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COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

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To: all members of the Committee

Dear Committee Member,

Please find enclosed the following documents:

(a) the report of a recent visit which I made to Brussels to discuss the Committee's emerging conclusions with the Commission. There will be an opportunity for a brief discussion of the report at the Committee's next meeting on 26th February under Any Other Business;

(b) the final version of the report by The Institute of Chartered Accountants of Scotland entitled 'Corporate Governance - Directors' Responsibilities for Financial Statements'.

Yours sincerely,

Nigel Peace

Nigel Peace
Secretary

COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE

EC IMPLICATIONS OF COMMITTEE'S PROPOSALS

Note by the Secretary

I visited the European Commission on 18 February to discuss the Committee's emerging conclusions and to discover whether there were any EC pitfalls of which we ought to be aware. I had meetings with the following officials from DGXV: Geoffrey Fitchew (Director General) and Martin Power (Assistant to the Director General); Gisbert Wolff (responsible for the 5th and 13th directives); Karel van Hulle (reporting to Gisbert Wolff on accounting matters); and Hesketh Richards (responsible for the European Company Statute). I received helpful briefing in advance of the visit from the DTI.

2 I drew the following conclusions from my discussions:

i) DGXV do not think at first sight that there is anything in the Committee's Code of Practice or recommendations on auditing that is likely to bring the Committee into immediate conflict with Community law;

ii) on various detailed points the Committee's Code of Practice does not take exactly the same line as the Commission has taken in the various outstanding company law proposals - for example, the draft European Company Statute requires boards to meet at least once every three months; and the draft fifth directive requires non-executive directors to be in a majority on a single-tier board. However the provisions in question are a long way from being agreed and even if they were agreed in their present form they are not such that the Committee's Code of Practice could not be adapted to accommodate them;

iii) the Committee's recommendations are not in line with the Commission's proposals on auditing in the draft fifth directive - for

example, the directive requires a compulsory change of auditor after twelve years, and will impose a new regime of liability on auditors. Again however the provisions are a long way from being agreed;

iv) DGXV's main concern is whether we would seek to extend the proposed new London Stock Exchange listing requirements (on disclosure about compliance with the Code, and on interim reporting) to non-UK companies listed on the London Stock Exchange. I said that at least so far as disclosing compliance with the Code was concerned, I would expect the Committee to want the requirement to extend only to UK companies.

3 I am following up the point at (iv) above with the London Stock Exchange and seeking confirmation that they do not foresee any insuperable difficulties.

4 In the course of the visit I built up a picture of the state of play on the various outstanding company law proposals. A summary is attached. The final paragraph records comments volunteered by Mr Fitchew about the Commission's longer-term plans.

Nigel Peace
Secretary
21 February 1992

EC COMPANY LAW PROPOSALS - SUMMARY OF PRESENT POSITION

(The following situation report is based on discussions both with DTI and DGXV.)

1 Four company law proposals feature on the list of measures to be adopted by the end of 1992 as part of the Single European Market programme:

i) the proposal for a European Company Statute;

ii) the proposal for a 5th Directive concerning the structure of public limited companies;

iii) the proposal for a 10th Directive concerning cross-border mergers;

iv) the proposal for a 13th Directive concerning takeovers.

However the 5th, 10th, and 13th directives are not under active consideration in the Council and there is little prospect of their adoption by the end of 1992. Most attention under the current Portuguese Presidency and the forthcoming UK Presidency in the second half of 1992 will be focussed on the European Company Statute. The Commission appears reasonably confident that it will be agreed, although in its present form it contains elements which are unacceptable to the UK and other member states.

2 Agreement is also possible this year on 2 minor directives - a 'Comitology' directive, expected shortly, which will introduce a streamlined procedure for updating or amending the technical provisions of existing directives (but will also give the Commission more power); and an amendment to the Second Company Law Directive to extend the rules on the acquisition of a company's own shares to cover acquisition by subsidiaries.

The European Company Statute

3 The proposal consists of two documents - a regulation on the statute for a European Company, and a complementing directive on the involvement of employees in the European Company.

4 The proposed regulation will allow a new type of corporate identity to be created, a European Company or Societas Europaea (SE). SEs will be limited liability companies similar to plcs. Issues dealt with in the regulation include:

a) formation and registration

b) capital, shares, debentures and the attached rights

c) boards

d) general meetings and their powers

e) accounts and audits

f) winding up, liquidation, insolvency and suspension of payments

g) tax relief for losses of overseas branches

h) sanctions for infringements.

The provisions on boards are at Annex A. Noteworthy provisions include Article 67, requiring the board to meet at least once every three months, and Article 72, specifying various matters which must be considered by the board.

5 The proposed directive on worker participation will require SEs to involve their workers in one of four models of participation. Member States may limit the options available to SEs registered in their territory.

6 The Government is currently undertaking fresh consultation on the proposal. The consultation document states HMG's views as follows:

> 'The Government has yet to be convinced of the need for an ECS, a view endorsed by the results of the 1989 consultation exercise... It also has fundamental objections to the proposal to impose compulsory worker participation models. The Government also opposes the legal bases and special tax provisions proposed for the ECS...

The Commission's revised proposal is an improvement in some respects as regards the clarity of the text, but it does nothing to meet the UK's fundamental objections outlined above. Furthermore, in the Government's view, it is still seriously deficient technically, and will need considerably more refinement in order to reduce the risk that it will at best cause problems for the unwary, and at worst offer the unscrupulous a way of avoiding the requirements of national plc law. The Government is particularly concerned that the current provisions on formation of an SE, and on the transfer of registered office, do not offer adequate protection for shareholders and creditors.

Another fundamental concern of the Government is the interface between the provisions of the ECS and national law... It is in many cases not clear whether the provisions of the ECS on a particular topic are to be considered as exclusive, or whether national law may impose additional restrictions or requirements.'

7 A Presidency redraft is now in circulation which would make substantial changes to the text of the regulation. For example, article 72 now no longer contains a specific list of matters to be considered by the board but instead requires a minimum list to be specified in the memorandum and articles of association of each SE. Additionally the provisions on capital and shares and on accounts and audit have been left to the law of the member state of the registered office of the SE.

The Fifth Directive

8 The fifth directive will apply to all public limited companies incorporated in the Community. It contains a number of proposals relating to the structure and duties of boards; the responsibilities and liabilities of individual directors; the rights of minority shareholders; the conduct of general meetings of the company and the validity of their decisions; the independence of auditors; and the adoption and audit of the annual accounts. The directive does not impose a two-tier board system on all companies: the requirement is rather for member states to ensure that every company conforms either to a one-tier or two-tier system, as specified in the directive. However the specification for the one-tier system, like the two-tier system, includes compulsory provisions for employee participation.

9 The chapter on auditing is at Annex B. Article 62 is of interest in the context of Caparo - it requires member states to regulate the civil liability of auditors, so as to ensure that compensation is made for any damage sustained by the company, any shareholder or third party as a result of wrongful acts committed by the auditor. However it also enables member states to allow the limitation of such liability by law or contract.

10 The directive was first proposed 20 years ago and little progress has been made towards agreeing it. HMG has profound reservations on the worker participation provisions and has many other difficulties. Other member states (especially Germany) have equally severe problems. However the proposal has not been withdrawn, as implied in the press recently, and the Commission are expected to revert to it if and when agreement is reached on the European Company Statute.

The Tenth and Thirteenth Directives

11 The thirteenth directive aims to lay down a minimum set of rules for takeovers of public companies while leaving member states free to adopt further or more detailed rules. It contains provisions on the timetable of offers, the offer and defence documents, the obligation on a bidder to bid for the rest of the shares when he has acquired a certain percentage, the prohibition of certain kinds of 'poison pill' actions designed to frustrate bids, and the independent supervision of the takeover process. Many of the provisions reflect those in the UK Takeover Code. However they are more inflexible and are cast as rules rather than principles. The Government has major concerns about this lack of flexibility and the risk of litigation during the course of takeover bids to which it might give rise.

12 The tenth directive applies to mergers between plcs in different member states as opposed to takeovers. It includes special rules for co-ordination of the different laws by which the two plcs are governed. It also includes worker participation provisions which are of particular concern to HMG. The proposal has been blocked in the European Parliament since 1987.

13 The Government sees the removal of barriers to takeovers as an important contribution to the completion of the internal market. It takes the view that

UK firms benefit domestically from operating in a market which is significantly more free from technical and structural barriers to takeovers than is the case in other member states, but are confronted by artificial and unequal constraints to their international growth and may accordingly be unable to realise the full benefits of the internal market. It has therefore urged the Commission to take action to reduce and eliminate those practices which act as barriers to takeovers in the EC. Following a study, the Commission has now proposed several measures. One of the proposals entails amending the Second Company Law Directive to extend the rules on acquisition of a company's own shares to cover acquisition by subsidiaries and may be adopted before too long (paragraph 2 above). The other proposals however have been put forward in the shape of amendments to the draft 5th and 13th directives and are therefore bogged down in the general lack of progress on these directives.

Longer-term Commission thinking

14 On the subject of the Commission's longer-term plans, the Director General of DGXV has recently indicated that:

a) the Commission is working on a draft 'Comitology' directive;

b) it is possible that the audit section of the draft Fifth Directive might be detached from the rest of the proposal and put forward as a separate directive;

c) members of DGXV might have ideas for more far-reaching legislation on the independence of auditors, but they are not Commission policy;

d) banking supervisors in the Community are concerned about the duties of auditors, as a result of the BCCI collapse, and might want to require any financial conglomerate to be audited by a single auditor.

NDP
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