TREASURY, RISK AND FINANCE PROFESSIONALS ACT

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Cc: Mark Newman, Department for Business,
Enterprise and Regulatory Reform
1 Victoria Street, London SW1

Sent by e-mail to mark.newman@berr.gsi.gov.uk

31 October 2007

Dear Sir

Re: Consultation on the Simplification of EU Company Law and Accounting and Audit Regulation

2nd Company Law Directive: Pre-emption rights

The Association of Corporate Treasurers is a professional body for those working in corporate treasury, risk and corporate finance. Further information and contact details are provided at the back of this letter and on our website, www.treasurers.org.

This letter is on the record and may be freely quoted with acknowledgement.

The ACT comments from the stand-point of issuers and not that of investors. Our members have a clear interest in flourishing and liquid markets which can provide capital at the lowest practical cost. Our approach to policy issues is set out in our Manifesto (web-link at the back of this letter).

We have consulted our membership and other interested professionals in this immediate instance through our Policy and Technical Committee. Our general position regarding pre-emption rights is, however, of long standing.

We understand that you requested comments on this topic by mid-October. However we would like to add our support to the comments regarding pre-emption rights made in their response to you to you by the Association of British Insurers on 15th October 2007.

Pre-emption rights are essential to prevent possible transfer by a company's management of value to new shareholders, away from existing shareholders, without the latter's consent. Transfer of value can occur in two ways:

- Issue of shares by the company at an under-value
- Transfer, by the issue of shares by the company, of fractional ownership and dilution of existing holders' influence in shareholders' collective decision making

Protection against this mischief is a fundamental shareholder right and is of great value to shareholders. The absence of such protection in a particular jurisdiction reduces the attractiveness of share ownership and would be expected, over time, to increase the cost of capital for companies. The principle of such protection should run throughout the Single

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Market both as part of investor protection and to help reduce the complication arising in investing from one Member State into another.

Of course, questions of proportionality arise can arise in particular cases. The principle of pre-emptive issues remains important. Provided the principle applies throughout the Single Market, practices whereby existing shareholders can permit companies to undertake non-pre-emptive issues that are small in relation to total shares in issue can potentially reduce delays and costs. As a practical matter this potential flexibility is very important to our members, but our support of the underlying principle is not diminished by this.

The history of pre-emption in the UK is relevant. Pre-emption used to be able to be adopted by all companies in their Articles of incorporation and was by many. However, after abuses by managements, the principle was incorporated into company law. It is excludable by private companies in their articles, but mandatory for public companies. It can be waived by shareholder resolution in particular cases. This works well and the earlier scandals have not been repeated.

A fundamental reason for the development of company law is that the interests of shareholders and managers may differ. If management can transfer value and fractional control of the company away from shareholders, more control can move to management, encouraging the kind of managerial capitalism seen in the United States[1]. This would be undesirable for Europe. The statutorily mandated principle of pre-emption is one small but important protection.

The US case may also be instructive for Europe in other ways. Pre-emption requirements had been axiomatic since the early days of the public company but their loosening or abandonment was encouraged by inter-State competition for company registration[2]. It seems that competition for company registrations in a single market with multiple registration-jurisdictions makes it harder for States to maintain standards of corporate governance, even if they are so minded.

The principle of pre-emption should apply throughout the Single Market. If that were to cease to be the case, it is essential that there be no restriction on Member States trying to retain or strengthen the principle within their own jurisdiction.

Yours sincerely,

John Grout
Policy and Technical Director

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[1] Describing the US regime:

> "The current system of corporate governance tends toward management indulgences. This is clearly reflected in key legal elements of corporate governance, which embrace increasing laxity. New empirical evidence also suggests that the trend of corporate governance is away from more demanding standards that seem to reduce agency costs and enhance financial and economic performance. The models that best explain corporate governance dynamics are economic models of special interest influence."

Ramirez, Steven A., "Special Interest Race to CEO Primacy and the End of Corporate Governance Law", *Delaware Journal of Corporate Law* (DJCL), Vol. 32, No. 2, 2007, ISSN: 0364-9490. Available at SSRN: http://ssrn.com/abstract=996204

[2] In principle, abuses in the US are discouraged by the risk of shareholders litigating against boards for breaches of fiduciary duties.

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The Association of Corporate Treasurers (ACT)

The ACT is an international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the worlds leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including The Treasurer magazine and the annual Treasurers' Handbook, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce, financial institutions and professional service firms.

The ACT's approach to policy issues is set out in our Manifesto at http://www.treasurers.org/technical/resources/manifestoMay2007.pdf.

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