the weight of each company.

CHAPTER VI - *"Corporate Restructuring and Mobility"*

Under this heading, the Group raised primarily five major topics in its Consultative Document :
- change of corporate seat, or domicile;
- the position of the acquiring company in a domestic merger under the Third Company Law Directive;
- the acquisition of a wholly owned subsidiary by the same means;
- creditor protection in restructuring transactions;
- squeeze-outs and sell-outs.

The need for Community company law provisions facilitating cross frontier restructuring figured as a high priority in almost all the responses to the Document, and there were calls for the Commission urgently to bring forward revised proposals for a Tenth and a Fourteenth Company Law Directives.

Where a company moves its real seat but not its registered office between two states which attach no importance to that move ("incorporation doctrine states"), neither the sates concerned directly in the change nor third states have any interest in inhibiting the move.

There was almost unanimous agreement that for a Member State to adopt a version of the "real seat doctrine" which automatically denies recognition to a company which has its real seat in a country other than that of its incorporation was a disproportionate measure which can never be justified.

Most respondents agreed that, in the case of a transfer of the real seat into a "real seat doctrine" state, there was a case for permitting the law of incorporation to be overridden to the extent necessary to respect requirements of the host state. The Group agrees with this view, but believes that any sanction inhibiting the freedom of movement should be subject to general EU principles, and it illustrates how they can be applied to various company law measures (capital maintenance; disclosure transparency and security of transactions; governance and company structure; employee participation).

A transfer of the real seat out of a state of origin may be regarded as a means of escaping the law of origin, but any sanctions imposed by that state should be subject to the same general principles. In addition, where the new host state seeks to impose its own law, a conflict of law may arise.

Third states are unlikely to be concerned in cases of moving real seat between a home and a host state, but a general rule should be developed with respect to the identification of the applicable law where necessary.

The Consultative Document noted that some provisions (e.g. special general meeting) of the Third Directive on domestic mergers serve no purpose for the acquiring company, given the nature and the effect of the transaction at issue, and therefore suggested that for domestic mergers such requirements should be removed at EU level and that for international mergers the Member State of the acquired company should be bound to accept the relaxation adopted by the Member State of the acquiring company. Similar considerations apply to the position of an acquiring company under the Sixth Directive. The great majority of responses agreed with these suggestions.

The case for relaxations of special requirements is even clearer for the acquisition by merger of a wholly owned subsidiary by its parent, and this was supported by almost all responses.

There is a wide diversity of practice in Member States in relation to creditor protection in restructuring transactions, while the policy considerations are the same and seem adequately met by the Second Directive provision on reduction of capital.

Responses to the consultation showed widespread support for the introduction of a squeeze-out and a sell-out rights, which would not be limited to the acquisition of a majority by way of a takeover bid.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item VI.1 **Tenth and Fourteenth Company Law Directives**	Recommendation VI.1. (see p. 101) There is a perceived need for Community action in the legislative field with regard to corporate restructuring and mobility, especially in the cross-border context. The Commission should urgently bring forward revised proposals for a Tenth Company Law Directive on Cross-Frontier Mergers and a Fourteenth Company Law Directive on Transfer of the Registered Office. Proposals in preparation are faced with the task of solving difficulties relating to board structure and employee participation. The solutions to these problems in the ECS may present a possible model for these issues.
Item VI.2 **Transfer of real seat between Incorporation Doctrine States**	Recommendation VI.2. (see p. 102) Where a company moves its real seat between two "incorporation doctrine states", there should be no room at Member State level or at EU level for attaching any sanctions to such a move which would be a wholly unnecessary interference with freedom of movement and operation of companies across the Community. This is likely to be found to be the effect of the Treaty. However, existing and proposed EU legislation should be aligned with this view.
Item VI.3 **Transfer of real seat into Real Seat Doctrine State**	Recommendation VI.3. (see p. 103) Where a company transfers its real seat to a real seat state, the law of the "host" state should be permitted to override the law of incorporation of the "guest" company, but only within the limits imposed by the principles of legitimate general interest, proportionality, minimum intervention, non-discrimination and transparency. External requirements of the "host" state, duly imposed on foreign companies with a view to these principles, should make any interference with internal governance of these companies redundant. This is especially true for the areas of capital maintenance, governance and company structure and employee participation. With regard to the latter, it is imperative that restructuring through liquidation and re-incorporation be only the ultimate step : any such remedy should allow the company and its organs sufficient time and opportunity to respond to the domestic requirements.
Item VI.4 **Transfer of real seat out of Real Seat Doctrine State**	Recommendation VI.4. (see p. 106) Where a company transfers its real seat out of a real seat state, any sanctions imposed by the "home" state should be subject to the above mentioned principles as well, and any conflict of law then still prevailing ought to be solved by reciprocity.
Item VI.5 **Transfer of real seat – Position of Third States**	Recommendation VI.5. (see p. 106) Third states, if concerned at all by a company's move of real seat, should be made to apply, in principle, the law of incorporation, with a renvoi to the law of the host state where appropriate.

Item VI.6 **Third Directive Mergers – Position of the acquiring company**	Recommendation VI.6. (see p. 107) With respect to domestic mergers, Member States should be allowed to relax special requirements of the Third Directive which are faced by the acquiring company. In order to facilitate international mergers, Member States of the acquired company should be required to accept such relaxation where it was adopted by the Member State of the acquiring company.
Item VI.7 **Third Directive Mergers – Acquisition of wholly owned subsidiary**	Recommendation VI.7. (see p. 108) Similar considerations apply to the acquisition by merger of a wholly owned subsidiary by its parent company. Consequently, relaxation of special requirements in domestic mergers should be permitted to the Member State of the acquiring company, and acceptance in international mergers of such relaxation, should be required from the Member State of the acquired company.
Item VI.8 **Creditor protection in restructuring transactions**	Recommendation VI.8. (see p. 109) A harmonised provision on creditor protection should be adopted at EU level to facilitate restructuring within the Community based on the Second Company Law Directive provision enabling a creditor to apply to the court where he can show that the company has not provided reasonable measures of protection.
Item VI.9 **Squeeze-outs and sell-outs**	Recommendation VI.9. (see p. 109) Member States should be required to create squeeze-out and sell-out rights at a level to be set at a 90% as a minimum and 95% as a maximum majority on a class by class basis, for listed and open companies. Before applying a similar regime to closed companies, further study into the relationship with contractual exit arrangements, etc. is required.

CHAPTER VII - *"The European Private Company"*

The Societas Europaea (SE) has been adopted in October 2001. The SE allows companies to merge and transfer their seat, across borders, and to do business as a "European company".

But SEs may not meet all the expectations of the business community, in particular SMEs. A European form of private company is promoted by a private initiative, to facilitate SMEs business in Europe, in particular through joint ventures.

This private initiative resulted in a proposal for a European Private Company (EPC). The proposal has been supported by UNICE and Eurochambers, as well as by the European Economic and Social Committee. The proposal is based on contractual freedom, and is presented as an adequate vehicle for SMEs active in different Member States.

On the other hand, it is argued by opponents that an EPC statute would be of little use if national companies were allowed to merge and transfer their seats across borders. Opponents also argue that the specific needs of SMEs could be met by a modernisation of national forms of private companies, in which process the proposal for a European Private Company could be used as a model for regulation at national level.

Responses to the consultation stressed that there are strong reasons to promote a European form dedicated to SMEs : a specific EU form should not be reserved to large companies, a flexible structure for joint ventures is necessary, the costs linked to the creation and operation of subsidiaries in other Member States would be greatly reduced, and the "European label" may be useful.

Respondents generally did not perceive the adoption of a model law as an adequate answer to the needs expressed by SMEs.

Any proposal regulating the EPC will have to address the information, consultation and participation rights of employees. Opinions differ on how these issues should be regulated. Conclusions on these issues have been reached by the European Economic and Social Committee, and the Group has not considered these issues in further detail.

The SE can be set up in one of four ways; the requirements imposed on the formation of SEs are not sufficiently flexible for SMEs.

Contrary to the SE Statute, which often refers to national law, the EPC has been drafted as a genuine European company, not subject to national company laws, in order to facilitate its international use. In such a situation, the European Court of Justice would have an important role to play : some are concerned about the difficulties which might arise, whereas others are more confident.

The majority of respondents, and the Group, find that a reference to national private law is unavoidable, since existing company laws in Member States are embedded in national bodies of private law.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item VII.1 European Private Company – Need for an EPC statute	Recommendation VII.1. (see p. 113) The desire to have an EPC statute to serve the needs of SMEs in Europe has been clearly and repeatedly expressed. However, the first priority should be to adopt the Tenth Directive on cross-border mergers, which is expected to meet one of the purposes of the EPC statute. The Group recommends that, before deciding to submit a formal proposal, the Commission carries out a feasibility study in order to assess the additional practical need for – and problems related to – the introduction of an EPC statute.
Item VII.2 European Private Company – Incorporation	Recommendation VII.2. (see p. 116) When considering the introduction of an EPC statute, the requirements imposed on the formation of an EPC should be sufficiently flexible to facilitate proper development of such new form. The EPC should be open to individuals, and not only companies, and the founders should not be required to come from several Member States. A minimum requirement would however be that the EPC is undertaking activities in more than one Member State.
Item VII.3 European Private Company – Reference to national law	Recommendation VII.3. (see p. 117) When considering the introduction of an EPC statute, a proper connection with the law of the jurisdiction of incorporation is to be established, since many concepts of private law are also applicable in company law.

CHAPTER VIII - *"Co-operatives and Other Forms of Enterprises"*

The European Council recently adopted a general orientation on the Regulation on the Societas Cooperativa Europaea (SCE). The approach for the SCE has been to take advantage of the substantial work developed in the harmonisation of company law at EU level, and the Regulation therefore includes a high number of references to provisions in existing Company Law Directives.

In the Consultative Document, we asked questions on the need for and the usefulness of proposals for Regulations creating the European Association and the European Mutual Society. The questions elicited few answers, but a majority of the responses received express positive views on these proposals. In addition, respondents generally felt that the EU should not seek to harmonise the underlying rules for associations and mutual societies.

The Group fails to see how uniform regulations of the European Association and European Mutual Society could be achieved if there is no agreement on harmonisation of the underlying national rules. On the other hand, the Group acknowledges that the progress made on the SCE regulation represents an important precedent for the other proposed Regulations.

In the Consultative Document, we raised similar questions on the need for and feasibility of a regulation for the European Foundation. The Group notes that the differences in national regulation by Member States seem to be here even more profound.

There is a concern that alternative forms of enterprises are used in the governance of listed companies to avoid application of transparency requirements on controlling shareholders.

There is also a concern that other legal forms sometimes operate substantial businesses in competition with companies, without being subject to similar disclosure and general corporate governance standards, which may lead to unfair competition.

The Consultation Document sought views on the usefulness of an EU definition of the concept of enterprise. Respondents showed a clear opposition to such a European rule.

A substantial percentage of respondents agree that the lack of information on basic data of some of these alternative forms of enterprise causes problems, in particular when contracting across borders in the EU, and that it would be appropriate to introduce basic disclosure requirements for certain economic actors. A substantial harmonisation program is however rejected.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item VIII.1 European Association / European Mutual Society	Recommendation VIII.1. (see p. 120) A European form of Association and a European form of Mutual Society are not regarded by the Group as priorities for the short and medium term. The impact of the forthcoming SCE Regulation on the co-operative enterprise should be studied closely before putting further efforts into creating these other European forms.
Item VIII.2 European Foundation	Recommendation VIII.2. (see p. 122) The Group reached the same conclusions about the need for and feasibility of a Regulation on the European Foundation, which might be even more difficult to achieve.

Item VIII.3 Alternative forms of enterprises – Model laws	Recommendation VIII.3. (see p. 122) The development of European legal forms for alternative forms of enterprises could benefit from a different regulatory approach : proponents of these European legal forms could consider themselves developing model laws for them. The EU could consider facilitating this work, which would contribute to basic convergence.
Item VIII.4 Alternative forms of enterprises – Disclosure	Recommendation VIII.4. (see p. 122) When alternative forms of enterprise are controlling shareholders, disclosure requirements, in particular relating to governance structures, should be extended to them. When these alternative forms operate substantial businesses, fair competition may require extension to them of disclosure and corporate governance standards.
Item VIII.5 General rules for enterprises – European definition	Recommendation VIII.5. (see p. 123) With respect to the usefulness of a European definition of the concept of enterprise, the Group recognises the difficulty of finding such a definition and therefore suggests that, if there is to be an EU initiative aimed at regulating entities regardless of their form, a list-based approach should be taken, in which every Member State lists the entities which would be subject to such a legislative instrument.
Item VIII.6 General rules for enterprises – Registration	Recommendation VIII.6. (see p. 123) In order to ensure access to basic information on alternative forms of enterprises, a framework Directive could require the registration of, at least, all limited liability entities with legal personality that engage in economic activities. Such a Directive should take advantage of technological developments, and linking of registries across the EU should be established.

CHAPTER IX - *"Priorities for Action"*

In this Report, we make a number of specific recommendations relating to various elements of the regulatory framework for company law in Europe.

If our recommendations are to be followed up, this will result in a substantial number of company law initiatives to be taken. Not all of this can be achieved simultaneously, and priorities will have to be set. The Group discussed possible priorities, and presents them in this Report.

The Group believes that much is to be gained from the setting up of a permanent structure to provide the Commission with independent advice on future regulatory initiatives in the area of EU company law.

The EU agenda for company law reform will be full the coming years, and it will require efforts of many. But the Group is confident that the results of these efforts will make them worthwhile.

On the basis of these observations, the Group makes the following recommendations.

Subject	Recommendation
Item IX.1 Company Law Action Plan	Recommendation IX.1. (see p. 125) The Commission should prepare a Company Law Action Plan which sets the EU agenda, with priorities, for regulatory initiatives in the area of company law and agree such an action plan with the Council and the European Parliament.
Item IX.2 Permanent advisory structure	Recommendation IX.2. (see p. 127) The setting up of a permanent structure to provide the Commission with independent advice on future regulatory initiatives in the area of EU company law should be duly considered.

CHAPTER I

INTRODUCTION

This document constitutes the High Level Group of Company Law Experts' Final Report, in conformity with the Group's terms of reference which were defined by the European Commission on 4 September 2001 and subsequently extended as a consequence of the Oviedo ECOFIN Council in April 2002.[1]

The Group's final report is based on Commission mandate

The Group was set up by the European Commission to provide independent advice in the first instance on issues related to pan-European rules for takeover bids and subsequently on key priorities for modernising company law in the EU.

Second part of the mandate is related to modern company law

According to the Group's mandate, these key priorities are :

- the creation and functioning of companies and groups of companies, co-operatives and mutual enterprises, including Corporate Governance;
- shareholders' rights, including cross-border voting and virtual general meetings;
- corporate restructuring and mobility (for instance, the transfer of the corporate seat);
- the possible need for new legal forms (for instance, a European Private Company, which would be of particular relevance for SMEs);
- the possible simplification of corporate rules in light of the SLIM-report on the Second Company Law Directive of 13 December 1976 on the formation and capital maintenance of public limited liability companies.

Key priorities listed in second part of the mandate

In pursuing its mandate, the Group has published a Consultative Document on the issues specified in the second part of its mandate, but including also general themes which appeared to be of importance for the future development of company law in Europe.

The Group published a comprehensive Consultative Document

Thus, the Consultative Document eventually concentrated on the following topics:

Which covered both :

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[1] A copy of the Group's terms of reference is provided for in Annex 1.

General Themes

a) General themes:

- Facilitating efficient and competitive business in Europe
- Modern company law making
- Disclosure of information as a regulatory tool
- Distinguishing types of companies
- Increased flexibility vs. tightening of rules
- Modern technology

And specific topics

b) Specific topics:

- Corporate Governance
- Shareholder information, communication and decision-making
- Alternatives to capital formation and maintenance rules
- The functioning of groups of companies
- Corporate restructuring and mobility
- The European Private Company
- Co-operatives and other forms of enterprise

This Report presents the conclusions and recommendations of the Group

Based on the responses received in this consultation[2], on the discussions in the hearing held on 13 May 2002 and on its own discussions, the Group now presents its conclusions and recommendations to the Commission and to the public in this Final Report[3].

[2] A summary of the main comments received by the Group is included in Annex 3.
[3] The Group's working methods are further described in Annex 2.

CHAPTER II

GENERAL THEMES

In the Consultative Document, we raised a number of general themes that we believed followed from the mandate given to the Group "to provide recommendations for a modern regulatory European company law framework designed to be sufficiently flexible and up-to-date to meet companies' needs, taking into account fully the impact of modern technology". The themes and specific questions we raised triggered a range of responses, in which a number of suggestions have been made. Overall, the Group feels that respondents support the approaches taken, which we continue to regard as valid.

Consultative Document raised several general themes

Responses show overall support for the Group's approaches

1. FACILITATING EFFICIENT AND COMPETITIVE BUSINESS IN EUROPE

In the Consultative Document, we said that we believed that our mandate denotes a distinct shift in the approach the EU could take to company law. Until now, this approach has been mainly to co-ordinate the safeguards which, for the protection of the interests of members and others, are required by Member States of companies and firms with a view to making such safeguards equivalent throughout the Union (Art. 44 (2) (g) EC Treaty). Nine Company Law Directives have resulted so far[4]. "Meeting companies' needs" has not been a prominent feature of this harmonisation exercise. The exercise has been much more driven by establishing a proper level of protection - throughout the Union - for those who are involved in and affected by the affairs of the company, in particular shareholders and creditors, with a view to preventing a "race to the bottom" by Member States. Whether this effect actually has occurred or would have occurred in the absence of harmonisation is unclear, and some would argue that in some areas we have actually seen a "race to the top".

The EU approach to company law harmonisation has focused on the protection of members and third parties

Several instruments have been adopted, with a view to establishing an equivalent level of protection throughout the EU

In doing so, we may have lost sight of what the Group believes to be the primary purpose of company law : to provide a legal framework for those who wish to undertake business activities efficiently, in a way they consider to be best suited to attain success. Company law should first of all facilitate the running of efficient and competitive business enterprises. This is not to ignore that protection of shareholders and creditors is an integral part of any company law. But going forward the Group believes that an important focus of the

Company law should primarily concentrate on the efficiency and competitiveness of business

This should be an important focus of

[4] First, Second, Third, Fourth, Sixth, Seventh, Eighth, Eleventh and Twelfth Company Law Directives : for full citations, see Annex 4.

EU policy in the field of company law should be to develop and implement company law mechanisms that enhance the efficiency and competitiveness of business across Europe. Part of the focus should be to eliminate obstacles for cross-border activities of business in Europe. The European single market is more and more becoming a reality and business will have to become competitive in this wider arena. In order to do so, it will have to be able to efficiently restructure and move across borders, adapt its capital structures to changing needs and attract investors from many Member States and other countries.

company law policy at EU level

Particular attention should be given to the elimination of obstacles for cross-border activities

Proper mechanisms for the protection of shareholders and creditors add to the efficiency of company law regulation, as they reduce the risks and costs involved for those who participate in and do business with companies. But the effectiveness of the mechanisms to protect shareholders and creditors that have been established so far, for example in the area of capital maintenance and corporate restructuring, is questionable, and some of them appear to be real impediments to efficient financing and restructuring of business in Europe. Where possible, these mechanisms should be replaced by ones that are at least as - and preferably more - effective, and less cumbersome. In this respect, Chapter IV on capital formation and maintenance contains a number of recommendations to simplify the current rules of the Second Company Law Directive in order to make them less cumbersome, but also proposes a more in depth examination of an apparently more effective and less complex alternative approach. In Chapter VI on restructuring, we make a specific recommendation on the regime for creditor protection for legal mergers and other restructuring transactions where similar issues arise.

Proper protection of shareholders and creditors is necessary

But not all existing mechanisms are effective

This Report contains some recommendations to simplify current rules

There was general support for these views in the consultation. Many respondents commented that the EU should not so much continue with its efforts to harmonise the substance of company law, but should first of all create the facilities to operate and restructure across borders. This clearly comes out as an important priority for the EU.

Responses to the consultation confirm the high importance of cross-border issues

Some respondents have put forward another important approach to future development of company law in Europe which the Group fully supports. Where various alternative systems exist in Member States for elements of the company's organisation and structure, the EU should as much as possible facilitate freedom of choice between these alternative systems for companies across Europe , rather than trying to agree upon one specific EU system or leaving the option to Member States. The European Company Statute offers an example, in imposing an obligation on Member States to ensure that those who wish to establish an SE can choose between a unitary board structure

Responses also call for a freedom of choice between alternative forms of organisation and structure

Choice is offered by the European Company Statute

and a two-tier board structure. We believe that at least all listed and open companies in Europe should have such a choice, not just the SE, as we set out in the Chapter on corporate governance.

And should be extended to at least listed and open companies

2. MODERN COMPANY LAW MAKING

We noted in our Consultative Document that the system of harmonising company law through Directives - that have to be implemented by Member States - may have led to a certain 'petrifaction'. Once Member States have agreed to a certain approach in an area of company law and have implemented a Directive accordingly, it becomes very difficult to change the Directive and the underlying approach. Simultaneously however, there is a growing need to continuously adapt existing rules in view of rapidly changing circumstances and views. The "shelf life" of law tends to become more limited as society is changing more rapidly, and company law is no exception. Fixed rules in primary legislation may offer the benefits of certainty, democratic legitimacy and usually strong possibilities of enforcement. But this comes at the cost of little or no flexibility, and disability to keep pace with changing circumstances. EU Directives are in practice even more inflexible than primary legislation

EU company law, once harmonised through Directives, is not easy to modify

Whereas there is a growing need for continuous adaptation

Fixed rules in primary legislation offer both advantages and disadvantages

We can see a movement in Member States to use alternatives for primary legislation by government and parliament, which allow for greater flexibility. Such alternatives include:

Alternatives used by Member States include :

- Secondary regulation by the government, based on primary legislation in which broad objectives and principles are laid down; the secondary regulation can be amended more quickly when circumstances require change. (This process also often enables more effective consultation and reflection of an expert consensus.)

Secondary regulation

- Standard setting by market participants, or in partnership between government and market participants, through which best practices can be developed, adapted and applied; monitoring and reliance on market response and general governance powers on the basis of a "comply or explain" rule can often replace formal legal enforcement in company or securities law.

Standard setting, and monitoring

- Model laws, which can be used voluntarily and varied where the circumstances warrant this, e.g. where different types of companies are concerned (see also Section 3 below). A high level of uniformity in company law has been achieved by a process of "natural selection" on the basis of model laws in the United States of America, offering the benefits of more responsive adaptability and scope for variation.

Model laws

The efforts of the EU in the area of company law have so far been

The EU should

limited to primary legislation through Directives normally to be implemented in formal company law in the Member States. The Group believes the Union should consider a broader use of these alternatives to primary legislation when going forward. In many areas, company law in Member States can be modernised without agreeing on specific detailed rules in Directives. The Lamfalussy process has been set up in order to be able to promote the development of integrated financial markets in Europe by primary legislation of concepts and principles in Directives, secondary implementation legislation, and finally co-ordination between the securities regulators with respect to interpretation and enforcement. This is an example of an effort to introduce more flexible law making in an area closely related to, and to some extent overlapping with, company law.

consider a broader use of these alternatives

In many areas, Directives do not have to contain detailed rules

The Lamfalussy process is to be seen as an example

Many respondents commented that where primary regulation through a Directive would still be necessary, the Directive should be restricted to setting principles and general rules, leaving the detailed rules to secondary regulation. Where recourse is made to secondary regulation, democratic legitimacy must be ensured. Respondents agreed with us that secondary regulation and mechanisms for standard setting or co-ordination of standard setting would be most suitable in such areas as corporate governance and the operation of the general meeting of shareholders, in order to encourage the development of best practice.

Responses to the consultation :

Principles-based Directives, and

Encouragement of best practice

There was more hesitation with respect to the use of model laws. Respondents commented that due to the considerable differences in legal technique and substantive law, the development of model laws which could be applicable throughout Europe, although conceptually interesting, would be difficult. Some respondents did see room for a co-ordinated effort to produce model documents in certain areas, such as model (electronic) proxy forms for voting by shareholders in absentia. Model documents and formats may be particularly helpful where modern technology is needed and helpful to allow efficient co-ordination of transactions – e.g. voting of shares across different legal and business structures. The Group in addition believes that, where the EU would consider the introduction of new legal forms, the model approach may offer an alternative through which an informal and organic convergence of the national regulations of such legal forms may be achieved (see Chapter VIII below on the development of other European legal forms).

Model laws seem difficult to use in different legal systems

But model documents and formats may be useful

And the model approach may foster convergence of national legal forms

For all alternative forms of regulation that may be introduced, but also for any new primary company law legislation at EU level, it is important to ensure that full and proper consultation takes place with industry, commerce, services, professions and other interested

For both primary legislation and any alternatives, proper consultation is

parties. Ensuring proper procedures for wide consultation is one of the key elements of the Lamfalussy procedure for securities regulation. Where the aim is to make company law rules that facilitate efficient and competitive business in Europe, consultation with all parties involved in business is indispensable. The Group recommends that wide consultation be an integral part of any future legislative initiative taken at EU level in the area of company law.

indispensable

This should apply to any future EU initiative

Making use of alternative forms of regulation as suggested requires a new structure to be built. The first area where this is required is corporate governance. In Chapter III on corporate governance, the Group specifically recommends the Commission to issue Recommendations to Member States on aspects of the functioning of the shareholders meeting and the role of non-executive and supervisory directors, and the EU to actively co-ordinate the corporate governance efforts of Member States.

Alternative forms of regulation require a new structure

To use first in the area of corporate governance

In addition, the Group believes there is a case for setting up a more permanent structure which could provide the Commission with independent advice on future regulatory initiatives in the area of EU company law. Such advice should as much as possible be evidence based. Consultation with industry, commerce, services, professions and other interested parties is an important method of gathering evidence. The structure to be set up could be made responsible for organising such consultation.

A permanent structure is to provide independent advice

Based on proper consultation

We believe a structure in whatever form or shape performing these roles would be helpful for the future development of a modern and effective company law in the EU and recommend that the Commission investigate how such a structure can best be set up.

Commission should investigate how to set up such a structure

3. DISCLOSURE OF INFORMATION AS A REGULATORY TOOL

Requiring disclosure of information can be a powerful regulatory tool in company law. It enhances the accountability for and the transparency of the company's governance and its affairs. The mere fact that for example governance structures or particular actions or facts have to be disclosed, and therefore will have to be explained, creates an incentive to renounce structures outside what is considered to be best practice and to avoid actions that are in breach of fiduciary duties or regulatory requirements or could be criticised as being outside best practice. For those who participate in companies or do business with companies, information is a necessary element in order to be able to assess their position and respond to changes which are relevant to them. High quality, relevant information is an

Disclosure can be a powerful regulatory tool

It creates an incentive to comply with best practice

And allows members and

indispensable adjunct to the effective exercise of governance powers. It is for these reasons that the Group has, for example, recommended that capital and control structures of listed companies should be disclosed comprehensively and that such disclosure should be updated continuously[5].

third parties to take necessary actions

Information and disclosure is an area where company law and securities regulation come together. It is a key objective of securities regulation in general to ensure that market participants have sufficient information in order to participate in the market on an informed basis. Where the relevant security is a share in a company, the information required from a securities regulation point of view overlaps with the information to be provided from a company law perspective.

Information and disclosure requirements are at the intersection of company law and securities regulation

Disclosure requirements can sometimes provide a more efficient regulatory tool than substantive regulation through more or less detailed rules. Such disclosure creates a lighter regulatory environment and allows for greater flexibility and adaptability. Although the regulatory effect may in theory be more indirect and remote than with substantive rules, in practice enforcement of disclosure requirements as such is normally easier. The Group believes that the EU, in considering new - and amending existing - regulation of company law, should carefully consider whether disclosure requirements are better suited to achieve the desired effects than substantive rules. Overload of information should however be avoided.

Disclosure requirements can be more efficient, more flexible and easier to enforce

They should be considered before adoption of substantive rules

Many respondents agreed with this approach and almost all respondents took the view that disclosure was particularly suited as a regulatory tool in the area of corporate governance. In the Chapter on corporate governance, we make a number of specific recommendations on disclosure requirements. Some respondents rightly noted that increased emphasis on disclosure should not lead to simple box ticking exercises or automatic application of recommendations in order to be seen to be doing the right thing. Disclosure requirements should require companies to provide a fair, relevant and meaningful description of their arrangements in a form designed to bring this about.

Responses to the consultation :

Disclosure is particularly suited for corporate governance

If based on a fair and meaningful description

4. DISTINGUISHING TYPES OF COMPANIES

Company law in Member States usually distinguishes between two types of companies : the public company and the private or "closed" company. The existing Company Law Directives in most instances

Company Law traditionally distinguishes

[5] See the Report on Issues Related to Takeover Bids, p. 25-26; see also the new Proposal for a 13th Company Law Directive, in particular its Article 10.

also use this distinction to determine the scope of the Directives. However, the distinction between public and private companies in practice is often highly artificial. In some Member States, the regulation of the private company is merely a copy of the regulation of the public company with little real distinction. At the same time, in some Member States, a vast number of public companies in fact have a closed character, with a limited number of shareholders and restrictions on the transferability of shares.

between public and private companies

But this is often not fully relevant in practice

In today's reality, we see three basic types of companies:

Three basic types:

- **Listed companies,** which we define as those companies with registered office in one of the EU Member States whose shares are admitted to trading on a regulated market. For company law purposes, this group should also include companies whose shares are regularly traded outside regulated markets. Where we refer to listed companies in this Report, we refer to this broader category of companies. Listed companies are not only subject to company law but also to securities regulation (laws, secondary regulation, supervision, stock exchange regulation), which to some extent overlaps with company law. They tend to have dispersed ownership, or at least dispersed minority shareholders, and the markets on which their shares are traded provide an external disciplinary mechanism.

Listed companies (whose shares are regularly traded)

- **"Open" companies,** whose shares are not admitted to trading on a regulated market or otherwise regularly traded, but whose internal structures would allow for listing, free transferability of shares and dispersed ownership outside a securities market.

Open companies (whose shares could be regularly traded)

- **"Closed" companies,** whose shares are not freely transferable and which therefore cannot be admitted to listing on a stock exchange, and in the case of which dispersed ownership outside a securities market is inconceivable.

Closed companies

There may be good reasons why the regulatory approach in company law for these three types of companies should be different. For listed companies, a certain level of uniform, compulsory, substantive rules may be required to sufficiently protect both shareholders (investors) and creditors. On the other hand, disclosure requirements and market forces may provide powerful alternative disciplinary instruments. Respondents to the Consultative Document agreed that, for genuinely closed companies, generally speaking there should be a wider scope for the parties autonomously to determine the structure of the company and the rights, responsibilities and obligations of those participating in it. The balance of the regulatory approach for open companies may have to be somewhere between that for listed companies and that for closed companies, or it may be argued that the potential for open companies to tap the markets justifies regulating them as if they were listed in some or all cases. When

The regulatory approach may vary for each type of companies :

Detailed rules for listed companies

Broad autonomy for closed companies

Balanced approach for open companies

Taking national differences into

considering EU legislation, the different development of types of companies in Member States needs to be taken into account.

account

5. INCREASED FLEXIBILITY VS TIGHTENING OF RULES

If we consider that, in company law regulation, it is important to provide for a framework for competitive business, this calls for flexible rules and forms of rulemaking, for light regulatory regimes where possible, scope for party autonomy and for less cumbersome and burdensome procedures.

Company law should provide a flexible framework for competitive business

However, there is a tendency to use the traditional field of company law to achieve all sorts of other regulatory purposes, for example to combat tax fraud. Lately there is an, understandable, urge to suppress commercial and financial activities by terrorists and other criminals who use companies for these activities. This development leads to quite the opposite of company law as a framework for competitive business : more compulsory rules, heavier monitoring and enforcement regimes and slower, more cumbersome and burdensome procedures for all.

Using company law for other regulatory purposes may lead to an undesirable tightening of rules

As it does not follow that we should limit the right of all to acquire and use a mobile telephone because criminals use mobile telephones too, we should be very careful with burdening company law with detailed and cumbersome rules because some criminals make use of companies as well as the honest. The vast majority of respondents agreed with the Group that the objective of combating fraud and abuse of companies as accepted legal forms should be achieved through specific law enforcement instruments outside company law, and should not be allowed to hinder the development and use of efficient company law structures and systems.

Responses to the consultation :

The development and use of efficient company law structures should not be hindered by anti-abuse provisions

6. MODERN TECHNOLOGY

Modern information and communication technology has a profound impact on our society. Law should adapt to this in that, on the one hand, it should ensure that legal norms and values are also applied in a digital or virtual environment, and, on the other hand, it should facilitate exploitation of the new possibilities which modern technology offers. In the area of company law, basic concepts and goals may not necessarily change as a result of modern technology. It may , however, offer new and more efficient means to achieve these concepts and goals.

Due to its profound impact on our society, modern technology requires various types of changes to (company) law

In company law, modern technology can have an impact in various areas:

In company law, modern technology can have an impact in various areas

- The **form** of legal acts in company law, of shares, and of disclosure and filing of company information.
- The **time** within which information has to be produced and disclosed, actions have to be taken, etc.
- The **place** where the company is located through the concept of the corporate seat, in order to establish jurisdiction over the company, both in terms of applicable law and competent courts.
- The **function** that existing company law mechanisms perform. This may be particularly relevant in the area of financial reporting and the relationship with capital maintenance requirements and the process of ensuring information to, communication with and decision-making by shareholders.

As to **form**, most Member States have already implemented or started processes of implementing new rules which facilitate the use of electronic means to replace the paper form of legal acts in company law and to dematerialise shares. There does not seem to be a need for the EU to take specific steps in the company law area, besides the more general initiatives it has already taken (e.g. the E-commerce Directive).

As to form, no need for specific company law actions at EU level

As to **time**, the Group believes the EU should not take initiatives to shorten periods specified in the company laws of Member States. Generally, law should not force citizens to act quicker now that modern technology allows speedier actions and decisions. Law may even wish to protect citizens against overhasty actions and decisions that are prompted by faster communication methods. In any event, this does not seem to be an area of priority.

As to time, no justification for shortening the periods currently foreseen in company law

As to **place,** the impact of modern technology on the concept of the corporate seat is discussed in Chapter VI. As to **function,** the consequences of modern technology for the rules on the information of, communication with and decision-making by shareholders are discussed in Chapter III.

As to place and function, the impact of technology is discussed in various Chapters

The impact of modern technology on disclosure and filing is an area where the EU could take initiatives. This is the scope of the First Company Law Directive, on the basis of which companies are required to file certain documents and other information relating to the company in a register which is accessible to the public. A proposal to amend the First Directive in order to facilitate electronic filing and to ensure electronic access to such registers has recently been

Initiatives could be taken in the area of disclosure and filing, in addition to the Proposal to amend the First Company Law

published[6]. There are two additional areas where modern technology can offer benefits: the company's website and access to company information across borders.

Directive

6.1. The company's website

Company information is filed and disclosed at various places, which creates efficiency problems for both companies and interested parties

Information which companies, in particular those with stock exchange listings, have to file and disclose is currently scattered over various places: commercial or trade registers, notifications in newspapers, filings with stock exchanges and with securities regulators. Some, but not all, of the information thus filed and disclosed is accessible to the public, but normally at significant cost and with considerable effort. Efficiency, both for the company concerned and for those seeking information about the company, could be enhanced tremendously if the company were to put the information it is required to file and disclose on its own website.

The Consultative Document suggested that companies could be required to maintain a specific section on their website, and/or a link with the register

The company could be required to maintain a specific section on its website, containing all legal and other information it is required to file and disclose, and to continuously update this information. The website is easily accessible to the public at low cost. Regulation would be required to ensure the quality of the content and the display of information in such a section on the website, and to provide that third parties relying on such information would be protected, as foreseen in the First Company Law Directive. The company could also be required to maintain two-way links with public registers that contain the relevant types of information.

Responses to the consultation were mixed

The Group believes that use of websites will be normal practice in a few years

The responses to these proposals were mixed : some were in favour, others believed this should, at least at this stage, be a matter for companies to decide and not for the EU or national legislator. However, we believe that one should take into account that it will take a few years at the minimum for any legislation following our recommendations to be implemented and applied in Member States. By then, the use of a website by listed companies for formal information and disclosure purposes can be expected to have become a widely recognised best practice. The case for pressing ahead now with a co-ordinated approach is very strong.

Listed companies should be required to maintain a company

In the light also of other EU legislative initiatives like the proposed Market Abuse Directive, the proposed Prospectus Directive and the forthcoming Directive on Ongoing and Periodic Transparency Requirements for Listed Companies, we believe that listed companies

[6] Proposal for a Directive amending the First Company Law Directive, COM (2002) 279: for full citation, see Annex 4.

in Europe should be required to maintain and continuously update a company information section on their websites where the information they are required to file and disclose under company law and securities regulations is posted. If appropriate links are maintained from websites of public registers and other authorities where filings have to be made to the company's website, posting information on the company's website and notification thereof to the relevant public registers and authorities should be sufficient for meeting the filing requirements.

information section on their website, together with the appropriate links

The possibility should also be considered of at least allowing other types of companies to fulfil their filing and disclosure obligations under company law by including such information on their websites, if appropriate links from public registers are established[7].

The same system could be allowed to other types of companies

6.2. Access to company information across borders

In addition to companies' websites, public registries and filing systems remain important for investors, creditors and others dealing with companies, as central depositories where all relevant company information can be found. Modern technology enables easy and cheap access to core information stored in such public registries and filing systems relating to companies across the EU. Access to such information is essential in the light of the increasing international nature of business activities in Europe. An integrated system in which core company information is easily accessible across Europe should include the following elements -

Easy and cheap access to core information stored in public registers and filing systems should be ensured on a cross-border basis

a) Linking companies registries

There are private initiatives to link the various registries that now contain formal company information, like the European Business Register which companies registries join in order to exchange information (www.ebr.org) and crXML, a project to develop a document exchange standard for data in respect of enterprises (www.crxml.org/crxml). The EU could consider co-ordinating and supporting these initiatives, and where necessary facilitating them.

Private initiatives aiming at linking companies registries could be encouraged by the EU

[7] The Group already suggested in its First Report on Issues related to Takeover Bids that it should be encouraged that companies use their websites as an efficient and effective medium for providing information on the companies' capital and control structures (p. 25 of the Report). The company's website can also play an important role in the information of, communication with and decision-making by shareholders (see Chapter III).

b) National central electronic filing system

In the United States of America and in Australia, central electronic filing systems are operated by securities regulators, in which all information to be filed by companies listed on stock exchanges is filed electronically and to which the public has electronic access (the EDGAR-system in the USA and the EDGE- and *e*Register-systems in Australia). These systems offer the benefit that relevant information of all stock exchange listed companies is stored and easily accessible in one specific electronic register. This may improve on the function that publication in the national gazette traditionally has: to provide for a central and chronological access to company information. Such a system could be filled and updated efficiently by links to the websites of listed companies on which they post and update their relevant information.

Central electronic filing systems are operated in USA and Australia

They offer an easy access to information on listed companies

Links with companies' websites could be established

Although the responses to our Consultative Document were generally in favour of this suggestion, doubts were expressed as to its feasibility in the short term. The Group does believe that such central filing systems will be desirable as central repositories of all relevant information relating to listed companies. In the light of the strengthening of disclosure requirements for listed companies which results from our recommendations, but also from other EU legislative initiatives like the Market Abuse Directive, the Prospectus Directive and the forthcoming Directive on Ongoing and Periodic Transparency Requirements for Listed Companies, we also believe such central electronic filing systems in Europe will become inevitable and their creation is just a matter of time. There is a strong case for their development on a co-ordinated basis.

Such central filing systems are not only desirable

They will sooner or later become inevitable

The EU should at the minimum actively support Member States and co-ordinate their efforts in creating such central electronic filing system for listed companies, and should ensure that such systems are properly linked. It should then consider at what stage it is appropriate to require Member States to have such a central electronic filing system.

Such systems should be supported

And possibly required

c) European central electronic filing system

Out of the system of national central electronic filing systems for listed companies which are properly linked, in the future a European central electronic filing system can evolve. Such a system would benefit a truly integrated financial market in Europe. We agree however with the majority of responses to our Consultative Document that it does not seem to be worthwhile for the EU to actively try to set up such a

A European central system would benefit the markets

But the creation and linking of

system now, as the markets, their participants and the systems they apply may be too different. The creation of national central electronic filing systems and links between them is a necessary and desirable first step.

national central systems should be a priority

To summarise, an important focus of the EU policy in the field of company law should be to develop and implement company law mechanisms that enhance the efficiency and competitiveness of business across Europe.

Summary : *Focus on efficiency and competitiveness*

Where mechanisms established so far to protect shareholders and creditors appear to be inappropriate impediments, they should be replaced by ones that are at least as – and preferably more – effective, and less cumbersome.

Inappropriate mechanisms to be replaced

In the future, the EU should concentrate primarily on the creation of the facilities necessary to operate and restructure across borders.

Importance of cross-border issues

Where various alternative systems exist in Member States for elements of the company's organisation and structure, the EU should as much as possible facilitate freedom of choice for companies across Europe.

Organisation and structure : choice

The EU should consider a broader use of alternatives to primary legislation (secondary regulation, standard setting and monitoring, model laws).

Alternatives to primary legislation

The Group recommends that wide and expert consultation should be an integral part of any future initiative taken at EU level in the area of company law.

Consultation is key

There is a case for setting up a permanent structure which could provide the Commission with independent advice on future regulatory initiatives. The Commission, with the support of Member States, should investigate how best to set up such a structure.

Permanent structure to be set up

The EU, in considering new – and amending existing – regulation of company law, should carefully consider whether disclosure requirements are better suited to achieve the desired effects than substantive rules.

Disclosure requirements to be favoured

Any disclosure requirement should be based on the obligation to provide fair, relevant and meaningful information.

Fair description

The regulatory approach should be different for the three types of companies identified by the Group.

Three types of companies

Listed companies should be subjected to a certain level of uniform and compulsory detailed rules, whereas closed companies should

Different regulatory approaches

benefit from a much higher degree of autonomy. The balance may be somewhere in between for open companies.

Company law not suited to fight against crime

The objective of combating fraud and abuse of companies should be achieved through specific law enforcement instruments outside company law, and should not be allowed to hinder the development and use of efficient company law structures and systems.

Mandatory use of website for listed companies

Listed companies should be required to maintain and continuously update a company information section on their websites, and maintain links with public registers and other relevant authorities.

Same possibility open to other companies

Other types of companies could be allowed to fulfil their filing and disclosure obligations by including such information on their websites, if appropriate links with public registers are established.

Links between registries to be encouraged

Existing private initiatives to link the various registries that now contain formal company information should be encouraged by the EU.

National central filing systems to be promoted

With respect to listed companies, the EU should at the minimum actively support Member States in their efforts to create national central electronic filing systems, and ensure that national systems are properly linked.

CHAPTER III

CORPORATE GOVERNANCE

1. INTRODUCTION

Original mandate: need for a general EU approach ?

The original mandate of the Group included a review of whether and, if so, how the EU should actively co-ordinate and strengthen the efforts undertaken by and within Member States to improve corporate governance in Europe. In that light, we raised four issues relating to corporate governance in Section 3.1 of our Consultative Document:

Consultative Document :

Information for shareholders and creditors

- Better **information** for shareholders and creditors, in particular better disclosure of corporate governance structures and practices, including remuneration of board members;

Shareholders' rights

- Strengthening **shareholders' rights** and minority protection, in particular supplementing the right to vote by special investigation procedures;

Duties of the board

- Strengthening the **duties of the board,** in particular the accountability of directors where the company becomes insolvent;

European code or co-ordination

- Need for a **European corporate governance code or co-ordination** of national codes in order to stimulate development of best practice and convergence.

Plus shareholder information, communication and decision-taking

We separately addressed issues relating to the processes of shareholder information, communication and decision-taking in Section 3.2 of our Consultative Document.

Extension of the mandate pursuant to the Enron case:

In a direct reaction to the Enron case, the Commission and the ECOFIN[8] have agreed to extend the mandate of the Group to review "issues related to best practices in corporate governance and auditing, in particular:

Four specific issues

- the **role of non-executive and supervisory directors**;
- the **remuneration of management**;
- the **responsibility of management for financial statements**;
- and **auditing practices**."

All issues are covered here

In this Chapter, we will address the original and newly added issues

[8] See Annex 1

Under five themes

under the following themes:

- disclosure
- shareholders
- the board
- audit
- corporate governance regulation in the EU.

Corporate governance is a system, with roots partly in company law

Before addressing these themes, we would like to stress that corporate governance is a system. It has its foundations partly in company law, setting out the internal relationships between the various participants in a company, and partly in the wider laws and practices and market structures which operate in different Member States. It follows that there are dangers in dealing with particular components of the corporate governance system in isolation from their wider context.

Many external issues are related to the overall system of corporate governance

In our First Report, we have dealt with the market for corporate control. This is one of the most important parts of external corporate governance or outside control.[9] Other market-oriented issues concern primarily securities regulation and are being dealt with in the framework of the Financial Services Action Plan of the Commission. Examples are the various disclosure obligations which securities laws impose on listed companies. But also the regulation of the services provided by investment banks and financial intermediaries of various kinds ("Institutional investors") and the work of securities analysts is crucial in the overall system of corporate governance. Finally, as we have seen over the last year, accounting and audit are fundamental elements of a corporate governance system.

This Report focuses on internal corporate governance

In this Report, we focus primarily on the internal corporate governance elements. We acknowledge that that is only part of the system of corporate governance, and appreciate that the EU is undertaking initiatives in other areas that contribute to the effectiveness of the corporate governance system in Europe.[10]

[9] Report on Issues Related to Takeover Bids, 10 January 2002, http://europa.eu.int/comm/internal_market/en/company/company/news/02-24.htm .

[10] Cf. The Commission Recommendation of 16 May 2002 - Statutory Auditors' Independence in the EU: A Set of Fundamental Principles (2002/590/EC), *Official Journal L 191, 19/07/2002, p. 22*. The various initiatives under the Financial Services Action Plan include the Proposal for a Market Abuse Directive (COM 2001 281) of 30 May 2001, the consultation on ongoing transparency requirements for listed companies launched on 8 may 2002 (http://europa.eu.int/comm/internal_market/en/finances/mobil/transparency/index.htm#secondconsult), and the Proposal for a Prospectus Directive (COM 2002 460) of 9 August 2002.

2. DISCLOSURE

In our Chapter on General Themes, we take the view that disclosure has a pivotal role in company law (see Chapter 2, section 3, above). We underlined this when we recommended in our First Report that listed companies in all Member States be required to disclose their capital and control structures.[11] On the basis of information about potentially defensive structures established in a company, the market would be able to react by discounts and higher costs of capital.

Disclosure has a pivotal role in company law

As we already underlined in our First Report

In our Consultative Document, we took the view that corporate governance in general is a particular area where disclosure should be a key component of a regulatory regime. Corporate governance is of increasing importance for investment decisions and for interventionist action by investors. In the consultation, there was overwhelming support for better disclosure of corporate governance structures and practices in Europe (see Annex 3). There was agreement that this should at least be required for "listed companies" whose shares are admitted to trading on a regulated market or are regularly traded on a non-regulated market (see Chapter 2, section 4, above).

High importance of disclosure for corporate governance

Was confirmed by responses to consultation

At least for listed companies

As to whether this should also extend to "open companies", whose internal structures would allow for trading on a market, or even "closed companies", the reactions were mixed. The Group takes the view that this is a matter for Member States to decide. The population and relevance of open and closed companies differ from Member State to Member State. We do not see an overarching EU interest in imposing these disclosure requirements on open and closed companies across Europe as a matter of European law.

For "open" and "closed" companies, no need for establishment of disclosure requirement at EU level

Listed companies in all Member States should be required to include in their annual report and accounts a coherent and descriptive statement covering the key elements of the corporate governance rules and practices they apply, regardless of whether these elements arise from mandatory law, default provisions, articles of association, resolutions of company organs, codes or other company processes. The statement should also be separately posted on the company's website.

Listed companies should publish an annual corporate governance statement

And post it on their website

The principle rules relating to the disclosure requirement, and the key items to be disclosed, could be laid down in an EU Directive[12]. The

A framework Directive could

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[11] See the Report on Issues Related to Takeover Bids, p. 25-26.

[12] We note that various existing and proposed EU Directives contain disclosure requirements relating to corporate governance, e.g. the Proposal for a Thirteenth Company Law Directive on Takeover Bids, the

Directive should not seek to regulate the details of the requirement to publish an annual corporate governance statement, as the views on what are the elements to disclose and the way they should be disclosed are likely to change over time. A system of flexible and efficiently adaptable subordinate rules should be created. We believe that the detailed rules should be set by the appropriate bodies within Member States in view of their national company laws, but the EU should ensure a certain level of co-ordination of the setting of these detailed rules by Member States. This should be part of the general framework to be set up in the EU to co-ordinate the corporate governance efforts of Member States (see Section 6).

set the applicable principles

Detailed rules would be set by Member States, with proper co-ordination at EU level

The annual corporate governance statement should at least include the following key items:

Information to be given at least on :

- The operation of the shareholders meeting, its key powers, the rights attached to shares, where applicable per class of shares, and how these rights can be exercised.

The shareholder meeting and the shares

- The operation of the board and its committees, the procedures for appointment of board members, the role and qualifications of individual board members and the direct and indirect relationships board members may have with the company beyond their board membership (see Section 4.1). Disclosure of directors' remuneration and other terms and conditions of appointment and removal should be required separately (see also Section 4.2).

The board's organisation and its individual members

- The shareholders holding major holdings as determined in Directive 2001/34/EC[13] and as foreseen in the Directive on Ongoing and Periodic Transparency Requirements, with a description of the voting rights and special control rights they can exercise, and, if they act in concert, a description of the key elements of the existing shareholder agreements.

The shareholders holding major shareholdings

And their voting and control rights

- The direct and indirect relationships between the company and holders of major holdings beyond the shareholding itself. This last element of disclosure is particularly important in many parts of Europe, as a substantial part of the share capital of European listed companies in those areas is held by large shareholders. The potential of conflicts of interests between these controlling

The other direct and indirect relationships with the major shareholders

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forthcoming Proposal for a Directive or Regulation on Ongoing and Periodic Transparency Requirements (http://www.europa.eu.int/comm/internal_market/en/finances/mobil/transparency/index.htm), Directive of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on securities (2001/34/EC). The Commission should ensure proper co-ordination between these various instruments, and that those subject to these requirements can make coherent disclosure of their corporate governance rules and practices.

[13] Directive of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on securities (2001/34/EC), articles 85 to 97.

[14] See IAS 24 "Related Party Disclosures"; see also Articles 9 and 10 of the Fourth Company Law Directives.

[15] Particularly in the light of recent developments in the USA (see the Sarbanes-Oxley Act of 30 July 2002, and the Proposed Rule - issued by the SEC on 22 October 2002 - on Disclosure Required by Sections 404, 406 and 407 of the Sarbanes-Oxley Act).

shareholders on the one hand and the company and its minority shareholders on the other hand is well documented in legal and economic literature. We believe all material transactions that have taken place between the company and holders of major holdings should be reported separately in the audited financial statements, with an explanation as to what extent these transactions are at-arms-length (see also Chapter V on groups and pyramid structures).

In particular all material transactions, with due explanation

- Other material related party transactions, like transactions with subsidiaries and associate companies, unless already specifically disclosed in the company's financial statements[14].

Transactions with other parties

- The system of risk management applied by the company, describing the core strategy and activities of the company and the particular risks related thereto. Where such a system does not exist, this must be disclosed. Introducing a requirement in EU law for listed companies to have a developed system of risk management needs further study[15].

Existence and nature of risk management system

- A reference to a national code of corporate governance with which the company complies or in relation to which it explains deviations. As to national codes of corporate governance, see Section 6 below.

A reference to a national code of corporate governance

The responsibility for the correctness of the corporate governance statement lies with the board as a whole, as is the case with the responsibility for financial statements of the company (see further par. 4.3 below).

Responsibility for the statement should lie with the board as a whole

3. SHAREHOLDERS

3.1. Shareholder information, communication and decision-taking

In a proper system of corporate governance, shareholders should have effective means to actively exercise influence over the company. As we emphasised in our Consultative Document, shareholders are the residual claimholders (they only receive payment once all creditors have been satisfied) and they are entitled to reap the benefits if the company prospers and are the first to suffer if it does not. Shareholders need to be able to ensure that management pursues - and remains accountable to - their interests. Shareholders focus on wealth creation and are therefore, in the Group's view, very suited to act as "watchdog" not only on their own behalf, but also, in normal circumstances, on behalf of other stakeholders.

Being the residual claimholders

Shareholders are ideally placed to act as a watchdog

For which they should have the necessary means

There is a particular need for this in the case of listed companies

This is particularly

where shares are widely held, or at least in the minority widely held. From the viewpoint of a single shareholder, it may frequently seem appropriate to sell his shares if he is dissatisfied with - or lacks confidence in – incumbent management, rather than try to change things within the company. However, this “rational apathy” may prove very disadvantageous if adopted as a general attitude among shareholders.

important in listed companies

Where minority’s apathy may have harmful effects

Reliance on shareholders performing this role presupposes that it is, indeed, possible for shareholders to influence the decisions of the company and, in addition, appears attractive for them to do so. This, in turn, depends on the costs and difficulties attached to exercising influence. The more costly and cumbersome it is to exercise influence, the more shareholders are likely to elect not to do so.

Shareholders’ influence will highly depend on the costs and difficulties faced

The traditional means to exercise this influence is through the shareholders meeting, where shareholders can debate with management and each other, and vote on resolutions put forward to them. In the Group’s view, the traditional shareholders meeting as a physical gathering of shareholders is unable in its present form to fulfil today’s expectations. As a result of increasingly international shareholdings by both institutional and private investors, the vast majority of shareholders is unable to physically attend the shareholders meetings of their companies. The actual meeting can no longer offer a sufficient central forum for shareholder information, communication and decision-taking.

Influence was traditionally exercised through the general meeting

Which is no longer physically attended by many

The Group believes modern information and communication technology can be very instrumental in devising new concepts and methods for shareholder information, communication and decision-taking, and its potential should be fully explored and used. Many respondents to our Consultative Document stressed that, at the current stage of development and availability of new technologies, the use of modern technology should not be imposed but should merely be facilitated. We agree that an appropriate balance must be struck.

Modern technology can be very helpful

If introduced in a balanced way

In order to facilitate the move towards an integrated European capital market, it is important that shareholders across the EU have equivalent opportunities and facilities to participate in the information, communication and decision-making processes of shareholders. While the focus in this paragraph is on listed companies, non-listed companies are likely to benefit from the facilities developed for shareholders in listed companies.

Equivalent facilities should be offered across the EU

Non listed companies could benefit from them

a) Notice and pre-meeting communication

One set of issues relates to the preparation of general meetings of shareholders. The communication between a company and its shareholders prior to a general meeting (including sending notices of such meeting) is frequently a one-way process with limited, if any, feedback from the shareholders.

Pre-meeting communication is frequently a one-way process

Where bearer shares have been issued, communication will have to take place through the public media by means of advertisements or other costly means. Communication among shareholders is also costly: shareholders are not able to identify each other, and therefore frequently have to use the public media if they want to get points across to other shareholders. But also in registered share systems, communication to and among shareholders is increasingly difficult as substantial numbers of shareholders, particularly in cross-border situations, do not appear in the shareholders register, but hold shares through intermediaries.

The biggest difficulties and costs arise with bearer shares

But registered shares also present some problems

Many of the issues touched upon here may be resolved, at least in part, by using electronic means of communication, including the company's website and the internet. Companies could put all their meeting materials (notice, annual report and accounts, agenda including proposed resolutions, explanatory notes, shareholder circulars) on their website, to which shareholders can get access at their own initiative, rather than the company being required to send information to them. Proxy and voting instruction forms may be downloaded and submitted by electronic means. Also, the website can include a section where voting instructions or proxies can be lodged. This use of the company's website is efficient both for the company and its shareholders, and the practical evidence is that it leads to a huge reduction in costs as compared to postal mailings of meeting materials and proxy forms.

Modern technology may offer a solution to many problems

Putting meeting materials and proxy forms on the company's website

Is efficient for both the company and its shareholders

In our Consultative Document, we asked whether listed companies should not only be entitled to use modern technology as suggested above (i.e. that the use should be permitted by Member States' company laws – the "enabling" approach), but should be compelled to do so. Many respondents have expressed the view that use of modern technology should be a matter for the companies and their shareholders to decide and not for the Member States or the EU to determine.

Many responses to the consultation supported the "enabling" approach

As we have noted in Chapter II, however, the Group believes that the time is ripe to take this matter further. We should take into account

Group believes we should anticipate future

that it will take a few years at the minimum for any legislation following these recommendations to be implemented and applied in the Member States. By then, the use of a website by listed companies for formal information and communication purposes should, and in all likelihood will, be a widespread and recognised best practice.

normal practice

In Chapter II, we have recommended, also in the light of other Community initiatives like the proposed Market Abuse Directive, the proposed Prospectus Directive and the forthcoming Directive on Ongoing and Periodic Transparency Requirements for Listed Companies, that listed companies be required to maintain a specific section on their website where they publish all information they are required to file and publish (see Chapter 2, section 6). This section on their websites should include all relevant materials relating to shareholders meetings, and should offer facilities for giving proxies or voting instructions on-line or for downloading and e-mailing proxy or voting instruction forms.

In Chapter II, we recommended that a specific website section be maintained

This section should include all meeting materials and proxy forms

However, we would not want to recommend at this stage that such section should also include bulletin boards and chat rooms through which shareholders can directly communicate with management and other shareholders. Attractive as these facilities appear to be, chat rooms and similar devices, as many respondents have noted, are often abused to send irrelevant or improper messages. A particular risk is that they are used to manipulate share prices, e.g. by shareholders placing incorrect or misleading information in the chat room. Many issues have to be reviewed before companies could be required to offer these facilities, e.g. the ability to limit access to these devices to shareholders entitled to it and to filter irrelevant, abusive, misleading and improper messages, and the related costs and benefits.

Mandatory bulletin boards and chat rooms are not recommended

Because of the risks of abuse

Which require further review of many issues

While listed companies in our view should be required to offer shareholders electronic facilities to access information and to give proxy notifications or voting instructions, shareholders should, at least for the time being, not be required, as a matter of EU law, to use exclusively these electronic facilities. It is clear that for some time to come not all shareholders will have access to them. It is not yet appropriate for the EU to require shareholders to use electronic facilities in order to be able to participate in the information, communication and decision-taking. Listed companies may therefore be required under national law to provide hard copies of meeting materials and voting forms to shareholders who request them. On the other hand, we believe it is no longer appropriate for Member States' company laws to require listed companies to actively send hard copies of meeting materials to the shareholders they know, even

Not all shareholders have access to electronic facilities

Shareholders should therefore not be compelled at EU level to use them

Member States could require

without their specific request. Offering electronic access to the relevant information through the company's website, and sending hard copy materials to shareholders at their request where deemed appropriate at national level, gives sufficient access to the relevant information for all shareholders.

listed companies to send hard copies, but only on specific request

Information and communication are key issues for shareholders of any company. The legal requirements or restrictions with respect to the right to ask questions and submit proposals for decision-making often prevent small shareholders from being active. In the Consultative Document, we asked whether there is a need, at EU level, to provide for minimum standards regarding the right for shareholders to ask questions and submit proposals for decision-making at the general meeting. Many have responded that they see no grounds for doing so, and in general the Group would tend to agree that, at least for the time being, the case is not made out for substantive mandatory provisions at EU level.

The rights to ask questions and table resolutions are often difficult to exercise

But responses to the consultation did not call for mandatory provisions at EU level

As already indicated, adequate and correct information on the company and its business is key to shareholder motivation. It is important that shareholders are able to ask questions and have them answered properly. Also, the right for shareholders to submit proposals for general meeting decisions plays an important role in the corporate context.

In practice, exercise of these important rights may be facilitated by modern technology

On the other hand, use of modern technology may lead to practical problems if shareholders can raise questions (and require answers) and submit proposals without restriction, among other things via the company's website. The company could virtually be flooded with questions and proposals, which would make the whole process unworkable. A balance has to be struck between these rights of shareholders and the ability of the company to manage this aspect of communication with shareholders without undue burdens.

But companies should be able to take measures to keep the process manageable

We do not think measures to avoid such unintended use of influence on the part of shareholders should be taken at EU level. Member States differ significantly with respect to the regulation of shareholder rights, due to, at least in part, differences in markets, culture, and shareholder behaviour. Each Member State should consider whether its company law leaves adequate flexibility for companies to put in place measures against unintended exercise of shareholder influence. At this point, we would only recommend that at EU level it is ensured that listed companies explicitly disclose to their shareholders how they can ask questions, how and to what extent the company intends to answer questions, and how and under what conditions they can submit proposals to the shareholders meeting. This should be an element of their mandatory annual corporate

The necessary flexibility for companies should be provided for at national level

But annual disclosure of how these rights can be exercised should be required at EU level

governance statement.

With respect to the right to submit proposals for resolution by the shareholders meeting, there is a link with the squeeze-out right of a majority shareholder and sell-out right of minority shareholders (see Chapter VI). The protection company law offers to the minority shareholders that cannot be squeezed-out by the majority shareholder should include the right to submit shareholder proposals. A minority greater than the maximum squeeze-out minority should have this power. If for example, under a Member State's company law, a 95% shareholder can squeeze-out minority shareholders, the level of shareholding required for the submission of proposals should not exceed 5% of the share capital. The EU should consider imposing this as a minimum rule on Member States.

The right to table resolutions is linked to the squeeze-out right

Thresholds should be set consistently

Member States could be required to do so

b) General meeting, voting in absentia, electronic access

We have said that the traditional general meeting of shareholders, as a physical gathering of participants who discuss and decide, is today no longer a sufficient and effective means to perform the relevant governance functions. In order for shareholders to be able to participate in the decision-taking, they must be able to vote in absentia, either by way of direct vote outside the meeting (cf. the "vote par correspondance" in France) or by way of a voting instruction and proxy to be exercised in the meeting by somebody else (e.g. the chairman of the board, a representative from a bank or a notary).

In view of the difficulties to attend meetings, shareholders should be able to vote in absentia

The Group believes that listed companies should be required to offer all shareholders (or the intermediaries designated by them) facilities to vote in absentia - by way of direct vote or proxies - by electronic means, and through hard copy voting instruction or proxy forms at their request. However, the Group recommends that such an obligation should only be imposed on listed companies to the extent that solutions have been found and implemented for the problems of cross-border holding of securities (see Section 3.2). It would be inappropriate and would lead to an undesirable level of legal uncertainty to require companies to offer these facilities if they do not have the means to determine who are the shareholders entitled to vote.

The necessary facilities should be offered, but not imposed, to shareholders

But only to the extent that cross-border holding problems have been solved

Another means to enhance shareholders' participation in the information, communication and decision-making processes is to allow absentee shareholders to participate in traditional general meetings via electronic means, including via the internet (webcast) and satellite. In some Member States, systems are being developed through which shareholders following the meeting on their computer

Some companies offer participation to general meeting via electronic means

or television screens can participate by raising questions and exercise voting rights directly during the meeting. This can reinforce shareholder influence with little trouble and at low cost. Security and reliability however must be assured.

Which increase shareholder influence in an efficient way

The EU should ensure that the company law requirements of Member States as to e.g. the place where a meeting should be held may not impede such developments. There are however, in the Group's view, insufficient grounds for compelling Member States to require listed companies to establish the facilities required for such participation in the present stage of technological development and reliability.

Use of electronic means in meetings should be possible

But not yet mandatory

The development of technological means through which shareholders can communicate with management and each other and can take decisions without actually meeting, and the facilitating of these developments in law, inevitably lead to the question whether a physical meeting of shareholders still plays any useful role. If it is felt that the physical meeting of shareholders is no longer essential, it would seem sensible to allow companies who offer a comprehensive electronic process of information of, communication with and decision-making by shareholders to abandon the physical general meeting altogether. The responses in the consultation were mixed.

Comprehensive use of electronic means might make a physical meeting useless

Responses to the consultation were mixed

The Group finds that the answer to this question depends not only on the technical possibilities but also on the various features of Member States' company laws, including the basic shareholder rights, such as the right to face management and ask questions (and demand answers) at the general meeting of shareholders, as well as with respect to protection of minority rights. Therefore, it should be left to Member States to deal with this question, at least for the time being. The decision to abandon the traditional type of general meeting should in any event be taken by - or with the consent of - the general meeting of shareholders with an appropriately strong qualified majority.

The permission to abandon the physical meeting should be a Member State decision

But it should require a qualified majority decision by the general meeting

3.2. Cross-border voting

Investors in European listed companies face particular problems if they reside in countries other than where the company is registered. Nowadays, investors usually hold their shares in securities holding systems through accounts with securities intermediaries, who, in turn, hold accounts with other securities intermediaries and central securities depositories in other jurisdictions. In cross-border situations, shares are typically held through chains of intermediaries. These cross-border chains cause particular problems in the determination of the entitlement of shareholders to exercise the voting

In cross-border situations, shares are typically held through chains of intermediaries

Which make it difficult to identify the person

rights on shares held through the chains, and the process of communicating with - and actual voting by - such shareholders.

entitled to vote

In reality, it is often either very difficult and cumbersome or practically impossible for shareholders in one Member State or outside the EU, to vote on shares in a listed company in another/a Member State. This problem is becoming all the more urgent as the cross-border nature of equity investment is increasing and is actively stimulated by the drive to create integrated financial markets in Europe and beyond. Our recommendations on shareholder information, communication and decision-taking, if implemented, would have a very imperfect effect if the resulting systems could not be applied in cross-border situations.

Cross-border voting is often almost impossible in practice

Integration of financial markets calls for an urgent solution

The legal problems related to cross-border voting in Europe have been reviewed by a separate international Group of Experts set up in January 2002 by the Dutch Minister of Justice. The Cross-Border Voting Group has conducted its own consultation process and reported to the Minister in September 2002.[16] Two members of the High Level Group have participated in the Cross-Border Voting Group, whose Final Report was submitted to the High Level Group.

A separate Cross-Border Voting Group has issued its Report in September 2002

The Cross-Border Voting Group recommends that the rights and obligations of accountholders and securities intermediaries in the securities holding systems in Member States be regulated at EU level, to ensure that accountholders across the EU can effectively exercise the voting rights on shares they hold through these systems.

Rights and obligations of accountholders should be regulated at EU level

To that end, the Cross-Border Voting Group basically recommends that accountholders in European securities holding systems, who are not participating in these systems as securities intermediaries holding shares for their accountholders (such accountholders are defined as “Ultimate Accountholders” in the Final Report of the Cross-Border Voting Group), should be acknowledged across the EU to have the right to determine how to vote on shares they hold in their accounts (the primary rule). An Ultimate Accountholder should be granted the options available under the law of the Member State of the company in which he holds shares to be either recognised as the formal shareholder entitled to vote, or to receive a power of attorney from the securities intermediary who is formally entitled to vote, or to instruct that securities intermediary to vote according to his instructions. Securities intermediaries are to be prohibited from voting on shares they hold for their accountholders, unless explicitly instructed or authorised by their accountholders.

Primary rule :

The right to determine how to vote should be recognised to Ultimate Accountholders

Who should be granted the options available in the company’s Member State

[16] The Final Report of the Cross-Border Voting Group has been posted on the website of the Dutch Ministry of Justice : http://www.wodc.nl

Where an Ultimate Accountholder is not a securities intermediary in the regulated European securities holding systems, but nonetheless holds shares on behalf of third parties (e.g. a US securities intermediary), such Ultimate Accountholder should be able to designate its clients to be recognised as entitled to determine how the shares are voted (the supplementary rule). These recommended rules are accompanied in the Final Report with further recommendations on the information, authentication and voting processes.

The Final Report contains also a supplementary rule

And further recommendations

Like the Cross-Border Voting Group, we believe that the issues identified by that Group urgently need to be addressed at EU level. A proper system for shareholder information, communication and decision-making in Europe facilitates the exercise of voting rights of all shareholders in European listed companies, regardless of the Member State in which they are located and whether they wish to vote on shares of companies in their own jurisdiction or in another jurisdiction. It is also important that such a system allows shareholders outside the EU to exercise their rights efficiently, as the Cross-Border Voting Group has recommended through the combination of the proposed primary and supplementary rule. Finally, such a system should operate efficiently for all parties concerned: shareholders, listed companies and securities intermediaries, with respect to both administrative and operational burdens and costs. Modern technology can be highly instrumental in achieving these ends and its use by all parties concerned should be stimulated to the maximum.

Issues identified by the Cross-Border Voting Group should urgently be addressed at EU level

In the interest of both European and non European shareholders

Efficiency for all parties would be enhanced by modern technology

We recommend that the Commission, as a matter of priority, consider the recommendations of the Cross-Border Voting Group - together with the recommendations in the previous paragraph on shareholder information, communication and decision-making - and in the light of these recommendations set up a specific project to build a regulatory framework for shareholder information, communication and decision-making that facilitates participation of shareholders across the EU and, where possible, outside the EU, in the governance of European listed companies.

A specific project should be set up at EU level to facilitate shareholders' participation

Some of the recommendations clearly need a Directive as a legal basis in order to work effectively, in particular relating to cross-border voting. Other elements, like the use of the company's website for communication with shareholders, and the requirement to offer electronic facilities for proxy voting, can and should be implemented quickly. Apart from a legislative initiative which may be appropriate, the Commission should consider issuing a Recommendation to Member States that they should adopt effective rules in their company

A Directive may be required for some issues, in particular cross-border voting

Whereas rapid use of websites and (electronic)

laws or other regulations ensuring that listed companies use their websites for communication with shareholders and offer electronic facilities for proxy voting.

proxy voting might be promoted by a Recommendation

3.3. Responsibilities of institutional investors

The increasing amounts of equity investments held by institutional investors within the EU has initiated a debate in certain Member States as to the role of institutional investors in the corporate governance of listed companies. Where traditionally, in companies with dispersed ownership, shareholders can produce little countervailing power against management, the rise of institutional investment may have changed this. The substantial holdings of institutional investors make the exit strategy (selling on the market) less attractive to them and they are increasingly inclined actively to engage in internal control within the company.

Institutional investors have large shareholdings with voting rights

And tend to use them more frequently than before

In the Consultative Document, we raised the question whether the role of institutional investors should be formalised by requiring them to disclose their policy regarding the investments they make and how they exercise their voting rights with respect to companies in which they invest. The views of respondents were mixed : some would be in favour of such an obligation, some would oppose it.

Responses to the consultation were mixed about the possible formalisation of institutional investors' role

The Group believes institutional investors have an important role to play in the governance of companies in which they invest. But there are also governance issues relating to the institutional investors themselves. Institutional investors are usually characterised as investors who invest on behalf of their beneficiaries, to whom they owe fiduciary duties as defined by law and the particular contractual relations between them. Pension funds invest contributions paid by employees (and often their employers) to fund their pensions; insurance companies invest premiums paid by policy holders to ensure payment of insurance claims, or to provide investment benefits on maturity of life policies; mutual and other investment funds invest contributions made by investors in the funds, etc. There are concerns about the potential for conflicts of interests of those who manage the investments on behalf beneficiaries, both in terms of their relationships with the companies they invest in and in terms of their internal reward schemes. This potential for conflicts of interests justifies, as a matter of good governance of institutional investors, their beneficiaries being entitled to know what their policies are with respect to investment and the exercise of rights attached to their investments. Beneficiaries are also entitled to demand to see the voting records showing how these rights have been used in a

Good governance of institutional investors requires

Disclosure to their beneficiaries of their investment and voting policies

And a right of their beneficiaries to the voting records showing how voting rights have been exercised in a particular case

particular case.[17]

Regulation of the relevant types of institutional investors should include an obligation on the institutional investor to disclose its investment policy and its policy with respect to the exercise of voting rights in companies in which it invests, and to disclose to beneficial holders at their request the voting records showing how these rights have been used in a particular case. The EU should ensure that Member States impose these rules in their regulation of the relevant types of institutional investors. We believe that such a requirement would not only improve the governance of institutional investors, but would also contribute to a considered participation by institutional investors in the affairs of the companies in which they invest for the benefit of corporate governance and company efficiency.

The EU should ensure that such rules are included in the regulations applicable at national level

Which should contribute to encourage active participation by institutional investors

We also raised the question whether institutional investors should even be required to use their voting rights in the companies in which they invest, as some institutional investors in the United States of America are required to do. The majority of the responses was negative and the Group agrees that such an obligation should not be imposed. We are doubtful as to the effect of such an obligation and fear that it may have counter-productive effects of institutional investors simply voting in favour of any proposed resolution to fulfil the requirement. We would not expect any additional value from the imposition of such mandatory voting once the requirement is imposed for institutional investors to disclose their voting policies and their actual use of their voting rights at the request of their beneficiaries.

Responses to the consultation did not support an obligation to vote

The Group agrees that there are no convincing reasons for imposing such an obligation

3.4. Special investigation rights of minority shareholders

Even if participating in shareholders meetings and voting are facilitated, many shareholders will refrain from doing so, often with good reason. This well-known phenomenon of "rational apathy" is not only common for private shareholders, but also for many institutional shareholders. In companies with one or more controlling shareholders, minority shareholders usually have no real influence, even if they vote. In groups of companies and particularly in multinational groups, the minority shareholders of the subsidiary, and even those of the parent, may just not know where the real problems are. In such cases, what is needed for shareholders is to first find out the facts (e.g. about related party transactions) and then to consider the appropriate course of action, which could be a shareholders'

In many cases, shareholders are inclined not to vote

Due to a lack of influence

And/or a lack of information

[17] See the relevant rules recently proposed by the SEC : Proposed Rule on Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies (http://www.sec.gov/rules/proposed/33-8131.htm) and Proposed Rule on Proxy Voting by Investment Advisers (http://www.sec.gov/rules/proposed/ia-2059.htm).

resolution or even an action to hold directors or others liable.

A number of Member States have recognised the need for a special investigation procedure. The core provisions are rather similar, but the details vary considerably. In some Member States, special investigations are rare whereas, in others, they are much more common and used for a variety of purposes. In most of them, it is recognised that the special investigation procedure, even if it is rarely used, is an important deterrent or "fleet in being".

The special investigation procedure offered in several Member States is an important deterrent

In accordance with the vast majority of responses to the Consultation Document, the Group believes that the shareholders' right to vote and their standard right to information should be supplemented by a European framework rule on the right of shareholders to require a special investigation and the procedure for it. The Group recommends the extension of the special investigation right to all companies, whether listed, open or closed. Such rights are particularly relevant if the company structures are complex and not transparent, as is often the case in groups of companies and in multinational enterprises. Special investigation procedures should not be restricted to the single independent company, but should as far as possible be open to use group-wide, where the issues are sufficiently significant to justify this.

A EU rule on special investigation right was supported by responses to the consultation

The Group recommends it for all companies

And where possible on a group-wide basis

Shareholders, in a general meeting or holding a minimum of 5 or 10 per cent of the share capital, should be given the right to apply to a court or appropriate administrative body to order a special investigation. In companies subject to the squeeze-out procedure, the minimum minority holding should not exceed the squeeze-out minority (see further Chapter VI below). The order should only be given when there is a serious suspicion of improper behaviour, in order to avoid the procedure being used as a "fishing expedition" or as an instrument of harassment. The investigation should be conducted by the court or administrative body ordering the special investigation, or by professionals under its supervision. A special investigation procedure offers an efficient and overall not too costly form of enhanced shareholder information.

Investigation right should be open to general meeting or a significant minority

Authorisation should be based on serious suspicion

The European framework provision can be short and precise. The details should be left to the Member States in order to enable them to make the rule compatible with the procedural and administrative practice in their jurisdictions. Also, the European provision should refrain from indicating what the (potential) sanctions of the findings of special investigation should be, as sanctions are generally left to national law. But Member States should ensure that they have effective sanctions in place. Also, we note that director's disqualification is a particularly effective sanction which should be

Details of the procedure should be left to Member States

As well as the determination of proper sanctions

available in extreme cases (see further par. 4.5 below).

4. BOARD OF DIRECTORS

4.1. The role of non-executive and supervisory directors

a) Role

Good corporate governance requires a strong and balanced board as a monitoring body for the executive management of the company. Executive managers manage the company ultimately on behalf of the shareholders. In companies with dispersed ownership, shareholders are usually unable to closely monitor management, its strategies and its performance for lack of information and resources. The role of non-executive directors in one-tier board structures and supervisory directors in two-tier board structures is to fill this gap between the uninformed shareholders as principals and the fully informed executive managers as agents by monitoring the agents more closely.

Many difficulties prevent dispersed shareholders from directly monitoring management

Which calls for an active role of non-executive or supervisory directors

Board reform is at the core of corporate governance in the Member States as well as outside the EU. There is an extensive and ongoing academic discussion on the pros and cons of the one-tier and the two-tier board system. There is no clear evidence which of the two is a more effective monitoring body. Each of the two systems has its specific advantages and disadvantages and may be appropriate in particular circumstances. They have been developed along their specific paths of legal and cultural development. Good corporate governance structures can be created in both board systems.

No particular form of board structure (one-tier / two-tier) is intrinsically superior

Each may be the most efficient in particular circumstances

As the policy debates in Europe on the Fifth Company Law Directive and the European Company Statute have shown, it is not advisable to make one of the two systems mandatory in Europe. Rather, the Group believes that at least listed and open companies across the EU should have the choice between the two systems, as has been recently introduced for the European Company (SE). By offering companies the choice between the two systems, companies could elect the system which best suits their particular corporate governance needs and circumstances. This is a good example where the European variation in systems can be beneficial and less detrimental to facilitating efficient and competitive business in Europe.

None of the two systems should be made mandatory across Europe

But at least listed and open companies should be offered the choice to opt for the system best suited to them

As we have noted, listed companies in some parts of Europe are often controlled by one or a small group of large shareholders. These large shareholders usually are well informed about the affairs of the

The presence of (a group of) controlling shareholder(s) is

company and closely monitor the executive managers. This is generally seen as a benefit of controlling shareholder-structures. However, the position of the controlling shareholder(s) creates potential conflicts of interests with minority shareholders who, as in companies with fully dispersed ownership, lack sufficient information and resources to monitor management and the controlling shareholder(s). In this type of controlled company, there is a need for monitoring by non-executive directors or supervisory directors on behalf of minority shareholders.

likely to result in closer monitoring of management

But non-executive or supervisory directors then have an important role on behalf of the minority

Non-executive and supervisory directors, who are not involved in the day-to-day affairs of the company, normally have a role of oversight of the executive managers in areas like the financial performance of the company and major decisions affecting its strategy and future. Apart from these, there are three areas where there is a specific need for disinterested monitoring by non-executive and supervisory directors:

- The nomination of directors
- The remuneration of directors
- The audit of the accounting for the company's performance.

Non-executive and supervisory directors have a general oversight role

Of particular significance in three areas

In these three areas, executive directors clearly have conflicts of interests. Nomination is about the continuation of their own jobs and the jobs of their colleagues and potential new colleagues, and the persons who monitor them. Remuneration is about the rewards the executive directors receive for their services to the company. Audit is about the probity of the financial and non-financial accounting for the performance of the company by the executive directors who are responsible for its performance.

Conflicts of interests may arise about

Nomination,

Remuneration,

And audit

Lack of monitoring by independent, disinterested non-executive directors in these three areas has been a major cause for the various corporate scandals that we have witnessed this last year. An important element of the regulatory response in the USA therefore focuses on strengthening the independent monitoring by non-executive directors in these areas.

The need for more independent monitoring is highlighted by the US regulatory response to recent scandals

The Group does not express a view as to how the full one-tier board or supervisory board should be constituted, and to what extent independent non-executive or supervisory directors should be members of it. But we take the view that, for all listed companies in the EU, it should be ensured that within the board, and to the extent these are matters for the board and not for the shareholders to decide, the nomination and remuneration of executive directors and the audit of the accounting for the company's performance should be decided upon by exclusively non-executive or supervisory directors

Group does not express views on composition of the full (supervisory) board

But promotes role of non-executive / supervisory directors

who are in the majority independent.

Practically this may be effectuated by creating nomination, remuneration and audit committees consisting of non-executive or supervisory directors who are in the majority independent. Independent in this respect means independent of the operational business of the company and of those who take primary responsibility as executive directors, and also not receiving any benefit from the company other than their fully disclosed remuneration as non-executive or supervisory director.

Nomination, remuneration and audit committees could be set up

Composed of a majority of independent directors

The Group considered whether such committees should consist exclusively of independent non-executive or supervisory directors[18], but rejected this as a European rule. In Europe, we have to take account of particular situations relevant to board structures, like the existence of controlling shareholders and boards which are partly co-determined by employees. Employees of the company and representatives of controlling shareholders would normally not be considered to be independent, but it would go too far to exclude them completely from participating in these key areas. Requiring oversight by non-executive or supervisory directors who are in the majority independent would ensure a sufficient level of independent oversight, while accommodating these particular European situations.

In Europe, it seems neither appropriate nor necessary

To provide that such committees should consist exclusively of independent directors

Experience shows that producing binding EU legislation in the area of board structures is a lengthy process. The result is also generally likely to be inflexible and not responsive to local and changing needs and conditions. The Group takes the view that the EU should try to achieve a substantial result in the short term. The Group recommends that the Commission issue a Recommendation to Member States that they have effective rules in their company laws or in their national corporate governance codes ensuring that the nomination and remuneration of directors and the audit of the accounting of the company's performance is decided upon by non-executive or supervisory directors who are at least in the majority independent.

To achieve a substantial result in the short term

The Commission should issue a Recommendation on the role of (independent) non-executive / supervisory directors

By "effective rules", we mean that as a minimum this requirement should be enforced on a "comply or explain" basis, requiring listed companies to either fully comply with the requirement or to disclose in their annual corporate governance statement to what extent and why they deviate from it. Member States should be free to decide how to implement this in their jurisdiction, through company law, securities

Effective rules should be enforced at least on a "comply or explain" basis

[18] Cf. Sarbanes-Oxley Act of 30 July 2002, sec. 301-305;
New York Stock Exchange Listing Rules (http://www.nyse.com/about/report.html),
NASDAQ Listing Rules (http://www.nasdaq.com/about/ProposedRuleChanges.stm).

laws, listing rules or otherwise.[19] As in the Commission's Recommendation on Auditor Independence[20], the Commission should announce its intention to monitor to what extent Member States have and enforce these rules and to consider further rulemaking at EU level if their efforts and resulting levels of company compliance with the regime are insufficient.

Adoption and enforcement of these rules should be adequately monitored by the Commission

b) Independence

The Commission's Recommendation should include standards for what is considered to be independent in this respect. It is important that, to qualify as independent, the non-executive or supervisory director, apart from his directorship, has no further relationship, with the company, from which he derives material value. Certain relationships with the company, its executive directors or controlling shareholders may also impair independence. The Recommendation should include a list of relationships which would cause a non-executive or supervisory director to be considered not to be independent.

Recommendation should include principles on independence

Non independent relationships could be listed

In the view of the Group, such a list should at least include:

Minimum list :

- Those who are employed by the company[21], or have been employed in a period of five years prior to the appointment as non-executive or supervisory director;

(Former) employees

- Those who receive any fee for consulting or advising or otherwise, from the company or its executive managers;

Advisors

- Those who receive remuneration from the company which is dependent on the performance of the company (e.g. share options or performance related bonuses, etc.);

Performance related pay

- Those who, in their capacity as non-executive or supervisory directors of the company, monitor an executive director who is non-executive or supervisory director in another company in which they are an executive director, and other forms of interlocking directorships;

Interlocking relationships

- Those who are controlling shareholders, acting alone or in concert, or their representatives. Controlling shareholder for the purposes of this rule could be defined, as a minimum, as a shareholder who, alone or in concert, holds 30% or more of the

Controlling shareholders

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[19] Some doubt whether the proposed Prospectus Directive allows Member States to impose additional corporate governance requirements on listed companies through listing rules. Although it can be argued that the proposed Directive clearly does not prohibit Member States to do this, it would be helpful if this could be clarified, so as to put that position beyond any doubt.

[20] For complete references, see Annex 4.

[21] For the purpose of this list, the company should include any of its subsidiaries, holding companies, fellow group companies and possible other associates.

share capital of the company.

In defining relations which disqualify a non-executive or supervisory director from being considered to be independent, related parties and family relationships should be taken into account.

Related parties and family relationships to be taken into account

As a complement to these specific rules on independence of non-executive or supervisory directors, the Group believes listed companies should be required to disclose in their annual corporate governance statement which of their non-executive or supervisory directors they consider to be independent and on what grounds. Where they are not independent, the statement should explain what the dependency is. This would enhance the transparency of the actual role and position of non-executive and supervisory directors, and would enforce proper application of the independence rules. When a new director is proposed for appointment, similar disclosure should be made in the notice explaining the proposed resolution. The responsibility for the statement on independence is a collective board responsibility, but the individual director, or proposed director, with respect to whom the statement of independence is made carries a personal responsibility for its accuracy.

Information on individual independence should be given annually

And together with any proposal for appointment

Under an appropriate regime for (personal) responsibility

c) Competence

The company laws of all Member States include general rules on the competence which is expected of non-executive and supervisory directors. These rules are usually formulated in very abstract terms, like "the competence and skills which are to be expected from a director in his position". Whether or not a non-executive or supervisory director is competent generally is difficult to assess beforehand. It also depends on the role a director has on the board. In the light of the collective responsibility of all board members for the financial statements of the company (see Section 4.3 below), basic financial understanding is a fundamental skill all board members should possess or acquire upon their appointment. Apart from that, board members may be elected for their expertise in particular areas.

Existing rules on competence are generally abstract

Competence must be assessed together with role

Basic financial understanding is always required

But other skills may be of high relevance

In order for shareholders to be able to place sufficient trust in the non-executive or supervisory directors, they should be informed about their particular competencies in light of the board's composition. Listed companies should include in their annual corporate governance statement a profile of the board's composition, and should explain why individual non-executive or supervisory directors are qualified to serve on the board in the light of this profile. Again, there should be similar disclosures in proposals for initial

Competence should be explained annually against profile of board composition

And on appointment

appointment.

The increased importance attached to the role of non-executive or supervisory directors today requires them to make sufficient time available to fulfil their responsibilities. This should cause non-executive and supervisory directors to limit the number of non-executive or supervisory board positions they accept. What is an appropriate maximum number of non-executive or supervisory board positions will vary from person to person and according to the specific responsibilities involved in each position. In order to make this transparent to shareholders, listed companies should be required to disclose what board positions in other companies their non-executive or supervisory directors hold.

Shareholders should be able to assess whether sufficient time is available

Through proper disclosure of number and nature of board positions held in other companies

4.2. The remuneration of directors

Remuneration is one of the key areas where executive directors have a conflict of interests. In order to align the interests of executive directors with the interests of shareholders, modern systems of remuneration usually include performance-related remuneration, often through grants of shares, share options or other rights to acquire shares or by payments which vary with the share price. The result is that the remuneration of executive directors to a certain extent is dependent on the share price.

Remuneration is one key area of conflict of interest

To align interests, remuneration is often linked to the share price

Remuneration through grants of shares and rights to acquire shares does not take away fully the conflict of interests of executive directors and has some negative side effects. To the extent these forms of remuneration allow realisation of profits as a result of short term share price increases, they increase the pressures for executive directors to produce short term positive results according to the time contingency in their remuneration terms. These results may well not be sustainable in the long run. Furthermore, these forms of remuneration lead to a shift of monetary benefits and control rights of shareholders to executive directors. As the share price is related to the reported financial performance of the company, the executive directors, who are also primarily responsible for the accounting for the company's performance, have an incentive to produce accounts which overstate the performance of the company.

This has some negative effects :

Pressure for short term results

Shift of monetary benefits and control rights

Incentive to manipulate the accounts

The Group has considered whether remuneration in shares and rights to acquire shares should be prohibited altogether but has rejected this view. The form and level of remuneration of executive directors should be left to the companies and their shareholders themselves, and no particular form of remuneration should be generally prohibited. Within an appropriate regulatory regime, remuneration in shares and

No need for a prohibition of remuneration in shares and share options

But appropriate

rights to acquire shares can still make a useful contribution to the alignment of the interests of executive directors with the interests of the shareholders. However, because of the acute conflicts of interest inherent in such schemes, they must be subjected to appropriate governance controls, based on adequate information rights.

rules should be in place

An appropriate regulatory regime at least includes the following elements:

Including four elements at least

1. The remuneration policy for directors generally should be disclosed in the financial statements of the company, and should be an explicit item on the agenda of the annual general meeting. Shareholders should annually have the opportunity to debate the remuneration policy of the company on the basis of a comprehensive disclosure of the policy, without having to go through the process of tabling shareholder resolutions. Some Member States require, or are considering requiring, a form of mandatory or advisory vote by shareholders on the remuneration policy. We do not believe a shareholder vote on the remuneration policy generally should be an EU requirement, as the effects of such a vote can be different from Member State to Member State. The important thing is that shareholders annually have the opportunity to debate the policy with the board. See however n°3 below for prior approval by shareholders of share and share option schemes.

Remuneration policy for directors should be annually disclosed

And debated in the annual meeting

But requirement for a vote on the policy should not be imposed at EU level

2. The remuneration of individual directors of the company, both executive and non-executive or supervisory directors, is to be disclosed in detail in the annual financial statements of the company. This includes all financial and non-financial benefits derived from the company, including golden parachutes and pension rights and other perquisites. Disclosure of the individual remuneration of directors is important for shareholders in order to appreciate the relation between the performance of the company and the level of remuneration of the directors. It also takes away the possibility of hiding particular elements of remuneration of individual directors in aggregate numbers and thus puts up a barrier against excessive (elements of) remuneration. Some have argued that disclosure of individual director's remuneration will only lead to an increase of remuneration as a result of human nature of directors comparing their income with that of their competitors and peers. This may be a negative side effect but, on balance, the Group believes it is more important to give shareholders the information on the basis of which they can hold directors accountable for the remuneration they extract from the company.

Individual remuneration of directors should be disclosed in detail annually

To clarify the relation with company performance

And to prevent potential abuses

The requirement to disclose the remuneration of individual directors should extend to non-executive and supervisory directors. Usually,

This applies also to non-executive

their remuneration is more straightforward than that of executive directors. Shareholders should be able to judge to what extent the remuneration of non-executive and supervisory directors is justified in view of their performance, and to what extent (elements of) their remuneration render them non-independent. We believe that remuneration of non-executive or supervisory directors in shares or share options, or which is otherwise related to the company's performance, should not generally be prohibited, but such remuneration should disqualify the non-executive or supervisory director from being considered to be independent (see the previous Section).

and supervisory directors

Who should not be considered to be independent if their remuneration is linked to company's performance

3. Schemes under which directors are remunerated in shares, share options or any other right to acquire shares or to be remunerated on the basis of share price movements, and any substantial change in such schemes, should be subject to the prior approval of the shareholders meeting. The approval relates to the scheme as such, i.e. the system of remuneration and the rules applied to establish the individual remuneration under the scheme, and does not relate to the individual remuneration of directors under the scheme. Such remuneration should be set by the remuneration committee. When put to the shareholders meeting for approval, the remuneration committee must properly explain the scheme to shareholders in view of the intended application and should set out the relationship of the scheme to the overall remuneration policy. It should also provide an overview of the costs of the scheme to the company in view of the intended application.

Share incentive schemes should require a general meeting approval

Based on proper explanation, by remuneration committee, of the applicable rules and their likely costs

4. The annual costs to the company of share grant schemes, share options schemes and other share incentive schemes should be properly accounted for in the company's annual accounts. The present accounting standards are too loose and are under reform, both US GAAP and IAS. Mandatory accounting for the cost of share incentive schemes will reduce the distributable profits of the company and may pose particular problems for start-up companies. However, some major companies have already voluntarily started to implement such accounting. The Group believes such accounting is a major restraint on exorbitant share incentive schemes, and maybe the only one that is really effective. This has led the Group to recommend that the principle of accounting for the cost of share incentive schemes be recognised in a European framework rule. The accounting standards setting bodies and the accounting profession generally should develop the appropriate standards in more detail.

An important way to prevent abuses is to require full reflection of share incentive schemes in annual accounts

The appropriate framework rule should be adopted at EU level

These elements of an appropriate regulatory regime should apply to all listed companies across the EU. Again, their application should not be delayed by a lengthy legislative process. We propose that the

Recommendation to be adopted rapidly should cover all listed

Commission include these elements in a Recommendation to Member States and announces its intention to monitor compliance by - and within - Member States, and to consider further rulemaking if compliance is insufficient.

companies

And be duly monitored

4.3. Management responsibility for financial statements

The probity of financial statements is very much at the heart of the concerns raised by Enron and similar cases. Many of the regulatory responses in the US and in Europe are focused on ensuring that financial statements correctly reflect the financial position of the company and are not manipulated, whether or not to the personal benefit of directors or of holders of blocks of shares in the company. This is vital for shareholders, creditors and, more generally, the financial markets and the economy.

Recent corporate scandals and responses highlight the key importance of trust in financial statements

Under the company laws of Member States, the responsibility for the probity of financial statements of the company is primarily a collective responsibility of the board : in a one-tier structure, this is a collective responsibility of both executive and non-executive directors, and in a two-tier structure, this is the collective responsibility of both the managing directors and the supervisory directors. This is reflected in many Member States in the requirement that all executive, non-executive and supervisory directors sign the annual accounts of the company. The Group believes this collective responsibility is an appropriate mechanism to avoid a limited number of board members, in particular certain executive directors whose performance is to be reflected in financial statements, having a decisive role in determining their content.

At national level, board traditionally has a collective responsibility for the probity of financial statements

Which avoids undue excessive individual influence

The collective responsibility of the full board(s) should extend not only to the annual and consolidated accounts, but, in principle, to all statements regarding the financial position of the company, including quarterly result announcements (where applicable) and financial statements in prospectuses and other public documents. An exception can be made for mandatory ad hoc disclosure, where consideration by the full board(s) will often be practically impossible. However, it is the collective responsibility of the full board(s) to ensure that an appropriate authorisation system is in place for such ad hoc disclosures.

Collective responsibility extends to all statements on the company's financial position

Except for ad hoc disclosure, where proper delegation must be organised

The collective responsibility of the full board(s) should also extend to statements on key non-financial data, such as information on the company's risk management system, its business prospects and investment plans, and strategies in technical, organisational and human resources areas. It also includes in particular responsibility for

It also extends to all statements on non-financial data

Including the annual corporate

accuracy of the annual statement relating to the company's corporate governance structures and practices.

governance statement

The Group believes that the collective responsibility of the board for financial and key non-financial statements should be confirmed as a matter of EU law.

EU law should confirm collective responsibility

4.4. Wrongful trading

In our Consultative Document, we particularly addressed the need to strengthen the accountability of directors when the company is threatened by insolvency and suggested the introduction of a European framework rule on "wrongful trading". This is a matter all Member States' laws have to deal with, usually in a combination of company law and insolvency law. Some respondents argued that, as this is a matter of insolvency law, the EU should not interfere with it at all. The Group rejects this view. The responsibility of directors when the company becomes insolvent has its most important effect prior to insolvency and is a key element of an appropriate corporate governance system. From this perspective, it is irrelevant whether rules relating to this responsibility are laid down in company law or insolvency law.

The introduction of a framework rule on wrongful trading at EU level

Was opposed by some respondents on formal grounds

Which are not shared by the Group

The gist of the UK "wrongful trading" rules, the French and Belgian "action en comblement du passif", and other Member States laws is similar : if the directors ought to foresee that the company cannot continue to pay its debts, they must decide either to rescue the company (and ensure future payment of creditors) or to put it into liquidation. Otherwise, the directors will be liable fully or in part to creditors for their unpaid claims.

Existing national rules make directors liable for not reacting when they ought to foresee the company's insolvency

The details of the national rules vary considerably. In some Member States there are no specific provisions, but a similar effect is achieved through general rules on directors' liability, sometimes by tort law, though the general duty to file a petition for bankruptcy in the case of actual insolvency comes too late. The concept of wrongful trading applies both to independent companies and to companies within groups. The directors of a subsidiary company are subject to the rules, as well as the parent company and its directors if they operate as de facto or "shadow" directors of the subsidiary. The beauty of the rule is that it does not interfere with the on-going business decisions of directors, as long as an insolvency situation is not yet foreseeable. A general obligation to file for bankruptcy in case of actual insolvency usually comes too late.

National rules vary considerably

But they apply also to group companies

And do not interfere with on-going business decisions

The majority of responses supported the suggestion of the Group to introduce a European framework rule on wrongful trading, which would hold company directors (including "shadow" directors) accountable for letting the company continue to do business when it should be foreseen that it will not be able to pay its debts. This support strengthened the Group in its view that it should recommend that such a rule be introduced. It would be a considerable improvement in the functioning of companies and groups of companies.

Responses to the consultation supported the introduction of a EU rule on wrongful trading

Which the Group recommends

It would protect creditors without overly restricting companies and their directors, as they can and must make their own choice in case of – foreseeable, not yet actually imminent - insolvency whether to attempt to rescue the company or put it into liquidation. A European wrongful trading rule would enhance creditors' confidence and their willingness to do business with companies. This is even more important in Europe, since doing business across borders may be perceived to be more risky than in one's own jurisdiction where information on business partners may be easier to obtain. Finally, a wrongful trading rule would introduce an equivalent level of protection for creditors of companies across the EU, without any need to harmonise the whole body of directors' liability rules in all Member States.

Without overly restricting management's decisions

Such a rule would enhance creditors confidence

And introduce an equivalent level of protection across the EU

4.5 Sanctions, Director's disqualification

The responsibility for the company's financial and key non-financial disclosure should be properly sanctioned by Member States. Member States should ensure that all board members can be held accountable for misleading financial and other key non-financial statements, and that appropriate sanctions are in place. What sanctions should apply (criminal sanctions, civil liability for damages, forfeiture of bonuses and profits gained through share and share option grants) in the EU is a matter for Member States.

Misleading disclosure should be properly sanctioned

Applicable sanctions should be defined by Member States

Yet the Group believes that there is a case for examining whether one particular type of sanction should be introduced across the EU : director's disqualification. Criminal and civil liability sanctions are often very difficult to effectuate, may often come too late, may have substantially different applications in the various Member States, and may in practice not operate as a strong deterrent against misconduct by directors. The disqualification of a person from serving as a director of companies across the EU is an alternative sanction, which may be easier to effectuate and has a powerful deterrent and longer term disabling effect.

Criminal and civil sanctions have some weaknesses

Which may be addressed by the introduction at EU level of director's disqualification

We recommend that the Commission further review whether director's disqualification can be imposed as a sanction at least for misleading financial and key non-financial disclosures, or more generally for misconduct by directors. Such review should look into the director's disqualification systems that apply in some Member States and the "fit and proper" requirements for directors, as contained in European banking and insurance legislation. The constitutional aspects of the sanction in some Member States should be considered.

Adoption of such a rule should be considered by the Commission

After proper analysis of existing national and European rules

5. AUDITING PRACTICES

Enron, Worldcom and similar cases have revealed that a proper audit of financial statements of the company is a fundamental element of a corporate governance system. Audit, in an appropriate form, is also an important safeguard in non-financial reporting. A proper audit depends on the role and performance of the external auditor, as well as the internal audit process of the company.

A proper audit is fundamental to good corporate governance

The Commission has already undertaken initiatives to deal with particular issues relating to the role and performance of the external auditor. The Commission's Recommendation of May 16, 2002[22] deals with such subjects as:

- Non-audit services provided by audit firms to their audit clients;
- Rotation of key audit partners;
- Employment of a former audit partner by the audit client.

Some initiatives have been taken by the Commission,

among which the Recommendation on Auditor Independence

Furthermore, the Commission has announced that it will produce a further Communication on policy issues, which would deal with the role of public auditors, code of ethics, auditor's liability and public oversight of the audit profession.

A new Communication on Audit is expected soon

We support these initiatives of the Commission and urge it to proceed with its further Communication. The Group itself has focused on the internal aspects of auditing practices, in particular on the responsibility of the board for audit. As we have said, we believe that within the board the responsibility for the audit of the company's financial statements should lie with non-executive or supervisory directors who are at least in the majority independent (see Section 4.1 above). The audit committee, which in practice is usually set up for these purposes, has a key role to play in the relationship between the executive managers and the external auditor. To this end, the audit

Group has focused on internal aspects of auditing practices

Key role for non-executive or supervisory directors

Main missions of audit committee :

[22] For complete references, see Annex 4.

committee[23] should:

- be responsible for the selection of the external auditor for appointment by the shareholders meeting (as is the rule in most Member States) or the full board, and the terms and conditions of their appointment;

Selection of auditor

- monitor the relationship of the external auditor with the company and its executive management, in particular to safeguard the external auditor's independence;

Monitoring of auditor's independence

- monitor non-audit services provided by the auditor firm, if any. Non-audit services by audit firms to audit clients raise concerns generally, and the Group sees a case for prohibiting them altogether. As long as they are not prohibited, they should be closely monitored by the audit committee;

Monitoring of non audit services

- meet with the external auditor at least every quarter, and at least once a year in the absence of executive managers;

Regular meetings with auditor

- ensure that the external auditor has access to all information required to perform his role;

Ensuring access to information

- receive the auditor's management letter with comments on the financial statements, and consider whether these comments should be disclosed in the financial statements.

Follow-up to management letter

The audit committee should also be pivotal in the internal aspects of the audit function. To this end, the audit committee should:

And internal aspects of audit:

- be responsible for reviewing the accounting policies of the company, and changes thereto;

Accounting policies

- monitor the company's internal audit procedures and its risk management system;

Internal audit

- meet regularly with those who are responsible for the internal audit procedures and risk management system;

Risk management

- consider to what extent the findings of the risk management system should be reported in the company's financial statements;

With due access to information

- have access to all internal information relevant to performing its role.

The Group recommends that the Commission include provisions on the role and responsibilities of audit committees in its Recommendation on the role of non-executive and supervisory directors, which we invite the Commission to issue.

Relevant provisions should be included in the proposed Recommendation

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[23] If no audit committee is set up, its role should be performed by the non-executive directors in the one-tier board or by the supervisory board as such, of which the majority then should be independent. For brevity sake, we will continue to refer here only to audit committee.

6. CORPORATE GOVERNANCE REGULATION IN EUROPE

In our Consultative Document, we addressed the issue how Europe should proceed with the regulation of corporate governance, and in particular whether a European code of corporate governance should be established. We expressed our reservations about a European corporate governance code.

Reservations were expressed in the Consultative Document about a EU corporate governance code

The adoption of such a code would not achieve full information for investors about the key corporate governance rules applicable to companies across Europe, as these rules would still be based on and part of national company laws that are in certain aspects widely divergent. We also doubted whether additional Europe-wide voluntary rules would contribute to the improvement of corporate governance, as Europe would either have to allow many alternative rules, depending on the various company law systems, or to confine itself to abstract, and perhaps largely meaningless, rules which would be compatible with all of these systems. Effective harmonising of corporate governance codes while leaving company law untouched is not feasible.

Such a code would fail to deliver full information

And would not be feasible

We finally emphasised that the key input for codes of corporate governance should come from the market and market participants. These codes are a means of building up reputation by voluntary compliance with rules of good behaviour. The market and its participants know best what rules enhance reputation. The EU as well as Member States should leave it to those who have an own interest in such codes, i.e. companies, investors, stock exchanges, etc. to take the initiative, while continuing to monitor the situation closely.

Key input for codes should come from the markets

And only be monitored by the EU and Member States

A clear majority of responses to our Consultative Document agreed with this approach and rejected the creation of a European corporate governance code.

Responses to the consultation reject a EU code

However, the Group does believe there is an active role for the EU to play in corporate governance, apart from the various initiatives we suggested in the previous Sections. The EU should actively seek to co-ordinate the efforts of Member States to improve corporate governance by changes in their company laws, securities laws (listing rules) or in their codes of corporate governance. Such a co-ordination is warranted in order to facilitate the convergence of the corporate governance efforts of Member States, which is already emerging, or at a minimum work to ensure that they do not unnecessarily diverge, and that Member States learn from each other's experiences. The co-ordination should not only extend to the

The EU should nevertheless co-ordinate the efforts of Member States

To facilitate convergence

Including with respect to enforcement

making of codes, but also to the procedures Member States have in place to monitor and enforce compliance and disclosure. This co-ordination structure should stimulate a continuous debate about what good corporate governance involves. In light of the recent regulatory initiatives in the USA, it is important that the EU also engages in a transatlantic debate on corporate governance, so that both the EU and the USA have a full understanding of each others' methods and practices.

On a continuous basis, and taking account of US developments

As the Weil, Gotschal & Manges Report[24] has shown, currently various corporate governance codes exist in Member States. We believe it is important that Member States designate one particular code of corporate governance as the code with which companies subject to their jurisdiction have to comply, or by reference to which they have to explain how and why their practices are different. This would also facilitate the co-ordination of the efforts of Member States.

Many codes currently exist

Each Member State should designate a reference code

We recommend that the Commission set up a structure which facilitates the co-ordination of the Member States' efforts to improve corporate governance. Member States should be required to participate in the co-ordination, but the process itself and the results of the process should be voluntary and non-binding. Market participants (including of course companies) should be invited to be actively involved in the co-ordination exercise.

A structure should be set up

To co-ordinate Member States efforts on a non-binding basis

Out of the co-ordination of the national corporate governance efforts of Member States over time, a general framework on corporate governance in Europe can be expected to emerge. The form and content of that framework, however, should not be determined beforehand, but should be left to the developments in Member States and in the wider business context and to co-ordination between them.

Co-ordination of national efforts may lead over time to a European general framework

To summarise, listed companies should be required to include in their annual report and accounts a coherent and descriptive statement covering the key elements of the corporate governance rules and practices they apply. This statement should also be separately posted on the company's website.

Summary : *Annual Corporate Governance Statement to be published*

The principles applicable to such an annual corporate governance statement should be set up in a framework Directive. The detailed rules should be set up by Member States in view of their national company laws, but the EU should ensure a certain level of co-

Based on common principles

[24] Comparative Study of Corporate Governance Codes relevant to the European Union and its Member States (http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm)

ordination.

Such a statement should contain a reference to the designated national code of corporate governance and/or company law rules with which the company complies or in relation to which it explains deviations.

Including reference to a national code

Responsibility for the annual corporate governance statement should lie with the board as a whole.

Under collective responsibility of the board

Listed companies should be required to maintain a specific section on their website where they publish all information relevant for their shareholders, as recommended in Chapter II. This section should include all relevant materials relating to shareholders meetings, and should offer facilities for giving proxies or voting instructions on-line or for downloading and electronic transmission of proxy or instruction forms.

All meeting materials and proxy forms to be contained in a specific website section

Member States should however be able to require listed companies to provide hard copies of meeting materials and voting forms to shareholders who specifically request them.

Sending of hard copies to be decided by MS

Listed companies should explicitly disclose to their shareholders how they can ask questions, how and to what extent the company intends to answer questions, and how and under what conditions they can submit proposals to the shareholders meeting. This should be an element of their mandatory annual corporate governance statement.

Rights to ask questions and to table resolutions to be explained

With respect to the right to submit proposals for resolution by the shareholders meeting, there is a link with the squeeze-out right of a majority shareholder and sell-out right of minority shareholders. Member States should be required to set the applicable thresholds in a consistent way.

Threshold to table resolution to be set consistently with squeeze-out and sell-out rights

Listed companies should be required to offer all shareholders facilities to vote in absentia – by way of direct vote or proxies – by electronic means, and through hard copy voting instruction or proxy forms at their request. The Group recommends that such a requirement should not apply to cross border situations to the extent that any necessary solutions have not yet been found and implemented for the problems of cross-border holding of securities in Europe.

Facilities to vote in absentia to be offered

To the extent that any necessary solutions have been found

Listed companies should be permitted, but not required, to allow absentee shareholders to participate in general meetings via electronic means (such as internet or satellite).

Electronic participation in meetings permitted

The permission to abandon the physical meeting should be a Member State decision, but such a decision should in any event be taken by – or with the consent of – the general meeting of shareholders with an

As well as abandonment of physical meeting

appropriate strong qualified majority.

A separate Group of Experts set up in January 2002 by the Dutch Minister of Justice issued its Final Report on cross-border voting in September 2002. In that Report, it is recommended that the rights and obligations of accountholders and securities intermediaries be regulated at EU level, to ensure that accountholders across the EU can effectively exercise the voting rights on shares they hold.

Consideration to be given to cross-border voting issues

The issues identified by that Cross-Border Voting Group, combined with the relevant recommendations of the Group, should be considered by the Commission as a matter of priority, with a view to building a regulatory framework that facilitates the participation of shareholders across the EU and, where possible, outside the EU, in the governance of listed companies.

With a view to building the appropriate regulatory framework

Regulation of the relevant types of institutional investors by Member States should include an obligation on those institutional investors to disclose their investment policy and their policy with respect to the exercise of voting rights in companies in which they invest, and to disclose to their beneficial holders at their request how these rights have been used in a particular case.

Institutional investors to disclose their investment and voting policies

Shareholders, in a general meeting or holding a maximum of at least 5 or 10 per cent of the share capital, should be given the right to apply to a court or appropriate administrative body to order a special investigation. A European framework rule should be adopted to this end, whereby this special investigation right should be guaranteed in all companies and as far as possible on a group-wide basis. Details of the procedure and determination of proper sanctions should be left to Member States.

Special investigation right to be offered in all companies

At least listed and other open companies across the EU should have the choice between the two types of board structure (one-tier / two-tier), so as to be able to elect the system which best suits their particular corporate governance needs and circumstances.

Permission for companies to freely adopt any of the two types of board structures

Listed companies should be required to ensure that the nomination and remuneration of directors and the audit of the accounting for the company's performance within the board are decided upon by exclusively non-executive or supervisory directors who are in the majority independent.

Key role to play by (independent) non-executive or supervisory directors

The Commission should rapidly issue a Recommendation to Member States that they should have effective rules in their company laws or in their national corporate governance codes to this end, which should

Based on a Recommendation to be issued rapidly

be enforced on a "comply or explain" basis at the minimum.

The Recommendation should include principles on independence, and could include a list of relationships which would lead a non-executive or supervisory director to be considered as not independent. Listed companies should be required to disclose in their annual corporate governance statement which of their directors they consider to be independent and on what grounds. Similar disclosure should be made when a new director is proposed for appointment.

Independence to be based on principles

And explained whenever necessary

Listed companies should include in their annual corporate governance statement a profile of the board's composition, and should explain why individual non-executive or supervisory directors are qualified to serve on the board in their particular roles. Similar disclosure should be made in proposals for initial appointment. Listed companies should also be required to disclose what board positions in other companies their non-executive or supervisory directors hold.

Disclosure about board's composition and qualifications

And other board positions held

The remuneration policy for directors generally should be disclosed in the financial statements of the company, and should be an explicit item for debate on the agenda of the annual meeting.

Remuneration policy to be disclosed and debated

The individual remuneration of directors of the company, both executive and non-executive or supervisory directors, is to be disclosed in detail in the financial statements of the company.

Individual director's remuneration to be disclosed

Schemes granting shares and share options and other forms of remuneration of directors linked to the share price should require the prior approval of the shareholders meeting, on the basis of a proper explanation by the remuneration committee of the applicable rules and of their likely costs.

Prior shareholder approval of share incentive schemes

The costs of all share incentive schemes should be properly reflected in the annual accounts, and this accounting principle should be recognised in a European framework rule.

Costs of these schemes to be accounted for

The Commission should adopt a Recommendation defining an appropriate regulatory regime for directors' remuneration in listed companies, which should include the four elements outlined above.

Appropriate regulatory regime to be included in a Recommendation

Responsibility for the probity of financial statements should be attributed, as a matter of EU law, to all board members on a collective basis. This responsibility should extend to all statements made about the company's financial position, as well as to all statements on key non-financial data (including the annual corporate governance statement).

Board to be responsible on a collective basis for financial and non-financial statements

A rule on wrongful trading should be introduced at EU level, which would hold company directors (including shadow directors) accountable for letting the company continue to do business when it

Introduction at EU level of a wrongful trading rule

should be foreseen that it will not be able to pay its debts.

Appropriate sanctions for misleading financial and other key non-financial statements should generally be determined by Member States. The Commission should nevertheless review whether director's disqualification can be imposed at EU level as a sanction, at least for misleading financial and key non-financial disclosures or more generally for misconduct.

Director's disqualification to be further reviewed as a possible sanction at EU level

The responsibility for supervision of the audit of the company's financial statements should lie with a committee of non-executive or supervisory directors who are at least in the majority independent. Provisions on the role and responsibilities of audit committees (or any equivalent body), with respect to both the external and internal aspects of audit, should be included in the proposed Recommendation on the role of non-executive and supervisory directors.

Role and responsibilities of audit committees to be defined in Recommendation on independent directors

The key input for codes of corporate governance should continue to come from the markets and their participants. Each Member State should designate one particular corporate governance code as the code with which companies subject to their jurisdiction have to comply or by reference to which they have to explain how and why their practices are different.

Each Member State to designate a reference code of corporate governance

A structure should be set up at EU level to facilitate the co-ordination of Member States efforts to improve corporate governance. Co-ordination should not only extend to the making of codes, but also to the procedures Member States have in place to monitor and enforce compliance and disclosure. Member States should be required to participate in the co-ordination process, but the results should be non-binding.

Co-ordination of Member States efforts to be co-ordinated by an EU structure, on a non-binding basis

CHAPTER IV

CAPITAL FORMATION AND MAINTENANCE

1. THE FUNCTION OF LEGAL CAPITAL AND THE COMPETITIVE EFFECT OF THE CURRENT RULES

The Consultation Document included a description of the traditional functions of legal capital in European Company Law, followed by three possible approaches for reform, and some special topics in the regulation of legal capital that deserved more detailed attention.

Consultation Document covered possible reforms of EU rules on capital, and special topics

The concept of legal capital is generally seen as one of the cornerstones of European Company Law. In the Consultative Document, the functions of legal capital, as described by orthodox legal and financial theory, were listed. A large majority of the respondents highlighted the fundamental functions of protecting creditors' and existing shareholders' interests. Many respondents highlighted this function of legal capital as a "retention figure" that prevents unlawful transfers of assets from the company to its members. Most respondents, and the Group itself, however do not believe that legal capital serves any function of indicating the adequacy of a company's assets for its entrepreneurial activity ("capital adequacy"), leaving aside the special regime of capital adequacy for certain regulated business activities.

Legal capital is seen as one of the cornerstones of European Company Law

Its main function is seen to be creditor and shareholder protection

But it does not reflect "capital adequacy"

In short, a considerable majority of the respondents agree that the most important functions developed by legal capital are the protection of creditors' and shareholders' rights. It is important to note, however, that many respondents added that the functions performed by legal capital are more important in theory than in practice: there is wide agreement that the concept of legal capital is not effective in attaining the objectives that are assigned to it.

Many responses to the consultation stressed that legal capital is not in practice effective in attaining its objectives

The rules on capital formation and maintenance have an impact on the cost of capital and credit, although that impact may be extremely difficult to assess. Most of the respondents do not believe that the peculiarities of the European legal capital regime put European companies at a competitive disadvantage in comparison with their competitors in other legal systems. Evidently, this question deserves thorough empirical research, which is difficult because the competitive effect of the legal capital regime is obscured by the presence of many other variables. However, none of the respondents argue that

European legal capital regime is generally not considered a competitive disadvantage for European companies

European companies enjoy an advantage thanks to the legal capital regime existing in the EU.

But it is no competitive advantage either

2. APPROACHES TO THE REFORM OF LEGAL CAPITAL IN EUROPE

In the Consultative Document, we referred to criticisms levelled against the legal capital regime in the Second Company Law Directive. The legal capital regime, it is argued, fails to adequately protect creditors, who are not so much interested in the capital of the company (and certainly not in the minimum capital) but much more in its ability to pay its short term and long term debts. It can also be said that the amount of legal capital, as shown in the articles of association, is a very primitive and inaccurate indication of the company's ability to pay its debts. There is an argument against the inflexibility and costs of the current regime, that could hamper in some way the ability of companies to obtain equity funding.

Legal capital is criticised for failing to protect creditors

Legal capital is a poor indication of company's ability to pay its debts

Current regime is arguably inflexible and costly

Finally, it is argued that the annual accounts have become an inadequate yard-stick for deciding whether the company has sufficient distributable reserves for it to make distributions to shareholders. As a result of changes in accounting standards, like standards on goodwill impairment and accounting for pension fund performance and costs of share and share option schemes, the accounts - and the reserves they show - become more and more volatile and less and less an indicator of the ability of companies to pay their current and future debts. Capital protection based on such accounts is becoming a delusion.

Annual accounts have become an inadequate yardstick for making decisions on distributions

And for assessing company's ability to pay its debts

Most of the respondents agree that there is room for improvement of the current regime, although there is controversy on which is the best possible course to reform the present system.

Current regime should be improved

In the Consultative Document, three alternative approaches were considered :

Consultative Document presented three approaches

- The first approach is based on the "SLIM" (Simpler Legislation for the Internal Market) proposals. This approach consists of an evolution of the current regime to a more simplified and modern capital regime. The purpose of the SLIM exercise was to simplify the Second Company Law Directive; as a consequence of this, more fundamental changes to the rules could not be considered by the SLIM Group, which proposed a number of measures intended to simplify and modernise the current legal capital regime. In the Consultative Document, this was suggested as one

First approach:

Simplification of the Second Directive

Based on the "SLIM" proposals

of the possible approaches to reform, supplemented by other recommendations that could be included in a wider reform of the Second Company Law Directive ("SLIM-plus").

Supplemented by further recommendations ("SLIM-plus")

- The second approach is roughly based on the experience of US jurisdictions that have passed statutes based on the Model Business Corporations Act. This approach would mean a radical departure from many of the features of European Company Law: the concept of legal capital does not exist in such a regime, and most of the rules related to capital formation and maintenance are different from the European rules, or even totally opposed to them. Apart from those basic features, in the US jurisdictions that follow this approach, the balance of powers between the general meeting of shareholders and the board of directors is usually tilted in favour of the latter, while the situation in Europe is different. In these US jurisdictions, the board of directors may issue new shares without any shareholders' involvement, but subject to the directors' fiduciary duties. Pre-emption rights are not recognised as basic shareholder rights, and they only exist where they are expressly recognised in the articles of association.

Second approach:

Inspired by US experience, it leads to a radical departure from:

- the concept of legal capital

- many rules on capital formation and maintenance

- the current balance of powers between shareholders and board of directors

- The third approach contemplated in the Consultative Document is also based on the elimination of the concept of legal capital, but seeks to integrate that fundamental change with some of the basic features of European Company Law, specifically the need for shareholder approval for operations that affect shareholders' equity.

Third approach:

Elimination of legal capital, but retention of shareholder controls

Very few respondents expressed support for the second approach. A substantial number of respondents preferred the first and third approach, with some of the respondents opting for one of them, but without excluding the other. Taking into account the consultation results, the Group recommends a two-step approach:

In view of support for the first and/or third approaches, the Group recommends two steps:

1. The Commission should, as a matter of priority, present a proposal for reform of the Second Company Law Directive, along the lines suggested by the SLIM Group, with the modifications and supplementary measures that are suggested in the present Report ("SLIM-plus").

First priority, to reform the Second Directive, based on "SLIM-plus"

2. The Commission should, at a later stage, conduct a review into the feasibility of an alternative regime, based on the third approach. The alternative regime need not replace the capital formation and maintenance rules of the Directive as amended according to the "SLIM-plus" proposals. Rather, the new regime could be offered as an alternative option *for Member States*, who should be able to freely decide to change to the new regime and

Later, to review the feasibility of an alternative regime, based on the third approach

impose it on companies subject to their jurisdiction or to retain the Second Directive rules as modified by the "SLIM-plus" reform. Obviously, the creation of a new regime will demand further study and consultation, but there is a very substantial and relevant percentage of answers to the Consultative Document that shows a strong interest in pursuing this alternative to the present capital formation and maintenance rules. In addition, the Group believes that the criticism directed at the current regime is so fundamental and serious that indeed an alternative regime aimed at efficient shareholder and creditor protection needs to be developed.

Such a regime could be offered as an option for Member States

Consultation indeed confirms strong case for the development of an efficient alternative regime

In the following pages, we give a brief overview of the SLIM-plus proposals and of an alternative regime that could be developed. The specific questions in the Consultative Document have been integrated in this overview. We acknowledge that the issues discussed here are complex and intricate. The nature of this Report does not allow a complete and exhaustive description of all necessary modifications. The aim of the Group here is to set the basic lines along which further work may proceed.

The basic lines of both approaches ("SLIM-plus" and alternative regime) are briefly presented in the following pages

3 MODERNISATION OF THE CURRENT CAPITAL REGIME IN THE SECOND COMPANY LAW DIRECTIVE ("SLIM-PLUS")

Any modernisation of the current capital formation and capital maintenance regime should remove, where possible, the defects perceived in it, while maintaining the virtues of the current regime.

A modernisation of the current regime has to be selective

The SLIM Group made a number of suggestions for changing the Second Company Law Directive:

"SLIM" proposals:

- elimination, in certain cases, of experts' valuations for contributions in kind;
- further possibility of issuing shares without pre-emption rights when shares are issued at their market price, or slightly below;
- possibility for companies of acquiring own shares above the percentages set in the Directive, and allowing for longer authorisations to the board;
- reduction of the prohibition of financial assistance;
- extension of the regime of compulsory withdrawal of shares.

- contributions in kind

- pre-emption rights

- acquisition of own shares

- financial assistance

- compulsory withdrawal

We have discussed these proposals, and extended the consultation to some other questions, some of which had already been pointed at in the SLIM report.

We discussed these proposals, and some other questions

a) Minimum capital

The Group has reached the conclusion that the only function of the minimum capital requirement is to deter individuals from light-heartedly starting a public limited company. We are not convinced that minimum capital, at its present levels, performs any other useful functions, but there is no evidence that it constitutes a hurdle to business activity either. It is probably wise not to spend much time on minimum capital in a reform to make the current system more efficient, and to direct attention to issues which are more relevant. The minimum capital requirement should not be removed, nor increased.

Minimum capital serves only one function

But is not seen to be a significant hurdle

Requirement should not be removed, nor increased

b) No par value shares

Wide demand for no par value shares is being expressed by the financial industry and the legal professions. Not only the SLIM group favoured the introduction of no par value shares, but also the Giovannini Group in its report on *The Impact of the Introduction of the Euro on Capital Markets*[25].

The introduction of no par value shares is widely demanded

Offering the possibility to have no par value shares does not necessarily require major changes in the system. The Second Company Law Directive already allows for shares to have a fractional value (also referred to as "accountable par") rather than a nominal value (see for example Article 8 providing that shares cannot be issued below their nominal or fractional value). Shares would have to express numerically the fraction of the capital of the company that they represent or, alternatively, the total number of shares outstanding. In a system in which shares are dematerialised, the updating of the percentage or of the total number of shares should be relatively easy: there should be continuous disclosure of all shares outstanding, and, at the very least, companies should be required to update the fraction any time that there are relevant changes to it. As for "paper" shares, they would have to include the appropriate fraction or the total number of shares, together with the date in which the fraction or the total number of shares was correct, and a reminder that the correct fraction can be obtained at any time from the company itself, or from the companies Register.

The Second Directive already allows for shares to have a fractional value rather than a nominal value

Shares with fractional value require proper and continuous disclosure of relevant figures

Whether or not the shares are dematerialised

It is debatable whether introducing shares without any reference to either nominal or fractional value would constitute a significant

It is debatable whether shares without any

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[25] See paragraph 2.2.2, letter D.

change in the system of the Second Company Law Directive. Many argue that Article 8 of the Directive - which prohibits issues with a discount to nominal value - is the only objection, and that a system of real no par value shares is consistent with the general approach of the Directive to capital formation and maintenance rules. Others take the view that real no par value shares would require a more fundamental change to the system of the Directive. We recommend that, as part of SLIM-Plus, it is reviewed how no par value shares can be accommodated within the Second Company Law Directive.

reference to either nominal or fractional value would be a significant change

Introducing them requires further review

c) Capital formation

As the SLIM Group diagnosed, one of the real problems of the system of capital formation created by the Second Company Law Directive is the valuation of non-cash contributions. Valuations performed by independent experts are expensive and do not offer a total guarantee of the assets' real value. The SLIM Group has proposed elimination of the need for an expert's valuation report where contribution consists of securities traded in a regulated market, which we fully endorse. Similarly, the idea of accepting a valuation that has been made in a preceding period should be considered, provided that the preceding valuation was made recently and there are no new qualifying circumstances that need to be taken into account. For other contributions in kind, there should be the possibility of relying on values derived from audited accounts, provided that the accounting principles used are still applicable to the assets. In that case, minority shareholders should have the right to apply to the court to require a valuation by an expert.

Valuations of non cash contributions are expensive and do not offer total guarantee

Requirement for expert valuation should be eliminated :

- where there is a market price

- where there is a recent evaluation

- where values derive from audited accounts

In the Consultation Document, we asked whether the possibility to allow the provision of services as valid contributions in kind should be introduced. A majority of the respondents are in favour of allowing services as contributions in kind, provided there are sufficient safeguards. The risk consisting of the lack of performance by the provider of services can be covered by placing shares in a escrow account, only to be released after the services have been provided, or, alternatively, by requiring the company to take an insurance policy to cover the absence of execution of services. Acceptance of services as a valid contribution in kind may be particularly useful for some types of companies (e.g. start-up companies, and technological or professional companies in which specialised services are an important asset to the company). We recommend that the Commission reviews the possibility of allowing the provision of services as contribution in kind in the revision of the Second Company Law Directive, with appropriate safeguards.

Responses to the consultation welcomed the possibility of allowing the provision of services as contribution in kind, with safeguards

This possibility should be further reviewed by the Commission

d) Pre-emption rights

Currently, Article 29 §4 of the Second Directive allows the right of pre-emption to be restricted or withdrawn only if stringent formalities (shareholders resolution adopted with qualified majority, presentation by the board of a specific written report) are observed. As the SLIM Group has suggested, for listed companies it would be appropriate to allow the general meeting to empower the board to restrict or withdraw pre-emption rights without having to comply with these formalities, but only where the issue price is at the market price of the securities immediately before the issue or where a small discount to that market price is applied.

For listed companies, additional freedom to suppress pre-emption rights should be allowed, but only if issue is made at market price or slightly below

If real no par value shares are to be introduced, the suppression of pre-emption rights needs to be reconsidered as pre-emption rights may then be the only effective protection left at EU level for shareholders against dilution.

Suppression of pre-emption rights to be reconsidered for real no par value shares

e) Capital reduction

In case of capital reduction, creditors have under the Directive the right to apply to the court to obtain security for their claims, unless the financial position of the company offers the creditor sufficient safeguards. It is up to Member States to provide for the conditions for creditors to exercise this right. In our Chapter on restructuring, we suggest that this model of creditor protection should be applied in all restructuring transactions where specific creditor protection arrangements are to be made (see Chapter VI, Section 5). The burden of proof should be on the creditors : creditors must show that they will be prejudiced by a capital reduction, instead of the company having to show that the creditor's position is secured. This would avoid creditors' hold-ups.

Current regime for creditor protection in case of capital reduction

Should be applied in all restructuring transactions

With the burden of proof on creditors

In addition, we believe that there is a case, if the capital maintenance scheme of the Second Directive is regarded as valid, for re-evaluating whether some safeguards are needed for creditors in the event of capital reduction to adjust legal capital to losses. If capital is reduced to adjust to losses, no assets are transferred to shareholders, but it allows future distributions to an extent that was impossible under the preceding legal capital.

In addition, the need for creditors safeguards when capital is reduced to adjust to losses should be reconsidered

f) Acquisition of own shares

As the SLIM Group suggested, there is a case for allowing acquisition

Acquisition of own

of own shares within the limits of the distributable reserves, and not to limit the acquisition to an entirely arbitrary percentage of legal capital, like the 10% limit of the current Directive. The same should apply to the taking of own shares as security. As to the design of share repurchase programs, the deregulating proposals made by the SLIM Group are to some extent countered by the need to control market manipulation. The Market Abuse Directive (presently at its second reading at the European Parliament) provides for a "safe harbour" for share repurchases, but the conditions to qualify for this exemption, to be set by comitology, will, in all probability, demand more stringent requirements than those included in the Second Company Law Directive. However, it should be possible to establish more flexible requirements for unlisted companies.

shares, and taking them as security, should be possible within the limits of the distributable reserves

This may not be compatible with Market Abuse Directive

But should at least be possible for unlisted companies

g) Financial assistance

The SLIM report proposed two alternative measures for financial assistance in the acquisition of the company's shares : either to allow financial assistance to the extent of distributable reserves, or to restrict the prohibition to subscription of new shares. A majority of respondents believe that the prohibition of financial assistance should be relaxed, but we note that some respondents' objections are based more on tax problems than on company law problems.

SLIM report proposed two alternative measures for relaxation of financial assistance rules

We would favour a solution whereby financial assistance is allowed to the extent of the distributable reserves. Such a solution would be consistent with the approach to the acquisition of own shares by the company. The distributable reserves should provide for full cover of the risk associated with the financial assistance. For example, the outstanding amount of a loan made by the company to acquire shares should be covered in full by the company's distributable reserves.

Group favours a solution whereby financial assistance is allowed to the extent of distributable reserves

In any case, a shareholders' resolution should be required, unless the assistance is given in the company's ordinary course of business as provided under Article 23 §2 of the Second Directive. We believe that there is a good case for allowing the shareholders meeting to authorise the board for a maximum period of time (e.g. five years) to engage the company in financial assistance within the limits of the distributable reserves. If this facility is to be allowed, there should be disclosure.

A shareholders' resolution should in principle be required

Shareholders meeting should be allowed to give authorisation to the board

h) Compulsory withdrawal of shares

The SLIM Group has recommended that a compulsory withdrawal of shares should be possible when a shareholder has acquired 90% of

SLIM report proposed

the capital, as an exception to the provision of Article 36 of the Directive that compulsory withdrawal is only possible if this is provided in the deed of incorporation or articles of association. In Chapter VI of this Report, we make general recommendations on squeeze-out and sell-out rights - for listed and open companies - where a shareholder has acquired, at the minimum, 90%, or, at the maximum, 95% of the capital of the company, where applicable on a class by class basis. These recommendations are in line with the recommendations we made in our first Report on squeeze-out and sell-out rights following a takeover bid. Such rights would effectively deal with the issue addressed by the SLIM Group.

extension of the situations in which compulsory withdrawal of shares is possible

This concern is met by our proposals in Chapter VI on squeeze-out and sell-out rights

i) Other topics

Other topics addressed in the Consultative Document included two concepts which could improve the effectiveness of the legal capital regime : the concept of wrongful trading - to enhance the responsibility of directors when the company is threatened by insolvency - and the concept of subordination of insiders' (shareholders, directors) claims where the assets of the company are insufficient for its activities. The responses to the consultation are very interesting and reveal different ways of analysis for these matters. A substantial number of responses argue that these concepts belong to insolvency law and should be addressed in that area, and not as part of a reform of company law.

Consultative Document covered wrongful trading and subordination of insiders' claims

Responses argue that these concepts belong to insolvency law

As we say in Chapter III, Section 4.4, we reject this view, as the responsibility of directors when the company is becoming insolvent has its most important effect prior to insolvency and this is a key element of an appropriate corporate governance regime. It is irrelevant whether rules like these are laid down in company law or insolvency law. We then recommend that as an element of good corporate governance, a European framework rule should be introduced on wrongful trading, combined with the concept of "shadow" directors. The concept of subordination of insiders' claims could be considered as part of the development of an alternative regime for creditor protection (see Section 4 hereunder).

Group rejects this view, as responsibility of directors has it most important effect prior to insolvency

EU rules on wrongful trading to be introduced and insider subordination considered with the alternative regime

4 AN ALTERNATIVE REGIME FOR CREDITOR AND SHAREHOLDER PROTECTION

Respondents to the Consultative Document generally supported the approach of abandoning the current legal capital regime and rebuilding a regime which fits in the European company law structure.

Responses to the consultation supported the development of

The idea of integrating modern solutions for creditor protection into the European style of company where shareholder powers are retained has an obvious appeal. As we said above, the alternative regime to be developed is not necessarily to replace the current regime based on legal capital. It could be offered as an alternative to Member States, who could elect to impose the alternative regime on companies subject to their jurisdictions. In order for Member States to be allowed to abandon the current legal capital regime and replace it with an alternative regime, the alternative regime should at least be as effective in achieving the objectives of creditor and shareholder protection as the regime based on legal capital. We believe that, in fact, mechanisms can be created which are superior in achieving these objectives.

an alternative regime for creditor protection within a framework of shareholder control

Member States could be allowed to replace the current regime

With a new, at least as effective, regime

a) Creditor protection

In theory, creditors are protected by legal capital, but it is clear that legal capital may account for only a small fraction of the company's assets. It then offers little protection for creditors as the company enjoys ample freedom to distribute assets to shareholders, irrespective of its solvency. It should also be noted that capital can be reduced - without creditor protection - to account for, or write off, losses, which reduces the protection of creditors to a minimum in cases where there have been accumulated losses eliminating distributable reserves, which is the case in which the creditors most need protection.

Legal capital offers little protection for creditors against distribution of assets

And no protection when capital is reduced to account for, or write off, losses

Creditors can be better protected if an adequate solvency test is developed. According to a solvency test, a company can only make distributions to shareholders if the company remains solvent after the distribution. In a legal capital regime, it is possible that a solvent company is unable to make distributions, or, conversely, that an insolvent company is able to make distributions. In this sense, a system based on a proper solvency test is superior, as far as creditor protection is concerned (but also as far as shareholders' interests and the financing prospects of the company are concerned).

Creditors - and shareholders - can be better protected if an adequate solvency test is developed

A proper solvency test should be required for any payment of dividend or other distribution, including share buy-back and capital reduction (if the concept of a reserve for share capital which is not distributable is retained) against repayment to shareholders. The solvency test should be based at least on two different tests to be performed before making the distribution:

A proper solvency test should be required for any distribution

Based on at least two different tests:

a) *Balance Sheet test or Net Assets test*: according to the balance sheet test, assets must fully cover or exceed liabilities – excluding shareholders' equity – after the proposed dividend payment or

a) Balance Sheet test or Net Assets test

distribution. The valuation method applied in this test must be justified by the position the company is in (going concern, liquidation).

b) *Liquidity test or Current Assets/Current Liabilities test*: according to this test, the company must have sufficient liquid assets to make payments of the liabilities as they fall due in the following period, e.g. the forthcoming twelve months.

b) Liquidity test or Current Assets / Current Liabilities test

Further study will have to take place in order to develop these two tests, as well as the valuation methods to be used and the relationship with valuation methods applied in the audited accounts of the company. The study should also consider reinforcing the two tests by requiring a certain solvency margin and the relevance of the going concern concept. Such a margin would ensure that the assets after the proposed distribution exceed the liabilities by a certain margin and/or that the current assets after distribution exceed current liabilities by a certain margin. Although one respondent criticised this as a "one-size-fits-all" approach, it may offer a proper mechanism to integrate legal and statutory reserves into a regime in which there is no legal capital. In this way, the functions performed by reserves are also more effective than in the current regime, as the net assets test is reinforced by an additional solvency margin.

Further study is required to develop these tests and the valuation methods to be used

Such a study should consider the introduction of a solvency margin, and the relevance of the going concern concept

On the basis of the solvency test, the directors of the company should issue a solvency certificate, in which they explicitly confirm that the proposed distribution meets the solvency test. A valid distribution can only be made when the directors have issued a solvency certificate. Where the audited accounts of the company indicate that the proposed distribution cannot meet the solvency test, directors should not be allowed to issue a solvency certificate. Directors are responsible for the correctness of the solvency certificate and Member States should impose proper sanctions (personal liability, director's disqualification) if the certificate is proven to be misleading. Sanctions could be extended to "shadow" directors, as we recommend for the framework rule on wrongful trading, which should be part of the alternative regime as well.

Any distribution should require issuance by the directors of a solvency certificate

With adequate sanctions for misleading certificates

b) Shareholder protection

The abolition of legal capital, along the lines set above, does not necessarily reduce the level of shareholder protection. On the contrary, the protection of shareholders can be substantially improved without the concept of legal capital.

Shareholders protection can be improved without legal capital

In the alternative regime, pre-emption rights of shareholders in case of new share issues should feature as a fundamental mechanism to protect shareholders. Pre-emption rights should only be excluded or limited on the basis of a specific shareholders resolution, which is based on objective criteria.

In the alternative regime, pre-emption rights are a fundamental protection mechanism

Apart from this, a company issuing new share capital must take into account the fair value of the shares at that time. A company should not be able to issue shares at a price that bears no relation to the real value of the existing shares. This objective is only partly achieved in the legal capital regime, as shares can be issued at any price above nominal value and sometimes even below nominal value. The value of existing shares can be diluted by issuing capital at a price over nominal value, but well below their fair value. The alternative regime should provide that shares must be issued at fair value, which would substantially improve the protection of shareholders as compared to the current legal capital regime. When elaborating the effects of this principle, the case could be considered for making a distinction between listed and unlisted companies.

To better prevent dilution, issue of new shares should be made at fair value rather than nominal value

A distinction could be made between listed and unlisted companies

For listed companies, the market price is a clear indication of the fair value. The fair value could be calculated as the average market price in a period immediately preceding the new capital issue. At best, there should be a limited scope for issues below market price to allow for a marketable discount and underwriting activities.

For listed companies, fair value should be based on average market price

For unlisted public companies, a possible rule would be that the value of shares derived from the audited annual accounts should be presumed to be the minimum price for which new shares can be issued. This presumption would only be rebutted on the basis of clear evidence of a lower fair value of shares at the time of the proposed issue of new capital. Where accounts are not audited, directors should certify the appropriateness of the consideration for the shares to be issued, and the shareholders meeting should explicitly agree.

For unlisted companies, fair value should be based on audited accounts

Additional safeguards should be offered for non audited accounts

The alternative regime should also address the issue of contributions in kind. One possibility would be to require a shareholders resolution for any share issue for which a contribution in kind is made (subject to the exceptions already adopted in the Second Directive for such valuations). The directors could be required to certify the appropriateness of the issue in exchange for the contribution in view of the fair value of the shares. There would need to be appropriate protection for minorities.

The alternative regime should provide for necessary safeguards for contributions in kind

To summarise, the Group agrees with most of the respondents to the consultation that there is room for improvement of the current legal capital regime, and proposes a two step approach.

Summary : *Reform of legal capital to follow a two step approach*

The Commission should, as a matter of priority, present a proposal for reform of the Second Company Law Directive, along the lines suggested by the SLIM Group, with the modifications and supplementary measures that are suggested in the present Report ("SLIM-plus"). Any modernisation of the current regime should remove, where possible, the defects perceived in it, while maintaining its virtues.

Priority to be given to "SLIM-Plus"

The Commission should, at a later stage, conduct a review into the feasibility of an alternative regime, based on the third approach presented in the Consultative Document. The alternative regime need not replace the capital formation and maintenance rules of the Directive as amended according to the "SLIM-plus" proposals. Rather, the new regime could be offered as an alternative option *for Member States*, who should be able to freely decide to change to the new regime and impose it on companies subject to their jurisdiction or to retain the Second Directive rules as modified by the "SLIM-plus" reform. The alternative regime should at least be as effective in achieving the objectives of creditor and shareholder protection as the regime based on legal capital.

At a later stage, review to be conducted on the feasibility of an (optional) alternative regime

It is probably wise not to spend much time on minimum capital in a reform to make the current system more efficient, and to direct attention to issues which are more relevant. The minimum capital requirement should not be removed, nor increased.

Minimum capital requirement to stay unchanged

The Second Company Law Directive already allows for shares to have a fractional value (also referred to as "accountable par") rather than a nominal value (see for example Article 8 providing that shares cannot be issued below their nominal or fractional value). Such shares would have to include the appropriate fraction or the total number of shares, together with the date in which the fraction or the total number of shares was correct, and a reminder that the correct fraction can be obtained at any time from the company itself, or from the companies Register.

Use of fractional shares to be based on appropriate disclosure

It is debatable whether introducing shares without any reference to either nominal or fractional value would constitute a significant change in the system of the Second Company Law Directive. We recommend that, as part of SLIM-Plus, it is reviewed how no par value shares can be accommodated within the Second Company Law Directive.

Introduction of no par value shares to be considered as part of "SLIM-plus"

With respect to contributions in kind, the requirement for an expert valuation should be eliminated in certain cases where clear and reliable points of reference for valuation already exist (market price, recent evaluation, recent audited accounts).

Contributions in kind : valuation requirement to be relaxed

In addition, the Commission should review the possibility of allowing, with appropriate safeguards, the provision of services as contribution in kind.

Contribution of services to be considered

As the SLIM Group has suggested, for listed companies it would be appropriate to allow the general meeting to empower the board to restrict or withdraw pre-emption rights without having to comply with the formalities imposed by Article 29 §4 of the Second Directive, but only where the issue price is at the market price of the securities immediately before the issue or where a small discount to that market price is applied.

Suppression of pre-emption rights to be reviewed for listed companies

If real no par value shares are to be introduced, the suppression of pre-emption rights needs to be reconsidered as pre-emption rights may then be the only effective protection left at EU level for shareholders against dilution.

Pre-emption rights to be further considered if no par value shares are introduced

The current regime for creditor protection (right to apply to a court to obtain security for their claims) in the case of capital reduction should be applied in all restructuring transactions. The burden of proof should be on the creditors.

Current creditor protection to be extended

In addition, there is a case for re-evaluating whether some safeguards are needed for creditors in the event of capital reduction to adjust legal capital to losses.

And reconsidered when adjusting capital to losses

Acquisition of own shares should be allowed within the limits of the distributable reserves, and not of an entirely arbitrary percentage of legal capital like the 10% limit of the current Directive. The same should apply to the taking of own shares as security. It should be possible to establish flexible requirements at least for unlisted companies.

Acquisition of own shares to be facilitated

Financial assistance should be allowed to the extent of the distributable reserves. A shareholders' resolution should in principle be required. The shareholders meeting should be allowed to authorise the board for a maximum period of time (e.g. five years) to engage the company in financial assistance within the limits of the distributable reserves. If this facility is to be allowed, there should be disclosure.

Financial assistance to be facilitated

The SLIM Group has recommended that a compulsory withdrawal of shares should be possible when a shareholder has acquired 90% of the capital, as an exception to the provision of Article 36 of the Directive that compulsory withdrawal is only possible if this is provided in the deed of incorporation or articles of association. The recommendations made in Chapter VI of this Report on squeeze-out and sell-out rights - for listed and open companies - would effectively deal with the issue addressed by the SLIM Group.

Concern about compulsory withdrawal of shares to be addressed

The responsibility of directors when the company becomes insolvent has its most important effect prior to insolvency and this is a key element of an appropriate corporate governance regime. We recommend that as an element of good corporate governance, a European framework rule should be introduced on wrongful trading, combined with the concept of "shadow" directors. The concept of subordination of insiders' claims could be considered as part of the development of an alternative regime for creditor protection (see below).

Introduction of concept of "wrongful trading" recommended and "subordination of insiders' claims" to be considered

In the alternative regime to be considered at a later stage, a proper solvency test should be required for any payment of dividend or other distribution. The solvency test should be based at least on two tests to be performed before making the distribution : a balance sheet test and a liquidity test.

Alternative regime: Any distribution to be based on solvency test

Further study is required in order to develop these two tests, as well as the valuation methods to be used. The study should also consider requiring a certain solvency margin and reviewing the relevance of the going concern concept.

Further study to include net assets and liquidity criteria

Directors of the company should issue a solvency certificate, in which they explicitly confirm that the proposed distribution meets the solvency test. Directors are responsible for the correctness of the solvency certificate and Member States should impose proper sanctions, which could be extended to "shadow" directors.

With solvency certification by directors

In the alternative regime to be considered at a later stage, exclusion or limitation of pre-emption rights should only be possible on the basis of an explicit shareholders' resolution, which is based on objective criteria.

Alternative regime: Pre-emption rights to be protected

In the alternative regime to be considered at a later stage, a company should not be able to issue shares at a price that bears no relation to the real value of the existing shares. The alternative regime should provide that shares must be issued at fair value, which would substantially improve the protection of shareholders as compared to the current legal capital regime. When elaborating the effects of this

Alternative regime: Issue of new shares to be made at fair value

principle, the case could be considered for making a distinction between listed and unlisted companies.

Alternative regime: Appropriate safeguards to be designed for contributions in kind

In the alternative regime to be considered at a later stage, the issue of contributions in kind should be properly addressed. One possibility would be to require a shareholders resolution for any share issue for which a contribution in kind is made (subject to the exceptions already adopted in the Second Directive for such valuations). The directors could be required to certify the appropriateness of the issue in exchange for the contribution in view of the fair value of the shares. There would need to be appropriate protection for minorities.

CHAPTER V

GROUPS AND PYRAMIDS

1. THE EXISTENCE OF GROUPS OF COMPANIES AS A USEFUL AND LEGITIMATE ECONOMIC REALITY

As we pointed out in our Consultative Document, groups of companies represent today the main corporate reality for big companies in most, if not all, Member States. We also pointed out that groups are acknowledged as a legitimate way of doing business in most Member States and, at EU level, by the Seventh Company Law Directive and by various other legal provisions, such as banking, insurance, and antitrust laws. This view received consistent and almost unanimous support in the consultation.

Groups are frequent

And their legitimacy is recognised

On the other hand, it is also widely recognised that groups of companies may present specific risks for shareholders and creditors at the various levels, and the consultation process has revealed that a need for protection of those interests is felt in the business community.

But the need for protection of some interests is widely felt

At the outset, the Group wishes however to outline that, as a general matter, the risks related to the existence of groups should not impact on their legitimacy as a useful economic reality. Moreover, the Group believes that the existence of a group of companies should not be in itself a reason to abandon the limited liability principle, except perhaps in the most patent cases of abuse on the part of the group or the parent company leading to insolvency of a subsidiary.

Existence of risks does challenge neither groups' legitimacy nor limited liability principle

As to the instruments of intervention, the Group takes the view that the enactment of an autonomous body of law, specifically dealing with groups, is not to be recommended at EU level; we do not recommend the undertaking of a new attempt to bring about the Ninth Company Law Directive on group relations. Rather, the Group recommends that the Commission considers provisions within the existing range of corporate law to address particular problems.

No full Directive on groups appears necessary

But some problems should be addressed

The areas where intervention could be needed are considered in the following sections, and relate in particular to: (i) the transparency of the group's structure and relations; (ii) the tensions between the interests of the group and of its parts; and (iii) the special problems of

Intervention could be needed in three areas

pyramid structures.

2. TRANSPARENCY OF GROUP STRUCTURE AND RELATIONS

Complete information and disclosure with regard to groups' structure and intra-group relations are a crucial pre-requisite to ensure that the functioning of groups remains compatible with the interests of shareholders and creditors at the different levels. The consultation process has revealed that transparency is felt as the most important area of intervention with regard to groups.

Responses to the consultation :

Transparency is the most important area of intervention

The consultation has also confirmed the view that the actual provisions of the Seventh Company Law Directive on consolidated accounts do not sufficiently address these concerns, in that consolidated figures do not reflect the financial situation of the various parts of the group and the degree of dependence of the subsidiaries on the parent company. Respondents have suggested a number of areas where specific information should be provided, covering the group structure, the managing system and the persons effectively entrusted with the power of direction, intra-group transactions and the procedures and the activities through which the direction is exercised.

Actual provisions of the 7th Directive are not sufficient

Respondents have suggested a number of areas where information is needed

Some of these areas are already covered by the Seventh Company Law Directive (such as information about the control chain, at least downwards). Other areas - for example, the disclosure of governance structures and rights attached to shares - are addressed elsewhere in this Report (see Chapter III on corporate governance).

Some areas are covered by the 7th Directive Or addressed elsewhere in this Report

In general, the Group takes the view that increased disclosure with regard to a group's structure and relations is needed. In order to ensure a consistent disclosure system, the parent company of each group is to be made responsible for disclosing coherent and accurate information relating to the group's structure and relations.

More information should be disclosed

By the parent company

The Group believes that a list of specific issues that are to be disclosed would not be useful here. Rather, we wish to indicate areas where mandatory disclosure would be appropriate, building as much as possible on existing rules. The recommendations provided in Chapter III on corporate governance are also to be considered fully applicable here.

Group indicates areas where mandatory disclosure would be appropriate

The first area is that of financial information. The consultation has indicated that the consolidated financial statements as regulated by the Seventh Company Law Directive should be accompanied by

First area : financial information

further financial information related to the group, covering for example the key financial figures of the major group's companies, the organisation of intra-group services and their allocation within the group's companies, intra-group and related party transactions, the group's policy with respect to supporting group members in distress and the group's internal and external debt structure and its financing and treasury policy.

Information contained in consolidated financial statements should be extended

The Group recommends that the Commission review the Seventh Company Law Directive's provisions in the light of the need for better financial disclosure, and consider whether improvements can be made consistent with International Accounting Standards.

Disclosure organised by 7th Directive should be extended

The consultation has also pointed out that a need for non financial disclosure, particularly with regard to the governance of groups of companies, is widely felt. Many of the suggestions received are covered by our recommendations on disclosure in Chapter III on corporate governance, and the Group believes that, were the relevant recommendations to be implemented, most issues related to the governance of groups would be sufficiently covered. The Group wishes only to recommend here that it is ensured that – especially where listed companies are involved - a clear and fair picture of the group's governance structure, including cross-holdings and material shareholders' agreements relevant to the control over the company, is given to the market and the public. This is also consistent with the disclosure recommendations in our First Report on Issues Related to Takeover Bids.

Second area : non financial information

Many issues already covered by Chapter III recommendations

A clear picture of the group's governance structure should be given

In addition, the Commission should review whether companies should be required to inform shareholders and the public when they enter into or exit from a group, including a statement by the company's directors as to the significance of the event with regard to the company's financial situation, governance, and performance.

A directors' statement might be required when entering or leaving a group

3. PROBLEMS FOR THE CREATION AND FUNCTIONING OF GROUPS OF COMPANIES: TENSIONS BETWEEN THE INTERESTS OF THE GROUP AND ITS PARTS

In some Member States, the creation and functioning of groups of companies is complicated by the fact that the management of the subsidiary may not take into consideration the common economic interests of the group of companies taken as a whole, unless this is in the particular interest of the subsidiary. Violations may make the directors liable both under criminal and private law. The result is regarded in some Member States as a clear impediment to the formation and functioning of groups of companies, nationally as well

Some Member States do not recognise the interest of the group as such

as within the EU.

In fact, the acknowledgement of the legitimate nature of groups of companies necessarily implies that the company law rules on conflicts of interest and on the duty to pursue the sole interest of each company's shareholders cannot be applied as such to groups, at least without taking account of the special position membership of a group creates. On the other hand, the protection of the interests of minority shareholders and creditors at the various levels has to be maintained, and it is therefore necessary to ensure that those interests are not prejudiced in the pursuit of the group's policy.

Group membership should lead to recognition of special position

With due protection of minority shareholders and creditors

A principle has been developed - with slight variations - in several Member States that tries to solve the conflict between the common interests of the group of companies taken as a whole and one or more of its members by providing that transactions which are beneficial for the group but are not in the direct interest of a single company can be considered as legitimate, provided that the interests of that company are safeguarded on balance. In other words, the prejudice suffered by a particular company in a certain transaction can be justified where the membership of the group ensures advantages to the same company so that its interests are safeguarded on balance. The work of the Forum Europaeum[26] in this field has been particularly helpful in clarifying the common principles underlying these rules in certain Member States.

In several Member States, a transaction made for the benefit of the group is legitimate

If the prejudice suffered by a particular company is justified by other advantages

The Group believes there is a case for requiring Member States to provide for a framework rule for groups that allows those concerned with the management of a group company to adopt and implement a co-ordinated group policy, provided that the interests of creditors of each company are effectively protected and that there is a fair balance of burdens and advantages over time for each company's (outside) shareholder. Such a regime would facilitate the creation and functioning of groups of companies. The details of the regime can be left to Member States.

A framework rule should allow the implementation of a group's policy

With necessary safeguards for creditors and minority shareholders

The adoption of such a framework rule would be all the more feasible when considering the improvement of the instruments to protect minority shareholders and creditors we recommend elsewhere in this Report, in particular the introduction of special investigation rights and sell-out rights for minority shareholders and the adoption of the concepts of wrongful trading and shadow directors (see par. 3.4 and 4.4 of Chapter III above, and par. 6 of Chapter VI below).

Other related recommendations in this Report would help such a rule to operate properly

[26] The Forum Europaeum Corporate Group Law consists of a steering committee composed of Academics from several European countries. For further information, see « Corporate Group Law for Europe », European Business Organization Law Review 1 (2000) : 165-264.

Another important area of possible intervention with regard to the proper functioning of groups is the law applicable to insolvent groups. When groups become insolvent, the separate treatment of individual group companies' bankruptcies causes both procedural and substantive problems, which are exacerbated when an insolvent group operates in different jurisdictions. In some Member States, a consolidated approach to group bankruptcies is possible under certain circumstances. We acknowledge that these problems are difficult to solve but this does not make a solution less desirable. Therefore, we recommend that the Commission takes the initiative to review the possibilities to introduce procedural and substantive consolidations of bankruptcies of group companies in Member States.

A consolidated approach to (cross-border) group bankruptcies is desirable

The introduction of rules on consolidated bankruptcies should be considered

4. PYRAMIDS

A group pyramid can be defined as a group structure characterised by a more or less long chain of control using several holding companies. The ultimate shareholders control each company in the chain by majority or controlling minority interests, leaving minority shareholders at each level. The result is that the ultimate shareholders may control the whole chain - up to and including the company at the bottom - on the basis of a small total investment. If, for example, the ultimate shareholders would own 50% at each level, in a chain of six companies including the company at the bottom only a total investment by the ultimate investor equivalent to 1.56% in the capital of the company at the bottom is required to have full control over the whole chain. This effect is created by having minority shareholders at each level finance the controlling stake of the ultimate shareholder in the level below. In order to facilitate this, often a number of the companies in the pyramid have separate stock exchange listings.

A pyramid is a chain of holding companies, with ultimate control based on a small total investment

Example

Pyramids use minority shareholders, often through a series of listings

Pyramidal structures may present specific problems. Pyramids are a source of agency costs in that they increase the private benefits of control and conflicts of interest, and therefore may come at an expense for the non-controlling shareholders. The lack of transparency of the ownership structure may have a number of problematic effects, such as lack of transparency in the group's operations and malfunction of the market for corporate control.

Pyramids are a source of agency costs

And a number of problems stem from their lack of transparency

The creation of specific rules for pyramids proves difficult, especially because the distinction between pyramidal groups and "normal groups" is hard in practice. At a minimum, the Group believes that full transparency with regard to the group's structure, governance, and operations (including material shareholders' agreements at the various levels relevant to the control of the group) is essential for

Pyramids are difficult to regulate with specific rules

But disclosure recommendations

solving the problems posed by pyramids. The disclosure recommendations made in Chapter III on corporate governance above are therefore very relevant for dealing with pyramid structures.

made in Chapter III are very relevant

The Group has particular concerns for those pyramidal groups that include listed companies, especially where these are placed at the lower levels of the chain. Where the sole or main asset of a holding company consists of shares in another listed company in the group structure, the stock exchange listing of the holding company usually does not have any additional economic value except to finance the control of the controlling shareholder.

Pyramidal groups that include listed companies raise particular concerns

In view of the weak position of the minority shareholders in such companies and the general concerns about lack of transparency and incontestability of control, we believe stock exchange listings should not be used for these purposes. We therefore recommend that the EU require the authorities in Member States, responsible for the admission to trading on regulated markets, not to admit to trading holding companies whose sole or main assets are their shareholding in another listed company.

Companies whose sole or main assets are controlling shareholdings should in principle not be admitted to trading

Exceptions should only be made where a strong case is made as to the economic value of such admission to trading beyond the financing of the control of the controlling shareholder. For existing pyramid structures that include such listed holding companies, a requirement should be considered for their delisting and offering minority shareholders shares in the controlled company in exchange for their shares in the holding company.

Exceptions only where economic value clearly demonstrated

Delisting could be used for existing pyramids

Finally, we note that additional pressure on pyramid structures is brought to bear by those who operate stock indices, by including only the free float in the weighing of companies in the index and excluding major shareholdings. Many operators of indices have already taken this approach, which the Group recommends.

Stock indices should properly reflect the free float of companies

To summarise, no new attempt to enact the Ninth Company Law Directive on group relations should be undertaken, but particular problems should be addressed through modifying existing provisions of corporate law in three areas.

Summary : *No need for a proposal for a Ninth Company Law Directive*

Increased disclosure with regard to a group's structure and relations is needed, and the parent company of each group is to be made responsible for disclosing coherent and accurate information.

Parent company responsible for

The Commission should review the Seventh Company Law Directive's provisions in the light of the need for better financial disclosure, and consider whether improvements can be made consistent with International Accounting Standards.

Better financial disclosure

With respect to non financial disclosure, it should be ensured that – especially where listed companies are involved – a clear picture of the group's governance structure, including cross-holdings and material shareholders' agreements, is given to the market and the public.

And better non financial disclosure

In addition, companies could be required to provide specific information when they enter into or exit from a group.

Entry or exit to be commented

Member States should be required to provide for a framework rule for groups that allows those concerned with the management of a group company to adopt and implement a co-ordinated group policy, provided that the interest of the company's creditors are effectively protected and that there is a fair balance of burdens and advantages over time for the company's shareholders.

Recognition of group's interest,

With appropriate safeguards

The Commission should review the possibilities to introduce in Member States rules on procedural and substantive consolidations of bankruptcies of group companies.

Need for rules on groups' bankruptcies

The EU should require national authorities, responsible for the admission to trading on regulated markets, not to admit holding companies whose sole or main assets are their shareholding in another listed company, unless the economic value of such admission is clearly demonstrated.

Specific rules for admission to trading of holding companies

Finally, operators of stock indices should properly take into account the free float in determining the weight of each company.

Stock indexes to reflect free float

CHAPTER VI

CORPORATE RESTRUCTURING AND MOBILITY

Under this heading, the Group raised primarily 5 major topics in its consultation document

In Chapter 5.1 of our April Consultation Document, we described the various types of corporate restructuring transactions and raised possible proposals for reform on five major topics :

- change of corporate seat, or domicile;
- the position of the acquiring company in a domestic merger under the Third Company Law Directive;
- acquisition of a wholly owned subsidiary by the same means;
- creditor protection in restructuring transactions;
- squeeze-outs and sell-outs.

We also invited comments on whether there were other aspects of corporate restructuring where reform at Community level was required.

1. PRIORITIES – RESTRUCTURING AND TENTH AND FOURTEENTH COMPANY LAW DIRECTIVES

There is wide demand for Community law to facilitate cross frontier restructuring

The need for Community company law provisions facilitating cross frontier restructuring figured as a high priority in almost all the responses to the Document and, as we have indicated above (see Section 1 of Chapter II), we support this view. Almost all also took the view that the areas we had raised were the ones requiring attention, though there were calls for the Commission urgently to bring forward revised proposals for a Tenth Company Law Directive on Cross-frontier mergers and a Fourteenth Company Law Directive on Transfer of Registered Office (i.e. of corporate seat or domicile).

The Commission has already taken steps to respond to this demand

Remaining areas of difficulty could be solved by analogy to the ECS

We understand that such proposals are in preparation. Our recommendations on the issues listed above will be relevant in considering their final form. The most important remaining areas of difficulty relate to board structures and employee participation. We did not consult on these matters but, in the course of our work, the European Company Statute ("ECS") has been adopted. The solutions to these problems in the ECS – i.e. freedom of choice for public companies in their board structures and employee participation based on agreement or fall-back minimum rules applicable only in cases where there is a legitimate prior interest - may present a

possible model for these issues. These are urgent matters for the additional reason that any necessary changes to domestic public company law may affect the mode of adoption of the ECS by the Member States.

2. CHANGE OF CORPORATE SEAT OR DOMICILE

2.1. Denial of recognition to a company moving its real seat

There was almost unanimous agreement that for a Member State to adopt a version of the real seat doctrine which automatically denies recognition to a company which has its "real seat[27]" in a country other than that of its incorporation was a disproportionate measure which can never be justified. We agree with this view, and believe that it is likely to be against EU law to take such an approach.

Broad application of "Real seat doctrine" to incapacitate companies is a disproportionate measure

2.2. Transfer of real seat between Incorporation Doctrine States

We similarly believe that, where a company moves its real seat but not its registered office between two states which attach no importance in terms of the law applicable to the company to that move ("incorporation doctrine states"), there should be no room at Member State law level (e.g. by a third state refusing to continue to recognise the company after such a change) or at EU law level, for attaching any sanctions to such a move which would be a wholly unnecessary interference with freedom of movement and operation of companies within the Community. Neither the states concerned directly in the change nor third states have any interest in inhibiting the move.

Any sanctions against transfer of real seat between incorporation doctrine states interferes unnecessarily with fundamental European freedoms

Again we believe that this is likely to be found to be the effect of the Treaty. However, existing and proposed EU secondary legislation should be aligned with this view. At present, the Regulations establishing the European Economic Interest Grouping and the European Company make it unlawful for such entities to have their "real seat" in a state other than their state of incorporation; this should be corrected. The contrary argument is that, for the sake of uniformity and simplicity, all EU legislation should always require conformity of the jurisdiction of registration with the place of the registered office; but this is an unnecessary interference with freedom of establishment.

EU legislation (whether proposed or existing) should take this risk of interference into account

[27] For the difficulties in defining this concept, and the consequent uncertainties and inhibition for companies which result, see the Consultation Document, page 33.

2.3. Transfer of real seat into Real Seat Doctrine State

a) General Principles

The law of a real seat "host" state should only be permitted to override the law of incorporation of a "guest" company, subject to the following conditions:

On the other hand, most respondents agreed that, where a company (a "guest" company) established its real seat in a state (a "host" state) where the effect of its law of incorporation was inconsistent with local mandatory requirements, there was a case for permitting the law of incorporation to be overridden to the extent necessary to respect those requirements of the host state. We agree with this view, but, consistently with the bar on refusing recognition on such grounds, we believe that the general EU law principles on freedom of movement must be applied – i.e. any sanction inhibiting such freedom of movement should :

- be imposed only to support a requirement of legitimate general interest; *(- Legitimate general interest)*
- not be disproportionate; *(- Proportionality)*
- require no more than is necessary and appropriate to secure the interest concerned; *(- Minimum intervention)*
- be non-discriminatory as between companies formed in the host state and the company concerned; *(- Non-discrimination)*
- be sufficiently transparent to inhibit to the minimum extent necessary the exercise in practice of the fundamental freedom of establishment. *(- Transparency)*

Where external requirements of the "host" state are sufficient, interference with internal governance of the "guest" company is inadequate

We believe that these are the general principles applicable to the imposition of local law inhibiting freedom of movement, consistent with the case law of the European Court of Justice[28]. Particularly close attention needs to be given to avoiding the application by the host state of domestic requirements which interfere with the internal governance of the company where external requirements are adequate measures of protection of the interest concerned – for example reporting requirements, provisions for external representation or other general obligations to protect creditors, such as wrongful trading duties. But such external requirements, while easier to justify as a less serious interference, still require to be justified against the general principles listed above.

[28] See for example case C-212/97, *Centros*; cases C-367/98, C-403/99 and C-503/99 (the "Golden Share cases); and the opinion of Advocate General Colomer in Case C-208/00, *Uberseering v Nordic Construction.*.

b) Application of the principles

It is possible to illustrate the application of these general principles in the light of our views on the value of various company law measures and the present state of company law harmonisation.

Examples of application of these general principles :

Capital Maintenance

So far as minimum capital and capital maintenance requirements are concerned, for public companies these have been harmonised by the Second Company Law Directive; conclusions on the value and importance of the minimum capital requirements more widely will need to be reached in the light of the conclusions drawn from our recommendations above. But we doubt the justifiability of invoking these requirements as a justification for interference with the internal governance of companies, given that many states are well able to secure the general interests concerned by less interventionist external means (see for example our references to wrongful trading in par. 4.4 of Chapter III above)[29].

Capital requirements of the Second Directive should not be used as a justification for interference with internal governance

We conclude that there is no case for Member States imposing minimum capital and capital maintenance requirements on “guest” companies, whether they have their real seat within their territory or not. Moreover, capital maintenance requirements are now regarded in many quarters as ineffective in their present form (as the responses to our consultation have demonstrated), and their deliberate avoidance has been held not to justify the incapacitation, or disqualification from business activity, of a company in the country of its adopted real seat in the latest Court of Justice case on the subject[30].

Such non-interference should apply regardless of where the "guest" company has its real seat

Disclosure, Transparency and Security of Transactions

So far as disclosure and transparency is concerned, the effect of the First and Fourth Company Law Directives is to require adequate measures of disclosure and substantive rules on validity of transactions for all companies, and the Eleventh Company Law Directive secures adequate disclosure by "guest" companies operating through branches. Our own proposals for enhanced disclosure in Chapter III reinforce this.

First, Fourth and Eleventh Directive regulate disclosure by "guest" companies or their branches

[29] See too ECJ Case C-212/97, *Centros*, [1999] CMLR 551.
[30] Same references as above.

Governance and Company Structure

As for governance and structure of companies, the European Company Statute recognises the legitimacy of either one tier or two tier boards. We recommend in Chapters II and III of this Report that all companies in the EU should have this option. Other rules of internal governance are best regarded as a matter of agreement between company members and their organs. We do not believe that there is a case for interfering with the internal governance of "guest" companies by "host" state laws on such grounds.

ECS-limits for interference with internal governance should apply generally

Employee Participation

Indeed the one area where such interference seems to be justified, recognised as a legitimate matter of general interest by the European Company Statute, is that of employee participation. However, any mandatory imposition of host state law in such a case must of course comply with the general principles. A total refusal to recognise a company on the ground that it fails to comply with the employee participation law of its place of real seat is clearly disproportionate; before a guest company should be subjected to sanctions on the ground of failure to comply with host state law on this matter, the connecting factor with the host state should be demonstrated to be sufficient and appropriate, and the remedy should be no greater than necessary to ensure the general interest in issue.

Interference by "host" state is justified, but total refusal to recognise a company because of its failure to comply with "host" state law on employee participation is disproportionate

At least where fewer than 50% of the employees are employed in the host state, any imposition of local law seems hard to justify, and, even where the connecting factor is sufficient, there should be provision to allow an agreed system of employee involvement to be adopted, analogous to that recognised by the ECS, and the company should be given time and opportunity to make the necessary changes in a way consistent with its law of incorporation. If our suggestion above for making domestic law more flexible on these questions is adopted, this solution is likely to be possible in most if not all cases.

Interference by "host" state should be subject to certain conditions

Only where an adequate accommodation of employee rights cannot be achieved consistently with home state law, should the ultimate step of a compulsory restructuring through liquidation and re-incorporation be imposed. Any such remedy should be ex post, that is to say it should allow the company and its organs sufficient time and opportunity to respond to the domestic requirements. There should be no question of an incurable “legal ambush”, disabling or fettering the company’s activities, coming about.

Compulsory restructuring through liquidation and re-incorporation should only be last resort

2.4. Transfer of real seat out of Real Seat Doctrine State

A transfer of the real seat out of a state of origin may be regarded as a means of escaping the law of origin, and there is an argument that that state's interests are engaged. Any sanctions applied in such cases must comply with the principles set out above. Moreover, where the new "host" state applies the law of origin (as will be the case where that state applies the incorporation doctrine and thus recognises "home" state law), there can be no case for taking special measures on the ground of transfer of real seat. (We recommend below that third states should be required to apply the law of incorporation subject to recognising the legitimacy of measures permitted above.)

Sanctions, if any, imposed by the "home" state have to comply with the above mentioned principles

Where the new "host" state seeks to impose its own law, a conflict of laws may in theory arise; but the principle of reciprocity should discipline the sanctions which the state of origin may impose – that is to say the state of origin must recognise the right of the "host" state to impose the measures which it would itself impose in the converse case of a company moving its real seat into its, that is to say the "home" state's, territory. The "home" state should thus be obliged to accept the imposition by the "host" state of requirements which it, mutatis mutandis, would impose in the converse case.

A conflict of law between "home" state and "host" state can be solved with reciprocity

2.5. Third States

Third states are unlikely to be concerned in cases of moving real seat between a home and a host state, but the general rule should be that they should apply the law of the state of incorporation, with a *renvoi* to the law of the host state where appropriate.

If concerned, third states should apply law of incorporation

We believe that these conclusions are consistent with the general principles of European law, and are likely to be adopted by the European Court of Justice. We recommend that the Commission should keep this problem under review, and adapt actual and proposed Community legislation to reflect the above approach, i.e. consistency with the principles of legitimate general interest, proportionality, minimum intervention, non-discrimination and transparency. We doubt whether further action will be necessary, but recommend that the situation be kept under continuing review.

The Commission should adapt Community law to reflect the above mentioned principles

Ongoing review of the situation is needed

3. THIRD DIRECTIVE MERGERS – POSITION OF THE ACQUIRING COMPANY

We noted in the Consultation Document that the effect of a Third Company Law Directive merger on an acquiring company is not different, in its effect on shareholders and creditors, from normal trading transactions involving the incurring of liabilities and the issue of capital, and was similar in economic effect to a share-for-share takeover. Nonetheless, the Directive envisaged a special general meeting of shareholders of the acquiring company to authorise the transaction, or at least special publicity and minority protection measures. These requirements are not reflected, nor we believe justified, as a matter of EU law, in other transactions with the same or similar effect.

Some special provisions of the Third Directive serve no purpose for the acquiring company, given the nature and the effect of the transaction at issue

We suggested that :

Suggestions:

- for domestic mergers, such requirements should be removed at EU level, leaving it to the domestic law of the Member States, or the internal governance rules of the company concerned, to adopt the appropriate measures in relation to shareholder control of such mergers;
- for international mergers, the Member State of the acquired company should be bound to accept that relaxation, where it was adopted by the Member State of the acquiring company, and possibly further;
- there might be a particular case, for international mergers, for requiring Member States of acquiring companies to promote interstate restructuring by removing impediments in acquiring companies on a harmonised basis.

- removal of such requirements at EU level for domestic mergers

- acceptance of such relaxation in international mergers

- removal of impediments for international mergers, at EU level

Similar considerations apply to the position of an acquiring company participating in a division by fusion (scission) within the Sixth Company Law Directive.

These considerations apply also in a Sixth Directive division

The great majority of responses agreed with the first two of these suggestions, and many also supported the third. The objections seemed based mainly either on the argument that the provisions worked as they stood and should not be disturbed, or that the point was a minor one and not worthy of attention.

There is broad support for the first two of the above mentioned suggestions

We believe that there is a case for removing unnecessary formalities of this kind, which are costly and inhibit commerce, and we would recommend the removal of the special requirements for acquiring

Following this, the Group sees a case for relaxing requirements as

companies in domestic mergers at EU level and the imposition of the corresponding obligation on states of the acquired company to accept this in the international merger regime.

described

However, we are persuaded that it would not be appropriate to prohibit these acquiring company formalities, even in an international merger. This is because the case for the imposition of such formalities is a matter of scale and degree. There will be occasions where acquisitions by merger, in the same way as other acquisitions, are so important to the company that special formalities, even to the extent of shareholder approval, will be appropriate. Member States should not be deprived of the power to make such requirements mandatory in appropriate cases, and this is a matter for appreciation at Member State level according to the practices of corporate governance operating in such states. The arguments in favour of liberalising international mergers are not sufficiently strong to override this.

However, Member States should retain discretion about the scope of such relaxation, in line with their practices of corporate governance

4. THIRD DIRECTIVE MERGERS : ACQUISITION OF WHOLLY OWNED SUBSIDIARY

Similar considerations apply to the acquisition by merger of a wholly owned subsidiary by its parent company. Here the case for a relaxed view of what should be required of the acquiring company is even clearer and almost all responses, including those which opposed the change in relation to mergers of unrelated companies, believed that not only should the Directive protections be removed but that they should cease to operate as a mandatory matter, at least in relation to international mergers. However, we believe that similar considerations apply and that it should be a matter for the Member State of the acquiring company and/or its constitution, to impose the necessary formalities in such cases.

Here, the case for relaxation of special requirements is even clearer, but Member States' discretion should be respected here, too

Some responses argued that provision should be made, in the proposed Tenth Company Law Directive for cross-frontier divisions of companies, to enable a restructuring involving the undertaking of a company to be divided between companies in different Member States. We doubt the need for this, given the possibility for parts of a business to be hived off into separate subsidiaries preparatory to disposal by merger, but we recommend that further empirical research should be carried out on whether such a provision for international scissions is necessary.

The necessity to regulate cross-border divisions within the 10th Directive seems doubtful, but warrants research

We therefore recommend the removal of the Third and Sixth Company Law Directive requirements for general meeting approvals or mandatory minority protection in the acquiring company, leaving

Therefore, the above mentioned relaxations should be made possible

Member States to adopt such provisions if they wish, and that, in the forthcoming Tenth Company Law Directive on International mergers, acquired company states should be required to accept the exercise of this relaxation by acquiring company states.

And this should be reflected by the Tenth Directive

5. CREDITOR PROTECTION IN RESTRUCTURING TRANSACTIONS

We pointed out that there is a wide diversity of practice in Member States in relation to creditor protection in restructuring transactions, while the policy considerations were the same and seemed adequately met by the Second Company Law Directive provision on reduction of capital. The case for adopting such a solution on a general basis is strongest in the case of international mergers (including formation of a European Company by merger), but there is also a strong argument, which we are inclined to accept, in favour of adopting the same provision for all transactions for the sake of simplicity.

There is a case for harmonisation of creditor protection throughout all kinds of restructuring transactions

This suggestion was widely welcomed and we recommend the adoption of a harmonised provision on creditor protection to facilitate restructuring within the Community, based on the Second Company Law Directive provision enabling a creditor to apply to the court where he can show that the company has not provided reasonable measures of protection.

Creditors should be enabled at EU level to apply to the court to obtain reasonable protection

Where a creditor has the benefit of an intra-group guarantee arrangement under national provisions adopting Article 57 of the Fourth Company Law Directive, this fact should of course be taken into account, and this in many circumstances may well mean that in an intra-group merger the creditor is unaffected.

However, intra-group guarantee arrangements should be taken into account.

6. SQUEEZE-OUTS AND SELL-OUTS

Most responses favoured the creation of a facility, for an overwhelming majority shareholder with 90-95% of the capital, compulsorily to buy out the minority, not only after a takeover bid as proposed in our First Report[31], but generally regardless of how the majority was acquired. The price would be set on the basis of a right to demand appraisal of a fair value. The respondents almost all supported a corresponding right for the minority to require a sell-out.

There is widespread support for squeeze-out and sell-out rights generally, with an important majority shareholding

[31] See now Articles 14 and 15 of the Proposal for a Thirteenth Company Law Directive.

Some argued that these rights should be restricted to a limited period after the majority was acquired or announced, to remove uncertainty. While we see the force of this argument, we can also envisage cases where the circumstances may change after the acquisition in such a way as to justify the invocation of either right. Others argued that such rights were only needed after a takeover and that there were serious problems in providing independent appraisal of fair value in the absence of an agreed offer.

Sell-out and squeeze-out only for a limited period ?

Or only after takeovers, given the difficulty of appraisal ?

In some Member States, at least once the mandatory bid rule is in operation under the proposed Thirteenth Company Law Directive, there will be a takeover bid before such majorities are achieved in most cases involving listed companies. Nonetheless, we would propose that this provision should apply to all listed and open companies, and we believe that there is a case for enabling minority holdings of this kind to be removed by either side, regardless of how they arise.

Squeeze-out and sell-out rights should apply to listed and open companies

Regardless of how they arise

We considered whether these rules should also apply for closed companies. Few of the responses to our consultation addressed this issue. While there is a case for the adoption of such a rule in closed companies, as another form of exit may not be available to minority shareholders, we hesitate to recommend this without further study. We are aware that it is very common that special arrangements are adopted in such companies to protect minorities, in joint venture or family situations for example, and careful consideration would need to be given before overriding vested rights in such cases.

But not necessarily to closed companies, which often have special arrangements for minority protection

Views differed on whether any such right should be exercisable on a class by class basis or by reference to the aggregate of company capital. On balance, we believe that the class by class approach, which was supported by the majority of respondents who addressed the point, is the better one. The strength of the argument on expropriation as an argument against mandatory squeeze-out rights depends on the relevant majority being acquired over comparable rights. Each class of capital has its own protections.

A class by class approach for exercising any such right is preferable to a reference to the aggregate company capital

We therefore recommend that Member States should be required to create such squeeze-out and sell-out rights at a level to be set at a 90% as a minimum and 95% as a maximum majority on a class by class basis, for listed and open companies. Before applying a similar regime to closed companies, further study into the relationship with contractual exit arrangements is required.

Squeeze-out and sell-out rights as described here above ought to be created by Member States

To summarise, there is a perceived need for Community action in the legislative field with regard to corporate restructuring and mobility, especially in the cross-border context. The Commission should urgently bring forward revised proposals for a Tenth Company Law Directive on Cross-Frontier Mergers and a Fourteenth Company Law Directive on Transfer of the Registered Office.

__Summary :__ Need for Community action, especially in the cross-border context (Tenth and Fourteenth Directives)

Proposals in preparation are faced with the task of solving difficulties relating to board structure and employee participation. The solutions to these problems in the ECS may present a possible model for these issues.

ECS solutions to be considered as a possible model

Where a company moves its real seat between two “incorporation doctrine states”, there should be no room at Member State level or at EU level for attaching any sanctions to such a move which would be a wholly unnecessary interference with freedom of movement and operation of companies across the Community.

Transfer of real seat between two incorporation states should not lead to any sanction

This is likely to be found to be the effect of the Treaty. However, existing and proposed EU legislation should be aligned with this view.

Where a company transfers its real seat to a real seat state, the law of the "host" state should be permitted to override the law of incorporation of the "guest" company, but only within the limits imposed by the principles of legitimate general interest, proportionality, minimum intervention, non-discrimination and transparency.

Transfer of real seat into real seat state should allow host state to take adequate measures, under strict conditions

External requirements of the "host" state, duly imposed on foreign companies with a view to these principles, should make any interference with internal governance of these companies redundant. This is especially true for the areas of capital maintenance, governance and company structure and employee participation. With regard to the latter, it is imperative that restructuring through liquidation and re-incorporation be only the ultimate step : any such remedy should allow the company and its organs sufficient time and opportunity to respond to the domestic requirements.

In particular, host states are to abstain, in principle, from interference with internal governance of a company

Where a company transfers its real seat out of a real seat state, any sanctions imposed by the "home" state should be subject to the above mentioned principles as well, and any conflict of law then still prevailing ought to be solved by reciprocity.

The same for transfer of real seat out of real seat state

Third states, if concerned at all by a company's move of real seat, should be made to apply, in principle, the law of incorporation, with a renvoi to the law of the host state where appropriate.

Third states to apply law of incorporation in any move of seat

With respect to domestic mergers, Member States should be allowed to relax special requirements of the Third Directive which are faced by the acquiring company.

Merger requirements to be relaxed for the acquiring company

In order to facilitate international mergers, Member States of the acquired company should be required to accept such relaxation where it was adopted by the Member State of the acquiring company.

Similar considerations apply to the acquisition by merger of a wholly owned subsidiary by its parent company. Consequently, relaxation of special requirements in domestic mergers should be permitted to the Member State of the acquiring company, and acceptance in international mergers of such relaxation, should be required from the Member State of the acquired company.

Similar relaxation even more important for acquisition by merger of a wholly owned subsidiary

A harmonised provision on creditor protection should be adopted at EU level to facilitate restructuring within the Community based on the Second Company Law Directive provision enabling a creditor to apply to the court where he can show that the company has not provided reasonable measures of protection.

Harmonisation of creditor protection with right to apply to the court is desirable

Member States should be required to create squeeze-out and sell-out rights at a level to be set at a 90% as a minimum and 95% as a maximum majority on a class by class basis, for listed and open companies.

Squeeze-out and sell-out rights should be introduced, for listed and open companies

Before applying a similar regime to closed companies, further study into the relationship with contractual exit arrangements, etc. is required.

CHAPTER VII

THE EUROPEAN PRIVATE COMPANY

1. A NEW LEGAL FORM COMPLEMENTARY TO THE SOCIETAS EUROPAEA (SE)

In October 2001, the “Societas Europaea“ (SE) finally became a reality. The Statute of the SE and the corresponding Directive on the rights of employees of SEs were adopted by the Council of Ministers and the European Parliament[32]. The SE represents a major breakthrough, especially because it makes it possible for European companies to merge across borders and to transfer their seat from one Member State to another. Moreover, it may be important for a company to do business as a European company and not as an Italian, German or French company. This latter objective of the SE, however, is only partly achieved, as the Statute often refers to the law of the Member State of incorporation and, as a result, different types of SEs will come to exist depending on where they have been incorporated.

The Societas Europaea (SE) has been adopted in October 2001

The SE allows companies to merge and transfer their seat, across borders

And to do business as a European company

The SE has been designed for large enterprises and may not meet all the expectations of the business community, in particular small and medium sized enterprises (SMEs), both independent companies and group subsidiaries, which constitute the larger part of companies in Europe.

SEs may not meet all expectations of business community, in particular SMEs

A private initiative of business, supported by academics in some Member States, has argued that there is a specific need for a European legal form of private company, to facilitate SMEs' business in Europe. According to this initiative, the European Economic Interest Grouping (EEIG) only gives a partial solution, because its activity must be the continuation of its members’ activity and it is an unlimited liability legal form. The initiative has specifically argued that the SE does not meet the expectations of companies who desire to establish joint ventures, as the SE Statute leaves little room for structuring the joint venture as the parties to it wish.

A European form of private company is promoted by a private initiative

To facilitate SMEs business in Europe, in particular through joint ventures

The private initiative has resulted in a specific, detailed proposal for a European Private Company – EPC –, complementary to the national forms of private companies in Member States and to the SE. The

This private initiative resulted in a proposal for a European Private

[32] For full citation of the Regulation and the Directive, see Annex 4.

proposal has been presented by the Paris Chamber of Commerce and Industry[33] and the French business confederation MEDEF (formerly CNPF)[34] in September 1998. The proposal has been drafted by a group of company representatives and specialists in company law from several nationalities, and has been supported by the Union of Industrial and Employers' Confederations of Europe (UNICE) and EUROCHAMBERS. More recently, in March 2002, the European Economic and Social Committee – EESC - has unanimously adopted an opinion on a European Company Statute for SMEs (own initiative opinion) stressing "the necessity for a European Company project for SMEs".

Company (EPC)

The proposal has been supported by UNICE and Eurochambers

And the European Economic and Social Committee

The proposal for a European Private Company statute is based on contractual freedom. This freedom covers the determination of corporate governing bodies, the organisation of relations among them, shareholders' rights, which might be unequal or specific, and the manner of access, withdrawal or removal of a shareholder, subject only to the limits of those rights laid down by the regulation. The EPC as proposed may not issue securities to the public or issue bearer shares. An EPC would, according to its supporters, offer an adequate vehicle for SMEs which are active in several Member States as well as for SMEs in several Member States merging their enterprises into a legal entity with a genuine European corporate identity.

The proposal is based on contractual freedom

And is presented as an adequate vehicle for SMEs active in different Member States

This opinion is challenged by those who argue that the only real benefit of the SE statute, and any possible EPC statute, is that it allows a cross-border merger of national companies and transfer of seats across borders that, in the absence of the Tenth and Fourteenth Directives, cannot otherwise be achieved by national companies. In this view, a specific European form – either SE or EPC – is of little use for business if national companies are allowed to freely merge and transfer their seats across borders.

But it is argued that an EPC statute would be of little use if national companies were allowed to merge and transfer their seats across borders

Opponents also argue that the European corporate environment should not be cluttered up with yet another legal form, if there is no specific need for it. If it is felt that national forms of private companies are insufficiently geared to facilitate SMEs and joint venture activity, an effort could be made to infuse more flexibility in the laws of Member States relating to private companies. This would not necessarily have to take the form of harmonisation through Directives, but could take a much lighter approach. Some think that the proposal for the European Private Company could be used as the starting point for a model for regulation of private companies in Europe. Such a

And that specific needs of SMEs could be met by a modernisation of national forms

In which process the proposal for a European Private

[33] http://www.ccip.fr/etudes/dossiers/spe/index.html

[34] http://www.medef.fr

model could be used by Member States to voluntarily amend their regulation of private companies. The EU should consider facilitating the adoption of a model for regulation of private companies in the Member States, including a mechanism to update the model if business needs so require.

Company could be used as a model for regulation at national level

Many respondents to our Consultative Document stressed that there are strong reasons to promote a European form dedicated to SMEs:

Responses to the consultation supported a EU form :

– Some respondents took the view that SMEs should also be entitled to the benefit of a European legal vehicle suitable to their needs and purpose, to compete on a level playing field. A specific European company form should not be reserved to big business only.

A specific EU form should not be reserved to large companies

– SMEs need a European structure to establish joint ventures, which leaves enough room for structuring the joint venture as the parties to it wish.

A flexible structure for joint ventures is necessary

– There is a significant cost argument in this context. An SME faces significant costs for in-house manpower and/ or outside counsel when setting up and operating subsidiaries of different shapes and forms in various Member States. The costs would be greatly reduced if the legal form of the subsidiaries in all Member States could be the same. With a view to EU enlargement, the creation of the EPC becomes even more important : with the accession of every new Member State, the advantages for the companies will grow exponentially.

Costs linked to the creation and operation of subsidiaries in other Member States would be greatly reduced

– It may be important even for SMEs to do business as European companies, and not as Italian, German or French companies.

The “European label” may be useful

Respondents generally did not perceive the alternative of adoption of a model law for regulation of private companies in Member States as an adequate answer to the needs expressed by SMEs.

Adoption of a model for national regulations was not supported

One issue that inevitably will have to be addressed in any proposal regulating the EPC is the information, consultation and, where applicable, participation of employees. In the MEDEF/ CCIP proposal, it was suggested that the rules relating to disclosure to and consultation of employees, and if applicable, their involvement in the corporate organs, should be determined by the law applicable to the registered office of the EPC. This does not address the concerns that may exist in some Member States that, by transforming or merging into an EPC national, companies could avoid application of, in

Any proposal regulating the EPC will have to address the information, consultation and participation rights of employees

Opinions differ on how these issues

particular, national participation rules. Some, mainly German respondents, raised this point. Other respondents took the view that this should not pose a problem. Some argued that the problem could be avoided completely by limiting the number of employees of the EPC (or its subsidiaries) below the thresholds for participation rights in Member States law. We note, however, that in some Member States, thresholds for employee participation are rather low (50 or 100 employees), and imposing a limit of numbers of employees related to these thresholds could therefore seriously restrict the application of the EPC by SMEs.

should be regulated

One solution could be to limit the number of employees of any EPC, but this may be overly restrictive

The EESC has addressed this issue as well and reached the following conclusions :

Conclusions of the EESC:

- The adoption of an EU Directive on the information and consultation of employees will address a number of issues for employees. It is intended to be applied above a threshold of 50 employees.
- Concerning the participation of employees in the company's governing bodies, the solution adopted for the SE is not to be adapted for the EPC, because it is too cumbersome and complex. A realistic and pragmatic approach is required, aimed at maintaining acquired rights while avoiding an excessively cumbersome system.
- If companies participating in the formation of an EPC already apply a form of participation, a negotiating group of employees should determine the conditions under which these could be extended. If no such rules existed and the number of employees was below a threshold of 250 as set in the Commission's Recommendation on the definition of SMEs, there should be no obligation to negotiate.

Information and consultation will be addressed by a Directive

Participation rights require a more pragmatic approach than in the SE

An obligation to negotiate should be imposed only in strictly defined circumstances

The Group has not considered the issues related to the involvement of employees in further detail, but just wishes to note that they have to be addressed if a regulation on the EPC is to be produced.

Group has not considered these issues in further detail

On balance, the Group acknowledges that the desire to have an EPC statute to serve the needs of SMEs in Europe has been clearly and repeatedly expressed. However, as priorities will have to be set, the first priority should be to adopt the Tenth Directive on cross-border mergers. We expect that one of the purposes of an EPC (to create cross-border joint ventures) can be met to a large extent by a facility for national companies to merge across borders. The Group recommends that, before deciding to submit a formal proposal, the Commission carries out a feasibility study in order to assess the additional practical needs for – and problems related to – the introduction of an EPC statute.

Desire to have an EPC statute has been clearly expressed

First priority should be the Tenth Directive

After which an EPC statute should be further considered

2. INCORPORATION OF THE EUROPEAN PRIVATE COMPANY

The SE can only be set up in one of four ways:

A SE can be set up :

- by the merger of two or more existing public limited companies, connected with at least two EU Member States; *By merger*
- by the formation of a holding company, promoted by public or private limited companies connected with at least two Member States; *By formation of a holding company*
- by the formation of a subsidiary, by companies connected with at least two Member States; *By formation of a subsidiary*
- by the transformation of a public limited company, which has for at least two years had a subsidiary in another Member State. *By transformation of a PLC*

Requirements imposed on the formation of SEs are not sufficiently flexible for SMEs

The EPC should be open also to individuals, and regardless of the number of MS originally involved

An unrestricted access to the EPC would facilitate its development

It has been noted that the requirement that only companies can incorporate an SE is particularly unhelpful for SMEs, many of which are incorporated and operated by individuals. It has also been noted that the requirement that companies from at least two Member States are to be involved in the incorporation of an SE is not suited for SMEs. When a statute for the EPC is being considered, access to it should in principle be unrestricted. It should be possible for one or more individuals or legal entities to form an EPC, whether or not they are nationals of one or more Member States. Some hold that the unrestricted access to the EPC is the only way to facilitate a full development of this form of company within the EU, and that the EPC should be available for every citizen of the Union. They stress the fact that it would enhance the "restatement" character of the EPC which should be an improved alternative to national forms of private companies, and as a result could trigger a process of convergence of national company laws.

As a minimum requirement, EPCs should undertake economic activities in more than one MS

Others argue that, without any link to a European dimension, as a matter of European Law there is no justification for the EU to be involved, and we agree. In this light, a minimum requirement would be that the EPC undertakes economic activities in more than one Member State. Thus when an EPC statute is being considered, access to its formation should be given to both individuals and legal entities who undertake activities in more than one Member State.

3. A GENUINE EUROPEAN COMPANY OR A STRUCTURE WITH A REFERENCE TO A NATIONAL LAW ?

Contrary to the

As we have said, the SE Statute often refers to national laws of

Member States applicable to public companies. The SE as a result only partly has a European character. The drafters of the proposal for the EPC intend this legal form to be governed only by the provisions of the regulation and the provisions of the articles of association which would not be inconsistent therewith. Of course, the EPC would remain subject to the general rules of Member States regarding accountancy law, tax law, penal law and bankruptcy law. One of the assumptions underlying the concept of the EPC is to create a genuinely European company, which is not subject to the company law of a Member State. This should facilitate the international use of this legal form, as those wishing to use it do not have to familiarise themselves with the company laws from other Member States.

SE Statute, which often refers to national law

The EPC has been drafted as a genuine European company, not subject to national company laws

In order to facilitate its international use

It is argued that this assumes an autonomous and exhaustive interpretation of the EPC regulation and the articles of association, ultimately by the European Court of Justice. This could raise concern about the strain this would impose on the European judicial system, and the delays and uncertainties for companies involved in resolving legal issues, but some respondents expect the SME practice to successfully deal with these issues. They argue that national courts and the European Court of Justice have demonstrated so far that they are able to interpret and develop further European company law from itself, and that they would be able to do the same with the EPC. This task, they say, is easier today than some decades ago when harmonisation of European company law started.

In such a situation, the European Court of Justice would have an important role to play

Some are concerned about difficulties

Whereas others are more confident

However, the Group notes that existing company laws in Member States are embedded in national bodies of private law. Many concepts of private law are also applicable in company law, e.g. concepts of legal acts, good faith, power of attorney, etc. The majority of respondents to the Consultative Document and the Group find it difficult to see how an EPC could operate completely outside such a national body of private law, in the absence of a European body of private law. For the proper operation of the company law applicable to the EPC, some connection will have to be made with the law of the jurisdiction of its incorporation. Such a reference to national law, it could be argued, would reduce to some extent the value of the EPC. But according to the supporters of the creation of an EPC, this does not reduce the strong need for it.

Majority of respondents and Group find that a reference to national private law is unavoidable

Which could reduce to some extent the value of the EPC, without removing the need for it

To summarise, the desire to have an EPC statute to serve the needs of SMEs in Europe has been clearly and repeatedly expressed. However, the first priority should be to adopt the Tenth Directive on cross-border mergers, which is expected to meet one of the purposes of the EPC statute. The Group recommends that, before deciding to

Summary : *Clear desire for an EPC statute*

First priority : Tenth Directive

submit a formal proposal, the Commission carries out a feasibility study in order to assess the additional practical need for – and problems related to – the introduction of an EPC statute.

To be followed by a feasibility study

When considering the introduction of an EPC statute, the requirements imposed on the formation of an EPC should be sufficiently flexible to facilitate proper development of such new form. The EPC should be open to individuals, and not only companies, and the founders should not be required to come from several Member States. A minimum requirement would however be that the EPC is undertaking activities in more than one Member State.

Formation requirements should be flexible

But any EPC should have activities in more than one MS

When considering the introduction of an EPC statute, a proper connection with the law of the jurisdiction of incorporation is to be established, since many concepts of private law are also applicable in company law.

A proper connection to national private law should be established

CHAPTER VIII

CO-OPERATIVES AND OTHER FORMS OF ENTERPRISES

1. REGULATION OF THE EUROPEAN CO-OPERATIVE, EUROPEAN ASSOCIATION AND EUROPEAN MUTUAL SOCIETY

The European Council recently adopted a general orientation on the Regulation on the Societas Cooperativa Europaea (SCE)

After the Consultative Document was published, the European Council adopted in July a "general orientation" on the Proposal for a Council Regulation creating the European Co-operative (Societas Cooperativa Europaea, SCE)[35]. According to Recital 2 of the Regulation, "it is essential that companies of all types the business of which is not limited to satisfying purely local needs should be able to plan and carry out the reorganisation of their business on a Community scale". In a similar vein, Recital 6 mentions the need to ensure "equal terms of competition".

This Regulation includes a high number of references to provisions in existing Company Law Directives

The number of rules in the Co-operative Regulation that apply provisions included in Company Law Directives is substantial. According to Recital 18 : "Work on the approximation of national company law has made substantial progress so that certain provisions, adopted by the Member State where the SCE has its registered office for the purpose of implementing Directives on companies, may be referred to by analogy for the SCE in areas where the functioning of the co-operative does not require uniform Community rules, such provisions being appropriate to the arrangements governing the SCE".

The SCE indeed takes advantage of the existing work on harmonisation of company law

The approach for the SCE has been to take advantage of the substantial work developed in the harmonisation of company law to the extent company law rules do not conflict with the peculiar traits of co-operatives[36]. The long list of articles[37] that call for the application of company law rules shows that the Company Law Directives can be used as instruments to complete many aspects of the Regulation on

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[35] For full citation, see Annex 4.

[36] The European Co-operative Regulation expressly mentions the First Company Law Directive, the Fourth Company Law Directive, the Seventh Company Law Directive; the Eighth Company Law Directive and the Eleventh Company Law Directive.

[37] The articles including rules that refer to company law are the following: Article 4 (law applicable to appointment of experts); Article 10 (documents sent to third parties); Article 11 (registration and disclosure requirements); Article 12 (publication of documents in the Member States); Article 20 (law applicable in the case of merger); Article 26 (report of independent experts); Article 28 (laws applicable to formation of merger); Article 29 (scrutiny of merger procedure); Article 32 (publication of merger); Article 47 (power of representation and liability of the SCE); Article 68 (preparation of annual accounts and consolidated accounts); Article 70 (auditing); Article 71 (system of auditing).

the SCE.

In the Consultative Document, we asked questions on the need for and usefulness of proposals for Regulations creating the European Association[38] and the European Mutual Society[39]. The questions elicited few answers, which may be caused by general unfamiliarity with the problems affecting alternative forms of enterprise, but also by a different perception of the priority to be given to these initiatives. Whatever the explanation, a majority of the responses received express a positive view on these proposals, which are regarded as useful instruments for the development of economic activities on a European-wide basis by associations and mutual societies.

On the European Association and the European Mutual Society, the consultation elicited few answers

But a majority confirmed their usefulness

In the Group's view however, these proposals should not take priority in the short or medium term. We have not been convinced of the need for these forms in order for associations and mutual societies to be able to become active across Europe. In addition, respondents generally felt that the EU should not seek to harmonise the underlying rules for associations and mutual societies, as they are fundamentally different in the various Member States. Regulations on the European Association and the European Mutual Society will probably benefit less than the SCE Regulation from the harmonisation achieved by the Company Law Directives. We fail to see how uniform regulations of the European Association and European Mutual Society could be achieved if there is no agreement on harmonisation of the underlying national rules.

The Group does not view these proposals as high priorities

Respondents felt that the EU should not harmonise the underlying rules

Which makes the adoption of regulations difficult

On the other hand, we acknowledge that the progress made on the SCE Regulation represents an important precedent for the other proposed Regulations directed at alternative forms of enterprise. We believe the impact of the forthcoming SCE Regulation on the co-operative enterprise sector in Europe should be studied closely before putting further efforts into creating these other European entities. There are important questions deserving analysis in the future application of the SCE Regulation.

The forthcoming SCE Regulation is a precedent for other Regulations

Its impact should be studied prior to the creation of other EU entities

It will be interesting to see how the SCE relates to the national forms of co-operatives. Will the SCE indeed be used for transnational restructurings and joint ventures? If so, this may enhance the competitiveness of co-operatives. But it might well be that the SCE will result in a *de facto* harmonisation, given the fact that the national forms are still subject to mainly national rules. In other words, the SCE will compete with national forms in being the most effective instrument to organise a business activity. This could also lead,

Particularly interesting will be the extent to which the SCE will compete with national forms of co-operatives

[38] Proposal for a Council Regulation on the European Association : for full citation, see Annex 4.
[39] Proposal for a Council Regulation on the European Mutual Society : for full citation, see Annex 4.

potentially, to a lack of balance between national legal forms of co-operatives and the SCE.

In the Consultative Document, we raised similar questions about the need for and feasibility of a regulation for the European Foundation. In this respect we have basically come to the same conclusions as we reached for the European Association and the European Mutual Society. For foundations, the differences in national regulation by Member States seem to be even more profound, making the drafting of a EU Regulation on a European Foundation without any form of harmonisation of national laws on foundations all the more difficult.

The Group reached the same conclusions on a Regulation for the European Foundation, which seems even more difficult to achieve

This said, it seems to us that this area of developing European legal forms for alternative forms of enterprise could benefit from a different regulatory approach. Instead of trying to produce Regulations for these alternative European legal forms, the proponents of these European legal forms themselves could consider developing model laws for them as indeed is already being done for foundations[40]. The EU could consider facilitating this work on model laws by those who could benefit from them. The work on such model laws would need to reach agreement on the basic characteristics the European legal form should have, and thus contribute to agreement on a certain level of harmonisation of these national legal forms. Once that level of agreement is reached, the introduction of alternative European legal forms could become feasible.

Instead of EU Regulations, the proponents of these legal forms could consider developing model laws

The EU could facilitate this work on model laws, which would contribute to basic convergence

The Group would like to make two further, related, comments on these alternative legal forms of enterprise. There is a concern that such forms are used in the governance of listed companies to avoid application of transparency requirements on controlling shareholders. Where foundations, associations, mutual societies or other legal forms are indeed controlling shareholders, it must be ensured that the disclosure requirements, in particular relating to governance structures, are extended to these legal forms as well.

When alternative forms of enterprise are controlling shareholders, disclosure requirements should be extended to them

Apart from this, there is also a concern that other legal forms sometimes operate substantial businesses in competition with companies, without being subject to similar disclosure and general corporate governance standards. This may lead to unfair competition and to an undesirable use of these other legal forms to escape appropriate disclosure and corporate governance requirements. When disclosure and corporate governance standards are being formalised, the EU and Member States should seriously consider how and to what extent they should be extended to other legal forms

When these forms operate substantial businesses, fair competition may require extension to them of disclosure and corporate governance standards

[40] See the international Bertelsmann Foundation project on a European Foundation, which is expected deliver recommendations by 2004.

which operate substantial businesses.

2. GENERAL RULES FOR ENTERPRISES

In the Consultative Document, we finally asked questions on the usefulness of a European definition of the concept of enterprise, and the appropriateness of an “Enterprise Directive” aimed at regulating several key aspects of every business activity carried out by legal entities, regardless of their form.

Consultation sought views on the usefulness of an EU definition of “enterprise”

Respondents showed a clear opposition to a European rule defining the basic elements of what it is to be considered to be an enterprise. The Group recognises the difficulty of finding such a definition, and would therefore suggest that, if there is to be an EU initiative in this area, a list-based approach should be taken, in which every Member State lists the entities which would be subject to the legislative instrument.

Respondents showed clear opposition

Groups suggests that a list-based approach is used in any initiative

A substantial percentage of respondents agree that the lack of information on basic data of some of these alternative forms of enterprise causes problems, in particular when contracting across borders in the EU, and that it would be appropriate to introduce basic disclosure requirements for certain economic actors. A substantial harmonisation program is rejected, both because of its inherent difficulties and because no need for it is perceived. However, the creation of a framework for disclosure of basic data related to different types of certain legal entities engaged in economic activities is perceived as a useful tool for trade within the EU Internal Market. The need for this would, in the Group’s view, be most prominent with respect to legal entities which confer limited liability on those controlling and participating in them.

Respondents agree that the lack of information on basic data creates problems

A substantial harmonisation is rejected

But a framework for disclosure of basic data would be useful

A framework Directive could require the registration of, at least, all limited liability entities with legal personality that engage in economic activities, and could ensure access to basic data like the entity’s name, address and contact details, directors or others controlling its external existence. Powers of representation should also be published. Such a Directive should take advantage of technological developments in the area of registration and filing as described in Section 6 of Chapter II. It could be left to Member States to decide whether this basic registration needs to be included in their commercial registries or special registries are to be set up for these purposes. Linking of such registries across the EU should again be established.

Registration of all limited liability entities engaging in economic activities could be required

In a way that takes advantage of technological developments

To summarise, a European form of Association and a European form of Mutual Society are not regarded by the Group as priorities for the short and medium term. The impact of the forthcoming SCE Regulation on the co-operative enterprise should be studied closely before putting further efforts into creating these other European forms.

***Summary :** No urgent need for a European Association, and a European Mutual Society*

The Group reached the same conclusions about the need for and feasibility of a Regulation on the European Foundation, which might be even more difficult to achieve.

The same for a European Foundation

The development of European legal forms for alternative forms of enterprises could benefit from a different regulatory approach : proponents of these European legal forms could consider themselves developing model laws for them. The EU could consider facilitating this work, which would contribute to basic convergence.

Development of model laws to be encouraged

When alternative forms of enterprise are controlling shareholders, disclosure requirements, in particular relating to governance structures, should be extended to them.

When these alternative forms operate substantial businesses, fair competition may require extension to them of disclosure and corporate governance standards.

Company disclosure requirements to be extended where necessary

With respect to the usefulness of a European definition of the concept of enterprise, the Group recognises the difficulty of finding such a definition and therefore suggests that, if there is to be an EU initiative aimed at regulating entities regardless of their form, a list-based approach should be taken, in which every Member State lists the entities which would be subject to such a legislative instrument.

No need for a European definition of "enterprise"

In order to ensure access to basic information on alternative forms of enterprises, a framework Directive could require the registration of, at least, all limited liability entities with legal personality that engage in economic activities. Such a Directive should take advantage of technological developments, and linking of registries across the EU should be established.

Registration of all limited liability entities engaging in economic activities to be considered

CHAPTER IX

PRIORITIES FOR ACTION

In this Report, we make a number of specific recommendations relating to various elements of the regulatory framework for company law in Europe. If our recommendations are to be followed up, this will result in a substantial number of company law initiatives to be taken, in the first instance by the Commission. We realise that not all of this can be achieved simultaneously. We would advise the Commission to make a Company Law Action Plan which sets the EU agenda for regulatory initiatives in the area of company law, and to agree such an action plan with the Council and the European Parliament.

This Report contains many recommendations

Proper follow-up would require establishment of an Action Plan

In this light, the Group has discussed which of its recommendations it believes should have priority in such an EU Company Law Action Plan. We have ranked the various recommendations into three categories of actions, to be undertaken on the short term, medium term and long term.

Group discussed priorities

And ranked them in 3 categories

SHORT TERM:

– improve the EU framework for corporate governance, specifically through:

Corporate Governance

  - enhanced corporate governance disclosure requirements;
  - strengthening the role of independent non-executive and supervisory directors, particularly in three areas where executive directors have conflicts of interests, i.e. nomination and remuneration of directors and audit of the company's accounts;
  - an appropriate regime for directors' remuneration, requiring disclosure of the company's remuneration policy and individual director's remuneration, as well as prior shareholder approval of share and share option schemes in which directors participate, and accounting for the costs of those schemes to the company;
  - confirming as a matter of EU law the collective responsibility of board members for the company's financial and key non-financial statements;
  - an integrated legal framework to facilitate efficient shareholder

information, communication and decision-making, on a cross-border basis, using where possible modern technology;

- setting up a structure to co-ordinate the corporate governance efforts of Member States;

– simplify the Second Company Law Directive on capital formation and maintenance, on the basis of the SLIM recommendations as supplemented in this Report ("SLIM-Plus"); *Second Directive*

– offer efficient mechanisms for cross-border restructuring and mobility of companies, specifically by adopting proposals for the Tenth Company Law Directive on cross-border mergers and the Fourteenth Company Law Directive on transfer of the seat. *Tenth and Fourteenth Directives*

MEDIUM TERM:

– require Member States to set up central electronic filing systems for listed companies; *Electronic filing systems*

– introduce an EU framework rule on special investigation rights for minority shareholders; *Special investigation right*

– introduce an EU framework rule on wrongful trading by directors and "shadow" directors; *Wrongful trading*

– review the feasibility of director's disqualification across the EU as a sanction for director's misconduct; *Director's disqualification*

– review the feasibility of an alternative to the capital formation and maintenance rules of the Second Company Law Directive, as amended according to the SLIM-Plus proposals; *Alternative to capital formation and maintenance*

– provide a framework rule for groups, allowing the adoption at subsidiary level of a co-ordinated group policy with proper protections of creditors and shareholders; *Rule allowing group policy*

– prohibit stock exchange listing, except where permitted after special economic justification, of holding companies whose sole or main asset consists of shares in another listed company, as a measure to restrict the use of pyramid structures; *Restriction of pyramids*

– simplify the current Third and Sixth Company Law Directives on legal mergers and divisions, to avoid superfluous formalities; *Third and Sixth Directives*

– introduce general squeeze-out and sell-out rights with a threshold of at a minimum 90% and at a maximum 95% of the company's share capital; *Squeeze-out and sell-out rights*

– launch a feasibility study in order to assess the practical needs for - and problems of - a European Private Company statute. *European Private Company Statute*

LONG TERM:

- assess the need for the creation of other European legal forms;
- introduce basic disclosure rules for all legal entities with limited liability.

Other legal forms

Disclosure for all legal entities

The Group believes that much is to be gained from the setting up of a more permanent structure to provide the Commission with independent advice on future regulatory initiatives in the area of EU company law.

A permanent structure should provide advice on future initiatives

The EU agenda for company law reform will be full the coming years, and it will require efforts of many involved to achieve results. But a lot of work needs to be done so that company law in Europe can make a proper contribution to the conditions for productive enterprise and the creation and maintenance of competitive and efficient economic and financial markets in Europe. The Group is confident that the results of these efforts will make them worthwhile.

Company Law reform will require significant effort

But expected results will justify this

To summarise, the Commission should prepare a Company Law Action Plan which sets the EU agenda, with priorities, for regulatory initiatives in the area of company law and agree such an action plan with the Council and the European Parliament.

***Summary** : A prioritised Company Law Action Plan to be prepared*

The setting up of a permanent structure to provide the Commission with independent advice on future regulatory initiatives in the area of EU company law should be duly considered.

Creation of an advisory structure to be considered

ANNEX 1

THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS' TERMS OF REFERENCE

PRESS RELEASE OF 4 SEPTEMBER 2001 (Extract)

Company law: Commission creates High Level Group of Experts

The European Commission has set up a High Level Group of Company Law Experts that will help the Commission to prepare a new proposal for a Directive on the conduct of takeover bids and to define new priorities for the broader future development of company law in the European Union. The group comprises seven members, selected on the basis of their competence in company law and the Commission's desire that the members should have broad experience of the various legal and economic systems in the EU. The group will hold its first meeting on 11 September 2001. It is due to deliver a preliminary report on its recommendations to the Commission concerning rules for takeover bids by the end of 2001 and a final report concerning broader issues for the development of EU company law by mid-2002.

Internal Market Commissioner Frits Bolkestein said "This High Level Group has been set up because the Commission wants to get top quality independent advice from leading European experts in the first instance on pan-European rules for takeover bids and subsequently on key priorities for modernising company law in the European Union.".

The Group will hold its first meeting on 11 September 2001. Taking account of the positions of the EU's Council of Ministers and the European Parliament during the last stages of negotiation of the previous proposal for a Takeovers Directive (see MEMO/01/255), the Group of High Level Experts will initially consider the following three issues:

- how to ensure the existence of a level playing field in the EU concerning the equal treatment of shareholders across Member States
- the definition of the notion of an "equitable price" to be paid to minority shareholders and
- the right for a majority shareholder to buy out minority shareholders ("squeeze-out procedure").

The Group is due to deliver a report on these issues, including possible solutions, to the Commission's services by the end of 2001.

During a second stage, the Group is due to provide recommendations for a modern regulatory European company law framework designed to be sufficiently flexible and up-to-date to meet companies' needs, taking into account fully the impact of information technology. The Group will examine best practice developed in the Member States (as well as in the USA) and consider a range of issues including the following:

- the creation and functioning of companies and groups of companies, co-operatives and mutual enterprises, including corporate governance
- shareholders' rights, including cross-border voting and virtual general meetings
- corporate restructuring and mobility (for instance, the transfer of the corporate seat)

- the possible need for new legal forms (for instance, a European Private Company, which would be of particular relevance for SMEs)
- the possible simplification of corporate rules in light of the SLIM report on the Second Company Law Directive of 13 December 1976 on the formation and capital maintenance of public limited liability companies.

The Group is due to deliver a final report to the Commission's services by mid-2002.

PRESS RELEASE OF 18 APRIL 2002 (Extract)

Financial services: Commission services publish analysis of repercussions of Enron collapse

The European Commission's services have published online an initial analysis of the repercussions for the EU of the collapse of Enron. The paper, entitled "A first response to Enron related policy issues" outlines steps that need to be taken to guard against similar events in Europe. It was presented by Internal Market Commissioner Frits Bolkestein to the informal meeting of Economics and Finance Ministers in Oviedo on 12-14 April (see also MEMO/02/72). Ministers welcomed the paper and endorsed the Commission's proposal to ask its High Level Group of Company Law Experts to review further corporate governance and auditing issues in the light of the Enron case. The paper emphasises that the EU is already working on most Enron-related regulatory issues through the Financial Services Action Plan, which aims to establish an efficient and competitive capital market that deserves investors' trust. The full text of the paper can be found on the Commission's Europa site.

The mandate of the High Level Group of Company Law Experts (see IP/01/1237) will be expanded to review further corporate governance and auditing issues. These will include the role of non-executive directors and of supervisory boards; management remuneration; and the responsibility of management for the preparation of financial information.

Ministers decided in Oviedo that the Group's preliminary conclusions and proposals for reform would be discussed at the June Council of Finance Ministers and subsequently at the Seville European Council in June. The final conclusions will be presented to the informal meeting of EU Finance Ministers in September.

ANNEX 2

WORKING METHODS
OF
THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS

The High Level Group of Company Law Experts comprises:

- Chairman Jaap WINTER, the Netherlands, Partner at De Brauw Blackstone Westbroek and Professor at the Erasmus University of Rotterdam
- José Maria GARRIDO GARCIA, Spain, General Counsel to the Comision Nacional del Mercado de Valores and Professor at the University of Castilla-La Mancha
- Klaus HOPT, Germany, Geschäftsführender Direktor Max Planck-Institut and Professor at the Anton Philips chair of the Tilburg University
- Jonathan RICKFORD, United Kingdom, Unilever Professor at Leiden University and Member of the UK Competition Commission
- Guido ROSSI, Italy, former President of the Italian stock exchange supervisory body CONSOB
- Jan SCHANS CHRISTENSEN, Denmark, Professor at the University of Copenhagen
- Joëlle SIMON, France, Legal Affairs Director, French Business Confederation – MEDEF

The Group began its work on 11 September 2001. After the presentation of its "Report on Issues Related to Takeover Bids" on 10 January 2002 in Brussels, the Group took up its work on the second part of its mandate, according to which the Group was to provide recommendations for a modern regulatory European company law framework.

To this end, the Group held meetings in Brussels every month from January 2002 to September 2002.

In order to include in its work the broadest possible spectrum of opinions, the Group published a Consultative Document on 25 April 2002, in which it asked those interested in and concerned with company law in Europe to comment on the issues specified in the second part of its mandate.

Before submitting its Consultative Document to the public, the Group appeared before the European Parliament Legal Affairs and Internal Market Committee on 16 April 2002, on which occasion the Chairman gave a basic overview of the main content of the Consultative Document.

Following the publication of the Consultative Document, a hearing was held in Brussels on 13 May 2002 with representatives of mainly European business and professional organisations for the purpose of obtaining first opinions on the Group's considerations contained in the Consultative Document.

The comments received on the Consultative Document were analysed and summarised for the Group by a team of researchers from the Company Law Department of the Faculty of Law of the Erasmus University in Rotterdam led by Professor J.B. Wezeman.

A summary of the main comments, prepared by the team, is included in Annex 3 (for respondents' nationality and sector of activity, see the overview on the following pages).

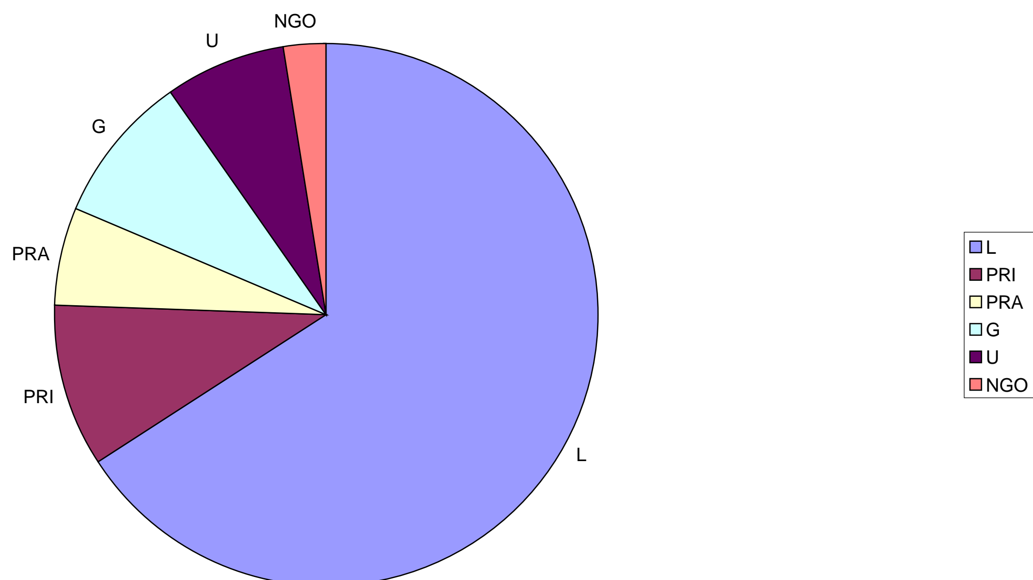
The Final Report of the Group is submitted to the European Commission and presented to the Press on 4 November 2002 in Brussels.

Overview of nationality and sector of activity of respondents:

a) Full text contributions (number received: 119):

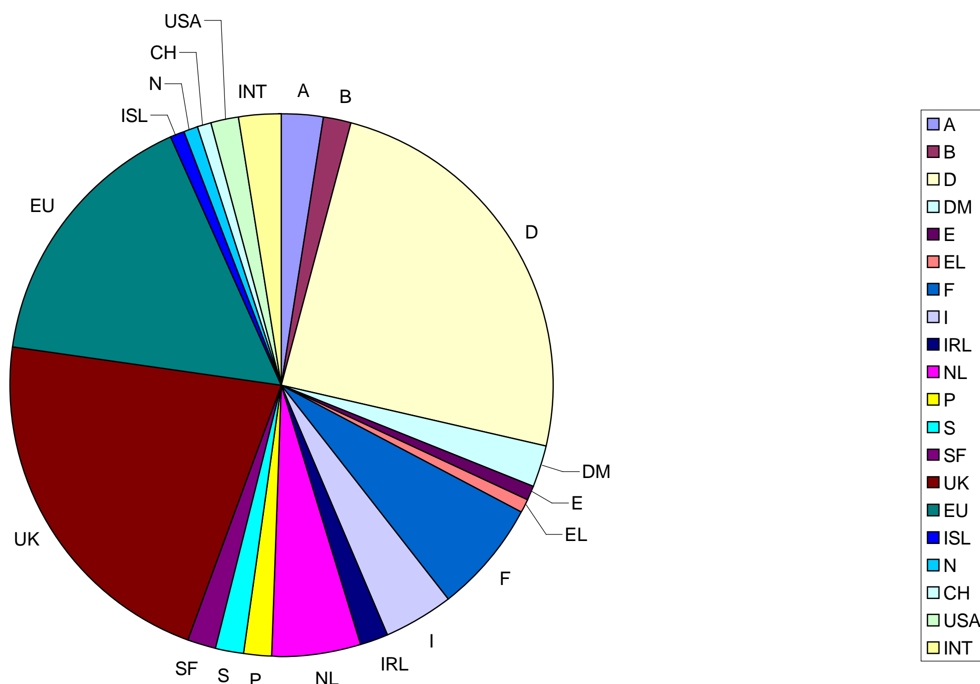
Nearly two thirds of all responses came from organisations representing various parts of industry, services and professions at national, European and international level (referred to by "L" in the following graph). About 10% of all contributions came from private entities (enterprises or individuals), while governments or government agencies accounted for more than 8 % of responses (referred to in the graph by "PRI" and "G" respectively). Less than 8% of the responses were received from academics ("U" in the graph). Slightly less than 7% were received from practitioners ("PRA"). The remainder (2,5%) was received from non-governmental organisations ("NGO").

Graph 1: Full text responses - respondents by sector of activity



In terms of nationality (or, as in the case of organisations, in terms of context of activity, be it European or even global), contributions from EU Member States accounted for more than three quarters of the total, whereby the greatest number of contributions was received from Germany (about one quarter of all contributions), followed by the UK (more than one fifth of all contributions) and by contributions received from a predominantly European context (slightly less than one sixth of all contributions).

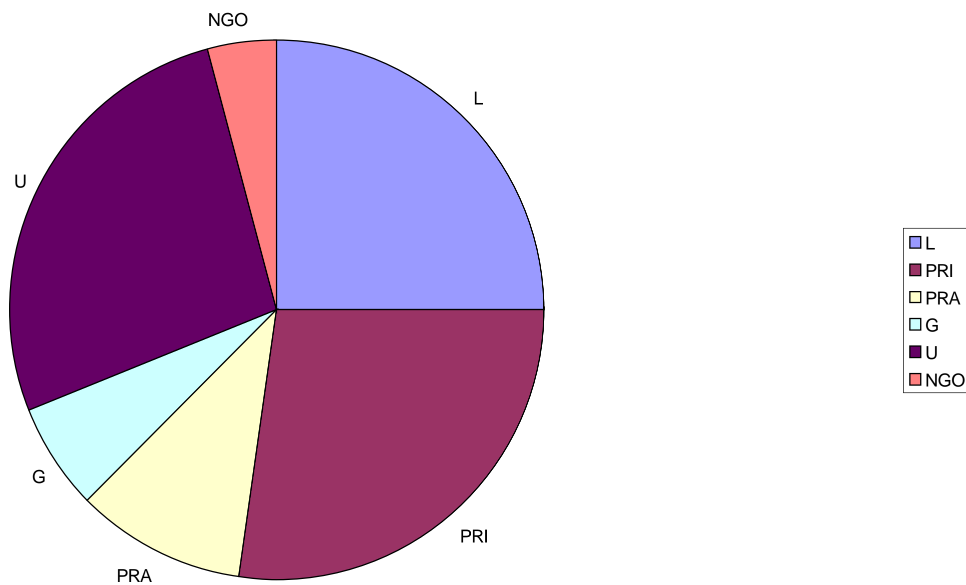
Graph 2: Full text responses - respondents by country



<u>b) On-line contributions (number received: 48)</u>:

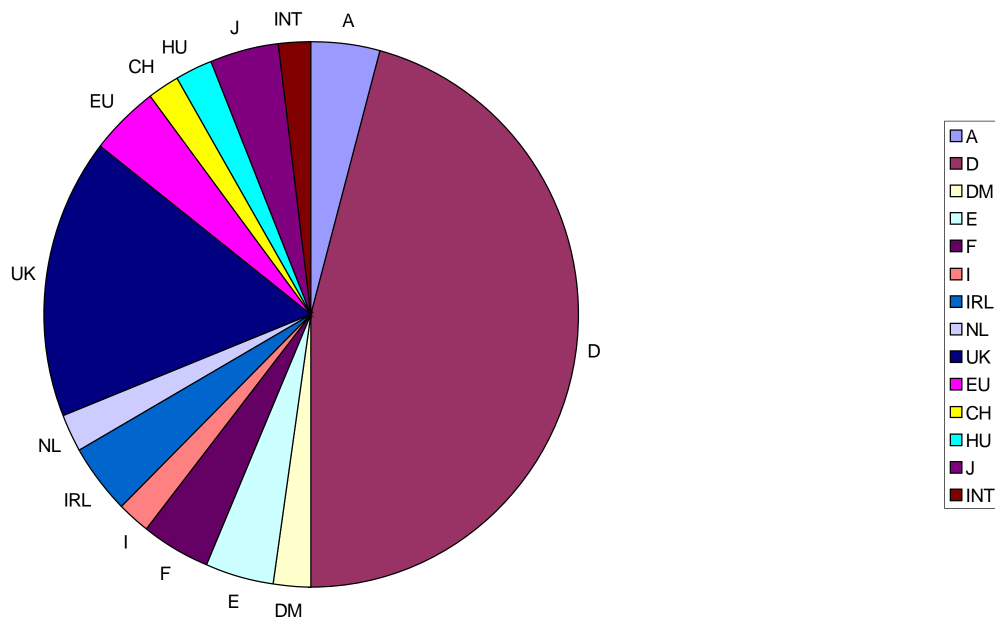
Here, more than one quarter of all contributions came from private entities (enterprises or individuals) and from academics respectively. One quarter of all responses came from representative organisations. Practitioners accounted for about one tenth of responses. The remainder was received from governments or government agencies (about 6%) and non-governmental organisations (about 4%).

Graph 3: Online responses - respondents by sector of activity



In terms of nationality (or, as in the case of organisations, context of activity, be it European or even global), contributions from EU Member States accounted for more than 80% of the total, whereby the greatest number of contributions was received from Germany (nearly half of the contributions), followed by the UK (one sixth of all contributions).

Graph 4: Online responses - respondents by country



ANNEX 3

SUMMARY OF COMMENTS
SUBMITTED TO THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS
IN RESPONSE TO ITS CONSULTATION DOCUMENT

Erasmus University Rotterdam

October 2002

Professor Jan Berend Wezeman
Martijn Bras
Ageeth Klaassen
Michelle Reumers
Maarten Verbrugh

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   - 6.3. A genuine European company
7. Co-operatives and Other Forms of Enterprise
   - 7.1. Regulation of the European Co-operative, European Association and European Mutual Society
   - 7.2. Harmonisation of national laws on co-operatives, associations and mutual

societies
7.3. Foundations in Europe
7.4. Enterprise law

INTRODUCTION

The European Commission has asked the company law department of the Faculty of Law of the Erasmus University in Rotterdam (the Netherlands) to support the High Level Group of Company Law Experts in analysing and summarising the comments the Group has received in response to its Consultation Document on a Modern Regulatory Framework for Company Law in Europe. The team of the Erasmus University was led by Professor Jan Berend Wezeman and included Martijn Bras, Ageeth Klaassen, Michelle Reumers and Maarten Verbrugh.

The team has prepared a number of detailed analyses, summaries, tables and charts for the Group. The summary of responses in this Annex is based on these analyses and summaries. This summary, with further tables and charts (on a no-names basis), can also be accessed at the Erasmus website at www.frg.eur.nl/pri/har/HLGannex.pdf

In total, the team has analysed responses from 119 respondents, excluding responses received on-line (which were analysed directly by the Commission services).

On the whole, respondents tended to support the proposals of the Group put forward in the Consultative Document. The following graph gives an impression of the thrust of the answers of respondents to the questions on the specific subjects raised in the Consultative Documents. Questions 11a, 12b, 14d , 15a, 15b and 16a stand out as questions with a high number of no-answers. Of these, the Group itself had indicated in the Consultative Document to favour a negative answer to questions 11a, 12b, 15b and 16a.

The following gives a summary and short statistical analysis of the various comments made in response to the questions in the Consultative Document.

Answers Consultation Total

Y N Other

90
80
70
60
50
40
30
20
10
0

7 8a 8c 8d 8e 9 10 11a 11c 12a 12b 13a 14a 14b 14c 14d 15a 15b 16a 16b 16c 18a 18c 18d 19a 19b 20a 21a

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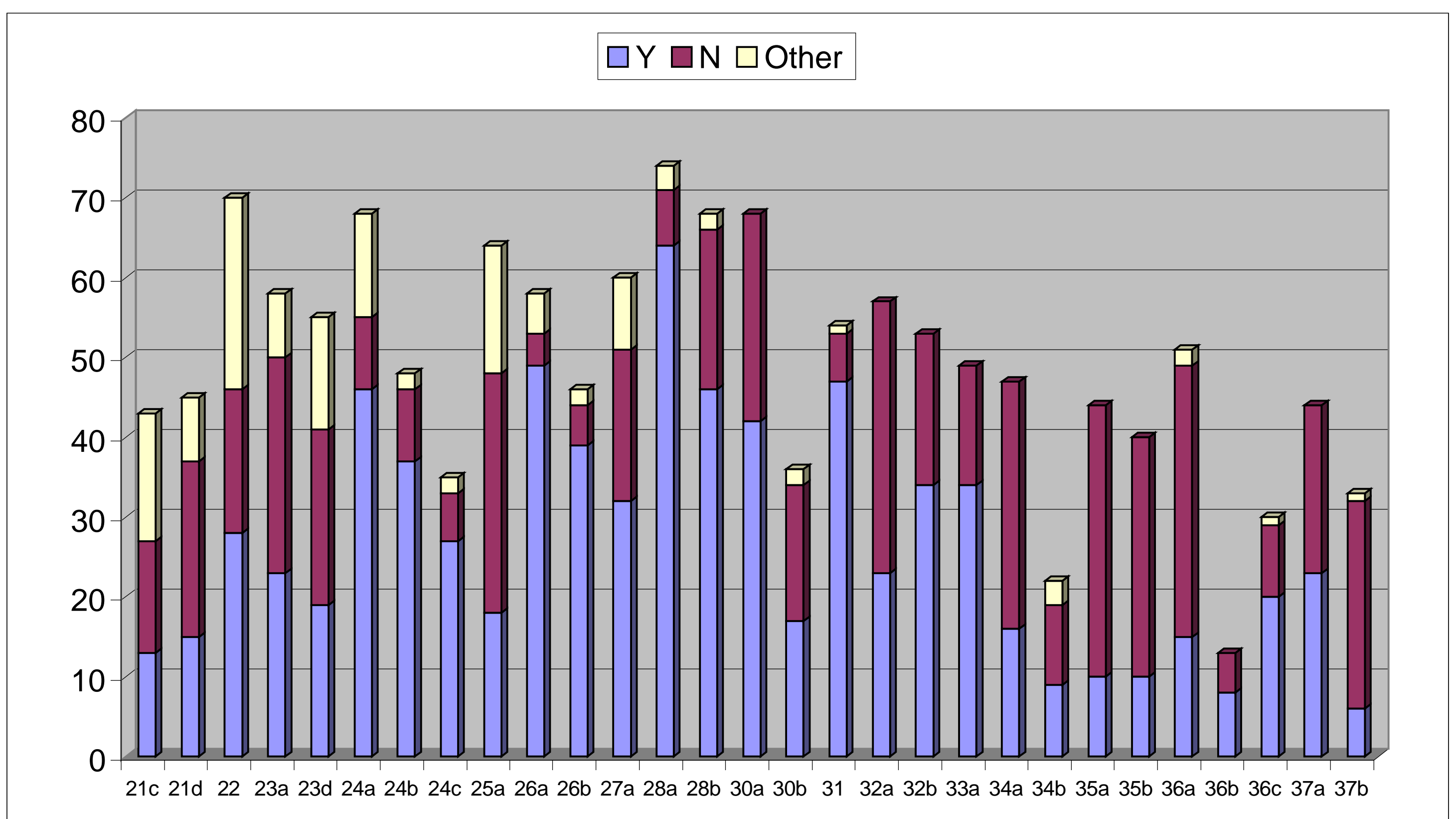

I - GENERAL THEMES (CHAPTER 2 of the Consultative Document)

1. Facilitating efficient and competitive business in Europe

Most respondents to question 1a agree that the European Union, moving forward in the area of company law, should primarily focus on developing company law, which facilitates the efficient and competitive operation of business across the Union, especially by deregulation and by creating more flexibility and permitting more variation. Often the capital rules of the 2nd Directive are seen as an unnecessary burden. For example: the suggestion is made to regulate the payment of dividend solely by means of a solvency test. Today's business practice demands a legal framework flexible in form.
Nevertheless, many respondents emphasise that the protection of shareholders and creditors remains important, although other ways of protection might be possible.
Also the remark that the EU should focus on general framework rules is often made.
Several respondents suggest a step-by-step approach, in view of the differences between the Member States, and not a general reform, respecting the different national cultures. These respondents emphasise the principle of subsidiarity, while some others express the need of further consultation with the business community before launching new proposals.
A few respondents think that the protection of investors and creditors remains the most important aim of company law.
Some respondents express that – apart from cross-border merger and transfer of the seat - there is no real need for further harmonisation, or that - due to the principle of subsidiarity - European company law initiatives should only be pursued where a clear need for community wide action can be demonstrated.

A large majority of the respondents think that progress should be made, as a matter of priority, in the areas of cross-border merger and transfer of the seat of the company (question 1b). In relation to this, also de-mergers and similar restructuring operations are sometimes mentioned and the need for efficient reorganisation procedures in order to avoid liquidation.
Other often mentioned topics are the need to harmonise insolvency procedures. A part from these topics, the following areas of company law were mentioned where progress should be made as a matter of priority by one or a few of the respondents: information needs of stakeholders/shareholders, including minority protection; public availability of company information across the EU; social law/collective labour law/safety at work; (a uniform structure of) commercial registers; a European private company; integration of participation of workers into company law; provisions on personal liability of the management; capital market law; uniform structure of the powers of representation, especially abolition of any ultra vires doctrines; availability of EU company law instruments (e.g. SE) to companies not residing in the EU; disclosure of payments ("publish what you pay"); creating a company law framework which first and foremost caters for small and medium sized companies ("think small first"); easy dissolution of companies (as in e.g. Denmark); co-ordination of the issue of sanctions in the area of company law, especially by recommendation to favour civil sanctions; requirement for every public company to state its objects; adequate debt/equity leverage; hybrid securities and voting bonds; mutual recognition of companies; environmental regulation; banking law applying to company financing; joint ventures and inter-company agreements; unification of partnership law. Tax rules, especially taxation of cross-border transactions, were mentioned as well.

2. Modern company law making

The majority of the respondents to question 2a agree to the concept of making more use of alternatives as indicated by the HLG to primary legislation in directives. Most respondents agree that directives are inflexible and can lead to petrifaction and should therefore be limited to principles with a global focus. The differences between national systems can be respected better in secondary regulation. Others think a pragmatic combination of all ways is preferable, mainly because "comply of explain"-rules can not replace enforcement in full. A few respondents, whilst not against alternatives, do not believe that model laws will prove particularly useful.
Some respondents recognise, however, that secondary legislation can lack transparency and democratic legitimacy and should only be used by way of exception and with care. An important group of the respondents – mostly German respondents - think that mainly for these disadvantages, the EU should in principle make use of directives. Some of these respondents think the procedure for modifying directives should be simplified.

The areas of corporate governance (e.g. conduct of general meetings) and accounting (and in general: disclosure) are mentioned often as areas of company law, which are particularly suited for an alternative regulatory approach (question 2b). Other areas mentioned by some are the use of IT or other fast changing or newly emerging topics; an optional uniform model law, especially for listed companies (cf. U.S.A); a framework for a whole legal entity (e.g. European Private Company); fundamental organisational rules and rules on share registers; listing rules (and content of prospectuses etc.) or other areas with capital market relevance.

3. Disclosure of information as a regulatory tool

Almost all respondents to questions 3a and 3b agree that disclosure requirements can sometimes provide a more efficient regulatory tool than substantive rules, especially in the area of corporate governance, disclosure of structures of groups of companies, conflict of interest, financial affairs, share options/board compensation/payments or other dealings with directors, substantial shareholders and related parties, and the capital structure of listed companies.
A few respondents only agree in case of listed companies.
Several respondents emphasise, however, that disclosure is only effective as long as there are clear rules concerning the information itself and as long as disclosure is enforceable. Disclosure requirements cannot fully replace regulation. Furthermore, costs and benefits of disclosure have to be carefully balanced and flooding the public with information of no relevance should be prevented. C.f.: "Moreover disclosure leads to an effect like in a football stadium: if everybody gets up, no one has a better view any more".
To avoid overload, co-ordination at EU-level for consistency and materiality is important. As for the dividing line between disclosure and more substantive regulation, one of the respondents refers to the ideas as set out in the Final Report of the Company Law Review in the UK (CLR). Also, disclosure requirements based on a definitive code of best practise have proven to be effective in improving corporate governance in the UK.
Some respondents think that there are already enough (or to many) disclosure requirements or that disclosure requirements cannot provide an efficient regulatory tool.

4. Distinguishing types of companies

A lot of the respondents to questions 4a and 4b express that there are good reasons to distinguish between three kinds of companies: listed companies, public (open) companies and private (closed) companies, since the interests involved are actually different. A large

group of others think only a distinction is necessary between listed and non-listed companies. The definition of “listed company”, however, needs to be considered carefully as the structure of the securities markets is changing.
In general, the respondents feel that the rules applying to private companies can mainly be dealt with at national level and that these rules can be more flexible and less mandatory, especially in the areas of incorporation, corporate governance (e.g. the communication with shareholders, the holding of general meetings and shareholder decision making), the internal organisation of these companies, accounting, alternative dispute resolution. Company law should not impose a corporate governance regime on small companies, which is designed to solve issues that are specific to listed companies, but should recognise the significance of a company’s financial size. Cf. the answer of one of the respondents: “think small first”, referring to the Report of the UK Company Law Review.

Some respondents believe no new categories should be created but we should use the existing distinction between private and public companies, with additional requirements for listed public companies. Rigid legislative distinctions between types of company based upon size or other criteria can create problems when a company changes from one category to another. They may also prove to be a barrier to growth. Some respondents stress the fact that it is not advisable to create two different legal forms, i.e. one for listed companies and one for closed companies, because the existence of two such forms might discourage closed companies’ access to the market.
Company law for listed companies should facilitate the efficient operation of the securities markets in Europe, whilst providing appropriate safeguard for investors (e.g. by means of stricter disclosure rules). A single respondent thinks, however, that the existence of markets suggest that there should be less mandatory legislation for the listed company than for the private company. Another respondent states that it should not be a question of more regulation for listed companies but a question of different regulation which for listed companies would underline the importance of transparency.
A few respondents think all companies, listed or not, who make a public call for financial resources, should be governed by the same rules. A few respondents think that it should be left to individual markets to provide further regulatory mechanisms appropriate to a publicly traded company or that basically one type of limited company is sufficient. Others think that only a distinction between private and public companies is necessary, as additional rules of a stock exchange will apply to listed companies. On the other hand, some respondents don’t see the need for distinction between public (open) and private (closed) companies, or think that it is not really a matter to be dealt with at EU level.

5. Increased flexibility vs. tightening of rules

In principle, almost all respondents to question 5 agree with the statement of the HLG, that company law should not be burdened with rules to combat fraud and terrorism. A few respondents, however, express that also company law should contribute in these areas, at least if there are no other options. Cf. the work of the FAFT concerning Corporate Vehicles. Also it might be envisaged to generally dematerialise shares, in order to enable Government authorities to know the identity of the shareholders. One respondent suggests that the HLG should consider whether implementation in national requirements of the provisions of the OECD Convention on Combating Bribery and Corruption has been an effective mechanism.

6. Modern technology

Almost all respondents to questions 6a and 6b encourage the use of modern information and communication technology, especially for listed companies. Some of the German respondents refer on this topic to the German Corporate Governance Codex.

Quite a few respondents think listed companies should be required to maintain a specific section on their website as the single place where they publish all relevant information (if proof can be given of what information was effectively present on the website at any given moment in time). Some of these respondents are nevertheless of the opinion that to file with the relevant national register should remain the primary obligation and that privately-controlled websites cannot replace – at least not for the time being - public registers when it comes to the protection of third parties. Some make the suggestion that a neutral third party should provide the required information on a website.
Most respondents, however, are of the opinion that website publication should not be compulsory. It is felt that not everyone has unlimited access to internet; that the legal, practical and technical risks and implications should first be investigated thoroughly; that technology is fast-evolving; that an obligation would lead to a significant increase of costs and risks for companies; that the security aspect of the electronic information published needs special attention since it is open for manipulation; that the idea of two-way links with public registers is questionable as Member States – but also accession countries – will probably have difficulties to offer such online-registers; that public registers have the advantage that once information has been disclosed it cannot be altered by companies; that an obligation to ensure that the information on the website is correct and up to date appears problematic; that it will extend a company's liability. Furthermore, most respondents think publication on a website cannot replace the official registers; therefore it has to be ensured that information available both in a public register and on a company website are properly synchronised.
The view that also non-listed companies are allowed to file and publish information on their website is broadly shared, as long as there is no obligation to do so and this kind of publication does not replace the official registers.

A large group of the respondents to questions 6c and 6d believe that a single central electronic filing system within the EU, where all public information on companies can be found, should be facilitated, but is not really feasible in the near future. Some respondents refer to the EDGAR-system in the USA, to the SOPHIE-system in France for listed companies, to the Australian Commercial Register ("Firmenbuch") as models worth copying, or propose to start with setting up, like e.g. Germany, national central electronic registers. One of the difficulties mentioned is the language question, where lessons may be learned from the multilingual Swedish Commercial Register.
Other respondents are more optimistic and more strongly support the idea of a single central commercial register for all companies or only for listed companies.
Several suggestions are also made by one of the respondents, referring to the national system linking Italy's 103 Chambers of Commerce through a high-speed/high-security electronic network and to the project to devise a European Business Register (EBR), financed by the European Commission, as well as to the European Commercial Registers Forum (ECRF).
Some respondents are opposed to the idea of creating a central register; they think that this can be left to the member states, that a central register would only lead to multiple notifications, or that a central register is not necessary if there would be a common standard for the national registers.
Most respondents agree that the European Union should facilitate or provide for the co-ordination of public company registers in the Member States, e.g. by introducing a uniform standard. However, a few respondents think there is no tasks here for the EU or that links between the filing systems in the member states will be sufficient. The technology is available to link existing registers into a virtual single system from a user perspective.

II - SPECIFIC TOPICS (CHAPTER 3 of the Consultative Document)

1. CORPORATE GOVERNANCE

1.1 The role of the European Union in corporate governance for European business

A majority (ca. 66%) of the 82 respondents to question 7 agree with the HLG that efforts to improve or strengthen corporate governance are necessary and important for efficient business activities in the EU and for an integrated European securities market. Nevertheless, many respondents are of the opinion that there is no need for legislation or a European Code. A small minority (11% of the 82 respondents) gave a negative response and is of the opinion that corporate governance systems will develop and progress in a natural way under pressure from the financial markets. Two respondents notice that competition among national jurisdictions in this area is preferable to the development of EU-wide standards.

1.2 Better information for shareholders and creditors, in particular better disclosure of corporate governance structures and practices including remuneration of board members

That there should be more disclosure on corporate governance structures and practices of companies in Europe, is expressed by a majority (60% of the 80 respondents) to question 8a. Elements to be disclosed are for example: shareholder rights and structures of company organs and defensive instruments, including voting agreements. Transparency is good for the confidence of the shareholders and it is an essential criterion in investment decisions. Several respondents, however, believe that regulation is not needed at European level. Only a small minority (ca. 14%) of respondents believe that more disclosure is not necessary and that this matter can be left to the market.
A majority of the 60 respondents to question 8b is of the opinion that more disclosure should only be given by listed companies and not by all “open” or “closed” companies. Only a minority thinks that open or even closed companies should give more disclosure as well. One respondent thinks that disclosure requirements are more needed for mutual and co-operative societies than for listed companies.
To question 8c a majority (ca. 64%) of the 64 respondents answers that disclosure should include an indication whether a certain corporate governance code is followed and where and why the code is not complied with. Several respondents prefer a “comply or explain” rule. A number of respondents are of the opinion that a European rule is not required. Only a small minority (ca. 9%) does not agree with the statement in question 8c.
Of the 74 respondents to question 8d a large group (ca. 49%) agrees with the idea that remuneration of individual board members should be disclosed, in particular if it is linked to the share price performance. Only 13 respondents (ca. 18%) do not agree. Some believe that the disclosure must be limited to listed companies. More respondents are of the opinion that disclosure should not be regulated at European level. The respondents give less information about how detailed remuneration information should be. Some respondents mention fixed salary, variable income, cash bonus, stock options, fringe benefits, and golden parachutes.
Arguments against disclosure are based on of privacy-concerns.
68 respondents answered question 8e; 25% is of the opinion that shareholders have a role in fixing the principles and limits of board remuneration. A large group of the respondents (ca. 47 %) believe, however, that this topic does not fall within the powers and scope of the general meeting. A few respondents suggest that this task must be entrusted to a remuneration-committee.

1.3 Strengthening shareholders' rights and minority protection, in particular supplementing the right to vote by special investigation procedures

Of the 77 respondents to question 9, 34 (ca. 44%) agree that shareholders' rights and decision-making, including minority protection, should be enhanced by European law, in particular by enabling the general meeting of shareholders, by resolution, or a qualified minority of shareholders to apply to a court or an appropriate administrative body for the ordering of a special investigation. A minority of ca. 23% (18 respondents) does not agree.
A number of respondents suggest that the German rule of "Sonderprüfung" can be used as a model for European regulation. All kinds of thresholds are mentioned, e.g. 1%, 5%, 10%, 25 %, a total of the share capital with a market value of Euro 100,000. An alternative for minority shareholders in family companies would be not a specific percentage but the minority shareholding following the biggest shareholder. Two respondents are in favour of enhancing the civil liability of members of the board towards their shareholders. Another remark is that the authority to implement the general principles in the light of the different types of companies and ownership structures should be left to EU members. Several respondents bring up the problem of abuse.
A few respondents are of the opinion that there is no need for harmonisation because the special investigation procedures in the individual Member States have proved successful in practice. Other respondents believe that national law should regulate the subject.

1.4 Strengthening the duties of the board, in particular the accountability of directors where the company becomes insolvent

A majority (56%) of the 81 respondents to question 10 feel that the European Union should introduce a framework rule which would hold company directors accountable for letting the company continue to do business when it is foreseeable that it can no longer pay its debts. Some respondents of this majority, however, believe that such a wrongful trading rule should be restricted, very general or should (also) be dealt with in insolvency law.
An important minority of ca. 40%, however, does not agree. Arguments against a wrongful trading rule are that company law should not deal with insolvency law, that this is not a topic for harmonisation but a topic of national law or that several practical problems would arise.
Several respondents state that efficient rules already exist, in e.g. Germany, Sweden, Iceland and Ireland.

1.5 Need for a European corporate governance code or co-ordination of national codes in order to stimulate development of best practice and convergence

Against a small minority (ca. 11%) the majority (ca. 66%) of the 83 respondents to question 11a believe there is no need for a voluntary European corporate governance code in addition to or instead of the various national corporate governance codes, because corporate governance questions are strongly determined by socio-economic differences in Member States. Differences in company law are also a reason to be against a European corporate governance code. It should be worked out by or left to the market Two respondents believe it is too early. Many respondents refer to the study of Weil, Gotshal & Manges or mention the OECD-code.
The 25 respondents who answered question 11b give examples of what rules and recommendations a European corporate governance code should contain: rules concerning disclosure and communication with shareholders, equitable treatment of shareholders, the function, responsibilities, independence of the directors, non-executives and auditors and the relation between them, disclosure and transparency, company policy on remuneration and information about conflict of interest.
A small majority (ca. 51% of 55 respondents) agree that the EU should facilitate the co-ordination of national codes in order to stimulate development of best practices and

convergence (question 11c). A minority of 36% believes that this should be left to the market; the market will provide or encourage the co-ordination.

2. SHAREHOLDER INFORMATION, COMMUNICATION AND DECISION-MAKING

2.1 Notice and pre-meeting communication

A majority (ca. 70%, versus a minority of 24%) of the 83 respondents think that listed companies should not be required to establish on their website electronic devices (bulletin boards, chat rooms or similar devices) that allow for electronic communication between shareholders and the company and among shareholders prior to general meetings, including with respect to notices of general meetings, submissions of proposals and questions and solicitations of proxies (question 12a).
Most respondents, however, feel that this is a matter that should be encouraged as a voluntary action. Generally, the use of chat rooms is not recommended due to the potential for abuse. Some respondents note that establishing communication between shareholders is not a responsibility of the company.
None of the 56 respondents to question 12b think that, if listed companies are required to establish electronic devices on their websites, shareholders should be required to communicate by electronic means and thus be compelled to abandon the use of traditional means of communication. It should be an alternative to those interested. To make this a requirement at this moment would inconvenience and disenfranchise a significant amount of shareholders.

Only a minority (ca. 38%) of the 77 respondents to question 13a think that there is a need, at the European level, to provide for minimum standards regarding the right for shareholders to ask questions and submit proposals for decision-making at the general meeting. It could encourage greater cross-border share ownership. Some note that all shareholders must have the right to ask questions. Many of these respondents see problems that would arise if a lot of irrelevant questions would be asked and the management would be obliged to answer. Solutions for this might be a maximum amount of questions to be asked be a single shareholder. Others think that minimum standards must be set and not all shareholders should be able to ask questions and submit proposals. Among those against harmonisation (48%), a lot of respondents note that this issue is a matter for national law.
Question 13b was answered by ca. 29% of respondents. Some standards that are thought to be sufficient are the following: shareholders should be able to ask 3 questions and have 5 minutes to speak, to submit proposals, the shareholder must own 5% of the shares; the right to put items on the agenda should require no more than an aggregate of 10% of the shares; no minimum for raising questions, not more than 250.000 Euro for submitting proposals, maximum time for submitting proposals should be 4 weeks.

2.2 The meeting, electronic access, proxy voting

A large majority (ca. 87% of 74 respondents) think that listed companies should be required to provide facilities for proxy voting by all shareholders (question 14a). However, caution has to be taken. Abuse of a proxy solicitation system by management and opposing shareholders is not unthinkable. Proxy contests can make the system very costly. Many respondents note that this matter should not be regulated on a European level.
A majority (ca. 73% of 72 respondents) think that listed companies should be enabled to offer to their shareholders electronic facilities for proxy voting (question 14b). A few respondents even think this should be required. None of the respondents think that shareholders should be compelled to use electronic proxy voting and that traditional proxies should be abolished.

Question 14c was answered by 67 respondents, of which ca. 85% agree that companies should be enabled to allow absentee-shareholders to participate in traditional general meetings via electronic means, including via the internet (webcast) and satellite. None think a requirement to do so is appropriate. Of the few respondents against enabling companies to provide these means, most think that the technology at this moment is not advanced enough to make this possible.
A majority of 80% of the 70 respondents who answered question 14d think that companies which offer a comprehensive electronic process of information to, communication with and decision-making by shareholders should not be enabled to abandon the traditional type of general meeting. Most think abandoning the traditional type of meeting is premature. Others think the ability to come face-to-face with the management can never be substituted by a virtual meeting.

2.3 Voting by institutional investors

A majority of ca. 66% (of 72 respondents) does not think that institutional investors in Europe, or alternatively all shareholders holding a certain percentage of the share capital, should be required to disclose their policy as regards to the investments they make, and as to how they exercise their voting rights (question 15a). Among those who object to this requirement, some respondents do note, however, that institutional investors should have to report to their beneficiaries on the way they exercise their votes. Arguments against the disclosure of policy are that confidentiality of business strategy from a competitive standpoint and equality of shareholders must prevail and that institutional investors should not be burdened with the extra costs.
A large majority (ca. 92% of 71 respondents) think that institutional investors should not be required to exercise their voting rights with respect to the shares they hold (question 15b). Some respondents feel that exercising of voting rights should be encouraged but not compelled. Others note that an obligation to vote would distort the voting process, unconsidered votes can be swamped by ‘required’ votes, that it would create a ‘box-ticking compliance culture’, it would lead to an unwanted dominance of institutional investors and to under-informed decision-making. The mere fact that they have fiduciary duties is not sufficient to oblige them to vote.

3. ALTERNATIVES TO CAPITAL FORMATION AND MAINTENANCE RULES

3.1 The functions of legal capital and the competitive effect of the current rules

The majority (ca. 68%) of the 65 respondents to question 16a does not think that legal capital effectively protects the interests of creditors and shareholders, and ensures capital adequacy. Many note that legal capital mainly serves as protection for creditors and secondly for shareholders and that it must not be abolished because it gives the best safeguards. Others note that it does not reflect the size of the company. Some respondents think that a more flexible regulation is needed in relation with further issues such as directors’ duties, insolvency law and creditor protection. A few respondents note that legal capital ‘more or less’ serves the four functions. A minority (ca. 25%) of the respondents firmly believes in the current system.
A large majority (73%) of the 55 respondents to question 16b think that there are possibilities of reaching the same results by means of other techniques than legal capital. The most popular option is a solvency test and a regulation on the liability/duties of directors. The solvency test should be linked to a declaration of solvency by the directors with appropriate penalties. Other possibilities are: financial reporting and disclosure requirements, equity regulation and a provision of guarantees by shareholders and directors to take over the company’s liability in case of insolvency. Of those (ca. 24%) who do not think that there are

other possibilities, most note that the current regime should be maintained and is appropriate.
A small majority (ca. 54%) of respondents does not think that European companies are at a disadvantage as against companies in jurisdictions with a more flexible capital regime (question 16c). Half these negative responses are from German respondents. Some respondents note that although the regime is strict, there is no real reason for radical reform. However, some improvements are welcome. Some respondents also think that the strict rules provide a better reputation for European companies. Respondents who do think that European companies are at a disadvantage blame this on the restrictive character and complexity of the system, in particular to issues such as financial assistance for the purchase of own shares, increasing capital by way of contributions in kind, issuing convertible bonds, no par-value shares and the weak protection of creditors.

3.2 Three approaches to the reform of legal capital in Europe

Of the 57 respondents to question 17a a large majority thinks a new approach to the reform of legal capital in the EU is needed. Ca. 10% of the respondents mention that there is no need for a new approach on a European level.
As to question 17b, a large group (ca. 45%) of those who think a new approach is needed, opt for the evolutionary approach 1: the SLIM-approach. They argue that the other approaches are too radical and not pragmatic. Advantages of the SLIM proposals as they are and as they might become, mentioned by respondents, are the possibility of no par-value shares, a solvency test, eased formalities, personal liability of directors a reduction of mandatory valuations, the extension of the period in which own shares can be purchased (licensed up to 5 years), purchasing own shares for more than 10 %, the possibility to exclude pre-emptive rights for a period of 5 years and a reduction of reporting obligations.
After the SLIM-approach, the revolutionary approach that rebuilds the US capital regime from a European point of view (the third approach in the Consultative Document), is favoured by 26% of respondents. The supporters of this approach argue that a tailored approach can eliminate legal capital and can combine the best aspects of the different systems. Finally, ca. 9% of the respondents favour the revolutionary US-approach (the second approach in the Consultative Document). It provides a helpful basis for further analyses, but should not be adopted wholesale.
A small group of the respondents (ca. 10%) mentioned other approaches or did not clarify their favourite approach.

3.3 Specific topics

Many respondents to questions 18a-18e were of the opinion that minimum capital should be kept, whereby the level should strike a balance between an appropriate impediment to set up a company on the one hand, and not setting the barrier too high on the other hand. Some would favour a minimum capital, which would be linked to the kind of activity of the company. Often respondents made a distinction between SME and other companies. Most respondents (of the ones that responded) think that “wrongful trading” is an effective instrument for creditor protection and about half consider that subordination is not an effective and desirable way of enhancing creditor protection.

Almost half (ca. 45%) of the 67 respondents to question 18a see the minimum capital requirement as an appropriate impediment to starting up a company, whereas 21 respondents (ca. 31%) do not agree. According to several respondents, the level is too low to be an impediment. Some respondents made a distinction between SME and other (listed or open) companies, whereby the impediment exists for SME; some answered that there should be no impediment at all.
Of the 66 respondents to question 18b, almost half would not abolish the minimum capital requirement or impose a stricter minimum capital requirement than the one presently in

force. Some respondents are in favour of abolishing (ca. 18%) or lowering the level of minimum capital, whereas ca. 15% feels for stricter requirements. Some of the other comments (positive, negative or other) to this question were: the level should be re-examined at least every ten years, one should distinguish between regulated and financial companies and other companies, the question of abolition or relaxation should take other forms of creditor protection into consideration (e.g. directors liability, insolvency law, etc.), the new Basel II standard shows that the legal capital should be much higher in most companies, no (additional) minimum capital for SME, effective rules on debt/equity should be in force, abolition with additional maintenance rules in place.

The majority (ca. 60%) of the 62 respondents to question 18c considers that "wrongful trading" is an effective instrument for creditor protection, only 15% disagreed. More than once the effectiveness is made dependent on the enforcement, with sometimes a reference to the difficulty of the burden of proof. And more than once the national situation was explained. Some (German respondents) were of the opinion that it should not be used outside insolvency law. Other comments (positive, negative or other) to this question were: the triggering effect should not be too late, if it does not require a proof of intent, it depends if it is applied to a financial sector, it should be compatible with the legal system, next to other instruments, it leads to endless debates on their application, it might lead to the management staying in charge too long, the experience is rather mixed, comes into play rather late in the life of a company, states should fix the rules, it has proved beneficial, the procedure is more difficult for smaller structures, it should be linked to the degree of guilt, it should not be harmonised, if introduced then it should look at the possibility of reorganisation rather than liquidation, it has a deterrent effect, the UK concept of fraudulent trading (sic) provides further safeguards, it is expensive.

About half of the 51 respondents to question 18d consider that subordination is not an effective and desirable way of enhancing creditor protection, while 21 respondents (ca. 41%) think it is. Some respondents stress the need of full disclosure, and some fear a deterrent effect on insiders to finance the company. Other comments (positive, negative or other) to this question were: it should not depend on the identity of the creditor but on the nature of the claim, it should be dealt with in insolvency law, any distinction should be left to the choice of the parties or to the member states, “capital-replacing-loans” (German case law) seem to have worked well, it would deter shareholders loans for troubled companies.

Question 18e (are there any other possibilities worth considering to protect creditors) was answered by 26 respondents. The comments made include: creditor protection would be improved by a shift of the burden of proof to show that the value attributed to contributions reflect the real value; Belgium has introduced the rule whereby the founders of the company can be held liable –jointly and severally- for “manifest under-capitalisation” for a two years period; disclosure should be improved; there is a case for allowing other forms of consideration for capital, including the provision of services and for simplifying the rules dealing with acquisitions of own shares; the prohibition of financial assistance could be changed; it may be appropriate to extend the scope of share capital, for example to cover services; alongside a claim for damage, a responsibility of criminal law should be envisaged; compulsory indemnity insurance, to be held by directors; new directors should: a) make a standard solemn oath that they understand their duties and responsibility, or b) take a test of their understanding of their duties and responsibility; the ‘New Money’ rules applied in the UK seem to work reasonable well; directors accountability rule should not only be triggered when the company is insolvent, but should be replaced by an “early intervention approach”; the formation of a rule based on the English common law rule of “doubtful solvency”; one could oblige companies to make a financial plan, whereby failing to do so could be the basis for a personal liability in case of insolvency; the financial early warning system in case of the loss of half of the guaranteed capital could be strengthened, if it is applied earlier; disqualification for a certain period, also as founder; one should think about introducing a common regulation on “lifting the corporate veil”.

Of the 73 respondents to question 19a ca. 43% agree that other forms of consideration, such as services, should be allowed as valid forms of consideration for capital, whereas ca. 37% do not. The advocates as well as the opponents often observe that allowing services as a valid form of consideration for capital would probably lead to valuation problems. Some of the advocates state that other forms of consideration for capital should be allowed, provided proper creditor protection and valuation procedures are introduced, or provided there are measures to protect minority shareholders. Some respondents to this question argue that other forms of consideration for capital should (at least) be allowed for private companies, provided that a clear creditor protection procedure and evaluation procedure are considered. Some of the opponents state that claims for services to be rendered are not enforceable and that future services, as opposed to services rendered, should therefore not be allowed as consideration for capital. Others mention that capital paid for by services and the like should not compete with the registered capital. Furthermore respondents notice that there might be accounting difficulties in case the services will be activated.

A majority (ca. 56%) of the 70 respondents to question 19b believe that the prohibition of financial assistance for the acquisition of own shares should be eliminated or at least that financial assistance should be allowed if it complies with the general rules for distributions to shareholders. Ca. 26% (18 respondents) don't agree. Advocates propose that financial assistance for the acquisition of own shares should be allowed, provided that creditor protection and evaluation procedures are introduced, or that the prohibition should be eliminated, subject to a solvency test where such assistance is given. Moreover, a few respondents refer to the exemption model for private companies under UK law, that is the so-called “whitewash procedure”. Some of the opponents believe that, although the prohibition should not be eliminated, it deserves further investigation whether financial assistance should be allowed if it complies with general rules for distributions to shareholders. Furthermore some respondents compare financial assistance for the acquisition of own shares with the repurchase of own shares by the company itself, and believe that the rules governing such assistance should be configured accordingly.

4. THE FUNCTIONING OF GROUPS AND COMPANIES

4.1 The existence of groups of companies as a useful and legitimate economic reality

Groups of companies appear to be frequent in most – if not all – Member-States. Only 2 of the 68 respondents to question 20a gave a negative answer. These negative answers state that groups of companies are not frequent in their respective countries.

Most of the 62 respondents to question 20b state long lists of advantages of groups. Disadvantages and risks are also stated, but the lists are shorter. All the other responses varied. Frequently mentioned advantages are amongst others: (increased) possibilities to allocate risks, to obtain better financing conditions and tax advantages, to foster synergies and to increase management efficiency and flexibility. Group structures also facilitate restructuring of businesses, and the applicability of the principle of limited liability encourages risk taking. Another frequently mentioned advantage is the possibility to maintain minority shareholders in subsidiaries, because this will strengthen the business' capital base. Frequently mentioned disadvantages or risks are: minority and creditor protection problems, creditor reliance problems, lack of transparency (in relation to intra-group dealing), problems arising from conflicts of interests between the (boards of the) subsidiaries and the (board of) the parent, complex and laborious management, audit problems and the lessening of competition, violation of fair competition rules, some companies may be sacrificed for the greater good of other companies in the group, problems regarding the distribution of responsibility among directors and statutory auditors within the group, and cascades.

4.2 Transparency of group relations

Half of the 72 respondents to question 21a do not feel that the 7th Company law Directive should be supplemented by rules that require greater transparency of group relations and possible risks arising from them both to the subsidiary and to the parent, while ca. 44% of the respondents do. Some of the adversaries argue that the risks arising for the subsidiary should be dealt with in the accounts of that subsidiary rather than in the consolidated accounts. Any additional requirements in this regard may therefore more appropriately be included in the 4th Company Law Directive. Others argue that supplementation is not warranted, because the IAS (or IFRS) will be implemented for listed companies (see especially IAS 24). Member-States may allow or require other companies to also use IAS. More generally it is sometimes stated that if enhanced transparency is required, details should be a matter for the accountancy standard bodies rather than be dealt with by further regulation at EU level.

If rules enhancing transparency were to be implemented they should – according to the 40 respondents that answered question 21b – include information on: the group structure, ownership, the managing system, the activities of the subsidiary and the group strategy behind it, intra-group transactions, related party transactions, cross guarantees and liabilities, siphoning of risks, interlocking directorships, remunerations to management, audit and compliance procedures, intra-group competition rules, conditions of trading, etc. Also reference is made to IAS 24 and IAS 34. It is furthermore stated that information rights of the supervisory board and the shareholders of the parents should be enlarged to activities at least in consolidated subsidiaries.

Question 21c was answered by 43 respondents; ca. 33% of these respondents is of the opinion that enhanced transparency rules should not be applied to listed companies, while ca. 30% do agree to the implementation of such rules for listed companies. The reason mostly stated for non-implementation of enhanced transparency rules for listed companies is that the IAS will be implemented in 2005, which will suffice in this regard. See especially IAS 14, 24 and 34. Some respondents remark that full transparency should relate to all companies, whether listed or not, because these rules not only benefit shareholders but also creditors.

Almost half of the 45 respondents to question 21d is of the opinion that special transparency rules for banks and other financial institutions are not needed. Arguments mentioned by the adversaries are amongst others that the Insurance Group Directive 98/78 already regulates the matter, that the Directive on the supervision of financial conglomerates will enter into force by the end of 2002 and that rules should be framed as to render special rules unnecessary. 33,3% of the respondents answered question 21d in the affirmative. These respondents mainly argue that special rules are necessary because financial institutions fulfil a public function. Rules should be implemented with respect to capital requirements, special qualifications for directors, holding company issues, risk analysis, etc.

4.3 Problems for the creation and functioning of groups of companies: tensions between the interests of the group and its parts

Ca. 59% of all respondents answered question 22; 40% of these respondents belief in the need of a “safe harbour” (which allows those concerned with the management of the companies within a group to adopt a co-ordinated group policy provided that creditors are protected and there is a fair balance of advantage for shareholders over time). A smaller minority (ca. 26%) argues that there is no need for such a “safe harbour”. Some advocates argue that European legislation will lead to harmonisation, which will in turn allow for the creation of cross-border groups of companies. One respondent argues that at EU level only general principles should be implemented, which then can be filled in by the Member States. Some German respondents argue that the German “Konzernrecht” in this regard has proven to be so successful and that EU rules could be modelled after the German rules, while others prefer the French solution or refer to the proposals from the Forum Europaeum on

Corporate Group Law. Opponents argue that rules at EU level are not necessary. Member States should deal with this problem. Also a general principle is not necessary, because this would leave the present situation – e.g. different rules in each Member State – in tact.

4.4 Pyramids

Ca. 49% of all 58 respondents answered question 23a. Ca. 47% of these respondents state that pyramids are not frequent in their country (A, DE, DK, F, IR, IS, NL, PL, SC, SE, SU & UK). Ca. 40% answered the question in the affirmative (B, DE, EL, IT & UK). Some answers are contradictory. 10 respondents for example state that in Germany pyramids are frequent, while 6 others say they are not. But respondents seem to agree that in Italy pyramids are frequent.
42% of the respondents answered question 23b; 30% of these respondents find pyramids useful, 38% find them harmful, 8% find them indifferent and 16% state that the answer to the question depends on the way pyramids are organised and managed.
The respondents that find them useful state for example that pyramids can be advantageous because they allow integration into a group of a company with minority shareholders, which helps to finance activities. Pyramids may also be helpful for supervisory reasons, as they avoid the whole group from becoming subject to supervisory measures outside the EU, and they have for a long time ensured a high rate of development.
Ca. 25% of all the respondents answered question 23c. Respondents considering pyramids to be harmful mention, amongst others, the following risks: lack of transparency, maximising control with a minimal investment, asymmetrical risk-sharing, the cascade-effect e.g. the transfer of legal capital from parent to subsidiary and then to the subsidiary of the subsidiary and problems with creditor and minority shareholder protection. Some respondents argue that the problems presented by pyramids are similar to those presented by groups.
55 Respondents answered question 23d. 40% of these respondents is of the opinion that specific measures beyond group transparency are not desirable for pyramids. It can be argued that special rules can be omitted if potential investors will be able to ascertain whether special rights are attached to a particular class of shares, which could affect their investment. Ca. 34% of the 19 respondents to this question believes special rules beyond transparency are necessary for pyramids. Among the proposed measures are: provisions avoiding company directors from mala gestio, provisions ensuring the independence of directors and cumulative voting for directors, and provisions providing a minimum disclosure of indirect holdings through pyramids and circular and cross-shareholdings.

5. CORPORATE RESTRUCTURING AND MOBILITY

On questions 24a – 29, a vast majority answered positive. In general, respondents are in favour of freedom of cross border mobility (transfer of seat, mergers, etc.) and relaxation of (unnecessary) requirements, but without loosing sight of the position of the shareholders and creditors (and in question 24, workers). According to a few responses, there should be no distinction between national and international transactions. Some stressed the subsidiarity principle, but overall a task for the EU was envisaged, either for minimum standards in the EU, or for harmonisation on specific topics. Often reference was made to national laws, and often with further explanations.

5.1 Change of corporate seat, or domicile

57% (68 respondents) answered question 24a. Of these 67% (46 respondents) answered positive, ca. 13% negative (9 respondents) and 19% (13 respondents) gave an answer other than yes or no. The majority (of the ones that responded) is in favour of the incorporation doctrine, which is more than 5 times the negative response. Of the positive answers, many argued for a (general) freedom of mobility across borders and abolition of barriers. Some

negative respondents saw the question in light of the different legal systems. More than once reference was made to an international transfer of seat without losing legal personality and to the 14th Directive. And more than once, case law of the ECJ (Centros, Überseering) was given, with sometimes the advise to wait for a judgement of the ECJ on this question. Some other comments (positive, negative or other) were: most cases of cross border transfer of seat are "smelly", the two systems are influenced by the available remedies, one should also look at competition law and civil law in general, the topic should also address transfer of registered office, the real seat is not easy to determine, uniform approach is needed to protect shareholders and creditors.
Ca. 40% (48 respondents) answered question 24b. Of these, 77% (37 respondents) answered positive, ca. 19 % negative (9 respondents) and 4% (2 respondents) gave an answer other than yes or no. A big majority (of the ones that responded) agrees that the Member States should be free to apply mandatory requirements, which is more than 4 times the negative response. Of the positive answers, many agreed with the proposition of the HLG, since there are no minimum common standards (e.g. shareholders rights, creditor protection, workers participation, tax) in the EU, which could lead to abuse of freedom of establishment or circumvention of rules. There was a call for uniform mandatory rules. Many respondents mentioned social laws and workers participation as examples of mandatory rules. Some respondents feared new barriers, uncertainty or discrimination. Some other comments (positive, negative or other) were: a European judicial institution should review these rules, reference was made to the Dutch law on "pseudo-foreign companies", several actions should no longer fall under company law, but under torts etc., a race to the bottom is feared if no mandatory rules would apply, a proportionality test should be introduced, the UK 'over sea companies' seem to work well, (partly) replace articles of company, conflicting rules might then be applicable, wait for decision ECJ.
The question on the connecting factor is not always answered. Answers were: an activity of the company, permanent operational presence, where management team de facto runs day-by-day operation, registered in their territory.
Ca. 29% (35 respondents) answered question 24b. Of these, 77% (27 respondents) answered positive, 17% negative (6 respondents) and ca. 6 % (2 respondents) gave an answer other than yes or no. A big majority (of the ones that responded) found that other Member States should be bound to recognise such provisions. Most respondents (ca. 71%) did not answer this question. The responses differ widely and not always seem to answer the question.

5.2 Third Directive Mergers – position of the acquiring company

Ca. 54% (64 respondents) answered question 25a. Of these, 28% (18 respondents) answered positive, ca. 47% negative (30 respondents) and 25% (16 respondents) gave an answer other than yes or no. A minority (of the ones that responded) found that the EU requirements for special provisions governing merger decisions in acquiring companies should be removed, which is 1.6 times less as the negative response. Most negative responses replied that this protection of shareholders was needed and a few also spoke about the protection of creditors. Some respondents did not answer the question in full, but merely replied that unnecessary provisions should be abolished. The difference between a merger and a takeover bid is stressed more than once. Other comments (positive, negative or other) were: the 3rd Directive already provides for relaxation, except in a 'reverse takeover'; the questionnaire does not take up the rule of Article 8, 3rd Directive (max. 10% in cash), it should be examined; often it is possible to change the acquiring company for the acquired company.
Ca. 39% (46 respondents) answered question 25b. Of these, ca. 30% answered positive (14 respondents: 5 for a simple yes, 2 for a yes for all mergers and 7 for a yes for all international mergers), ca. 28% negative (13 respondents) and ca.41% (19 respondents) gave an answer other than yes or no. Of the one-third positive responses, the majority found that the relaxation should be mandatory for an international merger (7), a minority for all

mergers (2) and a big number found that Member States should be bound to accept such relaxations in an international merger (5). Around one-third of the respondents did not find that Member States of an acquired company should be bound to accept any such relaxation in respect of an acquiring company in an international merger, or that the relaxation should be made mandatory for all international mergers, or even for all mergers. A big number (especially compared with other questions) gave an answer other than yes or no.
Many stress the necessity of a uniform regulation and the need to facilitate international mergers, some do not want to make a distinction between national and cross-border mergers. Other comments (positive, negative or other) were: Member States should be free to decide on domestic mergers, the scope of the 3rd Directive should be extended to international mergers, if the 10th Directive is adopted, then application of national laws is prevented, relaxation should be standardised to avoid distortion of competition, uniformity is needed for the internal market.

5.3 Third Directive – acquisition of a wholly owned subsidiary

Ca. 49% (58 respondents) answered question 26a. Of these, ca. 85% (49 respondents) answered positive, ca. 7% negative (4 respondents) and 8% (5 respondents) gave an answer other than yes or no. A big majority (of the ones that responded) found that Member States should be permitted to relax the directive requirements in the case of acquisitions of 100%-subsidiaries, which is more than 12 times the negative response.
An argument often mentioned is that no minorities are affected. Some argue that one still has to consider the position of stakeholders.
Ca. 39% (46 respondents) answered question 26b. Of these, ca. 85% (39 respondents) answered positive, ca. 11 % negative (5 respondents) and 4% (2 respondents) gave an answer other than yes or no. A big majority (of the ones that responded) found that the Member State of the acquired subsidiary should be required to accept such relaxation by the Member State of the holding company in an international merger, which is almost eight times the negative answer. Examples of comments given are: what about reciprocity, co-ordination is necessary, it is of no concern to the acquired company state, if it does not lead to tax avoidance and reduction of the position of the third party.
Ca. 26% (31 respondents) answered question 26c. Of these, ca. 65% (20 respondents) answered positive, 29% negative (9 respondents) and 7 % (2 respondents) gave an answer other than yes or no. A majority (of the ones that responded) found such requirements should be removed in all cases (13 respondents), international not, or in all such international cases (4 respondents). Most respondents (74%) did not answer this question.

5.4 Creditor protection in restructuring

Ca. 50% (60 respondents) answered question 27a. Of these, ca. 53% (32 respondents) answered positive, ca. 32% negative (19 respondents) and 15% (9 respondents) gave an answer other than yes or no. A (slight) majority (of the ones that responded) found that the creditor protection requirements for reductions of capital, mergers and transfers of registered office should be aligned as proposed by the HLG. Some others simply state that this is not necessary, or should be left to the Member States. Other comments (positive, negative or other) were: it may well be that an international merger affects the creditor's position more severely than a national one, a mixed (administrative and judicial) control is proposed, one only has to apply the 2nd Directive to all capital reorganisations, there should be a solvency test, insolvency law should be taken into account, Article 32, 2nd Directive should be clarified.
Ca. 25% (30 respondents) answered question 27b. Of these, 60% (18 respondents) answered positive, 3% negative (1 respondents) and ca. 37% (11 respondents) gave an answer other than yes or no. A big majority (of the ones that responded) found that such alignment should be confined to international mergers and transfers of corporate domicile (2 respondents), or that it should apply to all EU restructuring provisions (16 respondents). Most respondents (ca. 75%) did not answer this question. Comments (positive, negative or

other) were: yes, for the sake of equity and certainty, to avoid forum shopping, there is no reason to distinguish between national and international restructurings, etc.

5.5 Squeeze-outs and sell-outs

Ca. 62% (74 respondents) answered question 28a. Of these, ca. 87% (64 respondents) answered positive, ca. 9% negative (7 respondents) and 4% (3 respondents) gave an answer other than yes or no. A big majority (of the ones that responded) found that Member States should be required to introduce provisions enabling a majority shareholder (the majority to be set at not less than 90% nor more than 95%) in a company to buy out the minority for a fairly appraised price. Many respondents referred to the laws of their country, which enables squeeze-outs, with sometimes a different threshold. Overall, a practical need was found to be served with the rule. Some respondents only favoured a squeeze-out for listed (and de-listed) companies. A few responded that this should not be regulated at EU-level.

Other comments (positive, negative or other) were: it applies since 2002 in Germany and a quorum of 95% seems fair, one should consider a “Reversed Triangular Takeover”, the proposed threshold differs significantly from the one in the UK, is there a need to express the maximum of 95%?, in France the price is decided by a multi-criteria test, we favour 90% to create a level playing field, consider a lower threshold where consideration in shares is offered, the market price of the last three month should be taken, valuation should be done by an expert and in case of unlisted companies by the tribunal, the price should not be higher than the takeover price, one-person company may not be valid in all Member States, Member States should be allowed to introduce lower thresholds, anti-embarrassment rules should be established in case of non-quoted companies, etc.

Ca. 57% (68 respondents) answered question 28b. Of these, ca. 68% (46 respondents) answered positive, ca. 29% negative (20 respondents) and 3% (2 respondents) gave an answer other than yes or no. A majority (of the ones that responded) found that minority shareholders should have a corresponding right to be bought out where the 90-95% threshold has been reached.

Other comments (positive, negative or other) were: minorities already have the right to sell their shares, the UK Company Law Review rejected it, under certain conditions, for an equal treatment, etc.

Ca. 47% (56 respondents) answered question 28c. Of these, 55% (31 respondents) answered positive, 25% negative (14 respondents) and 20% (11 respondents) gave an answer other than yes or no. A majority (of the ones that responded) found that in companies with more than one class of share the rule should operate on a class-by-class basis. Other comments (positive, negative or other) were: it should operate in terms of voting rights rather than ownership of capital, attention should be given to convertible bonds, a two tier approach is suggested, depends on the threshold, it will make takeover bids more attractive for potential bidders, etc.

5.6 Other issues

Only a few respondents answered question 29 whether there is a need for legislation at the EU level providing for restructuring in ways not already discussed. Some of the answers were: there should be a European regulation on winding up, on material and procedural insolvency law and on recovery of companies in crisis; the possibility of “Reverse Triangular Mergers” (in line with Delaware law); the introduction of a squeeze-out rule below 90-95% in case minority shareholders of a subsidiary receive shares in the holding company; the restructuring measures that form part of the Financial Service Action Plan should form the priority focus of EU company law initiatives; legislation for an easy dissolution of private limited companies; the tax and stamp duty rules on share for share exchanges and de-mergers in separate jurisdictions; statutory, contractual and security rights of lenders.

6. THE EUROPEAN PRIVATE COMPANY

6.1 An initiative to establish a European Private Company

Ca. 57% (68 respondents) answered question 30a, ca. 62% positive, 38% negative. A majority thinks an EPC will or can be useful. SME's play an important role in the European economy, account for more than 90 percent of all European firms and should be facilitated with a fitting European form. The Regulation should not be complicated but it should deal with matters like directors liability and make use of the notaries expertise. It can be argued that if the legal form of subsidiaries were the same, the cost when setting up and operating subsidiaries would be reduced.
Some respondents suggest that it is better to monitor the further development of the SE before an EPC should be founded, others disagree. Some arguments mentioned by the minority against a new European form are the issue of co-determination, the lack of a need or interest for an EPC, a lack of predictability, an EPC cannot be governed exclusively by the Regulation, harmonisation is preferable.
Ca. 30% (36 respondents) answered question 30b, 47,2% of which positive, 47,2% negative, 5,6% other. Half of the respondents think that the model for regulation of a private company is an appropriate way to encourage flexible regulation in Member States. Some consider it to be a more interesting possibility than an EPC (at this moment). It could amount to a benchmark which all Member States would be encouraged to aspire. A minimum set of standards in the model law would be appropriate with reference to the first and second EU company law directives. Arguments against a model law are that it cannot be a substitute for an EPC and that this is no priority. One respondent notes that there is no hard evidence of the inefficiency of the laws of Member States at facilitating SME's.

6.2 Incorporation of the European Private Company

Ca. 45% (54 respondents) answered question 31, 87 % of which positive, 11% negative, 2% other. A big majority of the respondents conclude that it should be possible for an EPC to be set up by both individuals and legal entities and by one or more nationals of one Member State as long as the EPC undertakes economic activities in two or more Member States.
A small group of respondents do not agree with the element 'economic activities in two or more Member States'. Easy access and contractual freedom are mentioned as important factors. European governance will have to ensure equal positions for the shareholders in each Member State.

6.3 A genuine European company

Ca. 48% (57 respondents) answered question 32a, 40% of which positive, 60% negative. A minority thinks that the EPC, with respect to the company law applicable to it, could be exclusively governed by the provisions of the Regulation and the provisions of its articles which are not inconsistent therewith, with autonomous interpretation ultimately by the ECJ. Most think it is hard to see how an EPC could operate outside a body of national law or in the absence of a European body of private law and implementation will be very difficult. It would leave great legal uncertainty and would damage the credibility of the EPC. On the other hand one respondent notes that high costs for advice and information, uncertainties and accountability risks can only be reduced when reference to national law will be abolished. Shareholders must be able to regulate all important issues in the memorandum of association. Standard forms of articles of association should assist those forming an EPC. In the case of problems with interpretation, judges and arbitrators will decide. In the case of a legal vacuum, which according to some seems highly unlikely, referral to national law is unavoidable. The EPC should then be treated like one of the corporate forms in existence in the relevant Member State. Concerning the role of the ECJ some respondents note that an increase of its competence will be unjustifiable and it will lead to an unmanageable burden

for the ECJ. A few respondents note that tax harmonisation is the key for European companies.
Ca. 45% (53 respondents) answered question 32b, 64% of which positive, 36% negative. A majority thinks it is necessary to refer to the law applicable to the private companies in the Member States of incorporation where a question is not answered in the Regulation of the EPC or its articles of association. This would be an easy, efficient and transparent solution. Parties could freely choose the most efficient system.

7 CO-OPERATIVES AND OTHER FORMS OF ENTERPRISE

7.1 Regulation of the European Co-operative, European Association and European Mutual Society

Ca. 41% (49 respondents) answered question 33a, 69% of which positive, 31% negative. A big majority of the respondents considers the enactment of the proposed Regulations necessary or desirable. However, most respondents do not see this as a top priority. Those who are positive mainly support the proposal for co-operatives and secondly for mutual societies. One respondent was very positive about the high quality of the proposal for the European Co-operatives. The quality of the proposals for the European Association and the European Mutual Society are not up to par yet. The least desirable Regulation appears to be is that for the European Association.
Ca. 28% (33 respondents) answered question 33b, 58% of which positive, 33% negative, 9% other. The majority makes a positive assessment of the potential these Regulations have in the solution of the problems affecting co-operatives and other forms of enterprise in the European Union. A level playing field is necessary. However, a group of respondents notes that the proposals do not meet the expectations. If there is a need for a European Mutual Society or a European Association, the proposals for these forms are impractical. The proposed rule on employee participation devaluates the proposal for a European Co-operative to a great extent.

7.2 Harmonisation of national laws on co-operatives, associations and mutual societies

Ca. 40% (47 respondents) answered question 34a, 34% of which positive, 66 % negative.
A big majority does not think that there is a need to harmonise rules for the alternative forms of enterprise in Europe. Harmonisation is considered to be very difficult because of the diversity of the forms of enterprise and their specific role. Their impact is mainly local, so harmonisation is not necessary.
Ca. 19 (22 respondents) answered question 34b, 41% positive, 46% negative, 14% other. Less than half of the respondents think that it is satisfactory that the regimes in the proposed Regulations are completed by application of the Company Law Directives, which do not apply to the national forms of these enterprises. In the UK this system works for the building societies legislation, which mainly follows company law. Adversaries mention that this would bring forth a complicated system that will hollow out the regimes. Specific regulations should be drafted for different types of activity.

7.3 Foundations in Europe

37 % (44 respondents) answered question 35a, 23% of which positive, 77 % negative.
A big majority opposes the introduction of a European Foundation. Foundations are mainly locally rooted, a European form for foundations should not have priority and the principle of subsidiarity must prevail. In Germany even the federation does not have legislative power concerning foundations. Tax problems for foundations and its donors should however be abolished to promote cross-border donations. One respondent, who is very enthusiastic

about a European Foundation based on endowment contributions, is doing extensive research. One respondent notes that a European Foundation would be preferable to promote transparency.
Ca. 34% (40 respondents) answered question 35b, 25 % of which positive, 75 % negative.
A big majority is against harmonisation of national rules applicable to foundations. Harmonisation would limit the grown diversity of frameworks, which is an asset for founders and foundations. Two respondents note that the European Foundation and not harmonisation of national legislation should be the priority. However, harmonisation can also be a step towards a European Foundation and vice versa. Harmonisation in relation to key matters and tax law are mentioned as pros by a couple of respondents.

7.4 Enterprise law

Ca. 43% (51 respondents) answered question 36a, 29% of which positive, 67% negative, 4% other. A big majority of the respondents does not think a definition of 'enterprise' would be useful. Different legal structures need different legislation. A coherent definition will be difficult, is not needed and not yet possible.
Ca. 11% (13 respondents) answered question 36b, 62% of which positive, 38% negative. The majority thinks that 'economic activity' and 'organisation' should be the main elements in the definitions of enterprise. The formula should be broad. Durability should also be an element. One should be aware of the fact that the element 'economic' is not typical for non-profit organisations. Suggestions as elements are: marshalling of resources in an organised manner for the pursuit of a defined common purpose and co-ordinated and continuous organisation of assets existing in any Member State.
Ca. 25% (30 respondents) answered question 36c, 67% of which positive, 30% negative, 3% other. A big majority thinks basic harmonised rules should only apply to limited liability entities. Regulations for all forms of enterprise do not meet the specific needs for all forms of enterprise. Harmonising regulations on partnerships would be against the principle of subsidiarity.

37 % (44 respondents) answered question 37a, 52% of which positive, 48% negative. A small majority thinks there is a need to introduce harmonised rules in Europe for registration, access to core data and powers of representation relating to enterprises as defined in the document. Harmonisation of these areas is essential for cross-border trade, freedom of movement and the reduction of costs and risks. Whether harmonisation is possible at this moment is not clear. One respondent thinks that these issues should apply to all legal persons. Another respondent explains in his extensive answer that a common technological platform for the consultation and interpretation of national registers is preferable to a European register. The internet could be a useful tool. Those who are against harmonisation note that easier cross-border access should be ensured.
Ca. 28% (33 respondents) answered question 37b, 18% of which positive, 79% negative, 3% other. Most respondents do not see a need for other issues like financial reporting, branches, groups of enterprises, transformation and transfer of seat to be addressed in an Enterprise Law Directive.
An Enterprise Law Directive should be limited to constituting a general legal framework.

ANNEX 4

EXISTING AND PROPOSED EUROPEAN COMPANY LAW INSTRUMENTS

LIST OF EXISTING EUROPEAN COMPANY LAW INSTRUMENTS

Regulations

- Council Regulation (EEC) 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), [1994] OJ L 199/1;
- Council Regulation (2001/2157/EC) of 8 October 2001 on the Statute for a European Company (SE), [2001] OJ L 294/1 *supplemented by* Council Directive (2001/86/EC) of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees, [2001] OJ L 294/22;
- Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002, OJ L 243/1 on the application of international accounting standards.

Directives

- 1st Council Directive (EEC) 68/151 of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, [1968] OJ L 65/8;
- 2nd Council Directive (EEC) 77/91 of 13 December 1976 on co-ordination of safeguards, which for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent throughout the Community, [1977] OJ L 26/1;
- 3rd Council Directive (EEC) 78/855 of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies, [1977] OJ L 295/36;
- 4th Council Directive (EEC) 78/660 of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies [1978] OJ L 222/11;
- 6th Council Directive (EEC) 82/891 of 17 December 1982 based on Article 54(3)(g) of the Treaty concerning the division of public limited liability companies, [1982] OJ L 378/47;

– 7th Council Directive (EEC) 83/349 of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts, [1983] OJ L 193/1;

– 8th Council Directive (EEC) 84/253 of 10 April 1984 based on Article 54(3)(g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents, [1984] OJ L 126/20;

– 11th Council Directive (EEC) 89/666 of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State, [1989] OJ L 395/96;

– 12th Council Directive (EEC) 89/667 of 21 December 1989 on single-member private limited liability companies [1989] OJ L 395/40;

Recommendations

– Commission Recommendation (2001/256/EC) of 15 November 2000 on quality assurance for the statutory audit in the European Union: minimum requirements, [2001] OJ L 91/91;

– Commission Recommendation (2001/453/EC) of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual reports of companies, [2001] OJ L 156/33.

– Commission Recommendation (2002/590/EC) of 16 May 2002 on “Statutory Auditors’ Independence in the EU : A Set of Fundamental Principles”, [2002] OJ L 191/22.

Green Paper

– The role, the position and the liability of the statutory auditor within the European Union [1996] OJ C 321/1.

Communications

– Commission Communication "Accounting Harmonisation: A New Strategy vis-à-vis International Harmonisation", November 1995, COM (1995) 508;

– Commission Communication "Financial Services: Implementing the Framework for Financial Markets: Action Plan” of 11 May 1999, COM (1999) 232;

– Commission Communication (98/C143/03) "Statutory Audit in the European Union, the way forward", [1998] OJ C 143/3;

– Commission Communication of 13 June 2000, "EU Financial Reporting Strategy: the way forward”, COM (2000) 359;

– Interpretative Communication (98/C16/04) Concerning Certain Articles of the Fourth and Seventh Council Directives on Accounting, [1998] OJ C 16/4.

LIST OF PROPOSED EUROPEAN COMPANY LAW INSTRUMENTS

Regulations

– Amended Proposal for a Council Regulation (EEC) on a statute for a European Association, [1993] OJ C 236/1;

– Amended Proposal for a Council Regulation (EEC) on a statute for a European Co-operative Society, [1993] OJ C 236/17;

– Amended Proposal for a Council Regulation (EEC) on a statute for a European Mutual Society, [1993] OJ C 236/40;

Directives

– Proposal for a Directive of the European Parliament and of the Council amending Council Directive 68/151/EEC, as regards disclosure requirements in respect of certain types of companies, COM (2002) 279, 3 June 2002, OJ C 227/377;

– Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC, 83/349/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies and insurance undertakings COM(2002) 259/2 final, 24 September 2002, OJ C 227/336;

– Proposal for a Directive of the European Parliament and of the Council on take-over bids, COM (2002) 534 final, 2 October 2002.