EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE

Proposal for a Directive on the exercise of voting rights by shareholders

A CONSULTATIVE DOCUMENT

OCTOBER 2006

EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE

PROPOSAL FOR A DIRECTIVE ON THE EXERCISE OF VOTING RIGHTS BY SHAREHOLDERS

The Department of Trade and Industry invites your views on a proposal by the European Commission for a Directive to establish requirements in relation to the exercise of voting rights by shareholders of companies with a registered office in a Member State and whose shares are admitted to trading on a regulated market.

The proposal aims to improve shareholder rights and corporate governance in EU listed companies, as well as business competitiveness in general.

You are invited to send comments and supporting evidence on any part of this consultation, preferably by email, to:

David Styles
Corporate Law and Governance Directorate
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Email: david.styles@dti.gsi.gov.uk
Tel: 020 7215 0211
Fax: 020 7215 0235

The deadline for responses is 19 January 2007.

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Confidentiality: Your response may be made publicly available by the DTI. If you do not want all or part of your response or name made public, please state this clearly in the response. A summary of all responses received will be made available on the DTI website and circulated to all respondents to the consultative document.

We will handle any personal data you provide appropriately in accordance with the Data Protection Act 1998.

CONTENTS

FOREWORD

Shareholder rights are important. The rights which investors gain by holding shares in a company give them a say in how the company is run. By attending, speaking and voting at company general meetings, they can hold management to account and help to improve standards of corporate governance.

But the system only works if investors are kept properly informed about the company and about opportunities to have their say. This directive is about making sure that investors get that information, and that they can exercise their rights at general meetings – even when they are not able to attend it in person, as is often the case where investors are not based in the same EU Member State as the company whose shares they hold.

The voting process can be particularly complex when shares are held across EU national boundaries. The European Commission believes that existing EU legislation does not deal effectively with cross-border voting problems. It believes that those problems restrict investment, limit access to capital and undermine good corporate governance. We agree, and we support the proposal for a Directive in this area.

We have made good progress in the UK in improving voting levels at listed company meetings in the UK; and we can still do more to promote wider investor engagement, as we are doing in the Companies Bill currently before Parliament.

Our objective for this Directive is to agree an approach which improves standards across the EU to the benefit of both companies and their shareholders, without imposing unnecessary costs or bureaucratic restrictions, and taking full advantage of the opportunities of modern communications technology. We believe that the right approach is to set out clear principles but to leave flexibility in the way that individual Member States and companies apply them. There is a real risk that if you attempt to legislate for every detail in every part of the process, you will stifle shareholder democracy, not enhance it. This is particularly true when dealing with the laws of 25 EU Member States.

That is why we welcome key principles in the directive such as the abolition of share blocking, the facilitation of electronic voting and voting by proxy, and rights to table resolutions and meeting agenda items. But we are wary of restrictive rules which do not meet the criteria established in the Company Law and Corporate Governance Action Plan – that new EU company law should be “firm in the principle, flexible in application”.

Your views are very important. The UK has the largest and leading equity market in Europe, and the most dispersed shareholder structure. The Commission has already had two consultations on this matter. The response to

these from UK stakeholders was impressive and it is clear that the Commission listened to what we had to say. Many interested parties have continued to help us as negotiations have proceeded, but this is the time to submit your views formally.

Improving the effective exercise of shareholder rights across borders is important to enhancing governance, market confidence, and the opportunity for cross border investment. Getting this right will help both the UK and the EU compete successfully in the global economy.

Rt. Hon. Ian McCartney MP
Minister for Trade, Investment and Foreign Affairs

EXECUTIVE SUMMARY

Purpose

1.1 This consultative document seeks your comments on the European Commission's proposal for a Directive on Shareholder Rights, including the likely costs and benefits of the Directive indicated in our partial Regulatory Impact Assessment (RIA) at Annex A. Your views will inform the UK Government's ongoing negotiations.

1.2 In addition to this consultation paper, **the UK Government will be holding a public meeting on 14 November 2006**. The meeting will take place from 10.00am to 12.30pm at the DTI Conference Centre, 1 Victoria Street, London SW1H 0ET. If you would like to attend, please register your interest by emailing David Styles at david.styles@dti.gsi.gov.uk or calling 020 7215 0211.

1.3 The formal consultation period will end on 19 January 2007. As negotiations on these proposals are well advanced, early responses would be particularly welcome.

About the proposal

1.4 The proposal aims to improve corporate governance in EU companies trading on regulated markets by enhancing the rights shareholders are able to exercise. In particular, it seeks to achieve this by ensuring that shareholders owning shares in companies registered and listed in another Member State may vote without difficulty at company meetings. Shareholders, no matter where in the EU they reside, will benefit from timely access to complete information and simple means to exercise voting rights at a distance.

1.5 The process of voting at company general meetings differs widely across Member States, and is often a complex procedure. It is further complicated when shares are held across EU borders. The Commission believes that existing legislation at EU level does not address sufficiently the cross-border voting problems. At present, under the "Transparency Directive", companies are required to make a limited amount of information available in relation to company meetings; but the Transparency Directive does not deal with the shareholder voting process.

Key proposals

1.6 The Commission is proposing that a directive, where necessary, addresses the following four areas:

a) **The abolition of "share-blocking"**

Share-blocking is a process where, on a specific date prior to a company meeting (usually a number of weeks), shareholders are required to notify the company of their identity and intention to vote. After the date, the shares involved cannot be traded. This affects the ability of equity markets to operate efficiently and increases financial risks. The Commission instead proposes a "record date" system; under this regime, on a date prior to the meeting, shareholders are validated for voting at the meeting. A standard, harmonised record date is not proposed, but the date must not be earlier than 30 calendar days before the meeting, and Member States will not be permitted to impose excessive shareholder identification requirements. The UK voting process utilises a record date which, for most publicly traded shares, cannot be more than two days before the meeting.

b) **Sufficient advance notice for meetings**

It is clearly important that shareholders are given enough time to prepare for meetings. This involves adequate advance notice of meetings and access to related documents. A minimum notice period of 30 days is proposed. In the UK, the minimum notice periods are 21 days for Annual General Meetings (AGMs) and 14 days for Extraordinary General Meetings (EGMs).

c) **Removal of legal obstacles to electronic participation**

The ability to vote by electronic means is widespread in listed companies in the UK. It has speed and cost advantages. The Commission propose that Member States must not have barriers to electronic participation, save those relating to security and identification, which can be justified proportionately.

d) **The ability to vote without attending the meeting**

Given that most shareholders are not in a position to attend meetings in person, it is proposed that they should always have the right to vote in absentia, by post or electronic means, without appointing a proxy.

What happens next?

1.7 The Government will issue a summary of responses within three months of the closing date of this consultation. It is intended that the Government response to this consultation be issued at the same time.

How to respond and help with queries

1.8 Comments are welcome on all aspects of the proposal. In particular, we invite your views on the specific issues highlighted in this consultation document (a summary of the consultation questions is attached at Annex B). In relation to the partial Regulatory Impact Assessment at Annex A, any relevant data or other supporting evidence would be especially useful.

1.9 When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

1.10 A response can be submitted by letter, fax or email to:

David Styles
Corporate Law and Governance Directorate
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Email: david.styles@dti.gsi.gov.uk
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Additional copies

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Confidentiality & Data Protection

1.12 Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want other information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a

statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.13 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

1.14 The Department will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Help with queries

1.15 Questions about the policy issues raised in the document can be addressed to David Styles, using the contact details in paragraph 1.10 above.

1.16 A copy of the Code of Practice on Consultation is at Annex C.

THE PROPOSED DIRECTIVE

Introduction

2.1 The Government is committed to ensuring that our stakeholders have opportunities to feed in their views on all proposals published by the European Commission. This consultative document seeks your further comments on the European Commission's proposal for a Directive on Shareholder Rights, including the likely costs and benefits of the Directive indicated in our partial Regulatory Impact Assessment (RIA) at Annex A. Your views will inform the UK Government's ongoing negotiations.

2.2 The proposal is currently being discussed in a Council Working Group and also by the European Parliament. Negotiations on these proposals are expected to continue to move ahead at a steady pace through the next few months and early responses would be particularly welcome.

2.3 As well as formal consultations, we are in regular contact with our key stakeholders to gain informal feedback on the practical impact of proposals. This consultation paper already reflects input from a range of stakeholders and the proposal has in fact moved on since January as a result of this. We will continue to work with them throughout the negotiation and implementation processes.

2.4 The UK Government will also be gathering views through a public meeting on 14 November 2006. The meeting will take place from 10.00am to 12.30pm at the DTI Conference Centre, 1 Victoria Street, London SW1H 0ET. If you would like to attend, please register your interest by emailing David Styles at david.styles@dti.gsi.gov.uk or by calling 020 7215 0211.

Background

2.5 On 10 January 2006, the European Commission published its proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market, and amending Council Directive 2004/109/EC. The Commission's impact assessment was published on 17 February 2006 and is available at: http://ec.europa.eu/internal_market/company/docs/shareholders/comm_native_sec_2006_0181_en.pdf

2.6 This proposal is the last of those put forward in the communication from the Commission to the Council and the European Parliament (10041/03) of 21 May 2003 entitled *Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward* ("the Company Law Action Plan") to receive attention.

Legal base

2.7 The directive is part of the EEA agreement, so is potentially applicable to the EEA. The proposed legal basis for the Directive is Article 95 of the Treaty establishing the European Community. The Government has been seeking clarification of the reasons for this proposed legal base, as previous directives in the company law field have relied on Article 44 or, in the case of the Transparency Directive, on both Article 44 and Article 95.

The UK position

2.8 The UK has the largest and leading equity market in Europe and the most dispersed shareholder structure. There are 1,161 UK companies listed on the LSE Main Market with a total market capitalisation of £1,800 billion, and a further 300 overseas companies listed with a total market capitalisation of £2,000 billion[1]. Consequently, the regime of shareholder rights is well developed and shareholders in companies trading on the LSE, whether or not they are based in the UK, face no significant barriers to exercising their rights.

2.9 Shareholder participation in company meetings and the conduct of those meetings in listed companies is governed by a mixture of statutory provision (chiefly the Companies Act 1985 – see the paragraphs below on "Existing Legislation"), companies' articles of association, the Financial Reporting Council's "Combined Code on Corporate Governance", which have effect through listing rules under Part 6 of the Financial Services and Markets Act 2000, and common law provisions.

2.10 Voting can be a complex process. Intermediaries often hold shares on behalf of investors. Where this is the case, voting can involve a chain of events that encompasses companies, registrars, custodian banks, investment managers, central securities depositaries and proxy voting agencies. In the UK a great deal has been achieved by the co-operation of these intermediaries in the "Shareholder Voting Working Group". Over the past six years, the level of shareholder voting at AGMs in the FTSE 100 listed companies has steadily increased and now stands at nearly 60%; this compares favourably with other Member States.

2.11 The Commission say that shareholder participation is an essential precondition for effective corporate governance. Given that the complexities of voting are magnified when it takes place cross-border, the Commission believe that only action at EU level can deal with these complexities. In principle, the Government agrees with this view, subject to ensuring that any detailed measures agreed do not have the effect of undermining shareholder rights in the UK and therefore lowering overall standards.

Existing legislation

[1] LSE Main Market statistics, August 2006.

2.12 The proposed Directive is intended to “approximate” the requirements of Member States’ laws in respect of a number of points relating to company general meetings.

2.13 Currently, GB law on general meetings is found in the Companies Act 1985 and the corresponding Northern Irish law is found in the Companies (Northern Ireland) Order 1986. It is proposed to replace the relevant provisions of both the 1985 Act and 1986 Order with the provisions of Part 14 of the Companies Bill (formerly the Company Law Reform Bill: see http://www.publications.parliament.uk/pa/pabills/200506/companies.htm; in earlier prints of the Bill, Part 14 was Part 13). Also relevant are the new provisions on the exercise of shareholders’ rights (including the exercise of such rights by “indirect investors”), which it is proposed to introduce as Part 9 of the Bill. It is a feature of both the current and the proposed UK legislation that they allow companies considerable freedom to make their own rules about the conduct of meetings in their articles of association.

DETAILED PROPOSALS

3.1 The proposal will facilitate the cross-border exercise of shareholders' rights in listed companies through the introduction of minimum standards. This section considers each of the Articles in the proposed Directive and highlights the particular issues on which we would welcome your views.

Article 1 – Subject matter and scope

Article 1
Subject-matter and scope

1. This Directive establishes requirements in relation to the exercise of voting rights in general meetings of issuers that have their registered office in a Member State and whose shares are admitted to trading on a regulated market.
2. Member States may exempt from this Directive issuers which are
   (i) collective investment undertakings of the corporate type within the meaning of Article 1 (2) of Directive 85/611/EEC and
   (ii) undertakings, the sole object of which is the collective investment of capital provided by the public, which operate on the principle of risk spreading and which do not seek to take legal or management control over any of the issuers of their underlying investments, provided that these collective investment undertakings are authorised and subject to the supervision of competent authorities and that they have a depositary exercising functions equivalent to those under Directive 85/611/EEC.

3.2 The scope is limited to issuers of shares whose shares are traded on a regulated market. In the UK, these are essentially public companies trading on the London Stock Exchange (excluding stocks from the Alternative Investment Market[1]).

3.3 Paragraph 2 of Article 1 contains a Member State option to exempt undertakings for collective investment in transferable securities ("UCITS"). Where this option is used the proposed wording excludes the possibility of treating UCITS as issuers for the purposes of this Directive but does not prevent them from benefiting from the provisions in their role as shareholders of other companies.

Q1. Do you agree with the scope of the directive?

[1] Scope as defined in the Markets in Financial Instruments Directive (2004/39/EC).

Q2. Do you consider that we should exercise the exemption of UCITS in paragraph 2?

Article 2 – Definitions

Article 2
Definitions

For the purposes of this Directive the following definitions shall apply:

(a) 'issuer' means a legal entity governed by public or private law, including a state, whose shares are admitted to trading on a regulated market;

(b) 'regulated market' means a market as defined in Article 4(1), point 14, of Directive 2004/39/EC of the European Parliament and of the Council;

(c) 'shareholder' means any natural person or legal entity governed by private or public law that holds:
  (i) shares of the issuer in its own name and on its own account;
  (ii) shares of the issuer in its own name, but on behalf of another natural person or legal entity;

(d) 'credit institution' means an undertaking as defined in Article 1(1)(a) of Directive 2000/12/EC of the European Parliament and of the Council;

(e) 'proxy' means the empowerment of a natural person or legal entity by a shareholder to exercise some or all rights of that shareholder in the general meeting in his or her name and on his or her behalf;

(f) "omnibus account" means a securities account in which securities may be held on behalf of different natural persons or legal entities.

3.4 The key issues here are the definitions of "shareholder" and proxy". Different Member States' legal systems have different ways of defining and recording ownership of shares. These differences depend on a variety of factors, including whether companies in their jurisdictions have "registered" or "bearer" shares; whether shares are "immobilised" and/or "dematerialised" in centrally managed systems; whether shares are held directly or through one or more intermediaries; and whether (and how) their national laws permit different rights and interests relating to shares to be split between more than one person.

3.5 As a result, where the same chain of intermediaries exists in relation to the holding of shares in two companies, each based in a different Member State, the person who is classified as the "shareholder" in relation to one company's shares may not be so classified in relation to the other company's shares. What is important therefore, is that whenever there is a chain of intermediaries or there are circumstances in which rights and interests relating to the company's shares are split, the laws of each Member State make it clear to investors and intermediaries which persons are entitled to exercise the rights which this Directive confers.

3.6 The definition of shareholders at 2(c) uses the wording of Article 2(1)(e) of the Transparency Directive (and thus excludes holders of depositary receipts from its scope). It is arguable, however, given the specific purposes of this Directive as described above, that the definition of shareholder should be drafted so that it avoids references to "holding" shares and references to shares "held on behalf" of others; these have different meanings in different Member States. There is therefore a risk that it may not always be clear who is entitled to enjoy or exercise the rights conferred by the Directive.

3.7 Since the purpose of this Directive is not to harmonise shareholding structures across the EU, but to facilitate the exercise of shareholders' rights across Member State borders, it might be better if "shareholder" was defined in a way which makes it clear it is to be interpreted as having the meaning which it would naturally have under the law of the Member State where the issuer is incorporated. This should avoid any potential uncertainty about who is a shareholder for the purposes of the Directive.

3.8 Sub-paragraph (e) contains a definition of the term "proxy". The Directive aims to make it possible, in all Member States, for a shareholder to empower another person to exercise all his rights in a general meeting without going through special procedures or formalities such as the execution of a power of attorney (see Articles 10 and 11). This is currently not possible in all Member States. It is worth noting that the term "proxy" is used to refer to the abstract concept of "empowerment", rather than, as is more common in current English usage, either to the person appointed by the shareholder (who is known in the Directive as the "proxy holder") or the instrument under which he is appointed.

Q3. Do you agree with the definitions of "shareholder" and "proxy"? If not, how should they be modified? Do you agree with the alternative approach suggested above in relation to the definition of "shareholder"?

Article 3 – More stringent national requirements

Article 3
More stringent national requirements

Member States may make issuers which have their registered office on their territory subject to requirements more stringent than those laid down in this Directive.

3.9 The Directive is described as a minimum harmonisation directive. The intention is to introduce minimum standards that ensure that shareholders have timely access to complete information in relation to general meetings and have simplified ways of voting without attending the general meeting.

3.10 The Commission states in its proposal that Article 3 leaves Member States "free to introduce provisions which are more favourable to shareholders". It is not always evident what being "more favourable" to shareholders means in the context of particular obligations: in the UK, companies are often able to decide – on the basis of shareholder agreement – how to organise themselves in terms of rights granted to shareholders.

3.11 Given that an explanation of what "more favourable" means in terms of each article is most likely not a practical proposition, it might be preferable to express the freedom which Member States have to adopt further measures in support of shareholder rights by using slightly different wording – for example, "further obligations to facilitate the exercise" of such rights.

Q4. What do you think about the above suggestion? Do you have any other comments on Article 3?

Article 4 – Equal treatment of shareholders

Article 4
Equal treatment of shareholders

The issuer shall ensure equal treatment for all shareholders who are in the same position with regard to participation and voting in its general meetings.

3.12 The Article uses the general principle contained in Article 17(1) of the Transparency Directive and applies it to the rights of shareholders covered by this proposal for a Directive. A statement of principle is clearly important for a directive such as this, but respondents might have views on the adequacy or otherwise of the wording here. It may for example, not always be clear which shareholders are or are not "in the same position" for these purposes.

Q5. Do you think that it is useful to include a statement of principle such as Article 4 and if so are you content with the current wording?

Article 5 – General meeting notice

Article 5
General meeting notice

1. Without prejudice to Article 9(4) of Directive 2004/25/EC of the European Parliament and of the Council, any notice convening a general meeting on a first call shall be sent out by the issuer not less than 30 calendar days before the meeting.
2. The notice referred to in paragraph 1 shall at least contain the following:
   (a) a precise indication of the place, time and draft agenda of the meeting;
   (b) a clear and precise description of the procedures that shareholders must comply with in order to be able to participate and to cast their vote in the general meeting, including the applicable record date;
   (c) a clear and precise description of the available means by which shareholders can participate in the general meeting and cast their vote. Alternatively, it may indicate where such information may be obtained;
   (d) an indication where and how the full, unabridged text of the resolutions and the documents intended to be submitted to the general meeting for approval may be obtained
   (e) an indication of the address of the Internet site on which the information referred to in paragraph 3 will be posted.
3. Within the deadline provided for in paragraph 1, issuers shall post on their Internet sites at least the following information:
   (a) the meeting notice referred to in paragraph 1;
   (b) the total number of shares and voting rights;
   (c) the texts of the resolutions and the documents referred to in point (d) of paragraph 2;
   (d) the forms to be used to vote by correspondence and by proxy.

   Alternatively to the forms provided for in point (d) it shall be indicated on the site where and how the forms can be obtained.

3.13 It is important that shareholders receive adequate notice of all general meetings. Article 5(1) specifies a minimum notice period of 30 calendar days. However, an exception is made from this general rule in the case of situations of the type covered by Article 9(4) of Directive 2004/25/EC (the "Takeover Directive"), where a two week notice period is permitted.

3.14 Respondents may consider that there are other circumstances in which it is desirable from the point of view of companies and their shareholders for a

meeting to be called on less than 30 days notice. For example, UK law requires shareholder approval for particular types of transactions not covered by the Takeover Directive, and this is currently often given at "extraordinary" general meetings, which can be called on 14 days notice. In such cases, the transaction costs (ultimately borne by shareholders) would be increased if the minimum notice period for the meeting was 30 rather than 14 days. Moreover, where shareholders have the right in UK law to call a meeting, and wish to do so urgently in order to question the company's management about some proposed course of action, it may be desirable to call a meeting on less than 30 days notice if the views of shareholders are to be taken into account before management acts.

3.15 On the other hand, it may be said that 14 days is simply not long enough for information about general meetings to be transmitted across Member State borders, particularly when (as is often the case), there is a long chain of intermediaries between the issuer and the person who has invested in its shares and is entitled to decide how the voting rights attached to them are to be exercised (or where that person is a corporate entity which has its own internal decision-making processes to go through before it can cast its vote). It is also arguable that the more important the subject of a meeting is, the more important it is that it should not be held on notice which is too short for investors to respond in a considered way.

3.16 This Article requires the issuer to "send out" the meeting notice, which must contain basic information relating to the meeting. The meeting notice, along with further information related to the meeting, is to be made available on the issuer's website.

3.17 The Article does not specify to whom the notice must be sent. Under the mechanisms currently in use, in the case of bearer shares, the addressee would normally be the CSD, and in the case of registered shares, the registered shareholder. Any provision in the directive about the persons to whom meeting notices must be addressed would need to take account of these different approaches.

Q6. Is a 30 day notice period for all meetings appropriate? If not, what would you consider to be the minimum notice period appropriate to the cross-border context? Should there be a minimum single notice period for all general meetings, or should it be possible to call some kinds of meetings on shorter notice – and if so, which kinds of meetings on what period of notice?

Q7. Is the scope of the information and method of its delivery to shareholders adequately defined?

<u>Article 6 – Right to add items to the agenda of general meetings and to table draft resolutions</u>

Article 6
Right to add items to the agenda of the general meeting and to table draft resolutions

1. Shareholders, acting individually or collectively, shall have the right to add items on the agenda of general meetings and table draft resolutions at general meetings.
2. Where the right to add items on the agenda of general meetings and table draft resolutions at general meetings is subject to the condition that the relevant shareholder or shareholders hold a minimum stake in the share capital of the issuer, such minimum stake shall not exceed 5% of the share capital of the issuer or a nominal value of EUR 10 million, whichever is the lower.
3. The rights referred to in paragraph 1 shall be exercised sufficiently in advance of the date of the general meeting, to enable other shareholders to receive or have access to the revised agenda or the proposed resolutions ahead of the general meeting.

3.18 The right to add items to the agenda and to table draft resolutions enables shareholders to influence company decision-making more directly. It is usual to restrict the ability to add items to a general meeting agenda or to call or require the company to call a general meeting by reference to thresholds expressed in terms of shareholders holding a minimum proportion or number of shares. The Commission considers the thresholds in some Member States to be unduly high. This Article therefore confirms the right to add items to the agenda and to table draft resolutions as a matter of principle, and introduces maximum thresholds at EU level. Furthermore, the Article provides that the amended agenda and the new resolutions should be circulated to shareholders. In relation to annual general meetings, it is important for shareholders to be able to put items on the agenda sufficiently in advance of the meeting. The determination of the relevant deadline, however, is left to Member States.

3.19 Nevertheless, the Article as drafted does not provide shareholders with a right to call meetings, or require issuers to do so at shareholders' request. In addition, the rights to add items to the agenda would seem to be unfettered and would therefore apply to EGMs, which might have detrimental effects in terms of costs and the efficient running of these meetings.

Q8. Do you agree that rights for shareholders to add items to the agenda of general meetings and table draft resolutions at EGMs should be restricted?

Q9. Are the proposed thresholds for exercising the rights specified in this Article set at an appropriate level? Is it necessary to have a threshold expressed in terms of nominal value, as well as proportion, of shares?

Article 7 – Admission to the general meeting

Article 7
Admission to the general meeting

1. The right to participate and to vote in a general meeting shall not be subject to any condition requiring the shareholder to block the relevant shares by deposit or other means with a credit institution or another entity ahead of the general meeting, even if the blocking has no effect on the possibility of trading the shares.
2. The right to participate and vote in a general meeting of any issuer may be made subject to the condition that a natural person or legal entity qualifies as shareholder of the relevant issuer on a certain date prior to the relevant general meeting.
   The proof of the qualification as shareholder may be made subject only to such requirements as are necessary to ensure the identification of shareholders and to the extent that they are proportionate to ensure the identification.
3. The date referred to in the first subparagraph of paragraph 2 shall be fixed by each Member State for the general meetings of issuers having their registered office in that Member State.
   However, this date shall not be earlier than 30 calendar days before the general meeting.

Each Member State shall communicate the date so fixed to the Commission which shall publish these dates in the *Official Journal of the European Union*

3.20 Paragraph 1 prohibits share blocking (the practice of preventing shareholders from trading their shares during a certain period before a meeting), which deters investors from voting their shares. The financial risk associated with such a blocking period is high, due to possible market fluctuations during the blocking period.

3.21 Paragraphs 2 and 3 allow Member States to introduce a "record date" system as a requirement upon which access to the general meeting may be made conditional. Under such a system, eligibility to vote is determined by the holding of shares on a particular date prior to the meeting. The different processes for preparing general meetings and the consequent requirements in terms of timing differ considerably from one Member State to another. The Commission conclude, therefore, that it does not seem appropriate to introduce a uniform record date at EU level. The proposal leaves it to national law to determine any such date, within a maximum period of 30 calendar days preceding the general meeting.

3.22 In the UK, a "record date" for voting is defined as the date that voting entitlements are set and the point at which the eligible registered owners are identified for the purposes of voting and attending meetings. Under regulation 41 of the Uncertificated Securities Regulations 2001, issuers may currently set a

record date not more than 48 hours before the time fixed for the meeting for shares held in uncertificated form. This provides a balance between democracy (accuracy of voting entitlements when the meeting takes place) and market liquidity (ability of investors to trade in a company's shares).

Q10. Do you agree with the maximum 30 day record date period? Should the directive prescribe any other parameter for the setting of record dates (for example, that the record date must be at least a certain number of days after the date on which the notice of a meeting is issued)?

Article 8 – Participation in the general meeting by electronic means

Article 8
Participation in the general meeting by electronic means

Member States shall not prohibit the participation of shareholders in the general meeting by electronic means.

Requirements and constraints that act or would act as a barrier to the participation of shareholders in the general meeting by electronic means shall be prohibited, except in so far as they are necessary to ensure the identification of shareholders and the security of the electronic communication and are proportionate to ensure the identification.

3.23 This Article provides that obstacles to electronic participation in general meetings must be removed – except for any requirements or constraints which are necessary to ensure the identification of shareholders and the security of the electronic communication and are proportionate to the objective of identification.

Article 9 – Right to ask questions

Article 9
Right to ask questions

1. Shareholders shall have the right to ask questions orally at the general meeting and/or in written or electronic form ahead of the general meeting.
2. Issuers shall respond to the questions put to them by shareholders, subject to the measures which Member States may take, or allow issuers to take, to ensure the good order of general meetings and their preparation and the protection of confidentiality and business interests of issuers. A response shall be deemed to be given if the relevant information is available on the Internet site of the issuer in the form of "frequently asked questions".
3. Responses to shareholder questions referred to in paragraph 1 shall be made available to all shareholders through the Internet site of the issuer.

3.24 Company meetings are the main forum in which shareholders can exercise their right to ask questions. The Commission consider that there should be a corresponding obligation on the part of the issuer to reply to questions, subject to measures to ensure the good order of the meeting, confidentiality or the protection of business interests. The Commission also consider that a reply to a question is not necessary if the shareholder can obtain the relevant information easily from a "frequently asked questions" section on the company's website. Many UK companies operate procedures enabling shareholders to ask questions – and receive answers – before meetings, but this, and conduct of the meeting itself, is a matter of best practice, the company's memorandum and articles of association, the common law of meetings, and the chairman's role in running the meeting.

Q11. Is it necessary or appropriate to regulate the asking and answering of questions in the context of company meetings in this way?

Article 10 – Proxy voting

Article 10
Proxy voting

1. Every shareholder shall have the right to appoint any other natural person or legal entity as a proxy holder to attend and vote at a general meeting on his behalf. There shall be no restrictions as to the person who can be granted a proxy other than the requirement that the person possesses legal capacity.
   However, Member States may restrict the right of proxy holders to exercise the voting rights at their discretion in cases where:
   (a) they have a business, family or other relationship with the issuer,
   (b) they are a controlling shareholder of the issuer,
   (c) they belong to the management of the issuer or of one of its controlling shareholders.
   A shareholder may only appoint one person to act for him as a proxy holder in relation to any one general meeting.
2. A person acting as a proxy holder may hold a proxy from more than one shareholder without limitation as to the number of shareholders so represented. Where a proxy holder holds a proxy from several shareholders, he may cast concurrent votes for and against any resolution and/or abstain from voting on such resolution in accordance with the voting instructions of the shareholders the proxy holder represents.
3. A proxy holder shall enjoy the same rights to speak and ask questions in general meetings as those to which the shareholder it represents would be entitled, unless instructed otherwise by the shareholder.

3.25 This Article establishes a general right for shareholders to exercise their rights in a general meeting by proxy. The provisions of Article 10 are qualified in certain respects by Article 13.

3.26 The purpose of paragraph 1 is to remove all existing limitations on the persons who may be granted a proxy, other than the requirement that the person holding a proxy should have legal capacity. The UK has essentially a liberal proxy appointment system and does not experience particularly adverse consequences at general meetings as a result. For other Member States, substantial liberalisation of the proxy appointment process is a big step, and the Commission believe that some limitations may be justified where the proxy holder is in a situation giving rise to a conflict of interest. In such cases, Member States may decide that the appointment of such proxy holders is to be made subject to the issuing of formal voting instructions.

3.27 This Article also states that a shareholder may only grant one proxy in respect of his entire voting entitlement, but that a proxy holder should be able to hold proxies from more than one shareholder. Consequently, a proxy holder who acts on behalf of several shareholders should be able to cast split votes in

respect of any resolution, in accordance with the – potentially conflicting – voting instructions given to them by the shareholders.

3.28 Paragraph 3 clarifies that proxy holders should in principle have the same rights as those that the shareholder would enjoy in relation to the general meeting.

Q12. Is the system of proxy voting set out in Article 10 sufficiently liberal, or are some of the restrictions provided for in it inappropriate?

Article 11 – Appointment of proxy holder

Article 11
Appointment of proxy holders

1. The appointment of a proxy holder and the issue of voting instructions by the shareholder to the proxy holder shall not be subject to any formal requirements, other than such requirements as may be strictly necessary for the identification of the shareholder and of the proxy holder.
2. Proxy holders may be appointed by electronic means subject to such requirements, other than that of an electronic signature, as may be strictly necessary for the authentication of the appointer and the identification of the proxy holder.
3. Requirements imposed by Member States under paragraphs 1 and 2 shall be proportionate to their objectives.

3.29 The purpose of this Article is to prohibit unduly cumbersome formal proxy appointment and proxy instructions requirements. Nevertheless, in the Commission's assessment, issuers need to be sufficiently certain as to the identity of the shareholder and the proxy holder. Member States are, therefore, given the possibility of imposing requirements or allowing issuers to impose requirements with regard to the identities of the shareholder and the proxy holder, subject to proportionality.

Q13. Does Article 11 strike the right balance between ease of appointment and investor security?

Article 12 - Voting in absentia

Article 12
Voting in absentia

1. Any shareholder of a listed company shall have the possibility to vote by post in advance of the general meeting, subject to such requirements as may be necessary to ensure the identification of shareholders and are proportionate to this objective.
2. Member States shall prohibit requirements and constraints which hinder the exercise of voting rights attached to shares by electronic means by shareholders who are not physically present at the general meeting, except in so far as such requirements may be necessary to ensure the identification of shareholders and the security of electronic communications and are proportionate to this objective.

3.30 This Article introduces the possibility for shareholders to vote by post, by requiring Member States to permit issuers to offer a postal voting service. It appears that what is contemplated is something distinct from the ability to appoint a proxy by post: the difference being, as far as the UK is concerned, that a vote can only be cast by proxy if the proxy holder is present at the meeting to cast it. It is expected that UK law would need to be changed to facilitate the proposed new system of voting, but companies would not be obliged to offer it to their shareholders.

Q14. Is the ability to vote by post necessary and should it be made mandatory either for Member States to permit it or for companies to offer it to their shareholders?

Article 13 – Voting upon instructions

Article 13
Voting upon instructions

1. Member States shall ensure that any natural person or legal entity that under their laws is allowed to hold securities in the course of a business for the account of another natural person or legal entity may hold such securities in either individual or omnibus accounts.
2. Where the shares are held in omnibus accounts, it shall not be permitted to require that they be temporarily registered in individual accounts, in order to be able to exercise voting rights attaching to these shares at a general meeting.

3. Persons referred to in paragraph 1 shall not be prevented from casting votes attaching to the shares which they hold for the account of another natural person or legal entity, provided they have been instructed to do so by such other person or entity. The person or entity referred to in paragraph 1 shall keep a record of the instructions for a minimum period of one year.

4. Where a person or entity referred to in paragraph 1 holds shares of the same issuer in an omnibus account, it shall be permitted to cast votes attaching to some of the shares differently from votes attaching to the other shares.

5. By derogation from Article 10(1), third subparagraph, a person or entity referred to in paragraph 1 that holds securities in an omnibus account shall have the right to issue a proxy to every person on whose behalf it holds shares in such account or to any third party designated by that person.

3.31 Paragraph 1 establishes the right of persons that "hold shares in the course of business on behalf of investors" to hold such shares in individual or omnibus accounts. Individual accounts are considered more transparent and make the tracking of votes possible, but may also be more expensive to maintain than omnibus accounts, in which the shares of several clients are pooled.

3.32 Paragraph 2 explains that, in the case of omnibus accounts, the casting of votes may not be made subject to so-called re-registration requirements, i.e. the requirement that the intermediary temporarily segregate out each of its investors vis-à-vis the Central Depositary ahead of the general meeting in order to be able to exercise voting rights attaching to the relevant shares. This procedure, which exists in some Member States, is costly and time consuming.

3.33 Paragraph 3 ensures that the persons or entities referred to in paragraph 1 have the possibility of exercising the voting rights attaching to the relevant shares if investors have given them voting instructions. This is currently not the case in all legal systems. Financial intermediaries have to keep evidence of such instructions for a minimum period, in case of disputes arising in relation to votes.

3.34 Paragraph 4 gives the right to persons who hold shares of the same issuer in a collective account on behalf of several investors, to split the votes according to the voting instructions that investors have given to them.

3.35 Paragraph 5 provides that where a person is registered as the shareholder for the account of different investors he should have the possibility of issuing proxies to each of these investors or to persons designated by them. This is a derogation from the general limit on proxy appointments in Article 10(1).

Q15. Article 13 aims to ensure that the rights conferred by the directive can be effectively exercised in cases where shares are held through intermediaries acting on behalf of a number of different clients. Do you think that it covers the right ground to achieve this aim? Would you support further measures that deal with the passing of instructions

between intermediaries in the voting chain, as recommended by the European Corporate Governance Forum[1]?

Article 14 – Counting of votes

Article 14
Counting of votes

For the purpose of counting votes, all votes cast in relation to any resolution submitted to the approval of a general meeting shall be taken into account.

3.36 This Article provides that all votes cast in respect of any resolution must be taken into account when votes are counted. It is considered that this is important in order to ensure that the voting results make the wishes of the shareholders fully transparent.

Article 15 – Information after the general meeting

Article 15
Post-General meeting information

1. Within a period of time which shall not exceed 15 calendar days following the general meeting, the issuer shall publish on its Internet site the results of the votes on each resolution tabled at the general meeting.
2. The results of the voting shall include for each resolution at least the number of shares in respect of which voting has taken place and the percentages of votes in favour of and against each resolution.

3.37 Results of votes are very often given during the course of the company meeting. However, the Commission consider that those shareholders who did not attend the meeting – and in a cross border context this particularly includes shareholders not resident in the company's country of incorporation – should also have access to these results. This Article provides for the publication of voting results on the issuer's website.

3.38 Under current UK arrangements, where a vote is taken by a show of hands at a general meeting, it is usually the case that each person voting is

[1] The European Commission set up the ECGF in 2004 to examine best practices in Member States with a view to enhancing the convergence of national corporate governance codes and providing advice to the Commission. The Forum, which is chaired by the Commission, meets two or three times a year and comprises representatives from Member States, European regulators (including CESR), issuers and investors, other market participants and academics. The ECGF's recommendation can be found at:
http://ec.europa.eu/internal_market/company/docs/ecgforum/recomm_en.pdf;
http://ec.europa.eu/internal_market/company/docs/ecgforum/recomm_annex_en.pdf

counted as simply having one vote, rather than the count reflecting the number of shares he holds. The number of shares held by each person voting is normally only taken into account when there is a poll vote. Moreover, proxies are not generally entitled to vote on a show of hands. Although Articles 14 and 15 do not prohibit the use of voting by show of hands, it is clear that if a vote is only taken by this method it is not possible to report it as required by these Articles, which therefore make it mandatory to take a poll vote (or go through some equivalent procedure) on all resolutions of companies subject to the directive. Clearly such a system has advantages from the point of view of transparency, although it is likely to involve some increase in costs.

Q16. Should companies be required to count and publish voting results on their websites in the level of detail required by Articles 14 and 15?

Article 16 – Transposition

Article 16
Transposition

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by [31 December 2007] at the latest. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.
   When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.
2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 17 – Amendments

Article 17
Amendments

With effect from the date specified in Article 16(1), Article 17 of Directive 2004/109/EC is amended as follows.

1. Paragraph 2 is replaced by the following:
   "2. The issuer shall ensure that all the facilities and information necessary to enable holders of shares to exercise their rights are available in the home Member State and that the integrity of data is preserved. In particular,
   (i) the issuer shall designate as its agent a financial institution through which shareholders may exercise their financial rights; and
   (ii) he shall publish notices or distribute circulars concerning the allocation and payment of dividends and the issue of new shares, including information on any arrangements for allotment, subscription, cancellation or conversion."
2. In paragraph 4, the words "paragraph 2(c)" are replaced by "paragraph 2, point (i)".

3.39 Article 17 provides for an adaptation of Article 17 of the Transparency Directive in order to avoid the duplication of provisions with the same subject. Therefore, those parts of the Article that are also being dealt with in the current proposal (former paragraph 2 (a) and (b)) have been deleted in the new Article 17.

Q17. Do you agree with this approach?

RESPONSES

3.40 We look forward to receiving your views on these issues. Any supporting evidence that you are able to supply would be particularly helpful in our on-going negotiations.

3.41 Please send all responses to David Styles, as indicated in paragraph 1.10 of the Executive Summary, by 19 January 2007.

Thank you for participating in this consultation.

ANNEX A

PARTIAL REGULATORY IMPACT ASSESSMENT

Proposal for a Directive of the European Parliament and of the Council on the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market, and amending Council Directive 2004/109/EC.

Background

2. This proposal is one of the short term measures put forward in the communication from the Commission to the Council and the European Parliament (10041/03) of 21 May 2003 entitled *Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward* ("the Company Law Action Plan"). The proposal was published on 10 January 2006. An impact assessment followed on 17 February 2006. The full text can be found on the Commission website at http://ec.europa.eu/internal_market/company/docs/shareholders/comm_native_sec_2006_0181_en.pdf

Scope

3. The proposed Directive would apply to the exercise of voting rights in companies that are registered in the UK and whose shares are traded on a regulated market. There are around 1,100[1] companies registered in the UK whose shares are traded on the London Stock Exchange SEAQ and SETS (not including stocks from the Alternative Investment Market). These companies cover a diverse range of sectors and operate in a variety of EU and non-EU competitive environments. The following table provides an indication of the relative scope of the Directive:

Figure A – Companies covered by the Directive

UK registered companies trading on the LSE (SEAQ and SETS)*			
	By turnover (in millions)	By assets (in millions)	By no. of employees
Smallest company	£0.002	£0.013	1
Largest company	£152,618	£683,573	402,375
Average size	£1,358	£4,568	9491
Median size	£170	£138	1240

*Information from FAME database, 2004 figures. Data does not include stocks from the Alternative Investment Market.

Why is action required?

4. The Commission has identified a market failure in the exercise of cross-border voting rights in EU listed companies. The process of voting at company

[1] LSE Main Market statistics, August 2006: 1,161 companies registered in the UK. FAME database, August 2006: 1,066 companies registered in England, Scotland and Wales.

general meetings differs widely across Member States, and is often a complex procedure. It is further complicated by how shares are held across EU borders.

5. Not all shareholders can participate directly in influencing the companies they hold shares in and often they rely on others to do this on their behalf, e.g. pension fund managers, proxy voting agencies etc. When intermediaries hold shares on behalf of investors, voting can involve a chain of events that encompasses companies, registrars, custodian banks, investment managers, central securities depositaries and proxy voting agencies. Some shareholders, or their representatives, are currently unable to exercise their rights effectively due to barriers created by this complex situation. Difficulties include, for example, insufficient advance notice for meetings and a lack of information about how to participate.

6. The Commission believe that existing legislation at EU level does not address this failure sufficiently. At present, under Article 17 of Directive (2004/109/EC), the "Transparency Directive", companies are required to make a limited amount of information available in relation to company meetings; but the Transparency Directive does not deal with the shareholder voting process.

7. The UK has supported EU legislation in this area on the basis that there are particular issues in voting cross-border which need to be addressed. Nevertheless, the Government is keen to ensure that the measures being proposed do not undermine the framework for shareholder rights in the UK or impose unjustified additional costs on companies.

What is the objective?

8. The proposal aims to enhance the rights shareholders are able to exercise in relation to company meetings. In particular, it seeks to achieve this by ensuring that shareholders owning shares in companies registered and listed in another Member State may vote without difficulty at company meetings. The intention is to improve shareholder rights and corporate governance, with the purpose of improving capital flows, lowering the cost of equity capital, and helping to make companies listed on a regulated exchange more economically efficient. The benefits of this proposal are likely to complement the benefits anticipated from the Cross-Border Mergers Directive and the Takeovers Directive.

<u>Agency costs</u>

9. Traditional economics and finance literature on the issue of corporate governance views the firm as an economic profit-maximising entity where managers maximise value for shareholders. Rational (in the economic sense) risk-neutral shareholders (principals) rely on risk-averse managers (agents) to maximise shareholder value. This separation of ownership and control can give rise to a principal-agent problem, which becomes the raison d'être for corporate governance. Principals need to effectively monitor and to some extent control their agents to ensure that managers are acting in the best interests of the

company's owners and that the scope for moral hazard[1] is minimised. In doing so principals incur agency costs related to efforts they make by which agents can be monitored and influenced in the interests of owners.

10. Managers can increase agency costs by raising barriers to shareholder engagement and activism, which may result in the company being run on behalf of managers and not the owners. The proposed Directive aims to lower agency costs so that shareholders can engage more effectively and ensure the companies that they own are more efficient. Better governance can also be useful in lowering agency costs and facilitate a lower cost of equity capital. Evidence suggests that companies that improve the strength of shareholders rights are expected to see a reduction in their equity cost of capital[2].

How will this be achieved?

11. Three possible options were identified for achieving these objectives. The option of maintaining the current situation ("do nothing") was also considered.

Do nothing

12. This would mean leaving the UK legal framework (which already provides an effective framework for exercising shareholder rights) alone, and assumes that the market has the potential, in each Member State, to deal with the problems identified. However, given the complexity of the voting process, which is to some extent a reflection of market arrangements (as well as national legislation), there is no guarantee the market will act quickly enough to improve shareholder rights, or that appropriate legislative change will take place in other Member States.

Commission Recommendation

13. A Recommendation would offer flexibility on the part of Member States to implement it into their national systems on the basis of Commission guidelines. It would give the Commission the option to intervene at a later stage to introduce legislation where it thought necessary. However, a Recommendation would not guarantee the consistent EU-wide introduction of minimum standards in key areas which are the origin of cross-border voting problems and increased costs, such as share blocking, where what deters investors is the possibility that such a requirement may be present at national level (whether as a legal requirement or as a matter of market practice).

Regulation

14. A Regulation would introduce a uniform treatment, irrespective of Member State laws. It would guarantee the introduction of a tight common framework for cross-border related issues. However, the costs of a regulation could be

[1] Moral hazard – the perverse incentive whereby agents are not held responsible for their actions which encourages them to engage in risky behaviour.

[2] Huang, Henry, Cheng, C.S. Agnes and Collins, Denton, "Shareholder Rights and the Cost of Equity Capital" (February 2006). Available at SSRN: <http://ssrn.com/abstract=594505>

significant, since it would not be possible to offer flexibility across the significant differences in the way that different Member States' legal systems deal with some of the fundamental features of shareholding. The adoption of directly applicable rules through a regulation is therefore probably not the most desirable and efficient way of achieving the objectives pursued.

Directive

15. A directive would offer more scope to accommodate differences in Member State legal systems as regards the holding of shares, while introducing basic common minimum standards in relation to the exercise of voting and related rights. Directives have been frequently used in the field of company law and corporate governance: most recently, on the proposals for two directives amending the existing 2nd, 4th and 7th Company Law Directives.

16. In view of the fact that market forces can solve only some of the technical problems associated with the voting process, and these only in the longer term, **the Commission has concluded that a directive is the instrument best suited to guarantee minimum common standards while respecting Member State laws**.

17. The Commission is proposing that, where necessary, the following four key areas be addressed in the Directive:

a) The abolition of "share-blocking";
b) Ensuring sufficient advance notice for meetings (including a requirement that all general meetings of shareholders be called on at least 30 days notice);
c) Removal of legal obstacles to electronic participation;
d) The ability to vote without attending the meeting.

Costs and Benefits

Business sectors affected

18. The proposed Directive applies only to the exercise of voting rights by shareholders of companies having their registered office in a Member State and whose shares are admitted to trading on a regulated market. The proposal will apply to UK companies trading on the London Stock Exchange. Based on LSE data[1] there are 1,161 UK companies listed on the Main Market with a total capitalisation of £1,800 billion and a further 300 overseas companies with a total market capitalisation of £2,000 billion. These companies cover a wide range of business sectors and vary greatly in size, as shown in Figure A in the section on "Scope". Companies listed on the London Stock Exchange also operate in a variety of EU and non-EU competitive environments.

19. As noted already, voting can be a complex process. Where intermediaries hold shares on behalf of investors, voting can involve companies, registrars, custodian banks, investment managers, central securities depositaries and proxy

[1] LSE Main Market statistics, August 2006.

voting agencies. The costs and benefits for some of these groups are investigated below. We welcome your comments and data to assist us in developing this aspect of the analysis.

Costs and benefits of the key proposals

20. In the UK, many of the mandatory provisions of the proposed Directive would not introduce additional costs or burdens, since many of the minimum standards imposed by the Directive are already in line with existing voting arrangements. Where additional costs are expected, we believe the benefits will significantly outweigh them. The Commission has identified four specific areas as essential for enhancing transparency for shareholders and thereby improving corporate governance. The costs and benefits relating to these proposals are set out in Figure B.

Figure B – Costs and benefits of the key proposals

Costs	Benefits
Policy costs • A uniform notice period would prevent UK companies from calling EGMs on 14 days notice, which are often used to raise capital through a rights issue where shareholder approval is required. Longer notice periods may lead to an increase in underwriting costs and, hence, raise the cost of equity capital obtained from rights issues. (Article 5.1) • Companies could issue the meeting notice and fix the record date on the same day, resulting in shareholders being unable to recall shares in order to vote them. This may restrict enhanced shareholder engagement and result in a possible reduction in stock lending in the UK, which could have adverse implications for liquidity in equity markets. (Article 7.3) Admin costs • The requirement to produce written answers to shareholders' questions would certainly lead to a significant increase in administrative costs for a company. (Article 9) • Proxy voting and re-registration requirements are often costly and there is anecdotal evidence to suggest that the level of these costs does discourage small funds from voting. (Articles 14 and 15)	• Agency costs will be reduced through stronger shareholder rights (UK resident shareholders in EU listed companies should be in a better position to exercise their rights in EU companies); simplification of the process for the appointment of proxies; and clarification of who can be appointed as a proxy and enhanced rights of proxies in some Member States. • Shareholders should be able to exercise their rights more efficiently. • The cost of equity capital should be lower due to stronger corporate governance, resulting from enhanced shareholder rights.

Impact on investors, companies and other actors

21. The main beneficiaries from the proposal, in the short term, will be shareholders that currently own cross-border shares in their portfolios; who should benefit from lower agency costs. The existence of costs, associated with obstacles to cross-border voting, means that investors are unable to become as actively engaged in the governance of companies as they may wish or that they simply do not invest across borders.

22. Lower risks faced by shareholders with regard to the exercise of their rights should help to reduce that part of the risk premium for companies that have relatively weaker shareholder rights.

23. As noted earlier in this assessment, some studies have shown that companies that can improve shareholder rights can benefit from a lower cost of equity capital through increased investor confidence - "capital will not flow unless adequate investor protections are in place."[1]

Small business test

24. Small companies[2] make up around 20%[3] of the companies coming into the scope of this Directive and the net impact on them is expected to be positive. Small firms theoretically have a relatively higher cost of equity capital. Any improvement in shareholder rights should assist in reducing the cost of equity capital.

Mergers and takeovers – the market for corporate control

25. Strengthening shareholder rights also helps facilitate the market for corporate control. This will be aided by realising any potential interdependencies between this Directive and the Directives on Takeovers and Cross-Border Mergers, and the wider EU Company Law Action Plan. Evidence does suggest that companies with a low quality of governance and weaker protection of shareholder rights can improve their value if they merge or are taken over by companies with better governance and stronger shareholder rights. Similarly, and in recognition of the commercial reality associated with merger and takeover activity, companies with weaker governance and lower shareholder protection do

[1] Himmelberg, Charles P., Hubbard, R. Glenn and Love, Inessa, "Investor Protection, Ownership, and the Cost of Capital" (April 2004). World Bank Policy Research Working Paper No. 2834. Available at SSRN: <http://ssrn.com/abstract=303969>

[2] Small companies definition as set out in the Companies Act 1985. The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements: 1. Turnover of not more than £5.6 million; 2. Balance sheet total of not more than £2.8 million; 3. Not more than 50 employees.

[3] FAME database, August 2006.

merge and take over companies with stronger governance and shareholder protection, without an adverse affect on the value of the target company[1].

Assumptions/Unintended consequences

Non-resident shareholders in EU listed companies

26. Non-EU resident shareholders will be treated in the same way as EU resident shareholders. However, in line with other directives, investors who have an equivalent economic exposure to shareholders, but who do not hold shares (for example, holders of Depositary Receipts) may not enjoy the same rights as shareholders covered by the Directive.

Implementation in other Member States – "collective action problem"

27. The mandatory provisions in the Directive will bring harmonisation but, in some areas, the Directive permits a more flexible approach. The implementation of the Directive by other Member States may therefore result in some unintended consequences for UK shareholders.

Consultation

28. The Commission have conducted two detailed consultations on this issue. The first closed on 16 December 2004; the second on 15 July 2005. During the second consultation period, Commission officials visited London to meet a cross-section of key UK stakeholders. These stakeholders have been fully involved and consulted by the Department when preparing its replies to the Commission's consultations, and a UK stakeholder group has been formed.

29. The UK Government looks forward to discussing the proposal at a public meeting on 14 November 2006. The meeting will be held at the DTI offices at 1 Victoria Street, London SW1H 0ET. If you would like to attend, please register your interest by emailing david.styles@dti.gsi.gov.uk or by calling 020 7215 0211.

[1] Bris, Arturo and Cabolis, Christos, "Corporate Governance Convergence by Contract: Evidence from Cross-Border Mergers" (September 2002). Yale ICF Working Paper No. 02-32. Available at SSRN: <http://ssrn.com/abstract=321101>

ANNEX B

SUMMARY OF CONSULTATION QUESTIONS

Article 1 – Subject matter and scope

Q1 Do you agree with the scope of the directive?

Q2 Do you consider that we should exercise the exemption of UCITS in Article 1, paragraph 2?

Article 2 - Definitions

Q3 Do you agree with the definitions of “shareholder” and “proxy”? If not, how should they be modified? Do you agree with the alternative approach suggested in relation to the definition of “shareholder”?

Article 3 – More stringent national requirements

Q4 What do you think about the suggested wording? Do you have any other comments on Article 3?

Article 4 – Equal treatment of shareholders

Q5 Do you think that it is useful to include a statement of principle such as Article 4 and, if so, are you content with the current wording?

Article 5 – General meeting notice

Q6 Is a 30 day notice period for all meetings appropriate? If not, what would you consider to be the minimum notice period appropriate to the cross-border context? Should there be a minimum single notice period for all general meetings, or should it be possible to call some kinds of meetings on shorter notice – and, if so, which kinds of meetings on what period of notice?

Q7 Is the scope of the information and method of its delivery to shareholders adequately defined?

Article 6 – Right to add items to the agenda of general meetings and to table draft resolutions

Q8 Do you agree that rights for shareholders to add items to the agenda of general meetings and table draft resolutions at EGMs should be restricted?

Q9 Are the proposed thresholds for exercising the rights specified in this Article set at an appropriate level? Is it necessary to have a threshold expressed in terms of nominal value, as well as proportion, of shares?

Article 7 – Admission to the general meeting

Q10 Do you agree with the maximum 30 day record date period? Should the directive prescribe any other parameter for the setting of record dates (for example, that the record date must be at least a certain number of days after the date on which the notice of a meeting is issued)?

Article 9 – Right to ask questions

Q11 Is it necessary or appropriate to regulate the asking and answering of questions in the context of company meetings in this way?

Article 10 – Proxy voting

Q12 Is the system of proxy voting set out in Article 10 sufficiently liberal, or are some of the restrictions provided for in it inappropriate?

Article 11 – Appointment of proxy holder

Q13 Does Article 11 strike the right balance between ease of appointment and investor security?

Article 12 – Voting in absentia

Q14 Is the ability to vote by post necessary and should it be made mandatory either for Member States to permit it or for companies to offer it to their shareholders?

Article 13 – Voting upon instructions

Q15 Article 13 aims to ensure that the rights conferred by the directive can be effectively exercised in cases where shares are held through intermediaries acting on behalf of a number of different clients. Do you think that it covers the right ground to achieve this aim? Would you support further measures that deal with the passing of instructions between intermediaries in the voting chain, as recommended by the European Corporate Governance Forum[1]?

[1] The European Commission set up the ECGF in 2004 to examine best practices in Member States with a view to enhancing the convergence of national corporate governance codes and providing advice to the Commission. The Forum, which is chaired by the Commission, meets two

Article 14 – Counting of votes
Article 15 – Information after the general meeting

Q16 Should companies be required to count and publish voting results on their websites in the level of detail required by Articles 14 and 15?

Article 17 - Amendments

Q17 Do you agree with the approach set out in Articles 16 and 17?

or three times a year and comprises representatives from Member States, European regulators (including CESR), issuers and investors, other market participants and academics. The ECGF's recommendation can be found at:
http://ec.europa.eu/internal_market/company/docs/ecgforum/recomm_en.pdf;
http://ec.europa.eu/internal_market/company/docs/ecgforum/recomm_annex_en.pdf

ANNEX C

CODE OF PRACTICE ON CONSULTATIONS

The Consultation Code of Practice Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.

2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.

3. Ensure that your consultation is clear, concise and widely accessible.

4. Give feedback regarding the responses received and how the consultation process influenced the policy.

5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.

6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site, address http://www.cabinetoffice.gov.uk/regulation/consultation/index.asp

Comments or complaints

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

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