Response to the European Commission's Action Plan on Company Law and Corporate Governance

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by the former

Reflection Group on the Future of EU Company Law

The members of the former Reflection Group on the Future of EU Company Law, which published its report in April 2011, decided to publish their views on the "Action Plan on European Company Law and Corporate Governance" of the European Commission of 12 December 2012 as well as subsequent and related developments. We support the Action Plan and note that it has endorsed many proposals included in the report of the Reflection Group. However, some proposals have not been included, although they might be considered at a later stage (loyalty shares, review of the role of independent directors, the Single Member Company), and we reiterate our support for them. On the issue of cross border transfer of seat, we regret that the Commission is not more ambitious. We also reiterate our support for substantive measures in areas related to cross-border operations of companies, including improving cross border shareholder identification. We also support strong monitoring of whether a company has complied with a corporate governance code or, if it has not, it has provided a good quality explanation therefor, rather than imposing substantive regulation. In general, in the areas where substantive regulation is necessary, we call on the Commission to move carefully.

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I. Introduction

The Reflection Group on the Future of EU Company Law was established by the European Commission in December 2010. The members of the Reflection Group were appointed in their personal capacity and did not represent particular institutions or Member States (MS).[1] The Reflection Group delivered its report on 5 April 2011.[2] The Reflection Group Report was subsequently discussed at a conference held in Brussels on 16 and 17 May 2011.[3] Based on an on-line consultation in February 2012, the European Commission published an Action Plan on European Company Law and Corporate Governance on 12 December 2012.[4]

The members of the former Reflection Group met on 14 March 2013 to discuss the Action Plan with a view to making public their response.[5] The views expressed by the members are laid out in this paper and represent their personal opinion. [6]

In the opening part of the Action Plan, the European Commission notes that the different measures envisaged will not have the same scope, that all initia-

1 The members were José Engrácia Antunes, Theodor Baums, Blanaid Clarke, Pierre-Henri Conac, Luca Enriques, András Hanák, Jesper Lau Hansen, Harm-Jan de Kluiver, Vanessa Knapp, Noëlle Lenoir, Leena Linnainmaa, Stanislaw Soltysinski, and Eddy Wymeersch.

2 The Reflection Group Report (RG Report) is available on-line at: http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf and at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1851654.

3 The recordings of the sessions of the Conference and written contributions can be found at the European Commission (EC) web-page dedicated to company modernisation: http://ec.europa.eu/internal_market/company/modern/index_en.htm

4 The Action Plan (AP) is available on-line at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF

5 The members were able to meet in Luxembourg thanks to financial support offered by the University of Luxembourg and the University of Copenhagen at the initiative of Professors Pierre-Henri Conac and Jesper Lau Hansen.

6 While not all of the present authors would, as individuals, unreservedly subscribe to each of the views expressed herein, they do share the core understandings about the EU's role in European company law which underlie such views, as previously stated in the Reflection Group's 2011 Report. Hence the preference for not indicating personal dissenting views.

tives will be subject to ex-ante impact assessments, and that care will be taken not to inflict unnecessary burdens on companies, particularly small and mid-sized enterprises (SMEs). The Reflection Group welcomes this approach, which fully reflects its own emphasis on a focused approach that is based on a careful vetting of facts, focuses on the relevant problems, and avoids broad and imprecise categorisations.[7]

The European Commission groups its initiatives into three areas: enhancing transparency, engaging shareholders, and supporting companies' growth and competitiveness. It also proposes to codify various legal instruments to make the regulatory framework more user-friendly. The Reflection Group's response is structured in the same way, addressing the issues raised as well as commenting on issues not included in the Action Plan.

We note that the European Commission published a Green Paper on long-term financing in March 2013[8] and that this also covers some issues relevant for company law and corporate governance. The Green Paper refers to the possibility of giving further consideration to a number of specific proposals suggested by the Reflection Group in 2011 aimed at encouraging greater long-term shareholder engagement. These include granting increased voting rights or dividends to long-term investors.[9]

II. Enhancing transparency

1. Disclosure of board diversity policy and management of non-financial risks

In the Action Plan at p. 6, the European Commission concludes:

> In order to encourage companies to enhance board diversity and give greater consideration to non-financial risks, the Commission will make in 2013 a proposal to strengthen disclosure requirements with regard to their board diversity policy and risk management through amendment of the accounting Directive.[10]

7 Cf. RG Report (n. 2) at 8.
8 See Green Paper, *Long-Term Financing of the European Economy*, Brussels, COM(2013) 150/2, 25 March 2013, at 14 ("Ideas have also been advanced to encourage greater long-term shareholder engagement, which could be subject to further consideration, such as analysing the possibility of options around granting increased voting rights or dividends to long-term investors")
9 Ibid at p.14. Cf. RG Report (n. 3.1.3) at 46.
10 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

In respect of disclosure of board diversity policy, we support the observation that it is crucial for the proper function of a board that it be composed in such a manner that it is sufficiently diverse to engage with all relevant challenges that may face the company and its operations and, consequently, we support openness and disclosure of company policies on recruiting at all levels of the company. Even where other important societal considerations are at stake, such as ensuring gender representation, it is important that regulation of board composition is drawn up as part of company law and that directors must be the best persons for the job, both to ensure the efficient functioning of company law and to avoid, or at least minimise, the disruption of the existing distribution of powers that allows shareholders to choose their boards reflecting private property rights.

In April 2013, following the Action Plan, a proposal to amend the Accounting Directive was introduced,[11] to require disclosure of certain non-financial information in companies above a certain threshold[12] and a description of the company's diversity policy in large listed companies on a comply-or-explain basis. The Commission noted that this option was preferred by most stakeholders over other options such as a compulsory diversity policy or action focusing only on recruitment policy.

The proposal in respect of disclosure of board diversity policy is applicable to companies that fulfil two of the three following criteria: balance sheet total 20 M EUR, net turnover 40 M EUR and 250 employees.[13] The Reflection Group notes that the proposed threshold is relatively low and, at least in some MS, would impose transparency requirements on companies with small boards. The Reflection Group suggests that the threshold be harmonised with the proposal on non-financial reporting directive of April 2013.[14]

Taking into consideration the complexity and diversity of governance systems within the Union, we believe such a soft law approach to requiring disclosure of board diversity policy is preferable.[15] A soft law approach is not necessarily weak and could be strengthened by the use of "naming and shaming" for

11 Proposal for a Directive amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups (2013/0110 (COD))

12 Article 1(1)(a) provides that the obligation to include a non-financial statement containing information relating to at least environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters will only apply to those companies whose average number of employees exceeds 500, and exceeds either a balance sheet total of 20 million euros or a net turnover of 40 million euros.

13 Art. 19(4) and 3 of Accounting directive 2013/34/EU.

14 See footnote 12.

15 See, however, in favour of a hard law approach, D. Ahern and B. Clarke, "Can a 'Comply or Explain' Approach Inspire an Effective Commitment to Board Diversity?"

companies which do not achieve targets. In addition, a hard law approach can lead to box ticking whereas what really matters is to encourage the right tone at the top. We consider that the right tone at the top needs to be strengthened in general in order to have effective application of corporate governance codes.

The Reflection Group also notes that, before the publication of the Action Plan and at the initiative of DG Justice, the European Commission introduced, in November 2012, a proposal for a Directive on improving the gender balance among non-executive directors of companies listed on stock exchanges.[16] This proposal imposes on listed companies that do not have at least 40 per cent of non-executive directors of each gender, other than SMEs,[17] an obligation to make appointments to those positions on the basis of a comparative analysis of the qualifications of each candidate, applying pre-established, clear, neutrally-formulated and unambiguous criteria, in order to attain the said percentage by 1 January 2020, at the latest. The Directive leaves it to Member States to lay down rules on sanctions applicable in case of breach of this Directive.

As stated above, the Reflection Group rather supports an approach based on transparency requirements.

In general, where initiatives such as this are directed at current problems, they should be subject to sunset clauses to ensure their continued relevance is reviewed after an appropriate interval of time. We note that such a sunset clause is included in the proposed directive of November 2012 on improving the gender balance among non-executive directors of companies listed on stock exchanges.[18]

In respect of risk management, we observed in the Reflection Group Report that the elaborate and costly US Sarbanes-Oxley Act of 2002, especially its Section 404 on *Management assessment of internal controls*, did not prevent the financial crisis and that there are, therefore, limits to what can be achieved by increasing disclosure or substantive obligations relating to risk management. However, this should not be an obstacle to improving the situation at the

Presentation to the 12th European Company Law and Corporate Governance Conference (17 May 2013), Working Paper forthcoming.

16 Proposal for a Directive of the European Parliament and the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures, Brussels, 14. 11. 2012, COM(2012) 614 final.

17 SMEs are companies whose average number of employee is less than 250 and whose turnover is equal to or less than 50 million euros or their balance sheet total is equal to or less than 43 million euros.

18 Art. 10(2) of the Proposal for a Directive of the European Parliament and the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures, Brussels, 14. 11. 2012, COM(2012) 614 final.

European level.[19] In particular, the increased awareness of risks should imply that boards and management are expected to explain, avoiding a boilerplate approach, risk management functions and risk management policies, structures, and procedures in the corporate governance report, which can be done by amending the Accounting Directive 2013/34/EU.[20] Consequently, we support the European Commission so far. We note that the Directive already requires companies to describe, in its annual report, the principal risks and uncertainties the company faces and that the analysis thereof should include non-financial key performance indicators relevant to its particular business, to the extent necessary to understand the company's development, performance, and position.

We reiterate the view expressed in the Reflection Group Report that a general duty should be imposed on the board to take into account the risks of the company and to provide for the safe and prudent organisation of its affairs. The transparency requirements and the basic duties of the board to avoid financial risk, as well as non-financial risks (e.g., environmental, social, employee-related matters, respect of human rights, anti-corruption, and bribery aspects) are matters for mandatory law at the national, MS level. In view of the complexity of many of these issues, and the differences in national corporate governance structures, this risk management issue is also best dealt at the MS level. However, it could also be dealt with at the EU level by way of a Recommendation and guidelines on best practice on specific techniques of risk management or technical issues.

The proposal of reform of the Accounting Directive of April 2013 referred to above asks large companies to disclose a non-financial statement containing information relating to at least environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters on a comply or explain basis. [21] The statement will include (i) a description of its policies, (ii) results and (iii) the risks related to these matters and how the company manages those risks. The Reflection Group, with one member dissenting,[22] welcomes this development, as it should improve the taking into account of non-financial risks and is based on a disclosure approach.

19 RG Report (n. 2) at 39.

20 Ibid. at 44.

21 Art. 46 a, proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non- financial and diversity information by certain large companies and groups, Strasbourg, 16. 4. 2013, COM(2013) 207 final.

22 See Luca Enriques and Dirk Zetzsche, *The Risky Business of Regulating Risk Management in Listed Companies*, forthcoming in ECFR 2013.

2. *Improving corporate governance reporting*

In the Action Plan at p. 7, the European Commission concludes:

The Commission will take in 2013 an initiative, possibly in the form of a Recommendation, to improve the quality of corporate governance reports, and in particular the quality of explanations to be provided by companies that depart from the corporate governance codes.

We support the drive to make governance reporting clearer and more relevant, which includes the need to improve reporting – subject to the comply-or-explain principle – to ensure that companies provide adequate and understandable explanations in case of non-compliance.[23] The quality of reports and explanations varies very much from company to company, and even from country to country, so that a hard law approach is not warranted at the European level. Adequate reporting should receive express attention and be dealt with by MS. However, this should not lead to higher regulatory costs for all companies. Therefore, as mentioned in the Action Plan, we consider that the appropriate instrument to be chosen at the European level, if any action is warranted at all, is a recommendation. As to the content of such a recommendation, the Commission should proceed carefully and encourage markets and investors to exercise pressure if the quality of reports is poor.

Also, the Commission could encourage the establishment of national external monitoring bodies, such as the Dutch Corporate Governance Code Monitoring Committee[24] and the Swedish Corporate Governance Board.[25] The Financial Reporting Council in the UK is a different model, as it is not a monitoring body, but is also certainly worth considering.[26] These are all valuable models that do not go as far as the French, Spanish, or Portuguese regulator's direct intervention. In case the Commission would like to encourage the establishment of the first approach, a broad study on the efficiency of each approach would be highly advisable. In addition, or in the alternative, the Commission could also mandate "naming and shaming".

3. *Shareholder identification*

In the Action Plan at p. 7, the European Commission concludes:

The Commission will propose, in 2013, an initiative to improve the visibility of shareholdings in Europe as part of its legislative work programme in the field of securities law.

23 See also EcoDA, *Comply or Explain, Preserving Governance Flexibility with quality Explanations*, Report Ecoda Annual Conference 2012.

24 http://commissiecorporategovernance.nl/

25 http://www.corporategovernanceboard.se/

26 http://www.frc.org.uk

Although the nature of the initiative is yet unknown, we strongly support the principle that a company should be able to identify its shareholders. We hope, furthermore, that increased visibility of shareholdings will enable foreign shareholders to vote in a timely and less costly manner, which is not, at present, available throughout the European Union. A simple and efficient solution should be worked out with the financial sector, especially the organisations involved in holding investor securities on their accounts.

4. *Strengthening transparency rules for institutional investors*

In the Action Plan at p. 8, the European Commission concludes:

> The Commission will in 2013 come with an initiative, possibly through modification of the shareholders rights Directive,[sic] on the disclosure of voting and engagement policies as well as voting records by institutional investors.

We support the need to ensure that institutional investors represent the best interests of those for whom they act and support efforts to enhance accountability. We believe that this can be served by, *inter alia*, the disclosure of the institutional investors' policy of engagement; whereas we believe it would be counterproductive to mandate any engagement.

III. Engaging shareholders

1. *Better shareholder oversight of remuneration policy*

In the Action Plan at p. 9, the European Commission concludes:

> The Commission will propose in 2013 an initiative, possibly through a modification of the shareholders' rights Directive, to improve transparency on remuneration policies and individual remuneration of directors, as well as to grant shareholders the right to vote on remuneration policy and the remuneration report.

We support the observation that shareholders, as residual claimants in the company, are well positioned to serve as a check on managerial self-interest and, consequently, we support the idea that shareholders should have a say on pay. However, we note that say-on-pay can also produce unintended consequences. For instance, the experience in Sweden shows that say-on-pay measures led to boiler plate generic texts that are copied year after year, whereas in MS without say-on-pay measures, remuneration statements can be more detailed and specific.

In addition, it should not be underestimated that payment and the overall structure of remuneration in its many forms are among the most important elements in the contract between the company and its management and, therefore, crucial to the company's ability to recruit and stay competitive. Micromanagement by shareholders is not practical and should be avoided.

Equally, decisions on remuneration should be made by the shareholders of the company and not by legislators; consequently, legislation should limit itself to enabling shareholder oversight, but should not dictate the substance of what shareholders can vote about. Remuneration is intrinsically connected to the operation of the company and is, thus, highly specific and does not lend itself to easy categorisations. It should also represent a fine balance between just rewards and adequate incentives. To rely almost entirely on variable remuneration may make the directors and employees too prone to excessive risk taking, but to rely solely on fixed remuneration may remove an incentive to enhance performance, encourage higher fixed salaries, and may, thus, hurt not just the profitability of the company, but also its long term viability. It may make managers less risk sensitive and, therefore, increase risks for the firm as well as systemic risk.

Furthermore, it is important that shareholder oversight is implemented into the normal functioning of the company to avoid unnecessary disruption in the relationship between company and management (e.g., it is important to distinguish between remuneration policy, which is an *ex ante* measure that provides the acceptable framework of remuneration, and the remuneration report, which explains, *ex post,* how payments and entitlements have been distributed). Voting can be binding on the former, but should be advisory on the latter, leaving open other, perhaps more serious, responses from shareholders if they find the policy has indeed been violated.

We suggest that the Commission should consult on whether a vote on remuneration policy should be binding or advisory and, if binding, what the consequences of not following the policy should be.

2. *Better shareholder oversight of related party transactions*

In the Action Plan at p. 10, the European Commission concludes:

> The Commission will propose in 2013 an initiative aimed at improving shareholders' control over related party transactions, possibly through an amendment to the shareholders' rights Directive.

Although the initiative is yet unknown, we strongly support the drive to improve shareholder oversight of related party transactions (RPTs) in listed companies. It is important to ensure shareholder oversight of such transactions as they are, in our view, a major instrument through which a dominant manager or shareholder may abuse his or her position to the detriment of the company's shareholders, creditors, and other stakeholders.

We do not see a need for EU legislation for non-listed companies. Shareholders in small companies may be able to protect themselves against RPTs and have the incentives to do so. EU intervention in this field should be limited to listed companies. Non-listed companies may, however, benefit from the tool kit for the treatment of RPTs provided by EU legislation

A question arises as to whether the European Commission should consider a substantive requirement or a disclosure requirement in respect of RPTs. At first, it is important that RPTs are identified in such a manner as to provide effective and not-too-disruptive or costly protection, taking into account that it is not, in itself, unusual for shareholders to engage in transactions with their company and that shareholder voting is both time-consuming and expensive.

Before any action in this field is taken, a careful assessment is needed. This is an area at the core of national company law, which interacts with a number of well-ingrained national company law arrangements and doctrines. Therefore, any substantive intervention at the European level in this area should simply involve establishing a principle. We would support the establishment of a principle that shareholders decide but we would leave MS free to operationalise it with due exceptions and qualifications to take into account their diverse company law systems and, more broadly, their institutional environments. A solution similar to the Takeover Bid Directive, where derogations to the mandatory bid rule are permitted so long as shareholders are protected, could be a possible approach.

If the European Commission was to move in the direction of simply strengthening disclosure, it would be important to ensure that overlaps, duplication of reporting requirements, and inconsistencies with IAS 24 are avoided to the widest possible extent.

Depending on how RPTs are defined, it may be appropriate for minor RPTs and those that routinely arise in the ordinary course of business not to be subject to shareholder approval, but instead to be subject to more stringent reporting requirements in the annual report. However, because abuse may take place in the course of "routine transactions", sometimes due to weak auditors' supervision about what a routine transaction is, the European legislator could consider a more cautious approach and allow listed companies to provide in their statutes that routine transactions are not subject to shareholder approval.

3. Regulating proxy advisors

In the Action Plan at p. 11, the European Commission concludes:

> The Commission will consider an initiative in 2013, possibly in the context of the revision of the shareholders' rights Directive, with a view to improving the transparency and conflict of interest frameworks applicable to proxy advisors.

We support the European Securities and Markets Authority (ESMA) approach, as evidenced in its 2013 Report on Proxy Advisors, where it notes the benefits and drawbacks of relying on this service, recommending that the industry adopt a self-regulatory code of conduct.[27] This approach has also been accepted by the industry and work has begun on creating such a code that is expected later this year. The European Commission should continue to work with ESMA to ensure that proper attention is being given to this important area; but, considering that this is an industry mainly relied upon by professionals, it would be, in our view, helpful to await the outcome of the industry's self-regulation and to collect more information about the performance of the industry to establish if there are market imperfections or other issues that merit intervention before deciding whether further initiatives at a Union level are needed.

4. Clarification of the relationship between investor cooperation on corporate governance issues and the 'acting in concert' concept.

In the Action Plan at p. 11, the European Commission concludes:

> During 2013, the Commission will work closely with the competent national authorities and ESMA with a view to developing guidance to increase legal certainty on the relationship between investor cooperation on corporate governance issues and the rules on acting in concert.

The general principle of company law that shareholders should exercise control and serve as a check on managerial self-interest forms the guiding principle of most company law legislation including Directive (2007/36/EC) on Shareholders' Rights. It is important to realign this principle, however, with the principle of securities trading that a shareholder, upon acquiring control of a company, should be subject to a mandatory bid obligation to acquire all outstanding shares, as required by Directive (2004/25/EC) on Takeover Bids. The

27 The ESMA Final Report on Proxy Advisors of February 2013 is available on-line at: http://www.esma.europa.eu/content/Feedback-statement-consultation-regarding-role-proxy-advisory-industry. That report was preceded by an ESMA Discussion Paper in March 2012, which is available on-line at: http://www.esma.europa.eu/content/Discussion-Paper-Overview-Proxy-Advisory-Industry-Considerations-Possible-Policy-Options

latter obligation originates in the United Kingdom, where we note that it is subject to highly sophisticated regulation to ensure that it only applies in the context of actual share acquisitions and allows shareholders to coordinate their voting at general meetings of the company to a wide extent.[28] A major issue, of course, is that whilst the mandatory bid is triggered in the United Kingdom, Ireland, Denmark, and Italy only if the concert party makes an acquisition, in most other MS, it is triggered by the coming together of the concert party itself.

We support the European Commission's intention of cooperating with national authorities and ESMA and note, specifically, that the ESMA Takeover Group is working with this very problem.

5. *Employee share ownership*

In the Action Plan at p. 11, the European Commission concludes:

> The Commission will identify and investigate potential obstacles to trans-national employee share ownership schemes, and will subsequently take appropriate action to encourage employee share ownership throughout Europe

Company law in a number of MS already provides beneficial treatment to encourage employee share ownership. At the Union level, the 2nd Company Law Directive on Capital of 1976[29] harmonises some of these measures for public limited companies.[30] It appears to be a small-yet- beneficial step to remove obstacles to trans-national employee share ownership schemes, which is, thus, worthy of support. In general, we support all initiatives that would help to ensure that national schemes to benefit employees are not applied in a manner that discriminates against employees because of their nationality or place of employment.[31] However, while employee share ownership has beneficial effects to be recommended, it is also important to remember the virtue of diversification in personal investment. Investing heavily in the company for which she works may render the employee unemployed as well as penniless in the event that the company goes bankrupt.

28 See Note 2 on Rule 9.1, The City Code on Takeovers and Mergers.

29 Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent of 13 December 1976 (77/91/EEC) as amended by Directive (2006/68/EC).

30 See Art. 19(3).

31 Cf. RG Report (n. 2) chapter 3.2 at pp. 53–54.

6. Matters not covered by the Action Plan

a. The contribution of governance and investors to long-term viability of companies

In chapter 1 and 3 of our Reflection Group Report, we discussed the general principles of European company law and the contribution of governance and investors to long-term viability. We reiterate our observations in this respect, most notably that the national company law of the MS should be as flexible as possible where the interests of stakeholders are not compromised. Companies should be able to choose between one or more governance structures (one-tier, two-tier, or hybrids) and arrangements for closer alignment between shareholders and their companies should be accommodated (e.g. by multiple-voting shares, loyalty shares, and fixed tenures for board members), as long as such measures are made as enabling provisions of national company law to be adopted by the shareholders in a transparent manner. We further note the importance of distinguishing between passive long-term investments that are not necessarily beneficial for the company's development and engaged long-term investments that are more likely to be.

Prior to the financial crisis, emphasis was placed on the concept of 'independent' directors in EU company law.[32] In our Reflection Group Report, we discussed their role and functioning.[33] We note, again, that the widespread use of independent directors does not appear to have mitigated the crisis. This might be because they were never really "independent" because they lacked the necessary expertise or experience or because of behavioural issues, such as "group think". A major problem might be focusing too much on independence at the expense of core business expertise. Also, the issue of incentives must be addressed. In some jurisdictions, independent directors may be poorly paid, but bear the same risk as any other director, whereas in some other jurisdictions there is no difference between the remuneration of independent and non-independent directors. Their compensation should be made more attractive in order to better incentivize them, while at the same time leading them to reduce the number of positions held. Therefore, we reiterate our call for further study to be done in this area. Unless clear empirical support is offered, EU company law should refrain from supporting any particular kind of governance arrangement, but allow for national company law to offer variety and flexibility.

32 Cf. Recommendation (2005/162/EC) of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

33 Cf. RG Report (n. 2) chapter 3.1.6 (ii) at pp. 51–52.

b. The engagement by shareholders in the companies in which they invest

We support the European Commission in its desire to enhance the possibility of engagement by shareholders in the companies in which they invest. This, we believe offers a broad range of beneficial effects (e.g., to serve as a brake on managerial self-interest and to promote long-term sustainability by committed shareholders holding substantial investments). For this reason, we are very concerned about the inclusion of the notion of 'relevant information'[34] as an element in defining the information that can form part of market abuse in its proposal for a Market Abuse Regulation (MAR) (cf. Art. 6(1)(e) and Art. 6(3)). We strongly urge the European Commission to support the Council in its attempt to delete this provision from the final MAR. The above-referenced notion is far too vague to serve as a constituent element in a directly applicable regulation, particularly for actions on normally viewed as serious criminal activity. If it is to be retained, it should (as is the case under the present Directives) remain subject to the overriding requirement that the information must be likely to have a significant effect on the price of financial instruments for it to be inside information. Unless the situation is rectified, it is likely to discourage the confidential engagement by shareholders with management that is widely viewed as beneficial and is also likely to require issuers to disclose such a large amount of information as to make it more difficult for the market to identify which information is likely to have a significant effect on the price of financial instruments. It will also impose an unjustifiable burden on issuers. In our view, the unfortunate inclusion of this element shows the peril of observing an artificial distinction between company law and securities regulation, when they should be viewed in their totality. We appreciate that the European Commission is already aware of the importance of considering company law and securities law together, as is evident in respect of its determination to address the 'acting in concert' problem arising from the Directive on Takeover Bids.[35] It is equally important to ensure that the MAR does not provide new obstacles to shareholder empowerment.

34 It is proposed that Article 6(1)(e) should include as inside information "information not falling within paragraphs (a), (b), (c) or (d) relating to one or more issuers of financial instruments or to one or more financial instruments, which is not generally available to the public, but which, if it were available to a reasonable investor, who regularly deals on the market and in the financial instrument or a related spot commodity contract concerned, would be regarded by that person as relevant when deciding the terms on which transactions in the financial instrument or a related spot commodity contract should be effected."

35 Cf. chapter 3.4 above.

c. The European Model Company Act (EMCA)

The Action Plan does not include any reference to the work on a European Model Company Act (EMCA) that the Reflection Group Report welcomed.[36] The Reflection Group Report mentioned that "if the final result can serve as an adequate benchmark, the Commission could consider turning the EMCA into a recommendation". The Reflection Group continues to hope that the EMCA can serve as an inspiration to MS legislators and highlights that it is not intended as an alternative to traditional harmonisation. Once it is published, it will be subject to consultation with interested stakeholders.

IV. Improving the framework for cross-border operations of EU companies

1. Transfer of seat

In the Action Plan at p. 12, the European Commission acknowledges the importance of this issue, but, nevertheless, considers that any future initiative in this matter needs to be underpinned by robust economic data and a thorough assessment of a practical and genuine need for (and the use made of) European rules on transfer of seat, and concludes:

> Throughout 2013, the Commission will conduct public and targeted consultations to update its impact assessment on a possible initiative on cross-border transfer of registered office. Subsequently, the Commission will consider the appropriateness of a legislative initiative.

In the Reflection Group Report, current case law was analysed.[37] The findings were as follows: Firstly, it is for a MS to determine what constitutes the connecting factor between it and the company (i.e., the requirements to become a company legally formed according to the national law of that MS). Secondly, each MS is obliged to accept any company legally formed according to the national law of another MS. Thirdly, a company may move its registered office and thereby change its nationality, if such a change is in accordance with the national law of its original Home MS (i.e., where it was originally formed) and the national law of its new Home MS. In this respect, each MS may establish its national law as it sees fit, but national law must observe the principles of EU law in this as in everything else. In respect of the third observation, we concluded that the European Court of Justice (ECJ), in its decision in *Cartesio*,

36 Some members of the Reflection Group are involved in this project. On the EMCA project, see T. Baums & P. Krüger Andersen, *The European Model Company Law Act Project*, European Corporate Governance Institute, Law Working Paper No. 097/2008, March 2008. See also the EMCA website: www.asb.dk/emca.

37 Ibid. chapter 2.2.1 at 13–15.

had indicated a right for a company to transfer its seat,[38] and as the receiving MS was entitled to decide the company forms available within its territory, it was – effectively – a right to engage in a cross-border conversion. Subsequent case law has supported this analysis,[39] especially the ECJ's decision in *Vale*. In each case, the ECJ has valiantly taken its case law forward to help the mobility of EU companies within the internal market of the Union.

However, as noted in our Reflection Group Report, case law is, by its very nature, casuistic such that it cannot provide the legal certainty that is essential for companies to embark on the cross-border activities that may lead to savings in transaction costs. The outcome of the *Vale* case serves as good illustration: the Hungarian Supreme Court decided to reject Vale's petition to convert into a national Hungarian company because the company had chosen to de-register in its Italian Home MS before applying for re-registration in its new Hungarian Home MS.

There is an urgent need for the European Commission to respond in this area. It is true, as originally observed by the European Commission, that Directive (2005/56/EC) on Cross-border Mergers (CBMD) offers a route for a company to effectively change its seat and registered office and, thereby, its applicable national company law regime,[40] but this is complicated and costly and, consequently, mostly only available to larger companies, not the SMEs that the European Commission now endeavours to support in its Action Plan. On the contrary, the very fact that the CBMD offers a complicated-but-irrefutable route to seat change should ensure that MS are ready to offer all companies – including SMEs – a more straightforward route through an EU directive. As both the interests of employees as well as that of creditors and minority shareholders are protected by the CBMD, it should be feasible to draft the necessary legislation by relying on the same measures.

Considering that this issue was among the subjects that received the most backing in the European Commission's recent consultation,[41] we find it highly unlikely that the European Commission will uncover more 'robust evidence'

38 Cf. decision of 16 December 2008 in case 210/06, *Cartesio*.

39 Cf. decision of 29 November 2011 in case C-371/10, *National Grid Indus BV*, and decision of 12 July 2012 in case C378/10, *Vale Épitési kft*.

40 Cf. EC, *Impact assessment on the Directive on the cross-border transfer of registered office*, SEC(2007)1707, Brussels, 12. 12. 2007, where work on a 14th Company Law Directive on a transfer of seat was deemed unnecessary due to the recent adoption of the CBMD. It is true that a cross-border merger is effectively a cross-border conversion of the existing companies into the company form of the continuing company; however, a merger is considerably more complicated than a conversion, and the European Parliament has consistently called for legislative action in this area.

41 Cf. EC, *Feedback statement, summary of responses to the public consultation on the future of European company law*, July 2012, at 9, where it is noted that a great majority

than already available and we suspect that companies that may wish, in the future, to take advantage of such a measure may not be aware of the current consultation on it. Consequently, we urge the European Commission to initiate legislation as a matter of priority.

We are aware that political problems could arise in negotiations relating to cases in which a company already has employee participation that might be prejudiced by a transfer of seat. A well-known approach would be to include the "bargaining model" on codetermination in such a directive as already provided for in by the CBMD. However, this model is very difficult to implement and, in fact, only concerns some MS. If no compromise can be found on that level, an instrument of "enhanced cooperation" should be considered also in company law, as already recommended in the Reflection Group Report.

If it is still too difficult to get political agreement for a measure that would apply to all companies, it is important enough to merit considering alternatives to promote the possibility of a cross-border conversion for SMEs. One possibility would be to limit such legislation's scope further to cover only SMEs with employees below a certain threshold (for example, 500 employees or 250 employees, as this is the current definition of SMEs) that may trigger codetermination obligations. However, we think that this approach would be very difficult to implement in practice and would not be coherent with the need to have an integrated market.

We take note that the Commission has announced, at the European Corporate Governance & Company Law Conference of the Irish Presidency in Dublin in May 2013, that it does not propose to continue with this proposal as the impact assessment did not demonstrate enough benefits.[42] We regret that this issue will not be pursued at this time as the business case for it is strong.

2. *Improving the mechanism for cross-border mergers*

In the Action Plan at p. 13, the European Commission concludes:

> In 2013 the Commission aims to report on the outcome of the study and subsequently it will consider the appropriateness of amendments to the Directive on cross-border mergers.

The CBMD is a very important instrument for cross-border mobility and, in the absence of a directive on cross-border conversion, is also the only instrument to facilitate it and, consequently, it is to be lauded that the European

of respondents (over 80%) expressed a clear view and there was strong support of 68% for facilitating cross-border transfer of seat.

42 http://www.corpgov2013.com

Commission will work to improve the CBMD and enhance the legal certainty in its application by MS that companies may rightfully expect.

3. *Enabling cross-border divisions*

In the Action Plan at p. 13, the European Commission concludes:

> In 2013, following the results of the study on the application of the Directive on cross-border mergers, the Commission will consider an initiative to provide a framework for cross-border divisions, possibly though an amendment of the cross-border mergers Directive, as the latter is well known to stakeholders and it provides a tested framework for cross-border restructurings.

While we support the effort to provide cross-border divisions, we consider the need for reform of the CBMD to be considerably more urgent and, consequently, we hope that any effort in this area will not hold back work on these more pressing issues.

4. *Smart legal forms for European SMEs and the Single Member Company*

In the Action Plan at pp. 13–14, the European Commission notes the lack of progress in regard of the European Private Company (SPE) as a vehicle of choice for SMEs and that alternatives should be explored and the European Commission concludes:

> The Commission will continue to work on the follow-up to the SPE proposal with a view to enhancing cross-border opportunities for SMEs.

While we continue to support the SPE as originally envisioned by the European Commission, we share its view that continued legislative opposition may necessitate exploring alternatives to provide a most vital support for European SMEs as well as large European groups. As noted in our Reflection Group Report, one such alternative is to provide a common template for a single member company (SMC).[43] While the Reflection Group fully endorses the SMC proposal set out below, we also note that it is a "second best" solution compared to a flexible SPE model.

We observe that simplified company forms have proven to be hugely successful (e.g., the SAS in France). As noted in the first chapter of our Reflection Group Report, it is crucial to break free of convention when legislating at the Union level. It is wrong and counterproductive to saddle company forms intended to be used for SMEs, which typically have few investors, with the same requirements applicable to large listed companies, which typically have a

43 Cf. RG Report (n. 2) at 58 and more detailed in chapter 4.2 at pp. 66–67.

broad, diverse, and dispersed investor pool.. SMEs have a very different need for simple and cost efficient structures that enable quick decision making by a single shareholder or a very small group of owners. It is important to rethink company law to provide solutions that are efficient and wanted by business. That is not to say that present EU company law cannot serve as an inspiration for what is, effectively, harmonisation for private companies. The 11th Company Law Directive on branches, which applies to public and private limited companies, and the original 12th Company Law Directive on single-member private companies may both serve as inspiration for providing more simplified company forms.[44] The former allows simplified disclosure of accounts and simple decision making structures, which are further explored in the latter Directive, but within the confines of the national company law that can be very different. Thus, although both address problems that are relevant to SMEs, neither provides the uniform solution that is sought by entrepreneurs to take advantage of the Union's single market.

Against this background, we strongly urge the European Commission to begin work on a single template for an SMC that, as a unique company form, can provide a truly European vehicle for SMEs, as well as larger groups, that efficiently serves their needs at a low cost and that is recognisable across the Union.

By limiting the company form to wholly-owned enterprises, the question of minority protection is moot and decision making can be made simple and efficient. General meetings can be replaced by formal decisions of the single owner. Management can consist of a single person who takes instructions from the single owner (if the two are not the same). Besides this requirement, the organisation of the management can be left to the decision of the single owner.

As a company with only one member and a simplified structure for decision making, the SMC would be ideal in organising groups of companies, an issue of particular interest to the European Commission in its Action Plan.[45] To ensure its availability for SMEs, single member ownership should be available for both natural and legal persons.

44 Cf. Eleventh Council Directive 89/666/E European Commission of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State; and Twelfth Council Company Law Directive 89/667/E European Commission of 21 December 1989 on single-member private limited-liability companies, since 21 October 2009 amended as Directive 2009/102/European Commission of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies.

45 Cf. chapter 4.6 of the AP dealt with below.

If it is intended to make it clear that the company form is intended to serve SMEs, limitations on the single member requirement could be imposed, for example, as to the maximum number of employees, capitalisation, and number of investors the company form can accommodate at its inception.[46] If this approach is adopted, the initiative would need to set out what is to happen once the company no longer meets those requirements. However, we do not support limiting the SMC to companies below certain thresholds and do not see compelling reasons for this. It should be open to all types of businesses, SMEs and non-SMEs alike. We find that larger companies may have better resources to use the new vehicle sooner than smaller companies but smaller companies, too, will find strong advantages in the SMC.

As a limited liability company with a single owner and a simplified structure of decision making, the traditional safeguards of capital to protect creditors could be modified, at least as an MS option, if an alternative method (such as an insolvency test) is used to protect creditors or a (mandatory) retained earnings requirement rather than a minimum initial capital. It would also be worth considering a provision to allow the single owner the right to formally instruct management if certain conditions or safeguards for creditors are present. As mentioned, governance should be left to the decision of the founder.

There should be no need for designating notaries, as the SMC can be constituted by private contract (see further about the use of a template). The company should be registered at the national official registry but this could be done by appropriate electronic procedures.

The appropriate legislative instrument would be a directive, because it is less intrusive and offers harmonisation that will dovetail with existing national company law and corporate governance in the individual MS. Some provisions may need to be maximum harmonisation provisions, to prevent MS imposing more onerous requirements (and so detracting from the attractiveness of a pan-European form). By not relying on a regulation as a legal instrument, the SMC would be better able to draw on existing structures of national company law. This is important, because the SMC must be able to convert into other more mature company forms in national law if it outgrows the confines of the SMC regime. The intended harmonisation would be of national company law on private companies.[47] In order to identify the SMC and ensure

46 Such limitations require clear rules on conversion into other company forms in order not to obstruct the desirable continued growth of the company.

47 By the term 'private' company, reference is made to a limited liability company that is not covered by the 2nd Company Law Directive and does not have its securities admitted to a regulated market. It would be up to the individual MS whether the directive should be implemented by changing existing company law legislation on private companies or by adopting new legislation to accommodate the new company form.

its visibility at a Union level, a unique European name is required for the company form preferably akin to an acronym like the SE or SCE.

To reduce costs, a single template should be provided by the directive and connected to the name of the company form. The single template should provide both the necessary legislation to enable the SMC as a unique harmonised company form and a standard set of default articles that offer a simple set of preferred conditions for the internal organisation of the company. There should also be a one-click online registration process with the national business register. The single owner can always adopt more elaborate articles of association, as the template would only be a default (i.e., it would apply unless displaced by something else).

5. Promoting and improving awareness of the European Company (SE) and the

European Cooperative (SCE) Statutes

In the Action Plan at p. 14, the European Commission concludes:

> The Commission will, in 2013, launch an information campaign to increase awareness of the European Company (SE) Statute through a comprehensive website bringing together practical advice and relevant documents on the Statute and will examine how a similar action can be undertaken for the promotion of the European Cooperative (SCE) Statute.

We are not entirely convinced that the obvious lack of interest in these two organisational forms of EU company law, outside of Germany and the Czech Republic, is caused by a corresponding lack of awareness by the Union's business community. We suspect that a more important explanation lies in these forms' lack of simplicity and their inflexible codification of questionable features from traditional company law (e.g., the reliance on a statutory minimum capital, the formalities of formation, and the requirement that seat and registered office remain in the same jurisdiction which runs counter to the idea of a borderless internal market of the Union).[48] Thus, a reform of the statutes may yield better results, although that would require sufficient legislative support, which, taking into account the experience of the proposal for an SPE, may be found wanting. Consequently, we hope that it will not be a distraction from the many more pressing tasks of the European Commission.

48 Cf. our critique of the SE in the RG Report, chapter 2.7.1 at pp. 29–30.

6. Groups of companies

In the Action Plan at p. 15, the European Commission concludes:

> The Commission will, in 2014, come with an initiative to improve both the information available on groups and recognition of the concept of 'group interest'.

We welcome that the European Commission has provided priority to the two items that we identified in our Reflection Group Report in respect of groups of companies: disclosure and the concept of a 'group interest'.[49]

Groups of companies are ubiquitous throughout the Union, within all sectors, and at all levels of economic size – from the very small to the very large – spanning different jurisdictions and comprising one or more listed companies. The widespread use of groups is probably caused by a need to provide a single interest and governance structure to different business activities while, at the same time, separating and thereby encapsulating the different risks associated with these diverse activities as well as adapting to local business needs, by the use of limited liability companies.

The very concept of a limited liability company means that the topics of corporate governance and limited liability are closely linked. If shareholders can, directly or indirectly, govern the company and at the same time enjoy limited liability, safeguards are necessary to protect creditors and other stakeholders of the company. For this reason, it is necessary to provide disclosure to enable the public to understand the governance structure of the individual limited company. Traditionally, company law, both within national and EU law, provides for the publication of the company's articles (providing information about the system of governance) and disclosure of major shareholders. It would be natural to expand this disclosure obligation to provide information about the governance of groups as well. There should be a description of the main features of a company's group structure in a clear and investor-friendly manner. The parent should make available the list of its subsidiaries and of its significant holdings. The identity and activity of each subsidiary should be stated. Moreover, there should be a description of intragroup relations, both financial and business ones.

We are not convinced that legislation at the Union level is called for; on the contrary, we fear that substantive regulation of groups by EU law will disrupt the national company laws of the MS that function well and is likely, for that reason, to be resisted by MS causing a waste of resources and attention.

Instead, we recommend a soft law approach. It should be possible to agree on certain principles in respect of groups, both on the need for adequate disclo-

49 Ibid. pp. 59–75.

sure and the right to balance the interest of the overall group with that of the individual limited liability company. The appropriate instrument would be a company law recommendation and it should take note of the important distinction between a limited liability company that is wholly-owned within the group and one that has minority shareholders.

However, for listed companies, the Commission could consider a directive obligation on listed groups to state their policies in relation to group-related subjects and the way these policies have been applied in specific circumstances (e.g., dealing with RPTs within the group). The approach would be comparable to the one followed for corporate governance codes.

Among the principles that a recommendation on groups could include are:

– It is not illegal *per se* for the group to be managed as an entity and, for that reason, the management of the dominating company and the management of the dominated company may, respectively, give and take instructions as long as the interests of each individual company within the group, as an entity with liabilities of its own, is not materially compromised.

– It is not illegal *per se* for companies within a group to trade amongst each other as long as trading is done at prices that do not materially compromise any of the participating companies' viability.

– It is not illegal *per se* for companies within a group to offer financial assistance to other group members or to pool their cash, as long as certain conditions designed to protect the creditors of the debtor company are met (i.e., it is not likely that the debtor company will not be able to meet its liabilities).

Some members of the former Reflection Group have a different view, as already mentioned in the report of 2011: they are against any initiative in the area of groups. In case of any recommendation, they argue in favour of simply allowing MS to let companies recognise the interest of the group or, in other words, avoiding the imposition of such a business model on individual companies.

V. Codification of EU company law

As a final observation in its Action Plan at p. 15, the European Commission concludes:

> The Commission plans to adopt, in 2013, a proposal codifying and merging major company law Directives.

In our Reflection Group Report, we recommended merging certain legislative instruments (e.g., to create a common directive on corporate mobility to comprise the existing Directive on Cross-border mergers together with new harmonisation on cross-border conversions (transfer of seat) and divisions).[50] We, thus, agree that a certain level of codification can bring about clarity of existing legislation and provide users with a single source of law in their search.

However, such an exercise also presents serious drawbacks. It may prove time-consuming and potentially difficult if it moves beyond a mere compilation of existing EU legislation. The existing company law directives cover several decades of law making and reflect very different times and practices. If the codification entails redrafting and changes in the wording of provisions, it will raise questions of whether a new understanding is intended, making it difficult, if not impossible, to rely on existing practice, including case law by national courts or the ECJ. In addition, we are concerned that such a "codification" will not only result in disturbing the present system of knowledge, references, and commentaries, especially as small changes will be unavoidable, but also will create political difficulties because every MS might try to open a discussion on topics and to reach goals that have not been agreed upon earlier.

Consequently, we advise that any codification be done, if at all, in a piecemeal manner and not necessarily as an omnibus instrument covering all areas of company law and that it be done very conservatively. As also mentioned by a European Parliament opinion, [51] it is important that it does not divert resources and attention from the more pressing tasks of the European Commission.

50 Ibid., recommendations at p. 22.

51 European Parliament Resolution of 14 June 2012 on the future of European company law (2012/2669 (RSP), Klaus-Heiner Lehne on behalf of the Committee on Legal Affairs.