dti

EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE

Directive Proposals on Company Reporting, Capital Maintenance and Transfer of the Registered Office of a Company

GOVERNMENT RESPONSE AND SUMMARY OF RESPONSES

SEPTEMBER 2005

TABLE OF CONTENTS

PART 1: GOVERNMENT RESPONSES

1.1 INTRODUCTION	P. 2
1.2 GOVERNMENT RESPONSE ON THE 4TH/ 7TH COMPANY LAW DIRECTIVES	P. 3
1.3 GOVERNMENT RESPONSE ON THE 2ND COMPANY LAW DIRECTIVE	P. 6
1.4 GOVERNMENT RESPONSE ON THE (ANTICIPATED) 14TH COMPANY LAW DIRECTIVE	P. 10

PART 2: SUMMARY OF RESPONSES

2.1 INTRODUCTION	P. 12
2.2 SUMMARY OF RESPONSES ON 4TH/ 7TH COMPANY LAW DIRECTIVES	P. 14
2.3 SUMMARY OF RESPONSES ON 2ND COMPANY LAW DIRECTIVE	P. 31
2.4 SUMMARY OF RESPONSES ON (ANTICIPATED) 14TH COMPANY LAW DIRECTIVE	P. 52
ANNEX A – LIST OF ALL RESPONDENTS	P. 60

PART 1: GOVERNMENT RESPONSES

1.1 INTRODUCTION

The DTI published a consultation document on 10 March 2005 seeking views on:

- a draft EU Directive to amend the 4th and 7th Company Law Directives (company reporting);
- a draft Directive to amend the 2nd Company Law Directive (capital maintenance); and
- an anticipated proposal for a 14th Company Law Directive (transfer of a company's registered office).

The closing date for comments was 3 June. 28 responses were received in total.

Stakeholders were invited to express their views on any or all of the three proposals particularly with regard to whether they thought the proposed provisions would work in practice and would benefit business. The consultation also sought comments and evidence on costs and benefits as outlined in partial regulatory impact assessments attached to the consultation document.

The DTI is grateful to everyone who responded both formally and informally. The views expressed have been carefully analysed and helped to inform UK negotiating priorities on the two amending Directives. We shall also be sharing with the Commission the key issues raised in this consultation exercise.

Part 1 of this document sets out the Government response to the comments received on each individual proposal (sections 1.2 – 1.4). A summary of responses received can be found in part 2 (sections 2.2 – 2.4).

1.2 PROPOSAL TO AMEND THE 4TH AND 7TH COMPANY LAW (ACCOUNTING) DIRECTIVES

Context

The Commission published its draft Directive in October 2004. Council negotiations began in December 2004. Consultation was based on the text as it stood in March immediately prior to publication.

Key Issues in the Proposal

A. Accounting Disclosures ("Off-Balance Sheet Arrangements" and "Related Party Transactions")

Consultees expressed general support in principle for disclosure of off- balance sheet arrangements and related party transactions by companies. However, views were divided as to whether this was better achieved by EU legislative action rather than being driven by convergence of accounting standards. Alongside issues of principle consultees also raised technical and legal concerns about the Commission proposal suggesting that:

- the meaning of "off-balance sheet arrangements" should be clarified;
- there was similarly a need to clarify the application of these provisions to companies reporting under International Financial Reporting Standards (IFRS) and a need for greater consistency between the proposal and IFRS; and
- in order to minimise reporting burdens, the proposal should give companies the right to aggregate individual transactions in appropriate circumstances.

The comments received largely confirmed the Government's view that whilst the proposed disclosure provisions had the potential to enhance transparency, various technical improvements were necessary in order to maximize their usefulness. In Council negotiation therefore, the UK sought to improve the clarity and certainty of the original Commission proposals in relation to both the off-balance sheet and related party disclosure provisions, and their consistency with IFRS.

Another key issue that arose late in Council discussions was the possible raising of the threshold under which Member States may exempt small companies from the accounting disclosure provisions of the Directives. The Council has asked the Commission to carry out a study on this and it is the Government's intention to discuss this matter further with UK stakeholders.

B. Corporate Governance Statement

Respondents were generally supportive of EU legislative recognition of good quality corporate governance practices. This was tempered, however, by the clear message that such recognition should involve minimal legislative intervention and that the detail of corporate governance standards should remain a matter very much for Codes and best practice. To this end, there was very little support for additions to the provisions in the Commission proposal concerning the corporate governance statement. Some elements of that proposal also gave rise to concerns. In particular, there were different views on whether the corporate

governance statement should be required to form part of the directors' report or be a completely separate document (some respondents commenting that this should be left as a matter for Member States or companies).

The Government considers that an EU wide rule recognising the importance of high quality corporate governance reporting on the basis of the "comply or explain" ethos could play an important part in establishing a benchmark for corporate disclosure for companies traded on financial markets within the EU. In Council negotiation it therefore supported the Commission proposal in principle whilst aiming to ensure that unnecessarily rigid and detailed provisions, which would undermine the flexibility of Codes and best practice, were removed or amended.

C. Collective Responsibility of Directors for Annual Accounts and Report

There was general support for an EU wide rule confirming collective responsibility of directors for the annual accounts and report of the company. Consultees believed that such a rule would provide greater certainty for users of accounts across the EU. They considered, however, that collective responsibility should extend solely to the company and not go further, for instance to individual shareholders or groups of shareholders. The Government agrees and in Council negotiation therefore supported the Commission proposal.

Overall Assessment of the Proposal in the Light of Consultees' Views

The Council reached a provisional agreement ("general approach") to a modified version of the Commission proposal at the ECOFIN Council on 7 June 2005. The agreed text was based substantially on the three main elements of the Commission proposal published in October 2004 but included important drafted changes reflecting comments made by consultees. In particular:

- The scope of the proposed new "off-balance sheet" disclosure requirements has been clarified;
- Greater consistency was achieved between the proposal requiring "related party transactions" to be disclosed and International Financial Reporting Standards (IFRS) (this has the important effect of ensuring that more onerous reporting obligations are not placed on companies not subject to IFRS than on the generally larger companies which report in accordance with those standards);
- Clarifications were made to reflect the different corporate governance reporting structures within EU Member States; and
- An option has been provided to Member States either to make the corporate governance statement a part of the annual report or allow companies to produce the statement as a separate document.

In the Government's view these changes ensure that the proposal, in the form adopted by the ECOFIN Council, will have an overall beneficial impact on corporate disclosures and financial markets within the EU.

Next Steps

The proposal is currently being considered by the European Parliament. The lead committee on this dossier is the Legal Affairs Committee (JURI) with the rapporteur being Mr Lehne (Germany). The Economic and Monetary Affairs Committee (ECON) have also prepared an opinion. It is currently envisaged that JURI will complete its consideration of the dossier in early autumn and that its report will then be subject to a full vote of the European Parliament currently scheduled for the autumn.

The UK Presidency will be working with the European Parliament to produce a Directive that is acceptable to both the Parliament and Council, in line with the good progress that has been made to date in Council.

The Government will continue to assess the acceptability of the text in the light of the amendments proposed by the European Parliament. Responses received from consultees to the present consultation exercise will be valuable both in informing that process and in considering issues related to implementation of the Directive following its adoption at the EU level.

1.3 PROPOSAL TO AMEND THE 2ND COMPANY LAW DIRECTIVE (CAPITAL MAINTENANCE)

Context

The Commission published its draft Directive in October 2004. Council negotiations began in January 2005. Consultation was based on the text as it stood in March immediately prior to publication.

Key Issues in the Proposal

A. Relaxation of the requirements concerning valuation of non-cash consideration for the allotment of shares

Many respondents were of the opinion that the proposed relaxations would not make it significantly easier for companies to allot shares for non-cash consideration. They commented on the lack of clarity of some of the terminology used and expressed concerns that elements of the proposed process would introduce uncertainty for companies. There was a strong view that in order to reduce uncertainty for business the rights of minority shareholders to require a revaluation should be limited to the period before the contract is entered into. Respondents disagreed with the proposal to designate an independent body to review breaches of the new provisions, the majority advocating use of the courts instead.

The Government considers that the proposals, as currently drafted, could lead to business being reluctant to take advantage of the new relaxed procedures. The approach taken in EU negotiations has therefore been to clarify the terminology used and to minimise the uncertainty for business in terms of interpreting the new rules.

B. Relaxation of the requirements concerning acquisition by a company of its own shares (buy-back)

There was consensus amongst respondents that the proposed changes would introduce more flexibility for companies to buy back their own shares although likely benefit was perceived as limited. The majority of respondents also cautioned against any change which would allow companies to buy back all their shares. However, there was considerable support for allowing companies to repurchase own shares up to the limit of distributable reserves. Amongst the concerns expressed was the need to clarify whether cancellation of shares would still be possible under the new proposals which is currently the case in the UK.

The Government supports the relaxation of the conditions governing buy-backs and believes that it should introduce a degree of increased flexibility for companies. In negotiation, however, it is seeking to clarify that the proposals will allow acquisition of own shares for cancellation as well as acquisition of shares for holding in treasury so that UK companies continue to have the same degree of flexibility as at present.

C. Relaxing prohibition on financial assistance

The majority of respondents believed that the conditions governing the relaxation of financial assistance would be a disincentive to companies to apply these provisions, in particular the need for a 5 year solvency test which they considered to be unworkable in practice. There was a general view that the ability of shareholders to contest the resolution should be limited in some way, either to a specified majority and/or for a certain period of time, so as to reduce uncertainty and the risk of objections being raised for reasons other than a legitimate commercial objection. The proposals were also subject to a number of comments regarding clarification of the text which were felt necessary.

The comments have reinforced the Government's initial view that the conditions accompanying this relaxation would, in practice, dissuade companies from seeking to take advantage of it. This view has been put forward during negotiations and has been shared by some Member States.

D. Relaxing the procedures governing the waiving of pre-emption rights

The general view was that the removal of the requirement for listed companies to prepare a report for shareholder approval would not be helpful. The majority of respondents felt that companies would continue to seek shareholder approval for a waiver of pre-emption rights above 5% and that shareholders would continue to expect justification for such a request. There was also general support for the proposition that in order for the relaxation to apply the share price set should be at least 95% of the market price.

The responses have reinforced the Government view that the relaxation will, in practice, be of little benefit to UK listed companies as there will still be an expectation that shareholder approval for a waiver of pre-emption rights above 5% will require an explanation.

E. Enhancing standardised creditor protection in all Member States

The proposals to harmonise creditor protection and limit the right to object to a reduction in capital received significant support with the majority believing that the proposed limitation achieved the right balance of interests between companies and creditors. Respondents also felt that there was potential economic benefit in standardising creditor protection across the EU.

The Government notes the broad support expressed for these proposals which reflects its own initial assessment. These proposals have also met with general support amongst other Member States.

F. Introduction of "squeeze-out" and "sell-out" rights of majority shareholders and minority shareholders respectively

The majority of respondents did not believe that there should be a requirement to introduce "squeeze-out" and "sell-out" rights over and above takeover situations. The concerns raised ranged from the difficulty of setting a fair price and protecting minority shareholder interests to the value of the measure at all since the circumstances in which a majority shareholder reaches 90% of a listed company outside of a takeover situation are rare. In terms of the detail of the proposal as drafted, there were several alternative suggestions about how a fair

price could be computed, with opinion evenly divided between those supporting a valuation process involving an independent party and those who favoured basing the value primarily on the market price in some way. There was virtually unanimous support for the obligation to sell at a fair price to be made in cash, except where the minority shareholder agreed to an alternative.

The Government does not believe that the introduction of "squeeze-out" and "sell-out" rights is a deregulatory measure, compatible with the overall objectives of the proposal. It is of the view that more time is needed to assess the need for these general rights to be introduced at EU level and, if a need is identified, to work through the details to ensure protection of minority shareholders and calculation of a fair price.

Longer-Term Review of the Capital Maintenance Regime

Three quarters of respondents who commented on the longer-term review expressed the view that this should be a high priority for the EU. The reasons for this included concerns about the impact of the new accounting rules on the availability of dividends and the need to review the link between accounts produced for financial reporting and the need to break the direct link between accounts prepared for financial reporting purposes and the making of distributions.

The Government views this proposal as an interim step towards more fundamental reform of the capital maintenance regime and remains committed to pressing for a thorough review at the EU level. The Commission has proposed a study assessing the feasibility of alternatives to the capital maintenance regime. The tender for this study has been published on the Commission website (http://europa.eu.int/comm/dgs/internal_market/calls_en.htm#tender) with the deadline for receipt of tenders being 26 September. The study is due for completion in the autumn of 2006. The Commission will then consider whether to bring forward a proposal for an alternative to the current regime in 2007.

Overall Assessment of the Proposal in the Light of Consultees' Views

In the light of the consultation responses, the Government remains supportive of the objective behind the simplification exercise which is aimed at reducing burdens for business. However, it notes the general concerns expressed by the majority of respondents about the set of proposals:

- lack of clarity in aspects of the proposal;
- the uncertainty about how several of the proposed changes will work in practice;
- the likelihood of many of the new processes not being taken up by companies because they appear to involve alternative hurdles rather than removing barriers completely;
- insufficient flexibility in the proposals as drafted;

These concerns have already been voiced by the Government and other Member States during the Council negotiations to date.

Next Steps

The Luxembourg Presidency held a number of Council Working Groups to take forward negotiations on this proposed Directive. Negotiations are continuing under the UK Presidency with a view to securing a general approach agreement at the Competitiveness Council on 11 October.

The proposal is being considered in parallel by the European Parliament. The lead committee is the Legal Affairs Committee (JURI) with the rapporteur being Ms Kauppi (Finland). Final JURI consideration is expected towards the end of the year and its report is likely to be subject to a full vote of the European Parliament in early 2006. The Economic and Monetary Affairs Committee (ECON) have also prepared an opinion. The UK Presidency will work with the European Parliament to achieve a Directive that is acceptable to Member States, the Commission and the Parliament.

Responses to the consultation exercise have been, and will continue to be, valuable in informing assessments of proposed changes to the proposal during Council negotiations. They will also inform assessment of any amendments put forward by the European Parliament and issues relating to implementation of any final Directive following its adoption at the EU level. We will also share with the Commission the key points raised in the responses we received.

1.4 ANTICIPATED PROPOSAL CONCERNING THE 14TH COMPANY LAW DIRECTIVE (TRANSFER OF REGISTERED OFFICE OF A COMPANY)

Context

The proposal for a Directive to facilitate the transfer of a company's registered office between Member States forms part of the short-term phase of the EU Action Plan on Company Law and Corporate Governance published by the Commission in May 2003. The Commission carried out an online public consultation, seeking views on some of the key issues involved in the spring of 2004; the results of which are expected to inform the proposal which the Commission considers to publish towards the end of 2005. The Government's consultation sought views on the issues raised by the Commission as part of its consultative process.

Key Issues in the Proposal

A. Form and Scope of the Proposal

The majority of consultees considered that there would be benefit in an EU proposal for a co-ordinating Directive facilitating the cross-border transfer of a company's registered office. However, even in supporting the proposal, some respondents questioned the priority being given to bringing forward this proposal and thought there would be little demand from business to utilise such a Directive. Consultees were clear that any Directive should extend to both public and private limited companies to ensure that the needs of small and medium sized businesses are met as well as those of large companies.

The Government concludes that whilst there is no objection to a proposal for a Directive to facilitate the transfer of a company's registered office within the EU, UK interest is limited. Any Directive should apply to both public and private companies.

B. Technical Company Law Issues and the Decision to Transfer

Consultees supported the principle that a proposal by a company to transfer its registered office to another Member State should be decided upon by the company in accordance with the domestic law of the home Member State in relation to the alteration of a company's articles. There were, however, differing views about the need for, and possible extent of, any further provisions necessary to safeguard the interests of shareholders and creditors. Additionally, consultees raised a number of issues related to the practical consequences of a company transferring its registration from one Member State to another.

The Government will, therefore, proceed on the basis that the principles underlying the rules that apply in relation to the manner in which a company determines its constitutional affairs should form the basis on which a decision to transfer is taken. Further consideration will be given to the detailed technical issues that have been raised.

C. Employee Participation Issues

Employee participation is a system that exists within some EU countries (such as Germany and Sweden) which allows for the representation of employees on the board of companies over a certain size. The term also covers employees' rights to recommend and/or oppose the appointment of board members. The EU Consultation Document suggested that employee participation issues should be determined according to the general principle that the law of the Member State to which the company is transferring will apply, except where there is a higher level of participation – where such rights exist – in the Member State from which the company is transferring. In the latter scenario, participation arrangements would normally be negotiated between the management and employee representatives.

Consultees were evenly divided as to whether this proposal was the right way forward. Some consultees stated that the law on participation of the host Member State to which the company was transferring should apply in all cases. One respondent recognised that it is highly unlikely that UK companies wishing to transfer their registered office would need to enter into negotiations as the law of the host Member State would always apply.

The Government will look carefully at the detailed provisions of any draft Directive in this area. In broad terms, however it will seek to promote an approach which maximises the flexibilities for, and minimises the burdens on, companies. Under the currently planned provisions on employee participation, only UK companies wishing to transfer to a Member State with participation would be affected, and these companies would not need to enter into negotiations. The Government will seek to preserve that position.

Companies with existing participation arrangements transferring to the UK, would in most cases be required to enter into negotiations with employee representatives to preserve these rights. It is the case that protection of such existing participation arrangements is likely to be of fundamental importance to some Member States and the views of such States will have to be taken into account.

Overall Assessment of the Proposal in the Light of Consultees' Views and Next Steps

The Government remains committed to promoting cross-border restructuring opportunities for companies as an important part of the integration of the EU Single Market. In that context the proposed Directive for the transfer of the registered office of a company may be helpful to companies seeking to adapt themselves in response to changing market circumstances and the location of their customer and client base.

However, the Government notes the assessment made by consultees that, as outlined in the Commission consultation, the transfer of registered office procedure is likely to be of limited practical value and that consultees also had a number of technical concerns about the proposal. The Government, therefore, intends to assess the overall merits of the proposal, and the need for possible further consultation, as and when a draft Directive is published by the Commission. The responses received from consultees will be an important element in that process.

PART 2: SUMMARY OF RESPONSES

2.1 INTRODUCTION

2.1.1. Responses to the Consultation

Part 2 of this document provides a detailed digest of responses broken down according to the specific questions asked in the consultation document. Each proposal is dealt with in a separate section. Section 2.2 covers the proposal to amend the 4th and 7th Company Law Directives; section 2.3 the proposal to amend the 2nd Company Law Directive; and section 2.4 the planned proposal for a 14th Company Law Directive.

The DTI received a total of 28 substantive responses from a variety of interested parties including investors, regulators, accounting bodies, auditors, other professional bodies and individual companies as follows:

Category of Respondent	Number
Investors	4
Regulators	6
Accounting Bodies	4
Auditors	4
Other Professional Bodies	6
Individual Companies	4
Total	28

*The above figures include a response that is being treated as confidential as per the request from the respondent.

The full list of respondents is in Annex A.

2.1.2. Scope of the Consultation

The DTI published its consultation paper on 10 March 2005. It was aware that, given the differing perspectives of interested parties, views would vary as to the significance of the topics covered. It was also aware that the three proposals were not equally relevant to all respondents and therefore not all respondents would answer questions on all proposals. Consequently, the consultation document sought opinions and views on the key areas in relation to each of the proposals and consultees were invited to respond to any or all of the proposals as they chose.

The consultation document was published on the DTI's website. In addition printed copies were available on request. Some 130 organisations and individuals with a potential interest in the proposals were notified about the consultation by post.

2.1.3. Publication of Responses

The consultation period closed on 3 June 2005. Overall 28 responses were received of which one was confidential. Whilst quotes (not attributed to particular respondents) have been included to illustrate the range of views expressed, not all such views have been cited as to do so would result in an extremely lengthy document and some submissions made points very similar to those expressed by others. All the contributions received were helpful and have helped to inform Government thinking.

2.1.4. Other Consultation with Stakeholders

In addition to the formal consultation process, the DTI discussed the Commission's proposals with a number of stakeholders and held meetings with representatives of key bodies. These discussions helped to shape the questions raised in the formal consultation document and the Regulatory Impact Assessments attached to it and informed the UK position in the initial stages of negotiation on the two amending Directives. The Department continues to work closely with stakeholders on both dossiers.

Copies of the original responses – except the one submitted in confidence – are available for public inspection on request. Please contact Annette Grunberg on 020 7215 6467 or via email (annette.grunberg@dti.gsi.gov.uk) should you wish to see individual responses.

2.2 SUMMARY OF RESPONSES ON THE DRAFT DIRECTIVE AMENDING THE 4TH AND 7TH COMPANY LAW (ACCOUNTING) DIRECTIVES

A. Consequences for Directors: Establishing collective responsibility for all board members for the accounts and key non-financial information

Q1: Do you think it is helpful to have the issue of responsibility of directors clarified in EU law or should it be dealt with at national level only?

We received 22 responses to this question.

16 respondents supported an EU wide rule confirming collective responsibility of directors for the annual accounts and report of the company, 4 respondents felt this should be a matter solely for national law, 2 were content for there to be either an EU wide rule or for this to be left to national law. Advantages cited for such a rule included the certainty which would be provided for users of accounts across the EU (particularly with the "passporting" of company prospectuses within the EU), benefits in terms of the EU Single Market and the creation of a "level playing field" for business. It was also argued that such a rule would prevent businesses choosing to incorporate in Member States with the lowest regulatory standards. Those who considered responsibility of directors should remain a matter for national law felt that such a rule did not take account of different national cultures and legal frameworks (including "common law" and statute based approaches) within the EU.

Specific issues raised included:-

- It would not be appropriate to frame the collective responsibility rule in terms of detailed specifics and it was, therefore, important that collective responsibility be prescribed in terms of high level principles;
- Shareholders would be more likely to have confidence in information for which the board as a whole, rather than individual directors, took responsibility;
- Proper time should be spent on obtaining the right solution and so a relatively cautious approach should be taken in framing any such rule;
- The need for the proposal to properly address the position as regards the respective responsibility of administrative and supervisory boards in companies with two tier boards;
- Notwithstanding a collective responsibility rule, individual directors should be permitted to record reservations to protect their own position; and
- A collective responsibility rule might not take account of developments in other areas, such as directors' remuneration and disclosure of directors' addresses.

Quotes

"[We] welcome [ ] the fact that the board is to be made collectively responsible in EU law to the company for the accounts and key non-financial information. This should ensure that responsibilities are harmonised throughout the EU - dealing

with them at a national level could undermine the unity of the single market" – Investor

"We believe that it is helpful for EU law to provide that directors are collectively responsible for the annual accounts and the annual report. This should be beneficial for UK companies as it will establish a level playing field across Europe equivalent to the one that applies to them at home" - Auditor

"We believe that liability should be a matter for member state law but in the context of the EU Action Plan, it may be helpful to establish the principle of collective liability in the directive, while leaving the scope of application to the member states" – Professional body

"Companies trade and operate, directly and through subsidiaries, throughout the single market and therefore it is appropriate not only to have a degree of consistency as to directors' responsibilities established, but also for those responsibilities to be explicit, at an EU level" – Professional body

"We agree that in the longer term it would be useful to have harmonisation in the EU but as with most of these sorts of issues we favour a relatively cautious approach. A rushed solution will simply get it wrong" – Professional body

"We do not believe that the proposed wording would cause any problems to the UK at present, so we have no major problem with its being dealt with on a pan-EU basis. The wording could, though, have implications for the two-tier board, the adoption of which the Commission separately proposes to extend to companies throughout the EU" – Accounting body

"It is vital that responsibility of directors is clarified in EU law. It must be clear to directors, auditors and users of annual accounts which party is responsible for respective elements of the reporting process" – Auditor

"We believe that it can be beneficial for UK companies for this requirement to be made consistent in EU law. It helps to maintain a level playing field for business across Europe"- Auditor

"Unless certain standards of board responsibility are maintained across Europe, there is a risk that companies may choose to incorporate in member states with the lowest standards and have their shares admitted to trading elsewhere. This would be damaging to confidence, and we therefore believe that the principle should be established in European law"- Investor

"We believe that it would be appropriate for this issue to be dealt with at a national level, particularly in view of the fact that this is already, in part, taking place in the UK with the Company Law Review which is considering the issue of directors' duties" - Company

Q2: Do you agree that board members should be responsible to the company?

We received 21 responses to this question.

All of those who responded agreed that board members should be responsible to the company (except for one respondent who repeated that this matter should not be addressed in EU law at all).

Specific issues raised included:-

- It would not be right to extend liability of board members to a wide and potentially unknown body of third parties (and equally the liability of auditors should not be similarly extended);
- The importance of members having the right to determine the composition of the board;
- Regulation should not deter, through excessive potential liability, experienced businessmen from becoming directors;
- There should be greater disclosure in relation to the role of directors to enable a more complete picture to be obtained by users of accounts.

<u>Quotes</u>

"We support the English law framework under which directors are responsible to the company. In the context of our legal system this is entirely appropriate" – Investor

"We agree that any move to ensure that board members are responsible to the company should be supported" – Regulator

"Yes. We are keen to ensure directors' responsibilities are not extended further than necessary. To maintain a healthy economy we need regulation that encourages (rather than frightens) experienced businessmen to become entrepreneurs and directors" – Professional body

"We believe it should be left to the member state which responsibility a director has to the company. Directors have a contractual obligation, and with it some responsibility to the company, depending on the appointment. But it is possible that national regulation requires some directors to be responsible to stakeholders only. We do not believe this relationship between directors and the company should be regulated in European Law" - Company

"We believe that board members should be responsible for the company. We are aware that some other Member States are calling for an extension of this responsibility and we would strongly resist these calls. This is on the grounds that any extension of responsibility would have a crippling effect on the way directors carry out the business of the company, as the threat of personal liability to various third parties would greatly influence any decision making processes" – Auditor

"The proposal is consistent with the UK's structure of 'unitary' Boards and [we are] supportive of it. The principle of collective responsibility is an important underpinning of the relationship between the directors and the auditors. [We are] particularly supportive because from 1 July 2005 companies from other Member States will be able to passport prospectuses into the UK. It is, therefore, important that directors of companies from other EU Member States should have the same responsibilities as directors of UK companies" – Regulator

"Yes. We believe that board members are legally responsible to the company and should act in the best interests of the company for the benefit of its members as a whole" – Accounting body.

B. Off-balance sheet and related party disclosures

Q4: Do you agree with the proposal in principle? If not why?

We received 23 responses to this question.

15 respondents agreed in principle with the proposal and 8 disagreed. Whilst there was general support in principle for the disclosure of off-balance sheet arrangements (especially in the light of recent financial scandals), views were divided as to whether this was best achieved by EU legislative action rather than being driven by convergence of accounting standards.

Specific issues raised included:-

- Lack of clarity as to the definition of "off-balance sheet arrangement";
- Insufficient regard for existing provisions of International Financial Reporting Standards in relation to such transactions;
- Specific discussions should take place on the types of transactions perceived as giving rise to potential risk/abuse;
- The disclosure requirements as drafted were too wide;
- Disclosure requirements which lacked clarity could lead to the creation of volumes of data which, because of its lack of focus, impeded rather than facilitated understanding by users of accounts;
- More clarity could be provided in relation to the disclosure requirement by, for instance, including tables listing the types of transactions caught; and
- Forcing directors to consider whether such transactions where "material" could assist in risk management processes.

Quotes

"[We] welcome greater transparency and consistency in the disclosures in companies' accounts internationally. Thus, in principle, we support the disclosure of off-balance sheet arrangements and their financial impact if material to an assessment of a company's financial position" - Investor

"We strongly disagree with the proposal in principle. We consider the proposal is impractical due to inadequacies of the definitions" – Auditor

"We are not clear as to why the financial impact of arrangements, that under International Financial Reporting Standards (IFRS) quite properly do not result in consolidation, should be disclosed in the annual report. If it is felt that changes are needed, we would prefer to see open discussion of the specific problems for which a solution is required" - Auditor

"We do not agree with the proposal as we believe that such matters should be left to the relevant accounting standards body to issue a pronouncement on such matters" – Accounting body

"We have significant concerns about this proposal. We believe that financial reporting is best dealt with under accounting standards rather than legislation" – Investor

"Yes, we agree in principle – as it is important to have transparency. Also we believe that this measure will help to maintain confidence in financial markets following failures such as Parmalat. However, we strongly believe that the Directive should avoid any conflict with (and should not go further than) IFRS" – Regulator

"[We] support[ ] the adoption of IFRS by European companies and firmly believe[ ] that the full benefits of such an introduction will only be gained by eliminating departures from international standards through either the endorsement process or via the Accounting Directives" – Accounting body

"We strongly disagree with the proposal in principle. As explained in our response to Question 5, we believe that the disclosure requirement is impractical and unworkable because it is not sufficient clearly defined. Even if this issue could be successfully addressed through more detailed definition or guidance, we strongly disagree with the introduction of a requirement that is more onerous than the equivalent requirements in IFRS" – Auditor

"[We] strongly support [ ] the underlying objective of this proposal primarily because, if properly drafted, it would support European financial statements showing a "true and fair view" as concerns the members of the company" – Regulator

"[We] would support the proposal provided that the relevant accounting bodies do so. [We are] otherwise slightly nervous of any proposal imposed by the State or the EU"- Professional body

"In principle we believe that transparency is important to confidence" – Investor

"Yes. We support the Commission's objective of ensuring that the existence of material Special Purpose Entities (SPEs) is brought to the attention of users of financial statements. It should be appreciated, however, that companies applying the standards issued by the International Accounting Standards Board (IASB) will find it very difficult in practice to avoid consolidating SPEs" – Accounting body

"We disagree with the proposal in principle. Following the IAS Regulation, listed companies in the EU are required to produce financial statements in accordance with IFRS and many companies in the UK will probably do so on a voluntary basis. Compliance with the IAS Regulation means that the accounting and disclosure requirements of the EU Directive and UK law do not apply. In addition, UK GAAP and IFRS will converge over a relatively short period of time. Therefore, it seems completely inappropriate and contrary to the IAS Regulation for the EU to introduce additional accounting or disclosure requirements in respect of companies complying with IFRS" - Company

Q5: Do you think the proposal is clear enough to make it workable and capable of consistent application?

We received 19 responses to this question. 2 of those thought the proposal was clear enough whilst 17 of the responses disagreed.

Specific issues raised included:-

- The considerable judgement and interpretation that would be involved in interpreting terms such as "material" (and the difficult position that this would place auditors in when reporting on accounts);
- The imprecision and uncertainty of the term "arrangements" – which would inadvertently draw in matters such as "purchase orders," "employment contracts," "customer relationships" and "intellectual property";
- Companies should be able to aggregate disclosures of similar transactions;
- The possible use of extended commentary in the recitals of the Directive or through guidance (for instance, provided by the Accounting Standards Board) to clarify terms used; and
- The fact that figures related to arrangements disclosed (rather than simple narrative descriptions) were more helpful to users of accounts .

Quotes

"The current wording is unclear. What sort of arrangements might this capture? What is meant by financial impact?"- Auditor

"No, we do not believe that the proposal is clear enough and we envisage that it will be very difficult to achieve a reasonable level of consistency of application in practice" – Accounting body

"No, we do not believe that there is sufficient clarity to ensure that this proposal is applied consistently across the EU. However, we would not favour any greater detail being placed in European or national legislation. Rather, as stated above, we believe that this issue is properly a matter for IFRS and so for the IASB to develop its regime, should it choose so to do" – Investor

"No. The government notes the need to ensure that the Directive should not be in conflict with IFRS" – Professional body

"We agree with the Government's view that the proposals will leave scope for confusion, particularly in the areas identified such as purchase orders and contracts of employment. We therefore believe that the Commission needs to provide more guidance, such as in the recitals, on the type of arrangements that should be disclosed. We believe the government should pay particular attention to the views of the accounting profession on this subject" – Regulator

"The proposal is not clear. We believe off-balance sheet arrangements should be displayed as a figure, maybe with some additional annotations. We believe the rules should apply to small companies as well, maybe in easier form" – Company

"If the Commission proceeds with the current proposal, we believe it will cause significant practical difficulties due to the wide ranging nature of "off balance sheet arrangements", many of which are completely normal and unremarkable. At a minimum, the disclosure requirements should be more clearly limited to abnormal or artificial arrangements which are intended to remove assets or liabilities from the balance sheet" - Auditor.

"No, [we are] concerned about the clarity of the expression "business purpose of any arrangements". This wording will create uncertainty for both companies and auditors as to whether they are complying with the directives" - Regulator

"No, this does not appear to be the case. We do for example have some concern over the potential breadth of the proposal and the risk of it being interpreted as requiring the capture and disclosure of some issues that might not be appropriate" – Professional body

"No. The proposed requirement for companies to disclose all material 'arrangements not included in the balance sheet' is imprecise and open to interpretation" – Accounting body

"No. We believe that the proposal is entirely unclear and is neither workable nor capable of consistent application, particularly for companies complying with IFRS. Companies complying with IFRS (and indeed similar UK GAAP) will find it very difficult in practice to avoid consolidating SPEs" - Company

Q6: If you draw up accounts, do you think that the changes to UK disclosure requirements set out in paragraph 3.4.2 will add significant burdens?

We received 12 responses to this question. 7 of the respondents thought that it would not add significant burdens (subject, in some cases, to reiteration of the need to clarify the precise extent of the disclosure obligation) whilst the other 5 thought that significant burdens would be added (one of those commenting that such additional burdens were, however, justified by the benefits that arose in terms of greater transparency).

<u>Quotes</u>

"As managers of collective investment schemes, [we have] an interest in disclosures in accounts both as preparers of funds' accounts and from the perspective of our Members' clients as investors. In this respect, we do not believe that the disclosure of "arrangements not included in the balance sheet" will add a significant burden as there are few, if any, off balance sheet arrangements in funds' accounts that would fall to be disclosed" – Investor

"If the brea[d]th of possible transactions to be covered by the disclosures is not reduced, there will be extensive additional disclosures for many companies. This will impose any unnecessary significant burden on many of our clients for a disproportionately small benefit" – Auditor

"There will be some cost but the specific proposals will probably not add significant burdens; the significant costs would be related to any potential undermining of IFRS and of the possibility of global convergence" – Professional body

"In certain types of entity the proposed changes may well add significant burdens. However, for a large number of UK entities, the proposed changes are unlikely to have any significant effect" – Accounting body

"Yes. Any added disclosures or bringing more companies within the scope of the disclosure requirements would inevitably create a burden, but this is justifiable, subject to a narrowing of the definition of the 'company's arrangements'" – Professional body

"The proposed disclosure requirements would potentially involve extensive additional disclosures for many companies. They will impose a significant additional burden for very little benefit" – Auditor

"We do not believe that, if construed in accordance with their presumed intent, the proposal will impose any additional disclosure requirements on companies that prepare their accounts in accordance with UK accounting standards...It should, however, be borne in mind that incorporation of requirements into the law will impose an additional burden on preparers and auditors, by increasing the volume, if not the content, of the requirements with which they have to comply" – Regulator

Q7: If you are a user of company accounts, do you believe that this additional information will be useful, and, if so, what is the added value?

We received 13 responses to this question. 4 of those thought that the additional information would be useful (for instance in ensuring greater transparency and facilitating the integration of capital markets), 7 responses thought that it would not be useful and 2 considered that this depended on the clarity of the final provision. Of those respondents who felt that the additional information would not be useful, some of these linked their reply to the uncertainty of the provision as drafted.

<u>Quotes</u>

"While in principle most users believe that <u>material</u> arrangements should be disclosed, this is again subject to the overall view that the EU should be seeking to take a lead in making suggestions to the IASB for improvements to IFRS and to global standards rather than creating additional regional requirements"- Professional body

"We fear that the proposal will not lead to significant useful information being added. It is likely to lead to the disclosure of masses of data – particularly by companies with good reasons for complex financing structures – which would be of limited value, and potentially limited extra disclosure from companies which wished to use structures to mislead their owners and other stakeholders" – Investor

"The additional information will help in assessing the financial position of a company, although suitable aggregation should be allowed to avoid users of the accounts being swamped with information" – Professional body

"Given that the provision is likely to be interpreted inconsistently, the additional information will be of limited use, as it will not be possible to draw meaningful comparisons or to assume consistent treatment. If the provision[s] were clearer and therefore more capable of consistent application we believe it would be of value to users of accounts" – Professional body

"[We] consider[ ] that this additional information, if supplied as intended, could be useful, and could provide information that would help to ensure responsible credit granting and the setting of more appropriate credit limits" – Professional body

"Where disclosure is provided that is not compatible with the IFRS accounting framework, we believe this additional information will confuse, rather than enlighten users" – Company

C. Disclosure: New disclosure requirements on related party transactions to enhance transparency

Q8: Do you agree with the proposal in principle? If not why?

We received 23 responses to this question.17 of the responses agreed with the proposal in principle whilst 6 did not.

Specific issues raised included:-

- The need to ensure consistency between the definition of "related party transaction" in the Directive and that contained in International Financial Reporting Standards (for instance, by the elimination of inconsistencies such as the restriction in the Directive proposal to transactions not carried out under normal commercial terms which does not apply to disclosures required by IFRS);
- There should be a right to aggregate transactions of a similar nature;
- Disclosure of related party transactions was properly a matter for accounting standards rather than EU legislation;
- Such disclosures were a good means of seeking to ensure that directors were acting in the best interests of the company and avoiding conflicts of interest; and
- Intra group transactions should be excluded from the disclosure requirement.

<u>Quotes</u>

"We agree with the proposal in principle. Particularly, if it lifts the level of disclosure on related party transactions by companies in other Member States to a level comparable to that provided by UK companies under either IAS 24 or FRS 8 'Related party disclosures'" - Auditor

"We agree that companies should disclose [ ] related party transactions where material. However, we believe that the appropriate mechanism for introducing such requirements is through International Financial Reporting Standards (IFRS) and convergence of domestic accounting standards towards IFRS" - Auditor

"We agree that in principle companies should disclose related party transactions where material. However, this is subject to the comments above with regard to strategy" – Professional body

"No, we believe such requirements should be left to the relevant accounting standards setting body" – Accounting body

"We share the government's view that IFRS has the major role in ensuring that financial statements are properly transparent, and that any company law proposals should not interfere with the application of IFRS. Therefore, to the extent that this proposal does so (the consultation document says that it "largely avoids" it) we are not supportive of the proposal. We believe that financial

reporting is best dealt with under accounting standards rather than legislation, and so do not favour the introduction of legislation in this area" – Investor

"We support the proposals in principle. However, with regards to scope, we believe that proper disclosure of related party transactions is also important for small and medium sized companies. Therefore we do not believe that these companies should be exempt from the requirements" – Regulator

"The proposal essentially brings companies not required to report in line with International Accounting Standards in line with those that are. It is sensible that Europe should have a standard approach on this matter" - Investor

Q9: If you draw up accounts, do you think that in practice it will increase your disclosure requirements?

We received 11 responses to this question. 9 of these considered that disclosure requirements, either generally or in relation to their own accounts, would increase. The 2 further respondents did not consider that the provision would add to their own disclosure requirements.

Specific issues raised included:-

- The additional disclosure requirements would not increase the burden on companies reporting under International Financial Reporting Standards (which are already required to report related party transactions); and
- The disclosure burden could be reduced, impliedly without significant loss in terms of usefulness to the user of the accounts, by:-
  - a.) appropriate exemptions or alternative reporting mechanisms (particularly if group transactions were excluded and transactions of a similar nature could be aggregated); and
  - b.) Clarification of certain aspects of the provision, such as in relation to the restriction of the disclosure requirement to transactions not concluded under normal commercial conditions.

Quotes

"As preparers of funds' accounts and from the perspective of our Members' clients as investors, we do not believe that this will increase the disclosures in funds' accounts, as there are already comprehensive disc[los]ure[s] of related party transactions in funds' accounts" – Investor

"It will increase the disclosure requirements for a number of UK companies, in particular those companies which are part of a group" – Accounting body

"The disclosure requirements for our members are already increased as a result of IAS 24. In practice there is likely to be a further slight increase as business purposes will also require disclosure" – Professional body

"Disclosures will be increased in subsidiary accounts where there are material transactions with other group companies - but this will also be the case when the revised version of IAS 24 is implemented" – Investor

"We expect that there should be no difference for companies and groups complying with IFRS"- Company

Q10: If you are a user of company accounts, do you believe that this additional information will be useful?

We received 15 responses to this question. Of those who responded 12 thought that the additional information would be useful, whilst 3 thought that the additional information would not be useful or would only be of limited usefulness.

Specific issues raised included:-

- The new provisions would not change the reporting requirement in relation to most "listed" companies as these were already reporting related party transactions under International Financial Reporting Standards;
- There was a need to clarify the meaning of "material" for the purposes of the related party transaction reporting requirement;
- The most appropriate means of improving disclosure in relation to related party transactions was to make representations to the relevant accounting standard setters (rather than through EU legislation); and
- The extension of such disclosure requirements would lead to a more complete picture being presented to users of accounts and it was important that smaller companies were brought within such a disclosure regime.

Quotes

"As a means of lifting the level and quality of related party disclosures in other Member States' national GAAPs, we consider the additional information would be useful. However, the requirements should be similar to those of EU-endorsed IAS 24 and not go beyond those requirements in the manner we have identified in answer to Question 9" – Auditor

"While in principle most users believe that material arrangements should be disclosed, this is again subject to the overall view that the EU should be seeking to take a lead in making suggestions to the IASB for improvements to IFRS and to global standards rather than creating additional regional requirements" – Professional body

"We do not believe that the additional information would be useful. We believe that the disclosures under IFRS and UK GAAP are satisfactory" – Investor

"The additional information, particularly the business purpose of the transactions (which is not required by IAS 24) will be useful, although to avoid an overload of information suitable aggregation should be permitted" – Professional body

"We believe the additional information will be useful for users of accounts. It will add to the complete picture of the company and will [prove] an effective tool for the evaluation of the company's financial situation" – Company

"Yes. In many cases intra-group transactions are very important to understanding what a subsidiary company does. This might not be so important whilst the group remains intact, but could be very useful disclosure for example

when trying to understand how a group operates, or when elements of the group are sold" – Auditor

"We question whether the proposal will secure the publication of any information additional to that of existing UK or IFRS requirements that will be useful" – Regulator

"Where companies are not already complying with IFRS or UK GAAP requirements, we agree that it would be useful for related party transactions to be disclosed, although we believe this disclosure should be better aligned to IFRS and UK requirements" – Company

D. Corporate governance statement: Introduction of a new corporate governance statement

Q11: Do you think the introduction of a new corporate governance statement would contribute to the objectives [enhancing market confidence, removing disincentives to cross-border investment, etc.] set out in paragraph 3.5.2 above? If not why?

We received 22 responses to this question. 18 of those responses thought that it would contribute to the objectives whilst 4 of the responses believed that this would not be the case.

Specific issues raised included:-

- Such a provision would be an aid to investment as it would ensure potential investors in listed companies were able to receive equivalent information appropriately signposted across the EU;
- It was essential to keep the legal requirements to a minimum, leaving the detail to be fleshed out by guidance, national codes, etc. – this also properly took into account different traditions in Member States;
- Appropriate disclosure was an essential element of good governance standards;
- There was a risk of a "tick box" or "boiler plating" approach being adopted to corporate governance issues by the imposition of a corporate governance statement which would not promote the best reporting standards;
- There was a risk that, in trying to lay down high level principles, detailed prescription would result;
- The proposal avoided the pitfalls of being over prescriptive and it was particularly welcomed that there was no attempt to impose a requirement for there to be a report, certified by auditors, on the effectiveness of internal controls;
- It was right that EU legislation should lay down a basic benchmark for corporate reporting;
- It was important that third country (i.e. non-EU) issuers should not fall within the provision as such reporting burdens might conflict with their own national reporting requirements;

- There was scope for considering whether the requirement for a corporate governance statement might be dealt with more effectively through best practice in the EU Corporate Governance Forum;
- A "voluntary," market driven approach to corporate governance reporting had been extremely successful in improving reporting standards;
- There was growing evidence to support the view that good corporate governance has a positive impact on a company's share price;
- It was important that prescribing an annual corporate governance statement did not lead to legal definition within the EU or Member States of what constitutes an "explanation" for "comply or explain" purposes; and
- A "comply or explain" approach to corporate governance reporting allowed flexibility for companies and promoted dialogue between the company board and shareholders.

Quotes

"[We] believe[ ] that introducing a requirement for a corporate governance statement throughout the EU will help investment, as potential investors will receive equivalent information regardless of the Member State in which a company is listed" – Investor

"Yes. We believe that the DTI is correct in its assessment of the potential benefits to UK business that might be derived through the introduction of a new mandatory corporate governance statement to be included in listed company annual reports throughout the EU. We support the DTI in its endeavours to keep the legal requirements at a basic level, leaving more detailed requirements to national Codes" – Auditor

"We support the introduction of a corporate governance statement, as has been best practice in the UK for many years. However we agree with the Government that any legislation should set out the broad areas to be covered, with the detail to be left to Member States" – Regulator

"[We] welcome [ ] the requirement for listed companies to disclose information about their corporate governance practices and believe [ ] that this will benefit European investors and capital markets as a whole. The UK is rightly seen as a leader in the development of good corporate governance practice and we believe that raising the standards of disclosure in the European Union will be of benefit to UK business" – Accounting body

"The introduction of a new minimum standard corporate governance statement will help to raise the importance of corporate governance as a compliance issue" – Accounting body

"There is a growing body of evidence to support the assertion that good corporate governance has a positive impact on the company's share price. In practice companies in EU jurisdictions who do not currently have a robust corporate governance framework have most to gain from this requirement. In reality UK companies are unlikely to be significantly affected by these proposals" – Auditor

"We consider that a corporate governance statement of the scope set out in the draft Directive would be beneficial in setting a basic standard that would assist in cross border investment in the EU and, through the resulting transparency contribute to higher standards of corporate governance" – Investor

"The UK already has a high standard of corporate governance based on the "comply or explain" approach, which requires companies to make a report each year. We would only support measures that replicated those currently in place in the UK" – Company

"Comply or explain" is a market-based approach that was pioneered in the UK, but has increasingly been adopted in other Member States. [We] believe[ ] that for corporate governance issues it is a more appropriate model than direct regulation, as it recognises that shareholders are better placed than regulators to judge whether a particular company's corporate governance arrangements are adequate, and allows companies some flexibility in how they choose to apply best practice" – Regulator

Q12: Do you agree with what the Commission wants to be included in the corporate governance statement or do you think there should be something else included?

We received 19 responses to this question. 18 of those who responded considered that there should be no additions to the list of matters to be included in the corporate governance statement. A number of these respondents stated that they considered it was essential that the items prescribed by this provision should be kept to a minimum if flexibility for national codes and practice was to be preserved (in some cases, the view was expressed that the legislative requirement should amount to no more than a duty to follow a "comply or explain" Code). The only additional item that 1 respondent felt should be included was a requirement upon companies to explain the allocation of management responsibility within the company.

Quotes

"Whilst [we] welcome [ ] a requirement for a corporate governance statement, we believe that the Directive should not be more explicit than requiring "a comply or explain" statement on the key elements of a corporate governance code" – Investor

"We believe that the list should not be made more substantial. The key is full and open disclosure under sub-paragraphs (1) and (2), seeking a comply or explain response in comparison with whichever governance code the company specifies" – Investor

"[We] agree[ ] with the Commission's proposals in that they support and reinforce current best practice amongst listed companies. They also recognise the importance of disclosure in bringing about improvements in corporate governance. However, it is important to avoid lengthy disclosures which change little from year to year" – Accounting body

"We are happy with the proposals for the content of the corporate governance statement. We are pleased that the statement will require an indication of the

extent to which the corporate governance code has been complied with. This further reinforces the 'comply or explain' approach" – Auditor

Q13: Are there any elements in the corporate governance statement that should be excluded?

We received 19 responses to this question. 8 respondents considered that there were no items that should be excluded from the corporate governance statement proposal (although one of these questioned whether it was appropriate for the disclosures all to have to be made in one place within the company's report). One respondent considered that there should be further consultation with shareholders as to the extent of the legislative disclosure requirements in this respect. 10 respondents considered that items should be deleted from the list as follows:-

a.) Internal control and risk management systems (7 respondents) – Concerns expressed included that this was inconsistent with a proper focus on the significance of risk (for instance, it might lead to a narrow focus on reporting risk in relation to financial reporting), that this matter remained subject to the outcome of the Turnbull review in the UK and that it could reduce flexibility in reporting standards;

b.) Disclosure requirements required by the Takeovers Directive (3 respondents) – Concerns included the fact that much of this information did not change from year to year and should not have to be repeated and that this would result in an unduly long statement;

c.) Shareholder rights etc. (7 respondents) – A criticism of this requirement was that it should not be for companies to have to "teach" their shareholders basic matters that are contained in the law; and

d.) Composition and operation of board committees, etc. (4 respondents) - Views were expressed that this issue was more properly the subject of Commission recommendations rather than law and as to a possible loss in flexibility through such prescribed disclosures.

Quotes

"As already noted, we do not believe that the Commission should set in statute the detail to be disclosed in a corporate governance statement" – Investor

"We have reservations about specific provisions at EU level on internal controls, takeover provisions, shareholder rights and the composition and operation of the board and its committees, essentially laying down in EU law what should be in the national codes. This seems inconsistent with subsidiarity and support for those national codes" – Professional body

"We support the reference to a corporate governance code and explanation as to whether and to what extent the company complies. We strongly support the 'comply or explain' principle which has worked well in the UK for many years" – Regulator

"We believe the statement as it stands is very good" – Company

"We believe that general meeting and shareholder rights are already reasonably covered by disclosures required under accounting standards on rights attaining

to non-equity shares. We believe that a requirement in law to make this disclosure is unnecessarily onerous" – Auditor

"The requirements relating to shareholders' meetings are usually laid down in Company Law and the relevant aspects would be covered in the Notice of meeting and accompanying material usually sent out at the same time as the Annual Report. Shareholders' rights similarly are also a matter of Company Law. We do not believe either should be part of a corporate governance statement" – Professional body

"We do not believe that anything else should be included in the proposed corporate governance statement. On the contrary, we consider that some aspects of the proposed corporate governance statement are best left to be dealt with at Member State level, either through national corporate governance codes or supporting guidance at the national level" – Accounting body

"Whilst we do not believe that there are any elements that should be excluded, we believe that the elements should form high level guidance to Member States to follow and introduce at a national level rather than a tick-list." – Company

Q14: On the assumption that, in implementing the requirement, the Government would wish to avoid duplication of information in the report and accounts, do you believe that the annual report (the directors' report in UK accounts) is the correct place for the statement? If not, would you prefer the statement to stand alone, following the example of the directors' remuneration report?

We received 21 responses to this question. 12 respondents considered that the corporate governance statement should be part of the annual report and 3 respondents felt that it should form a stand alone document whilst 6 respondents considered that either the Directive should not prescribe the location of the statement or should allow Member States an option as to where the statement was situated.

A key issue that arose in connection with the location of the corporate governance statement was the extent of auditor verification of such a statement (particularly as it was pointed out that auditor responsibility varies across Member States in the EU). Some consultees considered that auditors should only be required to comment on objectively verifiable information. It was also noted that there would be confusion if the statement was subject to different levels of auditor verification in different Member States.

<u>Quotes</u>

"The key issue is that the corporate governance statement should not be located in a part of a company's report that is subject to a full audit as not all elements of such a statement are objectively verifiable" – Accounting body

"There is an advantage in not duplicating information. We believe it does not matter where this information will be placed. It could be up to national discretion" – Company

"We recommend, therefore, that the corporate governance statement should stand alone, following the example of the directors' remuneration report" – Auditor

"We understand that the draft Directive has subsequently been amended to provide that the new statement should be a free-standing report. We agree that this would be more appropriate." – Accounting body

"Our preference would be for disclosures (i) and (ii) in paragraph 3.5.1 to be shown in a separate statement, albeit still signed on behalf of the entire board. Disclosures (iii), (iv) and (v - if retained) would best be shown away from the main corporate governance statement" – Auditor

E. Cost savings and benefits

Q15: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are also welcome on any unintended consequences or other implications.

6 respondents commented on this issue. Specific issues raised included:-

- The possible risk of boiler plating if an overly prescriptive legislative approach to disclosure is taken;
- Information (rather than legislative prescription) was the best means of promoting competition between corporate governance regimes;
- Increased disclosure would be beneficial;
- Significantly increased costs might fall upon companies with traded debt listed securities (rather than shares) which were not currently subject to a full corporate governance disclosure regime;
- A preferable approach might be to reply upon best practice rather than legislation; and
- There was a need for greater consistency with International Financial Reporting Standards.

<u>Quotes</u>

"We agree with the risks identified in the RIA; in addition, there is a danger of boilerplate reporting in the annual statement as well of differences of terminology with the Turnbull guidance leading to confusion" – Professional body

"Costs of implementing the Directive would be low in the UK but may be high in other member states. It may, however, be considered that these costs are justified in the interests of greater transparency and consistency" – Professional body

"In [our] view, it is unlikely that companies would see any cost savings. In fact, [we] consider [ ] that the reverse would almost certainly be true. If it were to prevent another "Enron" or "WorldCom" situation, then there would be savings for shareholders and creditors, however" – Professional body.

2.3 SUMMARY OF RESPONSES ON THE DRAFT DIRECTIVE AMENDING THE 2ND COMPANY LAW DIRECTIVE (CAPITAL MAINTENANCE)

A. Relaxation of the requirements concerning valuation of non-cash consideration for the allotment of shares

Q1: Do you think that the proposed changes relating to the valuation of non-cash consideration will make it easier and cheaper for companies to allot shares for a non-cash consideration?

We received 13 responses to this question.

5 respondents did believe that the proposed changes would make it easier and cheaper for companies to allot shares for a non-cash consideration. 8 respondents disagreed, expressing a number of concerns:

- Lack of clarity and certainty about the details of the new proposed procedures.
- Whether a recent independent valuation carried out for a specific purpose could automatically be used to establish value for a share allotment.
- Proposed requirements being just as time-consuming as current requirements.

Quotes

"We think that the proposed changes will have only marginal benefit with respect to the allotment of shares for consideration of listed securities" – Auditor

"We do welcome these proposals, however, we share the Government's concerns in relation to some of the terminology used e.g. 'exceptional circumstances'" – Professional body

"We share the government's concerns in relation to the lack of clarity of some of the terms in the draft. However, on the face of it, this proposal would have the intended effect" – Investor

"No. We think the uncertainty as to the meaning of some of the provisions and the proposed right of minority shareholders to require a valuation in any event, will mean few companies would take advantage of these proposals" – Accounting body

"The proposed changes should make it easier and cheaper for companies to allot shares other than for cash" – Company

Q2: Do you agree that the courts are the correct body to review any breaches of the new provisions and that no other independent body needs to be designated to carry out this function?

We received 12 responses to this question.

10 of the respondents thought that the courts were the correct body to review any breaches (with the potential for support from expert witnesses, suggested by one respondent). 2 respondents disagreed and felt that auditors should have a role.

<u>Quotes</u>

"We agree that it is unnecessary to designate an independent authority to examine the legality of the non-cash considerations contributed as the courts would have jurisdiction to review any breach of these provisions, if need be with the assistance of expert witnesses" – Professional body

"Yes, we believe that the courts are the proper venue for any disputes and that there is no need to create any other adjudicative body" - Investor

"[We] would prefer to see, in the first instance, a company's auditors taking responsibility for agreeing all allotments for a non-cash consideration. Only thereafter, and assuming a dispute, should recourse be made to the courts" – Professional body

"There is a danger that a company could overpay given that definitions of the terms "weighted average price", "exceptional circumstances" and "new qualifying circumstances" are open to interpretation and that would be dilutive to the existing shareholders. The disclosures detailed in Article 10b should be disclosed in the annual report and be subject to audit review" - Investor

Q3: Do you agree that the right of minority shareholders to require a revaluation should be limited to the period before a contract is entered into?

We received 12 responses to this question.

10 of those agreed that the right of the minority to require a revaluation should be limited to the period before a contract is entered into. 7 of these suggested that this limitation should be dependent on minority shareholders having a reasonable period of notice of the allotment, to allow them a period of consideration (not provided for in the Commission's proposal). 2 of the respondents disagreed; 1 advocated that the minority should have the right to challenge the revaluation at any time under certain conditions. The other felt that there should be no reason to provide a right to require a revaluation at all.

<u>Quotes</u>

"We agree though a reasonable period of notice should be given to minority shareholders prior to notification of allotment in order to provide them with sufficient time to object to the arrangements" – Auditor

"We agree, provided that minority shareholders have had sufficient notification to consider whether they deem a valuation to be appropriate" – Professional body

"Yes, we agree that this is the only proper time for any such right to be applied, and we are strong supporters of it: minority shareholders need to have a mechanism to call directors to account for such decisions and to seek to protect their ownership interests" – Investor

"Yes. We are not clear how it would work in practice if permitted afterwards. Business transactions require a large degree of certainty" – Company

"Yes, otherwise we think it [is] unlikely that the new proposals would be workable in practice. However, there would need to be some mechanism for ensuring that shareholders have adequate notice of the impending transaction." – Accounting body

"[We] do[ ] not agree. Minority shareholders should be able to question the revaluation at any time, subject to the Statute of Limitations, when there is new information on, or evidence of, illegality/unfairness" – Professional body

"We feel that it is not really necessary to provide the minority with a right to require a revaluation since the conditions under which the revaluation[ ] is not required are already tightly defined.....there is a danger of giving undue power to a disruptive minority" – Professional body

Q4: Do you see any scope for further simplification of the rules relating to non-cash consideration? If so, please specify and give reasons for your proposal.

We received 9 responses to this question.

8 of the respondents thought that there was no scope for further simplification of the rules relating to non-cash consideration (1 of these indicated that the current proposals would already increase the risk of abuse). The remaining respondent felt that the proposals remained complicated and unclear and would benefit from further simplification.

<u>Quotes</u>

"We do not think that the Commission should devote time to simplifications at the expense of the urgently needed fundamental re-appraisal of capital maintenance" – Auditor

"The draft Articles are fairly complicated for a director to work through - they appear unnecessarily complicated and as mentioned by the DTI contain phrases such as "new qualifying circumstances" which must be defined" – Auditor

"[We] do[ ] not see any scope for further simplification of the rules relating to non-cash consideration. In [our] view, the proposed relaxation already increases the possibility of abuse" – Professional body

Q5: Do you have any other comments on the drafting of Articles 10a or 10b?

There were 6 responses to this question. Comments included:

- Lack of clarity about the definitions of "exceptional circumstances" and "new qualifying circumstances" and how these would operate in practice, in particular in markets with poor liquidity;
- The board should only have to inform shareholders **if** new qualifying circumstances occur and not **whether** they do;
- Whether it is realistic for a company to value transferable securities at their weighted average price over the last three months rather than at the time of the announcement of the deal;
- Whether it is appropriate to rely on the value of assets derived from previous audited accounts as in historic cost accounts assets are not generally stated at true market values.

Quotes

"As noted in the Consultative Document, "exceptional circumstances" and "new qualifying circumstances" are not defined. It is not even clear whether they are intended to cover the same ground, given the different terminology used. Article 10.a.1 recognises the position where a security's price has been affected by "exceptional circumstances". In some regulated markets for some securities there can be very poor liquidity with only occasional trades and this would not be exceptional but normal. We do not consider that disapplication of the need for valuation should apply in such cases" – Professional body

"We broadly agree with the relaxation of the rules requiring the valuation of listed securities offered as consideration (Article 10a (1)). However, we are puzzled by, and disagree with, the consequential proposition that the securities offered as consideration should be valued at their weighted average price of the previous three months" – Auditor

"We agree that, in 10a the definitions of 'weighted average price', 'exceptional circumstances', 'significantly change' and 'new qualifying circumstances' are unclear" – Professional body

"Proposed new article 10a (3) seems to suggest that the value at which an asset is stated in statutory accounts should be taken as establishing its true value. This is mistaken: financial statements do not purport to place a value on a company's assets—and still less on the company as a whole" – Regulator

"It is unclear to us what is meant by the phrases "*weighted average price*", "*exceptional occurrences*" and "*In the case of new qualifying circumstances*"; their meanings should be clarified. Further, subjectivity should be minimised, for instance, it might be difficult to determine whether there have been "*exceptional occurrences*", or "*extreme low liquidity*" as mentioned in the Commission Working Document" – Accounting body

B. Relaxation of the requirements concerning acquisition of own shares by a company (buy-back)

Q6: Do you think that the proposed changes will give companies more flexibility to acquire their own shares?

We received 15 responses to this question.

All the respondents thought that the extension of the authorisation period to 5 years and the potential to raise the limit from 10% to the amount of the company's distributable reserves would give companies more flexibility to acquire their own shares although several felt the scale of the impact and the primary beneficiaries in the UK were uncertain.13 respondents welcomed this additional flexibility but 2 expressed concerns about the proposals. There were mixed views about which of the two proposed changes would have the greatest impact on a company's flexibility. Specific issues included:

- A company would be able to set its own authorisation period within the 5 year limit;
- The ability to hold treasury shares would not be limited to UK listed or AIM companies;

- The ability of a company to return capital through buy-backs could have a negative impact on the return of capital through dividends.

Quotes

"We agree with the extension of the authorisation period to 5 years; each company may through resolution in general meeting of shareholders determine its own limit within that overall restriction" – Auditor

"Raising the limit beyond 10% would give more flexibility but in other respects we doubt that the relaxations will have any practical effect" – Auditor

"Yes. The proposals will give added flexibility, but the change is minimal for UK listed or AIM companies since it is merely the 5 year validity period for any standing consent that is to change. For other companies, the added flexibility could be significant, as it would enable them to hold own shares in treasury" – Professional body

"Yes, we support the proposed changes, especially the extension of the duration of shareholder authority to five years as this should introduce time and cost savings for companies" – Regulator

"Too much. 5 years duration is too long. 2 years should be maximum. Market price should be a stipulated condition" – Company

"[We] recognise the importance to companies of flexibility in the management of capital but [we] consider that the present arrangements provide sufficient flexibility" - Investor

"Yes, although we do not believe that expiry of authority to acquire own shares at the next Annual General Meeting is onerous" – Auditor

"Yes, the proposals should allow companies more flexibility to take advantage of the Treasury Shares regime, particularly removing the 10% cap" – Accounting body

Q7: Do you agree that a requirement to offer to purchase/sell shares to all shareholders would constitute an additional burden?

We received 15 responses to this question.

9 of those who responded thought that it would constitute an additional burden, although many were in agreement with the underlying principle, whilst the other 6 responses thought that it would not. Specific issues raised included:

- The importance of the principle, particularly in instances of re-sale into the market of treasury shares;
- The provisions should not be used by companies to circumvent pre-emption rules;
- There should be the ability for a company to carry out specific buybacks from specific shareholders with prior approval from independent shareholders;
- A minimum value buy-back would enable very small value transactions taking place that in aggregate would be very expensive. This could be viewed as fair treatment of shareholders as the minimum value would apply to all.

Quotes

"We believe that a requirement to purchase/sell shares to all shareholders is equitable, especially once a large tranche is potentially involved. Without such a requirement, a company might use these provisions to circumvent the pre-emption rules set out in Part IV of the Companies Act" – Auditor

"This need not form an additional burden, provided that companies also have the right to seek permission to make specified buybacks from specific parties" – Investor

"If this is the case, then we agree that it might impose an additional burden on companies – therefore it is important that the wording in article 19(1)(d) is clarified" – Regulator

"In principle it is a sensible protection for shareholders. The difficulty is the regulations (and therefore the cost) relating to making the offer. Also there needs to be an override mechanism such as a special resolution" – Company

"This may be burdensome if each shareholder is treated exactly the same and in the extreme, each is able to sell a minimum of one share back to the company. There should be a differentiation between treating all shareholders "equally" and treating all shareholders "fairly"" – Investor

Q8: Do you agree that companies should be free to repurchase own shares up to the limit of distributable reserves or do you consider that the current cap of 10% of issued share capital should be retained?

We received 15 responses to this question.

11 of the respondents were in favour of permitting repurchase of own shares up to the limit of distributable reserves. 4 of the respondents thought either that the current cap should be retained or that there should be some other limit set. Specific issues included:

- There was a need to ensure that companies could not be permitted to buy back all their shares;
- Shareholder approval would be a more effective way of establishing a general limit but providing for additional flexibility when required and when justified;
- Lack of clarity as to whether the proposed changes are intended to apply to all buy-backs or just those held in treasury. In the case of the latter, the need for a limit would be greater;
- There was a danger that increased flexibility and no limit could lead to management taking short-term decisions to increase earnings per share by reducing the shares outstanding.

Quotes

"We agree that companies should be free to repurchase own shares, as treasury shares, up to the limit of distributable reserves provided always that the law prevents a company from buying back all of its shares" – Auditor

"We believe that they should be able to purchase own shares up to the limit of distributable reserves" – Professional body

"We believe that such limits are likely to be best applied by shareholder guidelines and the approval of resolutions at general meetings rather than in legislation." – Investor

"We see a logic in the link to distributable reserves. The 10% limit has no solid foundation" – Company

"It is more important to limit the amount that can be held as Treasury stock. This should not exceed 5%." – Company

"The current cap of 10% should be retained. There is a potential agency problem of senior managers being remunerated through the awarding of options and then taking short term decisions to increase the earnings per share by reducing the shares outstanding." – Investor

"The current 10% cap should be retained for the general '5yr' approval but companies should be able to obtain 'event related' approval from shareholders for specific repurchases up to the limit of distributable reserves" – Professional body

"We think, short of a more radical change (for example a solvency test), companies should be allowed to repurchase their own shares up to the limit of distributable reserves without the current cap of 10%, provided always that the law prevents a company from buying back all of its shares" – Accounting body

Q9: If you disagree that a cap of 10% should be retained but consider that there should be a higher cap, what level of issued share capital do you consider would be appropriate?

There were 10 responses to this question. 6 believed that the limit should be based on distributable profits. 1 respondent suggested 15% and another 20%.

Quotes

"Subject to limitation on Treasury stock, there is no reason not to have a 20% cap." – Company

"We believe that the limit should be based on distributable reserves with no reference to the number of shares in issue" – Auditor

10: Do you think EU wide relaxation of the requirements concerning acquisition of its own shares by a company should go beyond the proposed changes? If so, what additional changes would you make and why?

We received 14 responses to this question.

All the respondents believed that the current proposals went far enough. Several went on to say that this was the view they took within the operation of the current capital maintenance regime but that what was really needed was a fundamental review of the current regime and consideration of a solvency based approach.

Quotes

"Within the confines of the current capital maintenance regime, we do not believe that they should go beyond the proposed changes. We do, of course, believe that the proposed EC study of reform of the current regime needs to be accelerated." – Auditor

"We recognise that the EU will be considering a solvency based approach in due course. We believe that this is maybe an area where a solvency test is really a better form of constraint. We would welcome a further study and evaluation of the concept of solvency testing" – Professional body

Q11: Do you have any other comments on the drafting of Article 19?

We received 3 comments in response to this question, 1 suggesting more detail in relation to the terms and conditions governing buy-backs,1 seeking more precision about the principle of equal treatment of shareholders and 1 seeking clarity that the right to buy back shares and cancel them remains.

Quotes

"We think "parameters" or something similar would be a better term than "conditions". We suggest that the references to maximum and minimum prices should expressly contemplate benchmarks or reference points as well as actual numbers – eg. x% above or y% below the traded price at the relevant time." – Professional body

"What, in this context, is the principle of equal treatment of shareholders?" – Professional body

"Further, we are concerned that the text, as it stands, might unintentionally remove a company's ability to buy back shares and cancel them. The ability of a company to cancel its shares is well established in the UK and we believe that companies would like it retained. Therefore, we should like clarity in the final text that the right to buy back and cancel shares will remain" - Auditor

C. Relaxation of prohibition on financial assistance

Q12: Do you agree that the conditions governing the changes proposed will be a disincentive for companies wishing to take advantage of relaxed financial assistance rules?

We received 15 responses to this question.

13 of those who responded believed that the proposals to relax financial assistance would act as a disincentive for companies. Specific issues raised included:

- The 5 year solvency test would be unworkable in practice for a number of reasons, not least the unwillingness of directors, accountants and auditors to sign off or verify such a solvency statement. A period of 12 months might be more appropriate and more realistic;
- The proposals should not be applied to private companies in the UK;
- A company should not be able to grant financial assistance if the proposed transaction reduces net assets below distributable reserves;
- The intention behind these individual safeguards is sensible but there could be scope for more flexibility in their application;
- The conditions governing the granting of financial assistance must necessarily be strict.

Quotes

"We agree that the conditions put in place will be [ ] a disincentive. However, we believe that the form of each makes it in its own way a sensible protection for shareholders and creditors in these circumstances. [ ] while the form of these tests seems to us justified, we agree that it might be appropriate for some of them to be made somewhat more flexible in their application" – Investor

"Yes. The five year solvency requirement is unrealistic. The proposed changes in the Company Law Reform Bill look sensible and are based on proper consultation to reflect the needs of the business community. The EU proposals appear to be out of touch with commercial reality" – Company

"Yes, including certain of the provisions being unworkable such as "consideration of solvency and liquidity for the next 5 years" "- Auditor

"Yes, especially the requirement for prior shareholder approval, the necessity to investigate the financial standing of the assisted person and the solvency rule" – Professional body

"Yes, we agree that the conditions are too onerous, such as the requirement that the company *"must be able to maintain its liquidity and solvency for the next five years"*". – Accounting body

"We do not consider that a company should grant financial assistance to a third party for acquisition of its own shares in anything other than highly exceptional circumstances [ ] Hence we believe that the tight restrictions placed around this relaxation in the Directive are the minimum required [ ]" – Investor

"Most operators are uneasy about a relaxation in financial assistance, therefore the conditions must be tough" - Company

Q13: Are there better ways of providing shareholders and creditors with safeguards than the proposed 5 year solvency test?

We received 14 responses to this question.

Suggestions for improving safeguards for shareholders and creditors included:

- Reducing the insolvency period from 5 years to 2 years or less. 12 months was the most favored period;
- Including a requirement for a solvency statement to include the assumptions on which the statement is based;
- Ex-ante shareholder approval should be an essential part of any process;
- Creditors would be protected through the distributable reserves test.

Quotes

"A solvency test goes to the core of the issue of protecting both shareholders and creditors, and it is therefore the appropriate form of test for this issue" – Investor

"We believe that a 12 months[ ] solvency test may be more realistic – as currently permitted under s.155 for private companies - although even this is arguably not needed if the distributable reserves test is applied" – Professional body

"The 5 year solvency test details are vague to the extent of how continuing solvency after certification is measured. Perhaps linking shareholder and creditor protection to credit ratings of a third party, where applicable, on an ongoing basis may provide more proactive and dynamic protection" – Investor

"We would recommend a one year solvency statement from the directors, such as the proposed solvency statement put forward in the DTI's Company Law Reform White Paper in respect of a reduction of capital by a private company" – Accounting body

Q14: Should the right to contest the resolution be open to any shareholder or should it be a specified majority? Should the right be exercisable only within a certain period of the resolution?

We received 13 responses to this question.

2 respondents did not wish to see any such right granted to shareholders at all. Of the remaining respondents all but 2 agreed that the right to contest the resolution should be limited both to a specified majority and for a certain period of time. 1 respondent advocated that the right should be extended to any shareholder but for a specified time period. Another did not specify the need for a time limit but did want to give the right to a single shareholder.

10% was mentioned by the majority of respondents who offered a percentage. 5% and 100 shareholders were put forward by single respondents.

Only 2 respondents suggested time periods – 2 weeks and 3 weeks following the resolution.

Quotes

"We believe the right to contest the resolution should be restricted to a minimum specified number or percentage of shareholders and that there should be a time limit on the availability of that right. A minimum percentage and number might be 10% or 100 shareholders respectively" – Auditor

"We believe that it should be open to a set percentage e.g. to shareholders owning more than 10% of the ordinary share capital of the company. We believe that it should only be exercisable within a certain period of the resolution" – Professional body

"In our view, there should not be any such right at all" – Professional body

"Business transactions require certainties. We must not have a situation where one small shareholder can hold others to ransom. If the contest is simply on the legality then assuming the test is clear the right to object on the legality is probably acceptable" – Company

"The right to contest should be set at a level that currently exists in order to allow minorities to voice concerns that may be legitimate, perhaps 10%? The right to exercise should be time limited" – Investor

"We maintain that shareholders' approval should not be required" – Professional body

"[We]consider[ ] that the right to contest the resolution should be open to any shareholder, and that the period should be limited" – Professional body

"We believe that the right to contest the resolution should be available only to a minimum specified minority in order to avoid a small number of shareholders using this right for purposes other than a legitimate commercial objection. The right should be limited in time; otherwise the directors would have no certainty as to whether they can proceed" – Accounting body

Q15: Do you have any other comments on the drafting of Articles 23a and 23b?

There were 5 responses to this question.

Specific issues raised included:

- The final paragraph of Article 23 (shares being acquired at fair price), querying whether this should be located in the section of the proposal dealing with pre-emption rights (Article 29) and whether its insertion under financial assistance provisions introduced a new principle;
- Clarification that the measure of the amount of the financial assistance will be taken as the amount of the loan, payment or guarantee;
- Clarification of what is meant by the shareholder right to contest the approval of a transaction and whether this implies the right to apply to the courts;
- The requirement to prepare a report for shareholder approval could be a disincentive for companies.

<u>Quotes</u>

"Presumably the measure of the amount of the financial assistance will be taken as the amount of the loan, payment or guarantee under the assumption that at worst the loan will not be repaid or the guarantee will be called and this will have to be written off by the company" – Professional body

"The wording "right to contest" needs tightening – for instance there must be no suggestion that there is a right to apply to the discretion of the Court" – Company

"We are concerned that this is an attempt to establish a new principle of a "fair price" for share issues or sales of own shares, by including this requirement in the financial assistance provisions where it would appear not to belong." – Accounting body

"The requirement to produce a written report to shareholders and obtain their agreement in general meeting will significantly reduce the speed at which directors can act" - Auditor

D. Relaxation of procedures governing the waiving of pre-emption rights

Q16: Do you think that this relaxation will remove an administrative burden in practice?

We received 14 responses to this question.

3 of the respondents thought that an administrative burden would be removed through the proposals (although 1 respondent did not feel that this was a good enough reason to make the change). The view of the remaining 11 respondents was that companies would continue to seek shareholder approval for a waiver of pre-emption rights above 5% and shareholders would continue to expect justification for such a request.

Quotes

"The Companies Act 1985 currently contains a requirement that shareholders are given a written statement where they are being asked to vote on a special resolution to disapply pre-emption rights. Typically, this statement consists of a few paragraphs to meet the statutory requirements and it is not therefore a significant burden on business" – Auditor

"We share the government's view that this limited proposal will make no practical difference. Companies seeking approval for issues of shares without pre-emption above 5% will always need to justify the need for such issues if they are to receive the approval of shareholders." – Investor

"In theory it should remove an administrative burden. However we would tend to agree with the DTI's view that in practice, UK shareholders would expect some explanation before they agree to disapply pre-emption rights above a minimum of 5% and therefore companies would need to produce a written report or risk failing to get approval" – Regulator

"We agree with the DTI's assertion that the real burden lies not with the requirement for a written report but with the cost and duration of the rights issue process" – Auditor

"[ ] the requirement to produce a written report is not a matter of concern to shareholders and therefore not an important protection. What does matter is the right to vote on dis-application, and the document is correct in presuming that the vote requires companies to make out a case for doing so" – Investor

"We agree with the Government that the removal of the requirement for a written report will not in practice remove an administrative burden, because UK shareholders expect to see a written report in any event before they approve a disapplication of pre-emption rights above a minimum (5% being the market standard)" – Accounting body

Q17: Do you agree with the Government's view on the setting of the share price at at least 95% of the market price, in order for the relaxation to apply?

We received 13 responses to this question.

All of the respondents agreed with the Government's view on the setting of the share price although 1 respondent suggested that 90% might be a more appropriate level for a smaller quoted company.

Quotes

"We support the government's proposed definition of market price" – Investor

"95% seems sensible for the larger quoted company, but 90% is more sensible at the smaller quoted level" – Company

"Yes, on the grounds that it is in line with the current guidance on discounts produced by the investor community in the UK" – Auditor

Q18: Do you have any other comments on the drafting of Article 29?

We received 5 comments in response to this question. These included:

"Delete the last sentence" – Company [Note: the last sentence relates to the right of shareholders to request the reasons for withdrawal or restriction of the right of pre-emption]

"Not as drafted, but we agree with the Government's view that this does not address the key points from a UK perspective" – Professional body

"It occurs to [us] that there are no powers for shareholders to prevent the withdrawal, only to request reasons for the withdrawal of their pre-emption rights. This could lead to a challenge being made under the Human Rights legislation" – Professional body

"We note that "*Shareholders may .. request .. the reasons for the restriction or withdrawal of the rights of pre-emption*", however, there appears to be no obligation on the company to comply with such requests. We agree with the Government that this right to request reasons should be exercisable at any time <u>before</u> the vote at the general meeting" – Accounting body

E. Enhancing standardised creditor protection in all Member States in situations of reductions of capital

Q19: Do you agree with the above proposal to standardise creditor protection across the EU?

We received 13 responses to this question.

12 of the respondents agreed with the proposal to standardise creditor protection across the EU as outlined in the proposal i.e. limiting the right of creditors to object to capital reductions only when it would impact on the company's ability to satisfy a claim. 1 of these expressed general support for the proposal but subject to implementation detail and another felt it might weaken the UK position for creditors. The 1 respondent who did not support the proposal stated that the burden of proof should remain with the company.

<u>Quotes</u>

"Yes. We believe that harmonisation is desirable, provided that it does not result in a standard being set that is the least onerous of all the Member States (the 'lowest common denominator'), and therefore of the least benefit to creditors" – Auditor

"Companies throughout Europe are generally able to operate throughout Europe so it is helpful if creditors are provided with basic protection in broadly the same format and manner throughout Europe" – Professional body

"Yes we agree. We believe it is beneficial to limit the right of creditors to object to reductions in capital to only in those circumstances where it would impact the company's ability to satisfy a claim" – Regulator

"Yes but it weakens the UK position for creditors and may not be easy to apply in practice" – Professional body

"[We] do [ ] not agree. In our view it can be difficult to prove "prejudice", and the burden of proof should remain with a company. That is, a company must prove "no prejudice"" – Professional body

"The proposal would limit the right of creditors to apply to the court to object to reduction in capital to circumstances where they can demonstrate that the result will prejudice the satisfaction of their claims. This is a sensible principle, which should apply across the EU" – Investor

Q20: Do you think there is any economic benefit in standardising creditor protection across the EU?

We received 11 responses to this question.

All 11 respondents believed there would be some economic benefit in terms of:

- Reduced cost of creditor guarantees, normally purchased by a company before applying to court;
- Greater protection for cross-border traders and thus increased flow of goods and services across the EU.

Quotes

"We believe that there might be some minor benefits in that a company seeking a capital reduction will normally buy creditor guarantees before applying to court. It may be that the cost of those guarantees might be cheaper as a result of this change" – Auditor

"We do not believe the economic benefits are significant, but we do think there are some advantages in clarifying creditor/company responsibilities" – Regulator

"We think it is desirable that investors in UK companies are not disadvantaged due to higher standards of creditor protection compared with other Member States. Similarly, it is desirable for UK creditors to be protected at least to the same extent as their European counterparts. However, we think the economic benefit of such measures would be marginal, and that fundamental reform of capital maintenance would provide much greater economic benefit, and so should be prioritised above such measures" – Accounting body

Q21: Does this achieve the right balance of interests between companies and their creditors?

We received 12 responses to this question.

The majority of respondents (10) thought that it does achieve the right balance or constitutes a move towards reaching the right balance. 2 of the respondents thought that it did not and were concerned about the practical implications, particularly for the ability of creditors to demonstrate that the capital reduction would prejudice satisfaction of their claims.

Quotes

"It is right and fair to ensure that creditors existing prior to the date of any capital reduction are protected. The second new paragraph in Article 32 (1) appears helpful in that it seems to allow the UK to retain ss 135 and 136 of the Companies Act" – Professional body

"Yes – obviously creditors need some form of protection, but companies should also have the right not have to enter into costly arrangements (bank guarantees/ settling debts before they have matured) to prevent this happening" – Regulator

"It will depend on the conditions laid down by Member States whether the right of creditors to obtain security for their claims can be set aside" – Investor

"If the right to object is restricted so they have to show their debts are put at risk – then movement is in the right direction" - Company

"We do not believe the proposal would work well in practice; for example, how can creditors credibly demonstrate that the capital reduction would prejudice satisfaction of their claims, especially as they will not normally have knowledge of other claims?" – Professional body

Q22: Do you have any other comments on the drafting of Article 32?

We received 5 responses to this question. 4 of these related to the clarity and degree of certainty contained in the current drafting. 1 comment questioned how the provision would work in practice without some means by which the creditor could have access to the full financial and creditor situation of the company.

Quotes

"We do not understand the reason for the words "at least" which appear twice. They create uncertainty" – Professional body

"The new article contains two important provisions: in the first paragraph the creditors have the right to security; in the second they have the right to commence an action to exercise that right. However, it is only the second right that has been made subject to the new condition (that the reduction has worsened their position). The first right also needs to be subject to that condition" – Auditor

"The problem of a phrase such as "right to obtain security" is vagueness. Under English law is this a "charge"? Certainly different EU jurisdictions will interpret such words differently" - Company

"We are supportive of this measure, but had some queries over the drafting" – Accounting body

"[ ] how can creditors assess any safeguards proposed to them by the company without access to the full financial and creditor situation" – Professional body

F. Introduction of "squeeze-out" and "sell-out" rights

Q23: Do you agree that this measure should not be included in this proposal and that any further consideration should be in the context of the proposed shareholder rights Directive?

We received 15 responses to this question.

12 of the respondents agreed that the measure should not be included in the current Directive proposal. The other respondents were indifferent. Specific issues raised included:

- "Squeeze-out" and "sell-out" rights, if introduced, should be introduced as a package;
- The thrust of the overall Directive proposal is deregulatory and these measures could not be considered as deregulatory;

- The mechanisms for ensuring effective minority protections should be well thought out before introducing the measure;
- The application of the measure would be very limited given the requirement for companies to de-list after the majority shareholder acquires 90%. Takeover situations are dealt with separately through the Takeovers Directive;
- The measure might provide a safeguard in situations where the majority shareholder exceeds the threshold over a period of time rather than in a takeover situation;
- The proposed shareholder rights Directive might not be a suitable vehicle for the introduction of this measure as it is expected to cover the mechanics of voting and annual general meetings.

Quotes

"We agree. However, we are strongly opposed to any proposal to introduce "squeeze out" rights for majority shareholders without comparable "sell out" rights for minority shareholders. "Squeeze out "and "sell out" rights are a package and should not be contemplated as separable components" - Auditor

"We agree with the government's view that this proposal does not fit comfortably within the context of a deregulatory directive. In the absence of a properly worked proposal for ensuring the protection of minority shareholders, we agree that this measure should not be included" – Investor

"We agree with this. The government notes that this is not a de-regulatory measure and that therefore it should be postponed and dealt with under a shareholder rights directive." – Professional body

"Yes, we would agree with DTI's assessment that this is not a deregulatory measure, and therefore should not be included in this proposal" – Regulator

"By the time it gets to 90% it should not be a listed company on the Official List. The impact of the differential AIM (not regulated) and Official List (regulated) market is curious" – Company

"It is difficult to conceive of a situation where ownership would cap 90 per cent without a mandatory bid. This is why the question of sell-out and squeeze-out is essentially one for the Takeover Directive [ ] but it may provide an additional safeguard against situations in one or other European markets where a majority shareholder passes above the threshold through a process of creeping control" – Investor

Q24: What should be the basis for computing "fair price"?

We received 12 responses to this question.

A number of suggestions were made as alternatives to the basis for calculation set out in the proposal and to supplement it. 2 respondents stated that it was not possible to prescribe one valuation method as circumstances would differ case by case. 2 respondents emphasized how difficult it would be to determine a fair price in these circumstances and 1 of these expressed concern about the proposals potentially deterring majority shareholders from seeking to rescue a company . Opinion was fairly evenly divided between those who supported a

valuation process involving an independent party and those who favoured basing the value primarily on the market price in some way. Specific suggestions included:

- Arbitration to apply if the proposed costs or valuation are argued to be unreasonable;
- Open market-value as determined by an independent FSA-authorised person;
- Price paid to minority shareholders should be no less than the price at which the majority shareholder acquired the shares taking them above the 90% threshold;
- The price used for the last transaction or the average of the transactions over a 12 months period;
- Consideration of issues such as the potential illiquid nature of the shares in question.

Quotes

"We believe it should be determined by an independent valuer as set out in the draft article" – Auditor

"We cannot specify a valuation technique nor should the legislation do so. We believe that the valuation methodology should be determined on a case by case basis by the valuer employed. Moreover, the difficulties of valuation are a telling objection to the proposal as a whole" – Auditor

"The only basis for arriving at a fair price is a valuation by an independent and competent body. We believe that the valuer should be appointed by the party who is being compelled to take action (so the minority holder in the case of a squeeze-out and the majority holder in a sell-out) and its reasonable expenses should be paid for by the other party" – Investor

"We would suggest open market value, assuming a willing seller and a willing buyer (with no discount for the fact that it is only a minority interest), as determined by a reputable independent FSA-authorised person, whose valuation is made available to all parties" – Professional body

"The fair price calculation may like to consider issues such as the potential illiquid nature of the shares in question, any ability those shareholders have to influence ongoing debates within the company due to unusual clauses in the articles of association, whether the controlling shareholders are content to continue to have a minority holding and whether the minorities are very keen to exit their position" – Investor

"This should be left to the independent expert (not authority) to ascertain, but presumably one of the factors would be the price paid in the transaction that took the acquirer's shareholding through the 90% barrier" – Auditor

"A 'fair price' will depend largely on the specific circumstances of the case however where possible it should be the 'Market' price" – Professional body

"In [our] view, it is not possible to answer this question. Any basis for computing a "fair price" will vary with circumstances and the shareholders' own view of a "fair price" – Professional body

Q25: Do you agree that it should be made clear that the obligation to sell at a fair price should be "in cash"?

We received 14 responses to this question.

All but 1 respondent agreed that it should be made clear that the obligation to sell at a fair price should be in cash although several qualified this by stating that alternatives should be possible where the minority shareholder agrees.

Quotes

"Yes though the minority shareholder should be entitled to receive some other form of consideration if he consents" – Auditor

"A takeover may have been done on a share for share basis, so that it might seem unfair if the remaining rump is paid out in cash. Notwithstanding this it would be even more unfair to disadvantage an unwilling minority by paying for their shares in anything other than cash" – Professional body

"We would have thought that if it is not a takeover then the price has to be paid in cash. Also if it is an independent listed company then fair price is market price with no discount" – Company

"No. It should be in whatever instrument and mix contained in the main offer, or if multiple acquisitions totalled the 90%, in whatever mix offered in the previous 12 months the seller prefers" – Company

"Yes, unless the minority shareholder agrees to non-cash consideration. Such non-cash consideration would need to be valued under the same rules as non-cash consideration given for shares issued" – Accounting body

Q26: Do you share the Government's concerns about the potential negative impacts of extending these rights beyond takeover situations?

We received 13 responses to this question.

9 of the respondents shared the Government's concern about the potential negative impacts. 2 of the remaining respondents, whilst not opposed to extending the rights beyond takeover situations, agreed that more thought needed to be given to protection of minority shareholder interests and an effective mechanism for determining fair price. 2 respondents did not share the Government's concerns.

Quotes

"We believe squeeze out and sell out rights are important whether the issue arises from a takeover situation or not. The minority shareholder is protected as long as his shareholding is properly valued. We understand the DTI's concern on the difficulty in arriving at a 'fair price'; guidance on valuation may need to be developed in this area" – Auditor

"We agree that further time is needed to consider the possible negative impacts [ ] There is a possibility of abuse, at least over the fair price"" – Professional body

"Yes. We are left with a feeling that we are being presented with a solution looking for a problem. This area needs more thought before it is driven forward" – Company

"Yes, we have serious reservations about this" – Professional body

"Provided the necessary protections are in place, we believe that it is appropriate for these rights to extend beyond takeover situations" – Investor

Q27: Do you have any other comments on the drafting of Articles 39a and 39b?

We received 3 responses to this question. The comments included the following:

"Paragraph 1 should specify that the Article relates to equity capital only" – Auditor

"The penultimate sentence refers to '*within three months after the minority shareholder was required to sell and the price was announced in accordance with paragraph 1.*' However paragraph 1 merely refers to a fair price. There does not appear to be any 'announcement' of price required" – Professional body

"It is likely the new rules would require the courts to become more closely involved in private commercial negotiations (on the assumption that unresolved disputes will occur) than has been the case in the past. This is unwelcome" - Auditor

G. Longer- term review of the capital maintenance regime

Q28: Do you think that the overall package of current proposals will make a significant and positive difference to companies wanting or needing to restructure their capital? If not, what other changes would you like to see?

We received 11 responses to this question.

The majority (8) of the respondents thought that the set of proposals under discussion would not make a significant and positive difference to companies as they had not introduced sufficient flexibility and left the rules complicated. 1 respondent felt that the proposal might be of some benefit in other Member States but not the UK. However, 2 of the respondents did feel that the changes, although not significant, were a step in the right direction and should be viewed as an interim step on the path to more radical reform. 2 respondents expressed the view that the changes proposed would make a difference to companies.

8 respondents pointed to the need for there to be a fundamental review of the capital maintenance regime in order to make it easier for companies to restructure their capital.

<u>Quotes</u>

"We believe some proposals will be of assistance whilst others will[ ] have little practical benefit. Overall this seems to be little more than tinkering on the edges" – Auditor

"The proposed changes to the capital maintenance regime, taken as a whole, do not make a significant, positive difference to the capital maintenance regime [ ] What is needed is a fundamental review" - Auditor

"The government is dubious whether the overall package of deregulation will introduce significant flexibility. We share those views, and regard the current moves as welcome but insufficient" – Professional body

"We would agree with the Government's assessment that the proposals should be viewed as an interim measure and that a more fundamental review is needed in order to truly assist companies that want or need to restructure their capital" – Regulator

"Possibly in EU Member States but not so much in the UK" – Professional body

"We consider that the current package is a useful tidying up exercise that goes as far is needed at present. We do not consider that there is an urgent need for further reform" – Investor

"We do not think the current proposals will make a significant difference, and we strongly urge the DTI to consider further urgent capital maintenance reform" – Accounting body

Q29: Do you agree that a fundamental review of the capital maintenance system and of alternative approaches is a high priority for the EU?

We received 19 responses to this question.

16 of the respondents agreed that this is a high priority whilst 3 of the respondents disagreed. Specific reasons for this high priority included:

- The need to break the direct link between accounts prepared for financial reporting purposes and the making of distributions;
- The impact of changes in accounting rules, specifically the move away from realised profits to fair value, on the distributions available to companies and the impact of non-cash deficits on a company's ability to pay dividends;
- The need to review the balance of interests of creditors and shareholders in relation to dividend payments;
- Consideration of the feasibility of a solvency test as a basis for recommending a dividend payment and the implications for this kind of test on the roles and responsibilities of directors;
- The complexity and expense of the current regime which does not always succeed in meeting its objectives;

Quotes

"Yes. We would not wish to pre-judge the outcome of such a review but we would urge the Commission to consider a 'solvency basis' as one of the alternative approaches to capital maintenance" – Auditor

"We should also mention that the current regime is becoming flawed as it is based on a supposition that realisation is the key driver of accounting profit recognition, and thus it based distributions on realised profits as shown in the accounts; whereas accounts, especially under IAS, are becoming less and less driven by realisation" – Auditor

"[ ] We believe that anything that can be done to simplify the capital maintenance regime would be of benefit to companies"– Regulator

"For the reasons explained [ ] we believe that such a review should be carried out as a matter of urgency with a view to breaking the direct link between accounts

prepared for financial reporting purposes and the making of distributions" – Auditor

"The whole question of dividend payments involves balancing the interests of creditors and shareholders, and requires proper review. We welcome the European Commission Accounting Regulatory Committee's decision to explore the impact of non-cash deficits on a company's ability to pay dividends and urge interested parties to continue to press for reform"- Accounting body

"If a solvency basis is considered, it will also be fundamental that the roles and responsibilities of directors are clearly defined. Any solvency projections will rely on judgments for which the directors have sole responsibility" – Accounting body

"We do not consider that there is an urgent need for reform [ ] we would therefore urge the Government to add fundamental review of the 2nd Directive to the list of initiatives which could be dropped" - Investor

H. Cost savings and benefits

Q30: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are also welcome on any unintended consequences or other implications

There were no responses to this question.

2.4. SUMMARY OF RESPONSES ON THE ANTICIPATED PROPOSAL CONCERNING THE 14TH COMPANY LAW DIRECTIVE (TRANSFER OF REGISTERED OFFICE OF A COMPANY)

Q1: Would it be useful to have provisions which enabled companies in the UK and other Member States to transfer their registered office to another Member State? If so, do you think that the right means of facilitating the cross-border transfer of a company's registered office within the EU is through a co-ordination Directive?

We received 12 responses to this question. 9 of the respondents thought that it would be useful to have provisions permitting the transfer of a company's registered office within the EU (although some of these questioned whether there would be much demand for such provisions and, accordingly, whether this issue should be a priority) whilst 3 of the respondents did not think such legislation was necessary or appropriate.

Specific issues raised included:-

- The relationship between this proposal and the existing right of companies ("SEs") formed in accordance with the European Company Statute Regulation to transfer their registered office (the view was expressed that there was no need to extend this provision to other types of company as transfer of a registered office was already achievable by the SE corporate form);
- Concerns were expressed about undermining legal and commercial certainties (how, for instance, might it be ensured that transfer of a registered office was not used by companies as a device to avoid their debts);
- It might be better to leave it as a matter for Member States to determine whether or not they wished to provide for inward and outward migration of companies; and
- Transfer of a registered office should not become a means of encouraging "forum shopping" by companies to migrate to the Member State with the lowest regulatory standards.

Quotes

"We agree that there should be provisions that enable companies, both public and private, in the UK and other Member States to transfer their registered office to another Member State. Use of a co-ordination directive would ensure that there is a consistent legal framework for such transfers" – Auditor

"Such provisions, subject to the existence of sufficient pre-migration rules, are useful in allowing companies to migrate if necessary. However, we do not consider the matter to be of such importance that it should be the subject of a co-ordination Directive and we believe it is appropriate for Member States to determine whether outward and inward migration should be permitted" – Auditor

"Since the proposal to introduce legislation on this matter has been adopted as a priority measure by the Commission, it seems clear that there is to be a Directive on this matter. We do not have any objections to the provision of an option for

companies to transfer their registered offices, and are only concerned to ensure that there are suitable safeguards to ensure that the interests of creditors, shareholders and other stakeholders are protected" – Accounting body

"Yes, subject to safeguards for minority and other shareholders. [We don't want to see companies shopping around for member states with the lowest standards or lowest enforcement of compliance with EU standards]" – Investor.

"[We] consider[ ] that it would be helpful to have provisions which enabled companies in the UK, and other Member States, to transfer their registered office to another Member State, but suggest[ ] that this should be in the context of the European Public Limited Companies Regulations 2004, that is, by becoming a Societas Europaea (SE). All such companies should be able to transfer their registered offices within the EU" – Professional body

"Such legislation, subject to there being sufficient pre-migration rules, could facilitate freedom of establishment within the EU. However, we query the statement in the background material to the underlying EU consultation that there is a "pressing need" for legislation at EU level allowing companies to transfer their registered office from one Member State to another. This would not appear to be the case for UK-based market operators, and therefore we query whether this Directive would make the best use of EU legislative time at this stage" – Accounting body

Q2: Do you agree that the scope of the Directive should be sufficiently broad to include both public and private limited companies? Are there any regulatory areas where you think special provision has to be made in relation to the transfer of companies?

We received 10 responses to this question all of which considered that both public and private limited companies should be included within the scope of the proposal. It was queried whether it was intended other types of corporate vehicle should be caught such as unlimited companies, limited liability partnerships, community interest companies and companies incorporated by Royal Charter. One respondent felt that a lighter touch approach should be taken in bringing forward the proposal in relation to companies which were not public interest entities.

On the issue as to whether the proposal gave rise to any special regulatory concerns, 4 respondents considered that no such concerns arose (one respondent noting that companies incorporated under the European Company Statute Regulation could already use such a transfer procedure irrespective of their field of activity), whilst 2 respondents considered that the Government should analyse how the proposal would work in particular fields of business activity (for instance, in relation to insurance or financial service sectors).

<u>Quotes</u>

"We do not have any objection in principle to the UK permitting outward or inward migration of both public and private limited companies. Whilst we do not have specific concerns with respect to a particular sector, we should like the Government to consider carefully every sector that uses limited companies as a vehicle for its activities before allowing migration from the UK" – Auditor

"We agree with the scope of the Directive. However, we are unaware of any regulatory areas where special provision should be made" – Regulator

"We do not see why both types of UK company should not come within the scope of the new Directive. LLPs too would appear to come within it" – Accounting body

"We believe principles can apply to both public and private companies, but the detailed regulation can and should vary in appropriate circumstances, with non-public interest entities receiving a lighter touch in regulatory terms" – Investor

"Yes, in our view the Directive should cover all forms of limited company, the salient features of which are understood throughout the Member States to be that they have legal personality and separate assets which alone serve to cover their debts. The Government should consider carefully every sector, to ascertain whether special procedures should be laid down e.g. for financial services or insurance sectors" – Accounting body

Q3: Do you agree that the proposal should only address the cross-border transfer of the registered office?

We received 8 responses to this question all of which agreed that the proposal should only address the cross-border transfer of the registered office.

Quotes

"This seems appropriate; other decisions can best be taken within the company and without the need for EU-wide co-ordination" – Investor

"Yes. There is nothing at present to restrict the transfer of a 'head office' or to prevent companies from operating in other member states" – Accounting body

"Yes, we agree that the proposal need not deal with transfer of head offices, which has already sufficiently been dealt with by European Court of Justice decisions" – Accounting body

Q4: Are you satisfied that sufficient clarity is already provided in relation to the issue of transfer of the head office of a company by the European Court of Justice case law? If not, what further issues should be resolved by EU legislation on this matter?

We received 3 responses to this question all of which considered that sufficient clarity is already provided.

Quote

"The import of the ECJ case law is substantially clear, we believe. It appears to us that few if any barriers to cross-border transfers will be countenanced" – Investor

Q5: Do you think that the proposed approach in relation to the taking of a decision by a company to transfer (relying on Member States' domestic laws in relation to alteration to a company's Memorandum and Articles) is the right one?

We received 9 responses to this question. All 9 of the respondents thought that the proposed approach is the right one in principle. However, concerns were expressed about the possible need for additional protections to be provided for

creditors (such as a right for creditors to object to a transfer proposal once it had been published by a company).

Quotes

"In principle, yes. However, we suspect that the detail would need to be thought through very carefully" – Auditor

"Yes, we believe that this mechanism provides the appropriate protections: full disclosure to shareholders and then formal approval as if this were a change to the company's constitutional documents" – Investor

"Yes. But we suggest that there should be an additional requirement that, following agreement by members, companies should publish their intentions via the Gazette and/or newspapers. Creditors should be entitled to object to the planned transfer within a specified period. The members' resolution, and ideally a follow up notice to confirm that no objection has been received, and details of the new registered office, should be filed with the national information agency." – Accounting body

"Yes, as long as minority and other shareholder rights are protected in Member States' domestic laws" – Investor

"Regarding the decision making process, we agree that members should vote on such decision, but we believe creditors should also be given the opportunity to object, for example, as under capital reductions or reconstructions in the UK. We also believe it should be mandatory (not optional) for Member States to implement measures to ensure protection for creditors and minority shareholders opposed to the transfer, which should be at least equivalent to their domestic procedures and protections for creditors and minority shareholders in capital reductions and reorganisations" – Accounting body

Q6: Are there any special provisions (apart from publication and the rules governing the decision to transfer) that you consider should be included to protect shareholders and creditors?

8 respondents commented on this matter. Specific issues raised included:-

- Possible need for rights of objection to the transfer to be given to shareholders and/or creditors;
- Special issues relating to the rights of minority shareholders which might be lost where a company chose to transfer on the basis of the majority shareholders' decision (one solution suggested was that such shareholders be given a statutory "sell-out" right at an equitable price);
- Whether it was appropriate to allow creditors of a company the specific right to renegotiate contractual terms where a company transferred;
- A number of practical difficulties needed to be resolved (particularly for Companies Registries within the EU, such as in relation to names adopted by transferring companies, accounting reference dates that would apply, the degree of verification that it was right to expect the registry to undertake, retention of the records of a company that had transferred, etc.); and

- Tracing the location of a company once it transferred from one Member State to another and matters related to the service of documents on such a company.

Quotes

"We note that it would be possible for a majority of shareholders to approve the transfer of the registered office to a Host State whose national law affords less protection to minority shareholders. The minority would not be able to block such a transfer and they would find themselves disadvantaged. We suggest that the co-ordination directive should provide that all Member States award specific protection such as "sell out" rights so that minorities are not locked in to a position which they find untenable" – Auditor

"We strongly support the inclusion in the proposed directive of a right of objection for shareholders and creditors such that they might apply to the courts and, if the transfer is considered prejudicial to their interest, stop the outward migration. A switch-over from one national company law to another is a major change for shareholders and creditors. They should be attended fair opportunity to have objections heard" – Auditor

"Minority shareholders who object to a move approved by the majority should be given an opportunity to sell their shareholding at a fair price. Creditors should not face automatic novation of their contracts with the transferring company, but should have the right to renegotiate should they wish to apply additional protections to their terms of business with the transferred company" – Investor

"The overriding protection for creditors should be that they are able to locate a company should they wish to contact it - this would mean that the Home State should retain a record of the new address of the registered office" – Auditor

"In the case of creditors, we think they should be given the right to object to migration such that they might apply to the courts and, if the transfer is considered prejudicial to their interest, stop the outward migration. In the case of minority shareholders, they should either be given a similar right to object or specific sell out rights" – Accounting body

Q7: Do you think that the outline proposals are sufficiently clear concerning which national law will govern the transfer decision and the company once the transfer has taken place?

We received 6 responses to this question. 2 of the respondents thought that the proposals were sufficiently clear whereas 4 of the respondents thought they were not. Particular areas on which further clarification was sought included the protection to be afforded to shareholders and creditors prior to the transfer of the company; that the home Member State's law would not be imported into the Host Member State when the transfer took place; that the company would be required to fully comply with the applicable requirements of the Host Member State's law following transfer; issues related to the respective Companies Registries involved in the home and host Member States and certainty as to retention of the public records concerning the company; clarification that the transfer would not affect the legal identity of the company; and the possible need for transitional arrangements to be made.

Quotes

"There are two issues which we suggest need to be clarified. Firstly, it should be understood that, following a transfer, while the company loses the legal identity it had in its home state and acquires a new one in its new host state, this does not affect the company's continuing status. Therefore, all contracts and commitments entered into prior to transfer will continue in force and the rights and responsibilities associated with those contracts and commitments will continue as they existed at the outset. Secondly, attention needs to be given to how the company's public record is to be dealt with. Interested parties in both the home state and the host state will have an interest in a transferring company's details. In the home state, the information agency will need, at the very least, to disclose the details of the company's new registered office and details of how information on the continuing activities of the company can be accessed. In the host state, we suggest that, as well as the documents which are required to be filed to incorporate the company there, there should be a requirement for the company to file its constitutional documents" – Accounting body

"They appear clear in principle but in practice it will be unworkable to switch completely from one law to another on a particular date and areas of legal uncertainty and challenge are likely. Certain transitional arrangements may have to be considered" – Professional body

Q8: Do you agree that the correct approach in relation to employee participation provisions should be that, as a general principle, the law of the Host State will apply (except where there is a higher level of participation – where such participation rights exist – in the Home Member State)?

We received 8 responses to this question. 4 of the respondents agreed, in principle, that the law of the Host State should apply (unless there was a higher level of participation in the Home Member State) whilst 3 of the respondents disagreed. The other respondent asked whether such participation provisions might provide a disincentive for UK companies to utilise the migration provisions.

Quotes

"We have not seen much evidence of UK companies using SEs as a vehicle for moving to another Member State. In large part, this may be due to the onerous procedures in the area of employee participation, with negotiations on participation arrangements lasting up to 12 months" – Auditor

"The rules of the Host State should apply without any regard to the employee participation rights that existed in the Home Member State. For example, creditors and shareholders who had hitherto had a different set of rights in the home Member State, will now have different, possibly lesser, rights in the host Member State; if creditors and shareholders are unable to bring with them their old home Member State rights, why should employees be singled out as a special case?" – Auditor

"We believe that the law of the Host State should apply to a company which has decided to transfer to that state. The laws of the former Home State should not be applied in any circumstances; to do otherwise runs counter to the underlying

intent of this proposal and to the fundamental principle of freedom of movement with the EU" – Investor

"We agree: as noted in the consultation, it is highly unlikely that a UK company would be required to enter into negotiations if it wished to transfer its registered office to another Member State" – Regulator

"We disagree. In our view, the national law of the host Member State should govern employee participation in all circumstances (even where there is a high level of participation) as otherwise migrations could result in many different varieties of UK company, governed by different employee participation laws, which would be confusing and unworkable, and potentially in conflict with existing UK company law" – Accounting body

Q9: Do you have any other comments on the provisions on employee participation?

The only respondent to comment further considered that it should not be a matter for the Companies Registry to have to certify the adequacy of employee involvement provisions.

Q10: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are invited, particularly, on the following aspects of the RIA:

a.) The likely number of UK companies (in particular, small companies) which might choose to use the cross-border transfer of registered office procedure proposed under the Directive;

Comments made by the 4 respondents were as follows:-

"We suspect that few companies would choose to do this" – Auditor

"This is difficult to quantify; it depends on how many opportunities are identified by smaller companies in Europe for them to take advantage of. If a number do take up the transfer procedure and are seen as being successful then more will follow, initially however we do not see the take up as being that great" – Regulator

"We think the number will be very small" – Professional body

"We think few companies would choose to do this" – Accounting body

b.) Whether section 9 of the RIA correctly identifies all likely costs of the transfer procedure and the cost estimates used are reasonable;

Comments made by the 2 respondents were as follows:-

"This would appear to be a reasonable cost estimate" – Regulator

"There will be additional costs of legal clarification and possibly challenge, translation of documents etc" – Professional body

c.) Any negative or disproportionate costs for small business that may arise from the proposal.

Comments made by the 3 respondents were as follows:-

"The draft directive states that the cost of the transfer is to be kept to the minimum. We assume that the EU is not going to set fees. As a Trading Fund Companies House will want to be able to re-coup their costs of transfer. [ ] How are [Companies House to be] expected to fund this? If transfer costs are more than incorporation costs, which seems likely, will Companies House be able to charge more for transfer than for incorporation? If a company's records are also transferred costs are likely to be higher than if they remain in the original Member State" – Regulator.

"We doubt whether many smaller companies will choose to use the cross-border transfer of the registered office. We have no further comments" – Auditor

"It is difficult to see how migration would be cost-effective for small businesses" – Professional body

ANNEX A – LIST OF ALL RESPONDENTS

Accounting Standards Board (ASB)

Association of British Insurers (ABI)

Association of Corporate Treasurers (ACT)

Association of Certified Chartered Accountants (ACCA)

Auditing Practices Board (APB)

Bank of England

Barclays

Bonnier Business Information

Boustead

Chartered Institute of Management Accountants (CIMA)

Companies House

Confederation of British Industry (CBI)

Deloitte

Financial Reporting Council (FRC)

Grant Thornton

Hermes

Institute of Chartered Accountants in England & Wales (ICAEW)

Institute of Chartered Accountants of Scotland (ICAS)

Institute of Chartered Secretaries and Administrators (ICSA)

Institute of Credit Management (ICM)

Investment Management Association (IMA)

KPMG

Law Society of Scotland

London Stock Exchange (LSE)

National Association of Pension Funds (NAPF)

PricewaterhouseCoopers (PwC)

Quoted Companies Alliance (QCA)

We received one additional response that, however, is being treated as confidential as per the request from the respondent.