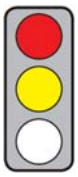
ACTION PLAN: COMPANY LAW AND CORPORATE GOVERNANCE

cep**PolicyBrief** No. 14/2013 of 8 April 2013

KEY ISSUES

Objective of the Communication: The Commission wants to modify company law and the rules on corporate governance.

Parties affected: Companies, supervisory and administrative boards and shareholders.



Pro: A single legal instrument on European company law increases legal certainty.

Contra: (1) The Commission's call for "diversity" in supervisory bodies, whether of gender or nationality, is misconceived. Of sole importance are professional qualifications. Corresponding reporting requirements on diversity within the supervisory body are disproportionate.

(2) Binding requirements for reporting on corporate governance and for official monitoring undermine the principle of "comply or explain" which is based on self-determination.

(3) EU legislation on employee share ownership is in breach of the principle of subsidiarity.

CONTENT

Title

Communication COM(2012) 740 of 12 December 2012: **Action Plan: European Company Law and Corporate Governance** – a modern legal framework for more engaged shareholders and sustainable companies

Brief Summary

- **General**
  - The Commission wants to reform company law and the legal framework for corporate governance.
    - Corporate governance is system which determines the way companies are managed and controlled and defines the relationships between the executive bodies – Board of Directors, Supervisory Board, Board of Management - and with shareholders as well as the relationships between the company and the public at large.
  - The corporate governance framework currently consists of a combination of national laws and voluntary regulations.
  - The Commission is principally aiming to
    - enhance transparency,
    - extend shareholders' rights of supervision, and
    - simplify cross-border operations.
  - And thus improve the competitiveness and sustainability of European companies.

- **Enhancing Transparency**

  Companies should provide shareholders and society at large with "better" information about their corporate governance. Institutional investors should have to explain their voting policies.
  - **Diversity within the supervisory organs and additional focus on non-financial risks**
    - In the EU there are two systems of management for listed companies:
      - Two-tier System: management and supervision are separate (Management Board and Supervisory Board).
      - Monistic System: management and supervision are carried out by a single organ (administrative board with managerial and non-managerial directors).
    - The Commission acknowledges the existence of these different national structures.
    - According to the Commission, "diversity of competences and views" (p. 5/6) – no additional definition provided - within the supervisory body is important for the effective oversight of the executive directors. Its efforts to achieve this diversity is intended to complement the proposed regulation relating to the gender quota [COM (2012) 614; s. cep**Policy Brief**].
    - It calls for greater transparency about how companies aim to achieve greater diversity of skills within the supervisory body.
    - The Commission also calls for reporting requirements to be extended to cover "non-financial aspects" without providing any definition of the term "non-financial aspects". Companies are thus to be encouraged to adopt a "sustainable approach to their business".
    - In 2013, the Commission wants to introduce disclosure requirements with regard to board diversity policy and risk management. For this purpose the Accounting Directive (78/660/EEC) will be amended.

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– **Transparency rules for institutional investors**
  - The Commission wants to oblige institutional investors to disclose their "voting policies" (p. 8) and their previous voting records in shareholders' meetings.
  - It plans a change to this effect in the shareholders' rights Directive (2007/36/EC) 2013 (p. 8).
– **Reporting on Corporate Governance**
  - The Commission welcomes the principle of "comply or explain" under which companies must either comply with the national Governance Code or provide explanations for their departure from it.
  - However it criticises the fact that many companies fail to provide sufficient explanation for departing from the codes.
  - It therefore wants to issue a Recommendation to Member States, in 2013, to impose detailed requirements on companies when explaining their departure from code recommendations.
– **Shareholders' identification**
  - Companies should know who their shareholders are. This will facilitate dialogue on corporate governance issues.
  - The Commission therefore wants to issue a legislative proposal, in 2013, which requires that
    - the names of the owners of name shares should be published,
    - the names of the owners of bearer shares should be published if the shareholders agree.

▸ **Improving shareholder oversight**

The Commission would like to improve shareholders' rights of oversight and thus integrate them more fully into the system of corporate governance.

– **Proxy advisors**
  - According to the Commission, "institutional investors with highly diversified equity portfolios" "frequently" (p. 10) transfer their voting rights in general meetings to proxy advisors". Proxy advisors have substantial influence on voting but are not regulated and are not transparent.
  - The same proxy advisors often also advise the companies themselves. This results in conflicts of interest.
  - The Commission therefore wants to regulate the activities of proxy advisors.
  - This could take place by way of a modification to the shareholders' rights Directive.
– **Oversight of remuneration policy**
  - The Commission requires companies to apply a management remuneration policy which stimulates longer term value creation.
  - In 2013, the Commission wants to introduce legislation whereby
    - shareholders have to vote on management remuneration policy and
    - companies have to submit a remuneration report which also contains the remuneration of the individual board members.
  - This could take place by way of a modification to the shareholders' rights Directive.
– **Oversight of related party transactions**
  - Until now, companies have had to provide information, by way of a note attached to the annual accounts, about the amount and nature of transactions entered into with persons or companies who are "related" to members of the management or to "controlling shareholders".
  - According to the Commission this is inadequate to ensure effective control by the shareholders.
  - In 2013, the Commission wants to legislate
    - that transactions above a certain threshold, which is yet to be determined, be subject to evaluation by an "independent advisor" (p. 10) and
    - the most substantial transactions have to be approved by the shareholders.
  - This could take place by a modification of the shareholders' rights Directive.
– **Employee share ownership**
  - When employees are also shareholders of the company which employs them ("employee share ownership") they have a keener interest in the success of the company.
  - Employees are long-term oriented shareholders.
  - The national employee share ownership schemes are very varied.
  - The Commission wants to examine how to encourage employee share ownership in companies that operate in several Member States so that all employees can benefit from the same opportunities. In addition, it wants, in particular, to identify and remove "potential obstacles to transnational schemes" (p. 11).

▸ **Facilitating the cross-border operations of companies**

– **Cross-border transfer of seat**
  - The Commission considers it to be an important issue that a company first has to be wound up in order to be reincorporated under the law of the receiving Member State.
  - The Commission wants to facilitate cross-border seat transfer.
  - It will conduct a Consultation on this by 16 April 2013.
– **Cross-border mergers and divisions**
  - The Commission wants to modify the Directive on cross-border mergers of limited liability companies (2005/56/EC) in order to facilitate cross-border mergers.

- For this it wants to "adjust" the following areas:
  - harmonisation of the methods for valuation of assets,
  - the duration of the protection period for creditors' rights and
  - the consequences for creditors' rights on completion of the merger.
- The Commission also wants to regulate cross-border divisions of companies. Until now, only divisions within a Member State were regulated (Directive 82/891/EEC).
- There are essentially two methods for the cross-border division of companies:
  - creation of a subsidiary and subsequent transfer of assets, or
  - domestic division followed by cross-border transfer of seat of the demerged unit.
- The Commission wants to introduce a legal framework for cross-border divisions, possibly by amendment of the cross-border mergers Directive.

– **Special rules for small and medium-sized enterprises (SMEs)**
  - The Commission criticises the lack of progress in the negotiations on the European Private Company (SPE) Statute [Proposal COM(2008) 396; see cep**Policy Brief**].
  - It wants to simplify the legal regulations on SMEs by way of this statute.

– **Promoting the European Company (SE) and European Cooperative (SCE)**
  - Companies complain in particular of high set-up costs, complex procedures and legal uncertainty when it comes to the formation of SEs and SCEs. The Commission shares many of the critical views.
  - However, the Commission does not currently see a majority in favour of a revision – or even a simplification – of the SE statute [Regulation (EC) No. 2157/2001] and the SCE statute [Regulation (EC) No. 1435/2003], which is why it does not provide any details of possible amendments.
  - In 2013, it wants to launch an information campaign about the SE and possibly also the SCE.

► **Codification of EU company law into a single instrument**

– European company law consists of numerous legal acts and is therefore difficult to apply. It can also result in regulatory gaps or overlaps.

– In 2013, the Commission wants to codify the following Directives into a single instrument: the Directives on
  - mergers (2011/35/EU and 2005/56/EC) and divisions (82/891/EEC),
  - the formation of public limited companies and the alteration and maintenance of their capital (77/91/EEC),
  - single-member private limited companies (2009/102/EC) and
  - foreign branches (89/666/EEC).

– The Directive on the interconnection of business registers (2012/17/EU) is to be amended.

Policy Context

The Commission put forward a similar action plan as long ago as 2003 which incorporated provisions on corporate governance into the Directives on accounting (78/660/EEC), shareholders' rights (2007/36/EC) and mergers (2005/56/EC). In 2011, it conducted public consultations on the European Corporate Governance Framework [COM(2011) 164; s. cep**Policy Brief**]. The results of this consultation prompted the Commission to propose the foregoing measures. The considerations on company law, in particular, followed a public hearing held on 16/17 May.

Options for Influencing the Political Process

Leading Directorate General:	DG Single Market and Services
Committees of the European Parliament:	Law (leading), Rapporteur N.N.; Employment; Industry; Economy
Federal Ministries:	Economy (leading)
Committees of the German Bundestag:	Labour (leading); Economy; Family

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

Varying rules on corporate governance in the Member States can lead to investors keeping their involvement within their own domestic market, with which they are familiar. Although EU-wide rules may therefore improve the cross-border mobility of capital, they are not adapted to the varying historical, legal and socio-economic characteristics of the Member States.

The Commission's **call for "diversity" in supervisory bodies, whether of gender or nationality, is misconceived. Of sole importance are the professional qualifications** of the supervisory body – gender and nationality are irrelevant.

Additional national requirements for reporting on corporate governance undermine the Corporate Governance Code's principle of "comply or explain" which is based on self-determination. The requirements – if they are to be consistently applied – must be nationally monitored. Companies thus find themselves under pressure to justify themselves which, in practice, results in a binding application of the Corporate Governance Code thus preventing intended variations.

The duty to disclose previous voting results burdens institutional investors with additional administrative work and provides only a small amount of added value – if any at all – in the form of information for companies and other investors. The duty to disclose "voting policies" comes to nothing because it is not possible to record what is a "policy" and what is not.

The regulation of proxy advisors should also be rejected. Institutional investors are highly professional market players and invest in accordance with their own risk and return profile and/or requirements. Where an advisor's conflicts of interest lead to voting which is disadvantageous to the institutional investor, the advisor will lose out in competition with other advisors for future business from the institutional investor.

An obligatory remuneration report provides shareholders and potential shareholders with an initial insight into the corporate culture and willingness of management to take risks. For reasons of efficiency, shareholders should not vote on remuneration because, for each new board member, either a general meeting would have to be called, or the candidate could only be offered contracts which have already been approved. The supervisory board should continue to negotiate management remuneration.

Employee share ownership is a socio-political instrument and therefore correctly regulated by the Member States. EU-wide measures are only permitted for cross-border problems. The Commission should not use "potential obstacles" as a motive for installing a – possibly obligatory – EU-scheme for employee share ownership because there is a risk that over-strict regulatory demands and administrative requirements will make employee share ownership unattractive for companies – due to the expense.

The codification of the existing EU Directives on company law into a single legal instrument increases user friendliness and legal certainty because it allows for legislative gaps, overlaps and discrepancies between the individual instruments to be discovered and removed.

Impact on Europe as a business Location

Facilitating seat transfers and cross-border mergers and divisions strengthens the internal market. The increased mobility of capital also strengthens competition between Member States for the most attractive investment conditions.

Legal Assessment

Competency

Basically unproblematic. In particular, the proposed reporting requirements and transparency rules can be based on Art. 50 (2) g TFEU (provisions on the protection of shareholders and others).

The codification of EU company law legislation into a single instrument must be based on the same competency rules as the individual legal instruments.

Subsidiarity

Uniform rules on employee share ownership for companies operating in more than one Member State are in breach of the subsidiarity principle because the respective national legislation already allows the companies affected to grant their employees share ownership. There is no indication of a collision between national rules or of national rules which are detrimental to the internal market, which would render action at EU level appropriate, nor are any identified by the Commission. The fact that companies and employees may benefit from uniform systems cannot be allowed to change this assessment otherwise the principle of subsidiarity would be eroded.

Proportionality

Rules on the protection of investors and others (Art. 50 (2) g TFEU) are only proportional when they are necessary. This requirement is met by statutory reporting obligations on the professional qualifications of members of supervisory boards, as shown by the example of supervisory boards of state banks which are appointed according to political considerations rather than ability. **Reporting obligations relating to the nationality or gender "diversity" within the supervisory board, however, are not necessary for the protection of the shareholders and others and are therefore disproportionate.** The decisive factor is solely the professional qualifications irrespective of background or gender.

Conclusion

The Commission's call for "diversity" in supervisory bodies, whether of gender or nationality, is misconceived. Of sole importance are professional qualifications. Corresponding reporting requirements on diversity within the supervisory body are disproportionate. Binding national requirements for reporting on corporate governance and its official monitoring undermine the Corporate Governance Code's principle of "comply or explain" which is based on self-determination. EU-wide legislation on employee share ownership is in breach of the principle of subsidiarity. A single legal instrument on European company law avoids and removes legislative gaps, overlaps and discrepancies and therefore increases legal certainty.