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EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE

Directive Proposals on Company Reporting, Capital Maintenance and Transfer of the Registered Office of a Company

A CONSULTATIVE DOCUMENT

MARCH 2005

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COMPANY LAW

EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE ACTION PLAN: A CONSULTATIVE DOCUMENT

DIRECTIVE PROPOSALS ON COMPANY REPORTING, CAPITAL MAINTENANCE AND TRANSFER OF THE REGISTERED OFFICE OF A COMPANY

MARCH 2005

The Department of Trade and Industry invites comments, by 3 **June 2005** on the issues set out in this consultative document.

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

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Corporate Law and Governance Directorate
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1 Introduction and Overview

1. INTRODUCTION

1.1 This consultative document seeks your views on three legislative measures which form part of the European Commission's Action Plan on Company Law and Corporate Governance (CLAP)[1]. Each of the three proposals is dealt with in self-contained sections. This opening section:

- helps you identify which, if any, of the proposals are of interest to you or your organisation and to which you might wish to respond;

- explains how the proposals fit into the EU's framework for company law and corporate governance.

1.2 Two of the measures we are consulting on have already been formally proposed by the European Commission:

- Draft Directive amending the Fourth and Seventh Accounting Directives (covering an annual corporate governance statement, increased disclosure of off-balance sheet arrangements, and related party transactions)

- Draft Directive amending the Second Company Law Directive (Capital Maintenance).

Negotiations on these proposals started in December 2004 and January 2005 respectively. Through the public consultations on the content of the Action Plan in 2002 and the pre-proposal consultation on amending the Fourth and Seventh Accounting Directives between April and June 2004, many UK stakeholders will have helped shape the proposals which have now emerged from the Commission. The DTI worked closely with the Commission and a number of stakeholders at these stages. **As negotiations on these proposals are expected to move ahead at a steady pace through the next few months, early responses on these proposals would be particularly welcome.**

[1] The Action Plan can be found at the Commission's website: http://www.europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0284en01.pdf

1.3 In relation to the Second Company Law Directive on Capital Maintenance, we are seeking views both on the current Commission proposal and on possible further, more radical reform of the Directive. The Commission will be launching a study later this year to review the capital maintenance regime and the feasibility of allowing Member States to introduce alternative approaches, such as a solvency based approach. It would be helpful to have stakeholder views to feed into that process.

1.4 The third proposal we are consulting on, a draft Directive on Transfer of Registered Office, has not yet been adopted by the Commission but is expected to be so in March or April 2005. The Commission, however, consulted on the issue in March 2004 outlining its proposed approach. Accordingly, this consultation is based on the content of the Commission's consultation document. This allows us to receive feedback from a wide range of stakeholders before negotiations on this proposal begin. **If the proposal, when published, does not differ significantly from the outline presented in this document, there will be no further public consultation. If, however, the actual proposal differs significantly from our expectations, we will issue a further public consultation on the proposal itself.**

2. GOVERNMENT'S APPROACH TO EU ACTION

2.1 The Government's approach to both EU and domestic reform is that company law should be seen primarily as facilitative, providing the key vehicle – the limited company – through which enterprise and entrepreneurship may flourish. Different types of problems at domestic and EU level may demand different solutions. EU measures must inevitably be concerned with market failures created by cross-border problems, and the objectives set out in 2.2 reflect that fact. But the overriding goals for both domestic and EU action are the same – growth, competitiveness and jobs. By pursuing those goals, the Government is aiming for a coherent approach to modernisation in the EU and the UK. In the UK, the Government is modernising and de-regulating the law to make it more accessible to business through its plans for company law reform, largely implementing the work of the Company Law Review.

2.2 The Government welcomed the CLAP as a platform for EU action when it was published in 2003. However, the Government considers it very important that the Action Plan is a living document and is kept under constant review. This approach is needed to ensure that the measures proposed are the right ones to deal with the most important market failures of the day and are limited to those which require a solution at the EU level. The Government believes that EU measures should further at least one of the following five objectives:

- Enhancing financial stability and market confidence.

- Extending investment opportunities across borders.

- Removing barriers to the efficient operation of markets, improving access to capital for companies.

- Making it easier for companies to set up cross-border operations.

- Creating trust in our companies and markets that will attract international investment and those seeking capital from around the world.

We also expect the Commission, once the need for EU action has been established, to consider whether the proposed means of addressing the problem is proportionate and whether a legislative approach is the only possibility.

2.3 In general terms, informal discussions with stakeholders have confirmed our general view that these proposals do meet these objectives. **We would welcome views on the detail of what is proposed and how alignment with the objectives could be improved.**

2.4 Once proposals have been published by the Commission the Government is committed to ensuring that our stakeholders have opportunities to feed in their views. As well as formal consultations we are using small stakeholder groups to gain feedback on the practical impact of proposals and we are using roundtables and written updates to keep a broader range of stakeholders informed of progress. This consultation document already reflects input from stakeholders and we will continue to work together throughout the negotiation and implementation processes.

3. OUTLINE OF THE PROPOSALS

3.1 Amendments to the Fourth and Seventh Accounting Directives

This proposal contains 3 specific elements:

- Clarification of the **collective responsibility of board members** for the annual accounts and reports (applies to all limited companies).

- Extension of **disclosure requirements regarding off-balance sheet arrangements** (applies to accounts of all limited companies except individual accounts of qualifying small companies and consolidated accounts of qualifying small and medium sized groups), and **related party transactions** (applies in the same way but not to companies preparing accounts under International Accounting Standards).

- Introduction of a separate **corporate governance statement** in the annual (directors') report (applies to all companies whose securities are traded on a regulated market). This statement would have to refer to the corporate governance code applied by the company and explain whether and to what extent the company complies with that code. It would have to include a description of the company's internal control and risk management system and information on:
  - major shareholding and related matters required by the Takeovers Directive
  - the composition and operation of the Board
  - the general meeting and shareholder rights.

3.2 Amendments to the Second Company Law Directive (Capital Maintenance)

This proposal aims to simplify some of the rules governing the capital maintenance regime to make it easier and quicker for public limited liability companies to make changes in their capital structure. It proposes 6 changes to the existing rules:

- Relaxation of the requirements concerning the valuation of non-cash consideration for the allocation of shares
- Relaxation of the requirements concerning acquisition of its own shares by a company (buy-back)
- Relaxing prohibition on financial assistance
- Relaxing the procedures governing the waiving of pre-emption rights
- Enhancing standardised creditor protection in all Member States for reductions of capital
- Introduction of "squeeze-out" and "sell-out" rights of majority shareholders and minority shareholders respectively.

The simplifications and changes proposed are a mixture of provisions that have to be transposed into national legislation on a compulsory basis and a number of optional modifications.

3.3 Proposal for a Directive on Transfer of Registered Office

This proposal aims to put in place a legal framework for companies registered in the EU to transfer their registered office from one Member State to another. It would not make legislative provision for the cross-border transfer of the head office of the company as existing European Court of Justice case law has supported the rights of companies to move their de facto head offices within the EU. In Great Britain both public and private companies registered under the Companies Act 1985 would be able to utilise the proposed transfer procedure.

4. HISTORY OF THE PROPOSALS

4.1 The proposals all form part of the CLAP published in May 2003. The CLAP follows closely the recommendations made in November 2002 by a High Level Group of Company Law Experts. This Expert Group was set up in September 2001 to identify how the EU regulatory framework for company law and corporate governance could be modernised.

4.2 The proposals we are consulting on were identified in the CLAP as short term measures for adoption by the end of 2005. The proposed Directive on transfer of registered office is also one of the few uncompleted measures within the EU Financial Services Action Plan agreed by Member States in Spring 2000.

4.3 The only remaining legislative measure to be brought forward by the Commission under the CLAP in 2005 is a **Directive on Shareholder Rights.** The Commission issued a pre-proposal consultation in September 2004, plans a second consultation exercise in mid 2005 and then hopes to bring forward a draft directive in late 2005. **Please contact us if you would like further details about this likely proposal** (contact details are in Section 5 below).

4.4 The CLAP contains a number of longer-term measures to be brought forward between 2006 and 2009. **Please contact us if you would like further details about the CLAP** (contact details are in Section 5 below).

5. YOUR OPPORTUNITY TO COMMENT

5.1 We would welcome comments and evidence on one or all of the proposals set out and especially on the costs and benefits in the Partial Regulatory Impact Assessments at Annexes A-C. Please reply to Annette Grunberg at the Department of Trade and Industry at the address below by **3 June 2005**.

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1 Victoria Street
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Email: annette.grunberg@dti.gsi.gov.uk
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2 European Company Law – Draft Proposal concerning the Annual Accounts of certain types of Companies and Consolidated Accounts

1. EXECUTIVE SUMMARY

1.1 *Background and state of play:*

On 27 October 2004 the European Commission published its proposal for a Directive of the European Parliament and of the Council to amend Council Directives 78/660/EEC and 83/349/EEC concerning the annual accounts of certain types of companies and consolidated accounts.

This is identified as a short-term priority measure within the Commission's Company Law and Corporate Governance Action Plan, published in May 2003.

This proposal is now being discussed in Council Working Groups.

The European Parliament has not yet considered the proposal.

1.2 *About the Directive:*

The overall objective behind the proposal is to further enhance confidence in the financial statements and annual reports published by European companies.

To meet this objective the Commission has proposed amendments covering the following three key issues, namely to:

- clarify board members' collective responsibility towards the company for the annual accounts and report (applies to all limited companies)

- extend disclosure requirements (regarding off-balance sheet arrangements and related party transactions) (applies to accounts of all limited companies except individual accounts of qualifying small companies and consolidated accounts of qualifying small and medium sized groups[2]).

- require companies whose securities are traded on a regulated market to include a new corporate governance statement in their annual reports (applies to all publicly traded companies).

The full text of the proposal can be found at: http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2004/com2004_0725en01.pdf

[2] As defined on page 16 of this consultation document.

2. BACKGROUND

2.1 On 27 October 2004 the European Commission approved a proposal for a Directive of the European Parliament and of the Council concerning the annual accounts of certain types of companies and consolidated accounts.

2.2 This proposal introduces amendments to Council Directives 78/660/EEC (4th Company Law Directive) and 83/349/EEC (7th Company Law Directive). The overall intention is to further enhance confidence in the financial statements and annual reports of European companies.

2.3 The Commission's commitment to take action in the area of corporate governance and disclosure requirements has been emphasized in its Action Plan, adopted by the Commission on 21 May 2003. In this Action Plan the Commission announced that it intended to take specific measures to clarify responsibility of board members for financial statements and key non-financial information, increase transparency in intra-group relations and transactions with related parties and improve disclosure about corporate governance practices. The Commission identified these measures as short-term priorities implying that action should be taken by the end of 2005.

2.4 The Commission's Action Plan follows recommendations of a High Level Group of Company Law Experts appointed by the Commission to look into wide ranging issues of company law. In its final report of 4 November 2002 this High Level Group recommended that the Commission should consider adopting measures to "improve the EU framework for corporate governance, specifically through:

- enhanced corporate governance disclosure requirements
- confirming as a matter of EU law the collective responsibility of board members for the company's financial and key non financial statements".[3]

2.5 Additionally, the Commission carried out an open consultation in summer 2003 on its Action Plan. The majority of respondents supported the Commission's Action Plan as an essential step to enhance confidence in EU capital markets. Recent corporate scandals, such as Parmalat, have strengthened the Commission's view that action is necessary. The short-term proposal is now being discussed in Council Working Groups. The European Parliament has not yet considered the proposal.

[3] The final report of the High Level Group can be found at the Commission website: http://europa.eu.int/comm/internal_market/en/company/company/modern/consult/report_en.pdf

3. THE KEY PROPOSALS

3.1 *Objectives of the proposal*

The overall objective of the proposal is to further enhance confidence in the financial statements and annual reports published by European companies.

In this respect, the Commission believes that "shareholders and other stakeholders need reliable, complete and easily accessible information".[4]

The Commission further believes that enhanced and consistent disclosures would facilitate cross-border investments and improve EU-wide comparability of financial statements and reports.

The Commission believes that these objectives cannot be sufficiently achieved by the Member States since national legislation differs.

3.2 *The key issues addressed*

The above objectives are addressed by focusing on three main issues: collective responsibility of board members, group disclosure requirements (related party transactions, off-balance sheet arrangements) and the corporate governance statement.

3.3 Consequences for Directors: Establishing collective responsibility of all board members for the accounts and key non-financial information

3.3.1 This applies to all limited companies incorporated in an EU Member State.

Member States must ensure that board members are collectively responsible towards the company, with the option left to Member States of extending this responsibility to individual shareholders, investors and other stakeholders.

3.3.2 Questions relating to 'Consequences for Directors'

The Government believes that in the light of recent corporate scandals confidence in the EU markets and the corporate governance of their companies would be enhanced by clear allocation of responsibility for the financial statements and annual report.

[4] Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC concerning the annual accounts of certain types of companies and consolidated accounts. Explanatory Memorandum p. 2.

The principle of collective responsibility of directors to the company for the financial statements and the annual report reflects the current position in common law in the UK.

However, some Member States do not yet provide for all directors/ board members to be collectively responsible for the financial statements and the annual report.

Q1: Do you think it is helpful to have the issue of responsibility of directors clarified in EU law or should it be dealt with at national level only?

Q2: Do you agree that board members should be responsible to the company?

3.3.3 *The 4th Directive (Directive 78/660/EEC)*[5] *is proposed to be amended by inserting the following articles*[6]*:*

Article 50b

Member States shall ensure that the members of the administrative, management and supervisory bodies of the company are collectively responsible towards the company for ensuring that the annual accounts and the annual report are drawn up and published in accordance with the requirements of this Directive.

Article 50c

Member States shall ensure that their laws, regulations and administrative provisions on liability apply to the members of the administrative, management and supervisory bodies referred to in Article 50b of this Directive.

[5] http://europa.eu.int/eur-lex/en/consleg/main/1978/en_1978L0660_index.html

[6] It should be noted that only European Community legislation printed in the paper edition of the *Official Journal of the European Union* is deemed authentic.

3.3.4 The 7th Directive (Directive 83/349/EEC)[7] is proposed to be amended by inserting the following articles[8]:

> ***Article 36a***
>
> *Member States shall ensure that the members of the administrative, management and supervisory bodies of the undertaking drawing up the consolidated accounts and the consolidated annual report are collectively responsible towards that undertaking for ensuring that the consolidated annual accounts and the consolidated annual report are drawn up and published in accordance with the requirements of this Directive.*
>
> ***Article 36b***
>
> *Member States shall ensure that their laws, regulations and administrative provisions on liability apply to the members of the administrative, management and supervisory bodies referred to in Article 36a of this Directive.*

3.4 Off-Balance Sheet and Related Party Disclosures

A) Disclosure: New disclosure requirements on off-balance sheet arrangements, including Special Purpose Entities

3.4.1 This applies to all limited companies incorporated in an EU Member State. Qualifying small companies as defined in section 247 of the Companies Act 1985 can be exempted from this requirement in relation to their individual accounts. Qualifying small and medium-sized groups as defined in section 249 of the Companies Act 1985 are exempt from the obligation to prepare group accounts.

Companies will have to disclose off-balance sheet arrangements and their financial impact if material to an assessment of a company's financial position. Particular attention is given to the use of Special Purpose Entities (SPE). These are entities set up by a company (usually financial institutions) to pursue a narrow and well-defined objective such as a securitisation transaction.

Currently, SPEs are captured in a consolidated balance sheet only if they qualify as subsidiary undertakings under International Accounting Standards ("IAS") or, in the case of non-IAS accounts, the relevant provisions of the Companies Act 1985 and Financial Reporting Standard ("FRS") 2. Put simply,

[7] http://europa.eu.int/eur-lex/en/consleg/main/1983/en_1983L0349_index.html

[8] It should be noted that only European Community legislation printed in the paper edition of the *Official Journal of the European Union* is deemed authentic.

this will be the case where the sponsoring company has the power to exercise dominant influence or control over the SPE. Many SPEs do not meet these criteria. However, under relevant IAS and UK accounting standards, financial assets and liabilities that are transferred to SPEs may nonetheless remain on the balance sheet of the transferor company. This will be the case where the transferor has continuing involvement and/or retains significant risks and benefits. The extent to which GB companies are able to use SPEs to achieve off-balance sheet treatment of arrangements is therefore unclear.

The proposal aims to achieve greater transparency by introducing a new disclosure requirement in the notes to the accounts for material off-balance sheet arrangements. To the extent that this disclosure goes beyond what is required under IAS, the Commission considers that EU companies applying IAS would also have to comply with this disclosure (through an amendment to the Accounting Directives).

There are issues of scope and definition given that the proposal refers to ”off-balance sheet arrangements” without specifying particular types of arrangement. The intention however appears to be to capture arrangements of a financing nature, where such arrangements have removed assets or liabilities from the arranger’s balance sheet or give rise to actual or potential benefits or obligations that are not recognised.

3.4.2 Questions relating to off-balance sheet arrangements

The Government believes that, in principle, the transparency in financial statements of off-balance sheet arrangements would contribute to further integrating capital markets, improving access to capital and increasing cross-border investment.

We are however interested in views as to whether the proposals are sufficiently clear to be capable of consistent application. Further, the proposed wording is broad and could be taken to capture a number of operational arrangements such as purchase orders and contracts of employment. The identification of those items that are ”material and of assistance in assessing the financial position” could require considerable judgement and interpretation by companies and auditors.

The Government also believes that the main driver for achieving enhanced financial statement transparency should be International Financial Reporting Standards (IFRS), and convergence of domestic accounting standards towards IFRS. Thus, the Directive should avoid any express conflicts with IFRS. In this connection, we believe it is beneficial that the proposal avoids detailed definitions or prescriptive requirements.

Although the Companies Act 1985 already includes requirements to disclose certain matters that might be within the scope of the proposal, such as information on derivative financial instruments, guarantees and financial commitments, the proposed disclosures go wider than existing legislation. As discussed above, accounting standards also set out detailed requirements on the recognition and de-recognition of financial instruments and the consolidation (or otherwise) of SPEs. In a UK context, the proposals are therefore considered to be a catch-all for relevant arrangements that are not required to be disclosed through other more specific measures.

Q4: Do you agree with the proposal in principle? If not why?

Q5: Do you think the proposal is clear enough to make it workable and capable of consistent application?

Q6: If you draw up accounts, do you think that the changes to UK disclosure requirements set out in paragraph 3.4.2 will add significant burdens?

Q7: If you are a user of company accounts, do you believe that this additional information will be useful, and, if so, what is the added value?

3.4.3 *The 4th Directive is proposed to be amended by inserting the following additional paragraph into Article 43 (contents of the notes on the accounts):*

Article 43 (1)

(7a) the nature and business purpose of company's arrangements not included in the balance sheet, and the financial impact on the company of those arrangements, in so far as the information set out is material and of assistance in assessing the financial position of the company.

3.4.4 *The 7th Directive is proposed to be amended by inserting the following additional paragraph into Article 34 (contents of the notes on the consolidated accounts):*

Article 34

(7a) the nature and business purpose of any arrangements not included in the consolidated balance sheet, and the financial impact of those arrangements, in so far as the information set out is of direct relevance and assistance in assessing the financial position of the undertakings included in the consolidation taken as a whole.

B) Disclosure: New disclosure requirements on related party transactions to enhance transparency

3.4.5 Broadly speaking, this proposal will apply to those types of companies as for off-balance sheet arrangements. However, the proposal will not affect the disclosure requirements of those related party transactions that are covered by IAS already.

The proposal is very similar to IAS 24 *Related Party Transactions*. For example the proposal draws on the IAS 24 definition of 'related party'.[9] Related parties of a company include parties which the company controls, parties that have control, joint control or significant influence over the company, parties subject to common control with the company, key managers of the company and their immediate family, and the company's associates and joint ventures.

The proposal only requires the disclosure of transactions not conducted under normal commercial conditions (IAS 24 does not limit the disclosures in this way). It is also proposed to require disclosure of the business purpose of transactions, which is not explicitly required under IAS 24.

Under IAS (as adopted for use in the EU), publicly traded companies are therefore already required to disclose information about transactions with related parties in respect of their consolidated accounts, for financial years beginning on or after 1 January 2005. Accordingly, the consolidated accounts of these companies will be little affected. At the same time publicly traded companies which opt to use IAS for their individual accounts will not be affected, nor will other companies which opt to use IAS in their individual and/or consolidated accounts.

The proposal, however, extends the legal requirement to disclose certain related party transactions to companies not preparing accounts under IAS, continuing instead to prepare them under the Accounting Directives as implemented in national law. Under UK accounting standards, information on related party transactions has to be presented in accordance with Financial Reporting Standard (FRS) 8. Under FRS 8, however, transactions with other members within a group of companies need not be disclosed in the parent company's individual and consolidated accounts and subsidiaries' accounts where 90% of the voting rights are controlled within a group.

[9] However, it differs in three respects: Firstly, the proposal requires disclosure only of transactions conducted other than on an "arm's length" basis whereas IAS 24 does not include this limitation. Secondly, the required disclosures include the business purpose of such transactions, which is not explicitly a requirement of IAS 24. Finally, the proposal requires disclosure only of material transactions. IAS 24 is silent on materiality although IAS 1 deals with this subject in general terms.

Therefore, companies using IAS already will be little affected. However, companies within a group that do not prepare their accounts under IAS may be affected since transactions between subsidiaries and other group members will not be exempt from disclosure anymore.

3.4.6 Questions relating to related party transactions

The Government believes that, in principle, the proposals for additional information in the financial statements on related party transactions would contribute to integrated capital markets, improved access to capital and increased cross-border investment.

The Government believes that the main driver for achieving enhanced financial statement transparency should be International Accounting Standards (IAS). Thus, the Directive should avoid any conflicts with IAS. And indeed, the proposal largely avoids this.

The Companies Act 1985 would need to be amended to introduce additional disclosure requirements for those companies not using IAS.

Q8: Do you agree with the proposal in principle? If not why?

Q9: If you draw up accounts, do you think that in practice it will increase your disclosure requirements?

Q10: If you are a user of company accounts, do you believe that this additional information will be useful?

3.4.7 *The 4th Directive is proposed to be amended by inserting the following additional paragraph into Article 43 (contents of the notes on the accounts):*

Article 43 (1)

(7b) the nature, business purpose and amount of any transaction entered into by the company with related parties, where that transaction is material and has not been concluded under normal commercial conditions. The definitions of related party set out in paragraph 3 of the International Accounting Standard 24 on Related Party Disclosures as set out in Commission Regulation (EC) 1725/2003 shall apply for the purposes of this Directive.

3.4.8 *The 7th Directive is proposed to be amended by inserting the following additional paragraphs into Articles 34 (contents of the notes on the consolidated accounts) and 41 (definition of affiliated undertakings):*

> ***Article 34***
>
> *(7b) the nature, business purpose and amount of any transaction entered into by the parent undertaking, or by other undertakings included in the consolidation, with related parties, where that transaction is material and has not been [concluded] under normal commercial conditions.*
>
> ***Article 41***
>
> *1a. The definitions of related party set out in paragraph 3 of the International Accounting Standard 24 on Related Party Disclosures as set out in Commission Regulation (EC) 1725/2003 shall apply for the purposes of this Directive.*

3.5 Corporate Governance Statement: Introduction of a new corporate governance statement

3.5.1 Applies to all companies incorporated in an EU Member State and whose securities (equity and debt) are traded on a regulated market in the EU.[10]

Companies will have to include, in a separate section of their annual reports, a new corporate governance statement, referring to:

i. The corporate governance code that applies to the company including an explanation as to what extent the company complies with the code (or an explanation where it does not)

ii. The company's internal control and risk management systems

iii. Major shareholdings and related matters already required by the Takeovers Directive

iv. The composition and operation of the board

v. The general meeting and shareholder rights.

Much of this information is currently required of listed companies in the UK. Such companies are also subject to the comply or explain principle in listing rule 12.43A.

[10] A list of regulated markets is contained on the Europa website: http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_072/c_07220040323en00030007.pdf

3.5.2 Questions relating to Corporate Governance Statement

The Government believes that proportionate EU action on corporate governance disclosure can benefit UK business by enhancing market confidence. It may also remove a current disincentive to cross-border investment created by differing levels and types of corporate governance disclosure in various Member States; potential investors will receive equal information regardless of the State of the company in which they are investing. Similarly, companies may find it easier to raise capital in other EU markets if there are shared minimum standards on corporate governance disclosure.

The Government also believes, however, that any legislation should set out the broad areas to be covered, with the detail to be left to Member States, either through guidance or their national corporate governance codes.

The requirements regarding the corporate governance statement and comply-or-explain principle largely reflect existing UK legislation. However, they would collect all the relevant information in a new part of the annual (i.e. directors') report.

Q11: Do you think the introduction of a new corporate governance statement would contribute to the objectives set out in paragraph 3.5.2 above? If not why?

Q12: Do you agree with what the Commission wants to be included in the corporate governance statement or do you think there should be something else included?

Q13: Are there any elements in the corporate governance statement that should be excluded?

Q14: On the assumption that, in implementing the requirement, the Government would wish to avoid duplication of information in the report and accounts, do you believe that the annual report (the directors' report in UK accounts) is the correct place for the statement? If not, would you prefer the statement to stand alone, following the example of the directors' remuneration report?

3.5.3 *The 4th Directive is proposed to be amended by the insertion of the following Article after Article 46 (contents of the annual report):*

Article 46a

A company whose securities are admitted to trading on a regulated market, within the meaning of Article 4(1)(14) of Directive 2004/39/EC of the European Parliament and of the Council shall include a corporate governance statement in its annual report. That statement shall be included as a separate part of the annual report and shall contain at least the following information:

(1) a reference to the corporate governance code the company decided to apply or is subject to under the law of the Member State where it has its registered seat, accompanied by an indication, where the text of the applied corporate governance code is publicly available;

(2) an explanation as to whether and to which extent the company complies with the corporate governance code referred to under point (1);

(3) a description of the company's internal control and risk management systems;

(4) the information required by Article 10, paragraph 1, points (c), (d), (f), (h), and (i) of Directive 2004/25/EC of the European Parliament and of the Council;

(5) the operation of the shareholder meeting and its key powers, and a description of shareholder's rights and how they can be exercised;

(6) the composition and operation of the board and its committees.

To the extent a company departs from the corporate governance code referred to under point (1), the company shall explain from which parts of the code it departs and the reasons for doing so.

3.5.4 *The 7th Directive is proposed to be amended by inserting the following paragraph into Article 36 (the consolidated annual report):*

Article 36 (2)

(f) A description of the group's internal control and risk management systems in relation to the process for preparing consolidated accounts.
In case the consolidated annual report and the annual report are presented as a single report, this information must be included in the section of the report containing the corporate governance statement as provided by Article 46a of Directive 78/660/EEC.

4. OTHER ISSUES

4.1 Cost savings and benefits

A partial regulatory impact assessment (RIA) is attached at Annex A.

Q15: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are also welcome on any unintended consequences or other implications.

4.2 What happens next?

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.

4.3 How to respond and help with queries

4.3.1 You are invited to send comments, including your thoughts on the likely costs and benefits and any implementation issues that might arise by **3 June 2005** preferably by email to:

Annette Grunberg
Corporate Law and Governance
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Phone: 020 7215 6467
Email: annette.grunberg@dti.gsi.gov.uk

4.3.2 If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

Annette Grunberg (as above)

Or:

Nick van Benschoten
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V 321
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5. SUMMARY LIST OF CONSULTATION QUESTIONS

5.1 Consequences for Directors: Establishing collective responsibility of all board members for the accounts and key non-financial information

Q1: Do you think it is helpful to have the issue of responsibility of directors clarified in EU law or should it be dealt with at national level only?

Q2: Do you agree that board members should be responsible to the company?

5.2 Off-Balance Sheet and Related Party Disclosures

A) Disclosure: New disclosure requirements on off-balance sheet arrangements, including Special Purpose Entities

Q4: Do you agree with the proposal in principle? If not why?

Q5: Do you think the proposal is clear enough to make it workable and capable of consistent application?

Q6: If you draw up accounts, do you think that the changes to UK disclosure requirements set out in paragraph 3.4.2 will add significant burdens?

Q7: If you are a user of company accounts, do you believe that this additional information will be useful, and, if so, what is the added value?

B) Disclosure: New disclosure requirements on related party transactions to enhance transparency

Q8: Do you agree with the proposal in principle? If not why?

Q9: If you draw up accounts, do you think that in practice it will increase your disclosure requirements?

Q10: If you are a user of company accounts, do you believe that this additional information will be useful?

5.3 Corporate Governance Statement: Introduction of a new corporate governance statement

Q11: Do you think the introduction of a new corporate governance statement would contribute to the objectives set out in paragraph 3.5.2 above? If not why?

Q12: Do you agree with what the Commission wants to be included in the corporate governance statement or do you think there should be something else included?

Q13: Are there any elements in the corporate governance statement that should be excluded?

Q14: On the assumption that, in implementing the requirement, the Government would wish to avoid duplication of information in the report and accounts, do you believe that the annual report (the directors' report in UK accounts) is the correct place for the statement? If not, would you prefer the statement to stand alone, following the example of the directors' remuneration report?

5.4 Cost savings and benefits

Q15: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are also welcome on any unintended consequences or other implications.

Section 3: European Company Law – Draft Proposal Concerning the Formation of Public Limited Liability Companies and the Maintenance and Alteration of their Capital

1. EXECUTIVE SUMMARY

1.1 *Background and state of play*

On 29 October 2004 the European Commission published its proposal for a Directive of the European Parliament and of the Council to amend Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (the Second Company Law Directive).

This is identified as a short-term priority measure within the Commission's Company Law and Corporate Governance Action Plan, published in May 2003.

The proposal is now being discussed in a Council Working Group.

The European Parliament has not yet considered the proposal.

The Commission plans to carry out a study into the capital maintenance regime later in 2005. The Action Plan states that the study should consider alternative approaches to legal capital e.g. solvency based approaches. The results of the study will then be used to decide whether to bring forward a proposal for an optional alternative to the capital maintenance rules as laid down in the Second Company Law Directive.

1.2 *About the Directive*

The proposal, described by the Commission as "moderately deregulatory"[11], seeks to simplify some of the capital maintenance provisions set out in the Second Company Law Directive. These provisions regulate the ability of public limited liability companies to alter the size, structure and shape of their capital.

[11] Preliminary Impact Assessment Statement, Annex 1 of the Proposal for a Directive amending Council Directive 77/91/EEC, as regards the formation of public limited liability companies, 29 October 2004.

The proposal aims to improve the efficiency and competitiveness of these companies by making it easier for them to react more promptly and at less cost to developments in the markets relevant to them.

In putting forward the proposed changes, the Commission has sought to ensure that the protection offered to shareholders and creditors under the current regime is not reduced.

The specific simplifications and changes to the capital maintenance regime contained in the proposal are a mixture of provisions that have to be transposed into national legislation on a compulsory basis and a number of optional modifications.

The proposals can be summarised as follows:

- Relaxation of the requirements concerning valuation of non-cash consideration for the allotment of shares;
- Relaxation of the requirements concerning acquisition of its own shares by a company (buy-back);
- Relaxing prohibition on financial assistance;
- Relaxing the procedures governing the waiving of pre-emption rights;
- Enhancing standardised creditor protection in all Member States for reductions of capital;
- Introduction of “squeeze-out” and “sell-out” rights of majority shareholders and minority shareholders respectively.

All these proposals would apply to public limited liability companies. The introduction of “squeeze-out” and “sell-out” rights and relaxation of procedures governing pre-emption rights would only apply to public limited liability companies whose shares are traded on a regulated market[12].

[12] As defined in Article 4(1)(14) of Directive 2004/39/EC.

2. BACKGROUND

2.1 On 29 October 2004 the European Commission published a proposal for a Directive of the European Parliament and of the Council to amend Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (the Second Directive).

2.2 The intention to simplify some provisions of the Second Directive originated in 1999. As part of the fourth phase of the Simplification of Legislation on the Internal Market process (SLIM) launched by the Commission in 1998, a Company Law Working Group issued a report in September 1999 which contained recommendations on the areas where simplification could be achieved. These recommendations were considered again as part of the work of the High Level Group of Company Law Experts, appointed by the Commission in September 2001. In their report published in 2002 they accepted most of the earlier recommendations and incorporated a few additional suggestions aimed at modernising the Second Directive. These recommendations, known as SLIM-Plus were contained in the Commission's Action Plan on Company Law and Corporate Governance published in May 2003 and identified as a short-term priority for adoption by the end of 2005.

2.3 The Action Plan also provides in the medium-term for a feasibility study into more radical changes to the capital maintenance regime. This study is due to begin in late 2005, with completion within an 8 to 12 month period. Following the study, the Commission will then decide whether to bring forward a proposal for an optional alternative to the capital maintenance regime for those Member States wishing to use this option.

2.4 The short-term proposal is now being discussed in a Council Working Group. Subject to progress, the proposal could be discussed by EU Ministers at the June 2005 Competitiveness Council.

2.5 The European Parliament has not yet considered the proposal.

3. THE KEY PROPOSALS

3.1 The proposal, described by the Commission as "moderately deregulatory" seeks to help businesses become more efficient and competitive. It hopes that the simplifications put forward will make it easier for them to react more quickly to market developments. There are six proposals in the directive. These are summarised in the following six paragraphs and are accompanied by the proposed Commission text together with some questions which the proposals raise, on which we would particularly welcome views.

3.2 Relaxation of the requirements concerning the valuation of non-cash consideration for the allocation of shares

3.2.1 If a company wishes to issue shares for a non-cash consideration e.g. for assets, there will no longer be a requirement, under certain circumstances, for it to obtain a prior valuation by one or more independent experts. Valuations will still be required if requested by shareholders holding at least 5% of the issued share capital or if there are circumstances which could have affected the value of the asset contributed.

3.2.2 Questions relating to valuation of non-cash consideration

This is an optional measure which Member States may choose to incorporate into national legislation.

Although welcome, the relaxation of the current provisions are subject to a number of conditions, some of which are not defined e.g. what is meant by the "weighted average price", what are "exceptional circumstances" or "new qualifying circumstances"?

The removal of the requirement to obtain valuations will reduce costs and speed up the allotment process for companies. However, the conditions do introduce a degree of uncertainty about whether a valuation would still be needed in some cases.

The Government is concerned that this uncertainty, coupled with the fact that minority shareholders may in any event require a revaluation, may have the effect of reducing take-up of the relaxed provisions.

The Government believes that it is unnecessary to designate an independent authority to examine the legality of the non-cash considerations contributed as the courts would have jurisdiction to review any breach of these provisions with the assistance of expert witnesses.

The Government believes that the minority shareholders' right to require a revaluation should be limited to the period before the contract is entered into.

Q1: Do you think that the proposed changes relating to the valuation of non-cash consideration will make it easier and cheaper for companies to allot shares for a non-cash consideration?

Q2: Do you agree that the courts are the correct body to review any breaches of the new provisions and that no other independent body needs to be designated to carry out this function?

Q3: Do you agree that the right of minority shareholders to require a revaluation should be limited to the period before a contract is entered into?

Q4: Do you see any scope for further simplification of the rules relating to non-cash consideration? If so, please specify and give reasons for your proposal.

Q5: Do you have any other comments on the drafting of Articles 10a or 10b?

3.2.3 *Directive 77/91/EEC is amended by inserting 2 new articles, 10a and 10b as follows*[13]*:*

Article 10a

1. Member States may decide not to apply Article 10(1), (2), and (3) where, upon a decision of the administrative or the management body, transferable securities, as defined in Article 4(1)(18) of Directive 2004/39/EC are contributed as consideration other than in cash, and those securities are valued at the weighted average price at which they have been traded on one or more regulated market(s) as defined in Article 4(1)(14) of that Directive in the 3 months preceding the effectuation of the respective consideration other than in cash.*

*OJ L 145, 30.4.2004, p.1

However, where that price has been affected by exceptional circumstances that would significantly change the value of the asset at the effective date of the contribution, Articles 10(1), (2) and (3) shall apply.

(continued next page)

[13] It should be noted that only European Community legislation printed in the paper edition of the *Official Journal of the European Union* is deemed authentic.

Article 10a (continued)

2. Member States may decide not to apply Article 10(1), (2) and (3) where, upon a decision of the administrative or the management body, assets are contributed as consideration other than in cash which have already been subject to a fair value opinion by a recognised independent expert and where the following conditions are fulfilled:

(a) the recognised expert who has carried out the valuation is sufficiently trained and experienced in valuation of the kind of assets to be contributed;

(b) the fair value is determined for a date not more than 3 months before the effective date of the asset's contribution;

(c) the valuation has been performed in accordance with generally accepted valuation standards and principles in the Member State, which are applicable to the kind of asset to be contributed.

In the case of new qualifying circumstances, that would significantly change the value of the asset at the effective date of this contribution, a re-valuation has to be made on the initiative and under the responsibility of the administrative or management body. That body shall inform shareholders whether any such new qualifying circumstances have occurred.

In any event, shareholders holding an aggregate percentage of at least 5% of the company's subscribed capital may require a re-valuation of the asset concerned, and may demand a valuation by an independent expert, in which case Article 10(1), (2) and (3) shall apply.

3. Member States may decide not to apply Article 10(1), (2) and (3) where, upon a decision of the administrative or management body, assets are contributed as a consideration other than in cash whose value is derived by individual asset from the statutory accounts of the previous financial year provided that the statutory accounts have been drawn up in accordance with the requirements of Directive 78/660/EEC and have been subject to an audit in accordance with Directive 84/253/EEC.

In the case of new qualifying circumstances, that would significantly change the value of the asset contributed at the effective date of its contribution, a re-valuation has to be made on the initiative and under the responsibility of the administrative or management body. That body shall inform shareholders whether such new qualifying circumstances have occurred.

In any event, shareholders holding an aggregate percentage of at least 5% of the company's subscribed capital may require a re-valuation of the asset concerned, and may demand a valuation by an independent expert, in which case Article 10(1), (2) and (3) shall apply.

Article 10b

1. Where consideration other than in cash as referred to in Article 10a occurs without an expert's report, the persons, companies and firms referred to in Article 3(i) or the administrative or the management body shall, in addition to the requirements set out in Article 3(h), submit to the register for publication a declaration containing the following:

(a) a description of the consideration other than in cash at issue;

(b) its estimated value and the source of the valuation;

(c) a statement whether the values arrived at correspond at least to the number and nominal value or, where there is no nominal value, to the accountable par and, where appropriate, to the premium on the shares to be issued for them;

(d) if appropriate, a statement as to whether new qualifying circumstances with regard to the original value have occurred.

This declaration shall be published in accordance with Article 3 of Directive 68/151/EEC.

2. Each Member State shall designate an independent administrative or judicial authority which is responsible for examining the legality of the considerations other than in cash made in accordance with Article 10a and the declaration referred to in paragraph 1.

3.3 Relaxation of the requirements concerning acquisition of own shares by a company (buy-back)

3.3.1 Article 19 currently gives Member States the option of permitting companies to buy back their own shares. The Article stipulates certain conditions which such acquisitions must satisfy, but it does not preclude the imposition of additional conditions by Member States. The proposal (which substitutes a revised Article 19(1)) amends certain of the existing conditions, but, more fundamentally, stipulates that these are the <u>only</u> conditions which Member States may impose on the acquisition by a company of its own shares. Currently, a company wishing to purchase its own shares must be authorised by its shareholders and the duration of that authority may not exceed 18 months. The proposal is to extend that period to 5 years. In addition, where Member States have opted to permit companies to hold their own shares in treasury following a repurchase, rather than cancelling the same, currently such holding is subject to a limit of 10% of issued share capital.

The proposal is to allow companies to buy back their own shares up to the amount of the company's distributable reserves although Member States may opt to retain a limit, subject to a cap of 10% of the issued share capital. Under the Companies Act 1985, the right to hold up to 10% of issued share capital in treasury is limited to listed and AIM companies[14]. Any other company which buys back its own shares must cancel the same. We are seeking to clarify with the Commission whether such provisions would constitute "conditions"and therefore be prohibited under new Article 19(1).

3.3.2 Questions relating to acquisition of own shares

Subject to clarification of the extent of the permitted conditions referred to above, the Government welcomes the relaxation of these requirements which should be of benefit to business. They should lead to time and cost savings as there will no longer be a need to go back to shareholders for agreement within a five year time period.

There will also be greater flexibility for a company to purchase a greater number of its own shares.

It is unclear what is intended by the requirement to apply the principle of equal treatment of shareholders. If it means requiring an offer to purchase/sell shares to be made to all shareholders this could be viewed as an additional burden on companies.

The option for Member States to retain a cap limited to 10% of issued share capital is odd in the context of this proposal. If Member States may dispense with a cap altogether, it would seem to follow that Member States should be free to choose what level of cap they wish to impose.

Q6: Do you think that the proposed changes will give companies more flexibility to acquire their own shares?

Q7: Do you agree that a requirement to offer to purchase/sell shares to all shareholders would constitute an additional burden?

Q8: Do you agree that companies should be free to repurchase own shares up to the limit of distributable reserves or do you consider that the current cap of 10% of issued share capital should be retained?

Q9: If you disagree that a cap of 10% should be retained but consider that there should be a higher cap, what level of issued share capital do you consider would be appropriate?

[14] Section 162(4) and section 162A.

Q10: Do you think EU wide relaxation of the requirements concerning acquisition of its own shares by a company should go beyond the proposed changes? If so, what additional changes would you make and why?

Q11: Do you have any other comments on the drafting of Article 19?

3.3.3 *Directive 77/91/EEC is amended by replacing paragraph 1 of Article 19 with the following:*

1. Where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall make such acquisitions subject to the following conditions:

(a) authorization must be given by the general meeting, which shall determine the terms and conditions of such acquisitions, and in particular the maximum number of shares to be acquired, the duration of the period for which authorization is given and which may not exceed 5 years, and, in the case of acquisition for value, the maximum and minimum consideration. Members of the administrative or management body must satisfy themselves that, at the time when each authorized acquisition is effected, the conditions referred to in subparagraphs (b), (c) and (d) are respected:

(b) the acquisitions, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, may not have the effect of reducing the net assets below the amount mentioned in Article 15(1)(a);

(c) only fully paid-up shares may be included in the transaction;

(d) the principle of equal treatment of shareholders shall apply; in particular, acquisition and sale by a company of its own shares on a regulated market as defined in Art. 4(1)(14) of Directive 2004/39/EC shall be considered fulfilling that principle.

Member States may also subject acquisitions within the meaning of the first subparagraph to the condition that the nominal value or, in the absence thereof, the accountable par of the acquired shares, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, may not exceed 10% of the subscribed capital.

3.4 Relaxation of prohibition on financial assistance

3.4.1 Companies are currently unable to grant financial assistance to a third party for the acquisition of its own shares. Under the proposal, a company would be able to do so up to the limit of its distributable reserves. However, the assistance may only be given in certain circumstances and provided the company follows specific procedures.

3.4.2 Questions relating to financial assistance

Whereas the relaxation in Article 10a is optional, new Article 23 appears to be a mandatory provision which Member States will be obliged to transpose into national law.

The Government believes that the conditions subject to which financial assistance may be given are complex and onerous and are therefore unlikely to be utilised by companies.

Directors will be required to investigate the financial standing of the person being financially assisted, which will expose them to personal risk.

The amendment focuses only on a certain type of financial assistance (the grant of a loan or credit) whereas the Government would have preferred to see a gateway procedure permitting a broader range of financial assistance.

The requirement to certify solvency over a five year period is potentially unworkable and unduly onerous in practice. The Commission has indicated that it is not committed to this if an alternative safeguard for shareholders and creditors can be found.

The requirement to obtain prior shareholder approval on a transaction by transaction basis is unworkable in the context of most corporate transactions where financial assistance is an issue.

The Government believes that the only condition linked to the ability of a company to grant financial assistance should be that it should not reduce the net assets below distributable reserves.

Any individual shareholder may apply to court to contest the legality of the transaction.

The requirement that shares acquired by a third party must be made at a fair price relates to pre-emption rights which are already dealt with in Article 29. Its intended impact in the context of provisions dealing with financial assistance is unclear and the Government believes it should be deleted.

Q12: Do you agree that the conditions governing the changes proposed will be a disincentive for companies wishing to take advantage of relaxed financial assistance rules?

Q13: Are there better ways of providing shareholders and creditors with safeguards than the proposed 5 year solvency test?

Q14: Should the right to contest the resolution be open to any shareholder or should it be a specified majority? Should the right be exercisable only within a certain period of the resolution?

Q15: Do you have any other comments on the drafting of Articles 23a and 23b?

3.4.3 *Directive 77/91/EEC is amended by replacing paragraph 1 of Article 23 with a new paragraph and inserting two new Articles 23a and 23b as follows:*

1. A company may not advance funds, nor make loans, nor provide security, with a view to the acquisition of its shares by a third party, unless such transactions in national legislation are subject to the conditions set out in the second to fifth subparagraphs.

The transactions must take place on the initiative and under the responsibility of the administrative or management body at fair market conditions, especially with regard to interest received by the company from the third party and with regard to security provided to the company by the third party for the loans and advances referred to in paragraph 1. The credit standing of the third party must have been duly investigated and the company must be able to maintain its liquidity and solvency for the next 5 years. The latter must be credibly demonstrated by a detailed cashflow analysis based on the information at the time of the approval of the transaction.

The transactions must be submitted for approval by the administrative or management body to the general meeting for ex ante approval, whereby the general meeting shall act in accordance with the rules for a quorum and a majority laid down in Article 40. The administrative or management body must present a written report to the general meeting, indicating the reasons for the transaction, the interest of the company in effectuating such a transaction, the conditions at which the transaction is effectuated, the risks involved in the transaction for the liquidity and solvency of the company and the price at which the third party is to acquire the shares. This report shall be submitted to the register for publication in accordance with Article 3 of Directive 68/151/EEC.

(continued overleaf)

The aggregate financial assistance granted to third parties must not have the effect of reducing the net assets below the amount specified in Article 15(1)(a).

Where own shares of the company within the meaning of Article 19(1) or shares issued in the course of an increase in subscribed capital are acquired by a third party from the company, that acquisition must be made at a fair price, in order to avoid dilution of existing shareholdings.

Article 23a

A shareholder shall have the right to contest the general meetings' approval of a transaction referred to in Article 23(1) by applying to the appropriate administrative or judicial authority to decide on the legality of that transaction.

Article 23b

In cases where individual members of the administrative or management body of the company being party to a transaction referred to in Article 23(1), or of the administrative or management body of a parent undertaking within the meaning of Article 1 of Council Directive 83/349/EEC or such a parent undertaking itself, or individuals acting in their own name, but on behalf of the members of such bodies or on behalf of such undertaking, are counterparts to such a transaction, Member States shall ensure through adequate safeguards that such transaction does not conflict with the company's best interest.*

**OJ L 193, 18.7.1983, p.1.*

3.5 Relaxation of procedures governing the waiving of pre-emption rights

3.5.1 Under the proposal, if a publicly traded company[15] wishes to issue new shares disapplying the operation of the pre-emption requirements (new shares to be offered first to existing shareholders in proportion to their existing share holding), there will no longer be a requirement for the board, when seeking shareholder approval, to submit a written report to shareholders where the shares are to be issued at the relevant market price.[16]

[15] Companies whose shares are traded on a regulated market as defined in Article 4(1)(14) of Directive 2004/39/EC.

[16] We are seeking clarification from the Commission as to whether the reference to paragraph 5 in the new Article 29(5A) is correct since we believe that the reference should in fact be to paragraph 4. The distinction is relevant since our understanding of Article 29 is that there is no requirement to produce a written report when pre-emption rights are disapplied within the limits of the company's authorized share capital (as opposed to a disapplication relating to a specific issue of shares) and therefore this "relaxation" of the requirement to produce a written report is only relevant to a disapplication of pre-emption rights as referred to in paragraph 4 of Article 29 and not paragraph 5.

3.5.2 Questions relating to pre-emption rights

From a UK perspective the proposal does not address any of the key questions surrounding the disapplication of pre-emption rights. At the request of Ministers, Paul Myners has just carried out a thorough and wide-ranging study into the way the pre-emption right regime operates taking account of stakeholder views. No respondents to his Discussion Paper raised the question of the written report requirement. Almost all mentioned the cost and lengthiness of a rights issue and his final report recommends that Government and the FSA look at ways of shortening the timescale.

One reason that the written report requirement was not raised as an issue may be that in practice UK shareholders would almost always expect some explanation before they agree to disapply pre-emption rights above a minimum of 5% (the minimum set collectively by the institutional shareholder community). Companies which did not accede to such a request would simply fail to get approval.[17]

The Government is of the view that to make this proposal effective, the price at which the shares are issued will need to be measured against the market price prevailing on a date reasonably prior to the contract being entered into rather than on the date of issue. The price should be required to be at least 95% of the market price (i.e. a 5% discount should be permitted). This is in line with the current guidance on discounts produced by the investor community in the UK.

The right of "shareholders" to request reasons for the withdrawal of pre-emption rights should be exercisable at any time <u>before</u> the vote at the shareholders' meeting.

Q16: Do you think that this relaxation will remove an administrative burden in practice?

Q17: Do you agree with the Government's view on the setting of the share price at at least 95% of the market price, in order for the relaxation to apply?

Q18: Do you have any other comments on the drafting of Article 29?

[17] The documents relating to the review carried out by Paul Myners in relation to pre-emption rights are available on the DTI website at: http://www.dti.gov.uk/cld/public.htm

3.5.3 *Directive 77/91/EEC is amended by inserting paragraph 5a into Article 29 as follows:*

> *Where an administrative or management body of a listed company is given the power to restrict or withdraw the right of pre-emption in accordance with paragraph 5, under the additional condition, that the shares for a future increase in the subscribed capital must be issued at the market price which, at the time of issue, prevails on one or more regulated market(s) within the meaning of Article 4(1)(14) of Directive 2004/39/EC, the administrative or management body is exempted from having to present to the general meeting a written report as required under paragraph 4 of this Article. Shareholders may, however, request the administrative or management body to indicate the reasons for the restriction or withdrawal of the right of pre-emption.*

3.6 Enhancing standardised creditor protection in all Member States in situations of reductions of capital

3.6.1 UK law already provides creditors with the right to object to court to a reduction of capital. However, under the proposal the circumstances in which creditors will be able to apply to court to object to a reduction of capital will be limited to where they can demonstrate that the reduction will prejudice the satisfaction of their claims and the company has provided no adequate safeguards.

3.6.2 Questions relating to creditor protection

UK law currently provides all creditors with the right to object to court to reductions of capital.

The Government welcomes the limitation of the right of creditors to object to reductions of capital to circumstances where they can demonstrate that the reduction will prejudice the satisfaction of their claims.

Q19: Do you agree with the above proposal to standardise creditor protection across the EU?

Q20: Do you think there is any economic benefit in standardising creditor protection across the EU?

Q21: Does this achieve the right balance of interests between companies and their creditors?

Q22: Do you have any other comments on the drafting of Article 32?

3.6.3 *Directive 77/91/EEC is amended by replacing paragraph 1 of Article 32 with the following:*

1. In the event of a reduction in the subscribed capital, at least the creditors whose claims antedate the publication of the decision to make the reduction shall be entitled at least to have the right to obtain security for claims which have not fallen due by the date of that publication. Member States may not set aside such a right unless the creditor has adequate safeguards, or unless the latter is not necessary in view of the assets of the company.

Member States shall lay down the conditions for the exercise of the right provided for in the first paragraph. In any event, Member States shall ensure that the creditors are authorized to apply to the appropriate administrative or judicial authority for adequate safeguards provided that they can credibly demonstrate that due to the reduction in subscribed capital the satisfaction of their claims is at stake, and that no adequate safeguards have been obtained from the company.

3.7 Introduction of "squeeze-out" and "sell-out" rights

3.7.1 These rights are intended to address the problems of, and for, residual minority shareholders in a company. Essentially, rights are conferred on significant majority shareholders (holding 90% of the share capital) to compulsorily purchase the shares of the remaining minority ("squeeze-out rights") and parallel rights ("sell-out rights") are provided to minority shareholders to require the majority shareholder to purchase their shares. This concept will be new to the Second Company Law Directive. However, the Takeovers Directive, agreed in April 2004 for implementation by Member States by May 2006, already lays down an EU squeeze-out and sell-out rule following a successful takeover. This proposal would apply to all companies traded on a regulated market[18] in situations where the majority ownership threshold had been passed even other than as a consequence of a successful takeover. Member States can opt to raise this threshold to 95%.

18 Companies whose shares are traded on a regulated market as defined in Article 4(1)(14) of Directive 2004/39/EC.

3.7.2 Questions relating to "squeeze-out" and "sell-out" rights

The Government does not consider this to be a deregulatory measure and therefore questions its inclusion in this proposal. Similar rights will apply within 3 months of a takeover as a result of the Takeovers Directive agreed in April 2004. The introduction of more general requirements will require the extension of Part XIII A of the Companies Act 1985.

It is unclear on what basis a fair price would be arrived at by the independent expert/authority.

It should be made clear that the obligation to sell at a fair price should be "in cash" and forthwith.

The Government believes that this requirement should not apply retrospectively and should only apply to majority shareholders whose shareholding caps 90% following the implementation of the directive.

The Government has concerns that this proposal could have some negative impacts, for example, depressing the value of shares for minority shareholders. It believes that more time is required to consider the implications of extending these rights beyond takeover situations and would prefer the issues to be fully considered possibly as part of the work on the shareholder rights directive.

Q23: Do you agree that this measure should not be included in this proposal and that any further consideration should be in the context of the proposed shareholder rights directive?

Q24: What should be the basis for computing "fair price"?

Q25: Do you agree that it should be made clear that the obligation to sell at a fair price should be "in cash"?

Q26: Do you share the Government's concerns about the potential negative impacts of extending these rights beyond takeover situations?

Q27: Do you have any other comments on the drafting of Articles 39a and 39b?

3.7.3 *Directive 77/91/EEC is amended by inserting Articles 39a and b as follows:*

Article 39a

1. Member States shall ensure that a shareholder who holds at least 90% of the subscribed capital of a listed company, hereinafter referred to as the "majority shareholder" shall be able to require all the holders of the remaining shares, hereinafter referred to as "minority shareholders", to sell him those shares at a fair price. However, Member States may set a higher threshold provided that it does not exceed 95% of the subscribed capital of the company.

A company is considered to be a listed company within the meaning of this provision if its shares are traded on a regulated market as defined in Article 4(1)(14) of Directive 2004/39/EC.

2. Member States shall ensure that it is possible to determine when the threshold is reached.

3. Where the company has issued more than one class of shares, Member States may provide that the right to require the minority shareholder to sell as provided for in paragraph 1 shall apply only in the class in which the thresholds referred to in that paragraph are reached.

4. Member States shall ensure that each minority shareholder concerned may demand an appraisal of the fair price.

The appraisal of whether the price is fair shall be carried out by an independent administrative or judicial authority or by an independent expert appointed or approved by such an authority. Such experts may be natural persons as well as legal persons and companies or firms under the laws of each Member State. The demand for such an appraisal shall be exercised within three months after the minority shareholder was required to sell and the price was announced in accordance with paragraph 1.

*This Article is without prejudice to Article 15 of Directive 2004/25/EC**

**OJ L124, 30.4.2004, p.12.*

Article 39b

1. Member States shall ensure that minority shareholders in a listed company shall be able to require, jointly or individually, the majority shareholder to buy from them their shares in that company at a fair price.

2. Member States shall ensure that in cases where there is no agreement on the fair price between the prospective parties of the transaction mentioned in paragraph 1, the price is examined by an independent administrative or judicial authority or by an independent expert appointed or approved by such an authority. Such experts may be natural persons as well as legal persons and companies or firms under the laws of each Member State.

3. The provisions of Article 39a(1) second and third sentence, (2) and (3) shall apply mutatis mutandis.

4. Member States shall ensure an adequate procedure which guarantees a fair treatment of all minority shareholders.

5. This Article is without prejudice to Article 16 of Directive 2004/25/EC.

3.8 Longer-term Reform of the Capital Maintenance Regime

The Government is keen to see deregulatory initiatives which reduce unnecessary burdens on business. It therefore supports the objective behind the simplification of the Second Company Law Directive, namely to help companies react more quickly and flexibly to market developments. However, it is not certain that the proposal will be significantly deregulatory in practice and questions whether the modest changes proposed will make a radical difference to the way companies operate when wanting or needing to re-structure their capital.

The Commission views the proposal as an interim measure prior to carrying out a more fundamental review of the capital maintenance regime, including an assessment of alternative models e.g. those based on solvency tests. The Government is keen for the study to be carried out as soon as possible and will be seeking the views of stakeholders as the study progresses. It considers the consideration of alternative approaches to be a high priority for the EU.

Q28: Do you think that the overall package of current proposals will make a significant and positive difference to companies wanting or needing to re-structure their capital? If not, what other changes would you like to see?

Q29: Do you agree that a fundamental review of the capital maintenance system and of alternative approaches is a high priority for the EU?

4. OTHER ISSUES

4.1 Cost savings and benefits

A draft regulatory impact assessment (RIA) is attached at Annex B.

Q30: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are also welcome on any unintended consequences or other implications.

4.2 What happens next?

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.

4.3 How to respond and help with queries

4.3.1 You are invited to send comments, including your thoughts on the likely costs and benefits and any implementation issues that might arise by **3 June 2005** preferably by email to:

Annette Grunberg
Corporate Law and Governance
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Phone: 020 7215 6467
Email: annette.grunberg@dti.gsi.gov.uk

4.3.2 If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

Annette Grunberg (as above)

Or:

Nick van Benschoten
DTI Consultation Co-ordinator
Department of Trade and Industry
V 321
1 Victoria Street
London SW1H 0ET
Phone: 020 7215 6206
Email: nick.vanbenschoten@dti.gsi.gov.uk

5. SUMMARY LIST OF CONSULTATION QUESTIONS

5.1 Relaxation of the requirements concerning the valuation of non-cash consideration for the allocation of shares

Q1: Do you think that the proposed changes relating to the valuation of non-cash consideration will make it easier and cheaper for companies to allot shares for a non-cash consideration?

Q2: Do you agree that the courts are the correct body to review any breaches of the new provisions and that no other independent body needs to be designated to carry out this function?

Q3: Do you agree that the right of minority shareholders to require a revaluation should be limited to the period before a contract is entered into?

Q4: Do you see any scope for further simplification of the rules relating to non-cash consideration? If so, please specify and give reasons for your proposal.

Q5: Do you have any other comments on the drafting of Articles 10a or 10b?

5.2 Relaxation of the requirements concerning acquisition of own shares by a company (buy-back)

Q6: Do you think that the proposed changes will give companies more flexibility to acquire their own shares?

Q7: Do you agree that a requirement to offer to purchase/sell shares to all shareholders would constitute an additional burden?

Q8: Do you agree that companies should be free to repurchase own shares up to the limit of distributable reserves or do you consider that the current cap of 10% of issued share capital should be retained?

Q9: If you disagree that a cap of 10% should be retained but consider that there should be a higher cap, what level of issued share capital do you consider would be appropriate?

Q10: Do you think EU wide relaxation of the requirements concerning acquisition of its own shares by a company should go beyond the proposed changes? If so, what additional changes would you make and why?

Q11: Do you have any other comments on the drafting of Article 19?

5.3 Relaxation of prohibition on financial assistance

Q12: Do you agree that the conditions governing the changes proposed will be a disincentive for companies wishing to take advantage of relaxed financial assistance rules?

Q13: Are there better ways of providing shareholders and creditors with safeguards than the proposed 5 year solvency test?

Q14: Should the right to contest the resolution be open to any shareholder or should it be a specified majority? Should the right be exercisable only within a certain period of the resolution?

Q15: Do you have any other comments on the drafting of Articles 23a and 23b?

5.4 Relaxation of procedures governing the waiving of pre-emption rights

Q16: Do you think that this relaxation will remove an administrative burden in practice?

Q17: Do you agree with the Government's view on the setting of the share price at at least 95% of the market price, in order for the relaxation to apply?

Q18: Do you have any other comments on the drafting of Article 29?

5.5 Enhancing standardised creditor protection in all Member States in situations of reductions of capital

Q19: Do you agree with the above proposal to standardise creditor protection across the EU?

Q20: Do you think there is any economic benefit in standardising creditor protection across the EU?

Q21: Does this achieve the right balance of interests between companies and their creditors?

Q22: Do you have any other comments on the drafting of Article 32?

5.6 Introduction of "squeeze-out" and "sell-out" rights

Q23: Do you agree that this measure should not be included in this proposal and that any further consideration should be in the context of the proposed shareholder rights directive?

Q24: What should be the basis for computing "fair price"?

Q25: Do you agree that it should be made clear that the obligation to sell at a fair price should be "in cash"?

Q26: Do you share the Government's concern about the potential negative impacts of extending these rights beyond takeover situations?

Q27: Do you have any other comments on the drafting of Articles 39a and 39b?

5.7 Longer-Term Review of the Capital Maintenance Regime

Q28: Do you think that the overall package of current proposals will make a significant and positive difference to companies wanting or needing to re-structure their capital? If not, what other changes would you like to see?

Q29: Do you agree that a fundamental review of the capital maintenance system and of alternative approaches is a high priority for the EU?

5.8 Cost savings and benefits

Q30: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are also welcome on any unintended consequences or other implications.

Section 4: European Company Law – Anticipated Proposal Concerning the Transfer of Registered Office

1. EXECUTIVE SUMMARY

1.1 *Background and state of play*

A proposal for a European Directive related to the transfer of a company's registered office is a short term priority measure under the EU Action Plan on Company Law and Corporate Governance published by the Commission in May 2003.

The Commission carried out an online public consultation in advance of such a proposal in the spring of 2004, the results of which are expected to inform the final Commission proposal which is anticipated in the near future.

Progress on such a proposal has been facilitated by related EU developments, in particular:

- Adoption of the European Company Statute Regulation which came into effect on 8 October 2004 and will enable European companies registered under that legislation to transfer their registered office from one Member State to another;
- General approach agreement was achieved by the EU Competitiveness Council in November 2004 on the Cross Border Mergers Directive, which deals with a number of related cross-border restructuring issues; and
- Emerging European Court of Justice case law in the field of freedom of establishment.

The issue of "jurisdictional migration" (cross-border relocation of a company) was also considered by the independent Company Law Review in Great Britain which finally reported in the summer 2001, concluding that a legal framework for companies to migrate should be put in place.

1.2 *About the Directive*

The proposed Directive aims to put in place a legal framework for companies registered in the EU to transfer their registered office from one Member State to another.

Such a Directive could allow a company to more readily exercise freedom of establishment rights and so increase productivity through adapting its organisational structure to market changes or its position in those markets.

The Commission proposals are as follows:-

- The proposal would apply only to the transfer of the company's registered office (not head office);

- The decision to transfer would be taken by the general meeting of the company;

- The transfer would result in the company losing its legal personality in the original State of incorporation and being granted legal personality in the State to which it transferred (this would not involve winding up or dissolution of the company);

- Special protections for persons such as minority shareholders and creditors could be put in place by the Member State from which the company sought to transfer;

- A Member State could not prevent a company transferring out of its territory, except on limited public interest grounds, and could not prevent a company that had completed the necessary formalities transferring into its territory; and

- Provision will be made, in certain circumstances, for employee "participation" (employees on the company board), with the key principle being that any participation rules in the State to which the company transferred would generally apply (unless there were more stringent participation rules in operation in the State from which the company transferred).

The full text of the online Commission consultation (and summary of responses) on the proposal carried out in spring 2004 can be found at: http://europa.eu.int/comm/internal_market/company/seat-transfer/index_en.htm.

2. BACKGROUND

2.1 A proposed Directive to facilitate the cross-border transfer of a company registered office is one of the few uncompleted items under the EU Financial Services Action Plan (agreed to by Member States at the Lisbon Spring Council in 2000) and is designed to enhance the Single Market by creating a new mechanism for cross-border restructuring for European companies. The proposed Directive was also one of the short-term priority instruments, for adoption by end of 2005, contained in the EU Action Plan on Company Law and Corporate Governance published by the EU Commission in May 2003.

2.2 The proposed Directive would create a legal framework enabling companies to transfer their registered office from one Member State to another without having to be wound up. The Commission carried out an online consultation in advance of making a formal proposal in the spring 2004, setting out the main issues involved and their proposed approach. The proposals contained in the Commission's consultation paper form the basis of the current consultation. A formal Directive proposal is expected shortly from the Commission. The results of the current consultation will be used to inform and shape the UK's approach in negotiating the Directive once published by the Commission.

2.3 Currently, there is no co-ordinated European legislation governing transfer of a company's registered office from one Member State to another. Member States' laws take a variety of approaches on this issue. In Great Britain, such a transfer is normally done by means of a private Act of Parliament. There are, however, a number of important recent developments at the EU level that are of relevance in considering the future of the project to agree a Directive on the cross-border transfer of a company's registered office:

a) Agreement of European Company Statute Regulation – This instrument came into force on 8 October 2004 and will allow European Companies registered under the Regulation (Societas Europaea ("SE")) to transfer their registered office from one Member State to another without being wound up. It lays down a basic legislative framework for transfer procedures to take place. However, it does not apply to types of company other than SEs.

b) Cross Border Mergers Directive – General approach agreement on this Directive proposal was achieved at the EU Competitiveness Council in November 2004 (although the proposal is still being considered by the European Parliament). The compromise reached by the Competitiveness Council offers a number of solutions (for instance, in relation to the scope of the proposal and on employee participation issues) which might be applied to the transfer of registered office Directive). The Cross Border Mergers Directive will provide a framework for companies to "merge" cross-border, but the merger procedure will always involve two or more participating companies – at least one of which will be dissolved as a result of the procedure.

c) European Court of Justice freedom of establishment case law – There is a body of case law emerging from the European Court of Justice on the issue of the transfer of the de facto head office of a company between Member States. The current state of the case law, including details of the most important judgments, is more fully described in the Commission's consultation paper published last spring. However, the effect of the decisions made by the Court has essentially been to facilitate cross-border activities by companies through upholding their freedom of establishment rights under the Treaty.

2.4 Additionally, the issue of "jurisdictional migration" (the right of a company to move between States) was considered in the independent Company Law Review sponsored by the Department of Trade and Industry and which reported finally in July 2001[19]. The Review concluded that provision should be made under domestic law to facilitate the transfer of a British company to another State. Those proposals remain under consideration as part of the Department's wider consideration of the reform of company law.

19 The Company Law Review documents and other related material are available on the DTI website: http://www.dti.gov.uk/cld/review.htm

3. THE KEY PROPOSALS

3.1 Key purposes of the proposal

The Commission cite two key potential advantages for companies which might be achieved through the transfer by a company of its registered office from one Member State to another:

- "to be able to adapt [the company's] location or organisational structure both to market changes and to changes in its position on those markets by choosing the national law which, in its view, best meets its requirements;" and

- "[for the company] to be relieved of the obligation, when carrying out such adaptation, to go through liquidation proceedings."

3.2 Features of the Proposal

3.2.1 The Commission propose that a co-ordination Directive could be prepared to facilitate cross-border transfer of the registered office of a company. The Directive would have a relatively broad scope in terms of the types of companies which would be able to utilise the transfer procedure, it being proposed that the Directive would apply to companies which:

- Have legal personality;

- Have separate assets that alone serve to cover the debts of the company; and

- Are subject under national law to safeguards such as those required by the First Company Law Directive (e.g. registration, filing of documents, etc.).

3.2.2 In Great Britain, this would include both private and public limited companies registered under the Companies Act 1985. The Commission also state that special procedures could be laid down for companies carrying on regulated activities (this might include, for instance, companies in the financial services or insurance sectors).

3.2.3 The Commission propose that the Directive should only deal with the transfer of the registered office of a company between Member States. In particular, it is not intended to make legislative provision for the cross-border transfer of the head office of the company, as the Commission consider that the most common circumstances in which a company might seek to transfer its head office are already sufficiently assured by the existing European Court of Justice case law on this issue which, in sustaining freedom of establishment principles, has essentially supported the rights of companies to move their de facto head offices within the EU.

Q1: Would it be useful to have provisions which enabled companies in the UK and other Member States to transfer their registered office to another Member State? If so, do you think that the right means of facilitating the cross-border transfer of a company's registered office within the EU is through a co-ordination Directive?

Q2: Do you agree that the scope of the Directive should be sufficiently broad to include both public and private limited companies? Are there any regulatory areas where you think special provision has to be made in relation to the transfer of companies?

Q3: Do you agree that the proposal should only address the cross-border transfer of the registered office?

Q4: Are you satisfied that sufficient clarity is already provided in relation to the issue of transfer of the head office of a company by the European Court of Justice case law? If not, what further issues should be resolved by EU legislation on this matter?

3.3 Principles governing the cross-border transfer procedure

3.3.1 Broadly, the proposed transfer procedure consists of two elements:

a) Decision by company to transfer – This will be taken in accordance with the laws of the Member State in which the company is originally registered ("the Home State"). The Home State may lay down measures to protect the rights of certain categories of persons, including minority shareholders and creditors; and

b) Registration in new Member State ("the Host State") – On completion of the transfer from the Home State, no further incorporation formalities would be required in the Host State, provided that the transferring company met essential, substantive and formal requirements for registration in the Host State.

3.3.2 *More specific elements of the proposals are as follows:*

- Member States would be obliged to provide that companies governed by their national law could decide in general meeting (on the same basis on which changes to the Memorandum and Articles of Association can be approved) to transfer their registered office to another Member State.

- Details of the transfer proposal to be considered by a general meeting, together with the consequences of such a transfer, would need to be published in advance.

- The Host Member State could not refuse to accept transfer of a company from another Member State where the transfer proposal had been agreed, provided that the transferring company met the essential, substantive and formal requirements for registration of national companies in the Host State.

- Upon registration in the Host State, the company would lose its legal personality in the Home State and be removed from the register in the Home State. The transfer would not result in the company being wound up and, generally, the company's legal relationships with third parties would remain unaffected.

Q5: Do you think that the proposed approach in relation to the taking of a decision by a company to transfer (relying on Member States' domestic laws in relation to alteration to a company's Memorandum and Articles) is the right one?

Q6: Are there any special provisions (apart from publication and the rules governing the decision to transfer) that you consider should be included to protect shareholders and creditors?

Q7: Do you think that the outline proposals are sufficiently clear concerning which national law will govern the transfer decision and the company once the transfer has taken place?

3.4 Employee Participation

3.4.1 Employee participation is a system that exists in some Member States (such as Germany, Austria, Netherlands and Sweden) which gives employees the statutory right to be represented at board level. Great Britain does not have such a mandatory system and, except in specific circumstances in companies registered under the European Company Statute Regulation, there are currently no EU wide rules on employee participation.

3.4.2 Employee participation was defined at Article 2(k) of the Directive on employee involvement which accompanied the European Company Statute Regulation in the following terms:

"the influence of the body representative of the employees and/or the employees' representatives in the affairs of a company by way of:

(a) the right to elect or appoint some of the members of the company's supervisory or administrative organ, or

(b) the right to recommend and/or oppose the appointment of some or all of the members of the company's supervisory or administrative organ. "

3.4.3 In its consultation document in spring 2004, the Commission suggested that employee participation rights under the Directive on the transfer of the registered office of a company should be governed by the legislation in the Host State (i.e. the State to which the company will transfer). However, where employee participation rights are "more firmly enshrined" in the Home Member State, they should be maintained upon transfer or be negotiated with representatives of the employees.

3.4.4 If, as seems likely, the Commission adopts the broad approach taken in the Directive on employee involvement accompanying the European Company Statute and the Cross Border Mergers Directive, participation arrangements would normally, in the first instance, be negotiated between employee representatives (forming a Special Negotiating Body) and the company. Negotiations may last for up to 12 months. If no agreement is reached after the expiry of that period then standard rules on participation will apply.

3.4.5 The Commission's proposed approach means that employee participation would only apply to companies choosing to register in a Member State whose domestic law requires participation (and the transferring company is large enough to trigger participation rules), or where a company wishing to re-register already has participation. It also means that it is highly unlikely that a UK company (with no participation rights) wishing to transfer its registered office to another Member State would be required to enter into negotiations. Such a company would simply become subject to participation rules in force in the Host State.

Q8: Do you agree that the correct approach in relation to employee participation provisions should be that, as a general principle, the law of the Host State will apply (except where there is a higher level of participation – where such participation rights exist – in the Home Member State)?

Q9: Do you have any other comments on the provisions on employee participation?

4. OTHER ISSUES

4.1 Cost savings and Benefits

A partial regulatory impact assessment (RIA) is attached at Annex C.

Q10: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are invited, particularly, on the following aspects of the RIA:

a.) The likely number of UK companies (in particular, small companies) which might choose to use the cross-border transfer of registered office procedure proposed under the Directive;

b.) Whether section 9 of the RIA correctly identifies all likely costs of the transfer procedure and the cost estimates used are reasonable;

c.) Any negative or disproportionate costs for small business that may arise from the proposal.

Comments are also welcomed on any unintended consequences or other implications.

4.2 What happens next?

The next stage would be for the European Commission to formally make a Directive proposal which would then have to be considered by the European Parliament and Council. The responses received to this consultation are intended to ensure that the Government can respond to that proposal, once made, on an informed and timely basis.

4.3 How to respond and help with queries

4.3.1 You are invited to send comments, including your thoughts on the likely costs and benefits and any implementation issues that might arise by **3 June 2005** preferably by email to:

Annette Grunberg
Corporate Law and Governance
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Phone: 020 7215 6467
Email: annette.grunberg@dti.gsi.gov.uk

4.3.2 If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

Annette Grunberg (as above)

Or:

Nick van Benschoten
DTI Consultation Co-ordinator
Department of Trade and Industry
V 321
1 Victoria Street
London SW1H 0ET
Phone: 020 7215 6206
Email: nick.vanbenschoten@dti.gsi.gov.uk

5. SUMMARY LIST OF CONSULTATION QUESTIONS

Q1: Would it be useful to have provisions which enabled companies in the UK and other Member States to transfer their registered office to another Member State? If so, do you think that the right means of facilitating the cross-border transfer of a company's registered office within the EU is through a co-ordination Directive?

Q2: Do you agree that the scope of the Directive should be sufficiently broad to include both public and private limited companies? Are there any regulatory areas where you think special provision has to be made in relation to the transfer of companies?

Q3: Do you agree that the proposal should only address the cross-border transfer of the registered office?

Q4: Are you satisfied that sufficient clarity is already provided in relation to the issue of transfer of the head office of a company by the European Court of Justice case law? If not, what further issues should be resolved by EU legislation on this matter?

Q5: Do you think that the proposed approach in relation to the taking of a decision by a company to transfer (relying on Member States' domestic laws in relation to alteration to a company's Memorandum and Articles) is the right one?

Q6: Are there any special provisions (apart from publication and the rules governing the decision to transfer) that you consider should be included to protect shareholders and creditors?

Q7: Do you think that the outline proposals are sufficiently clear concerning which national law will govern the transfer decision and the company once the transfer has taken place?

Q8: Do you agree that the correct approach in relation to employee participation provisions should be that, as a general principle, the law of the Host State will apply (except where there is a higher level of participation – where such participation rights exist – in the Home Member State)?

Q9: Do you have any other comments on the provisions on employee participation?

Q10: We would welcome comments and evidence on the RIA, especially on the savings and benefits (or any costs) of the proposed Directive. Comments are invited, particularly, on the following aspects of the RIA:

a) The likely number of UK companies (in particular, small companies) which might choose to use the cross-border transfer of registered office procedure proposed under the Directive;

b) Whether section 9 of the RIA correctly identifies all likely costs of the transfer procedure and the cost estimates used are reasonable;

c) Any negative or disproportionate costs for small business that may arise from the proposal.

Comments are also welcomed on any unintended consequences or other implications.

Annex A

PROPOSED DIRECTIVE TO AMEND 4TH AND 7TH ACCOUNTING DIRECTIVES

Partial Regulatory Impact Assessment

1. PROPOSAL

1.1 On 27 October 2004 the European Commission approved and presented a proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC **concerning the annual accounts of certain types of companies and consolidated accounts**. It will amend the 4th and 7th Accounting Directives agreed in 1978 and 1983 respectively[20]. The proposal will now be discussed in Council Working Groups and in the European Parliament.

1.2 The full text of the proposal can be found at http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2004/com2004_0725en01.pdf

1.3 The proposal arises in the context of wider EU company law reform as outlined in the EU Company Law and Corporate Governance Action Plan of May 2003[21]. The measures contained in the proposal were identified as short-term priorities in the Action Plan. Recent corporate scandals, such as Parmalat, have strengthened the Commission's view that early action is necessary.

2. OBJECTIVE OF THE PROPOSAL

2.1 The overall objective of the proposal is to "further enhance confidence in the financial statements and annual reports published by European companies" through shareholders and other stakeholders having easy access to reliable and complete information (Commission Proposal's Explanatory Memorandum). The Commission believes that this will have the effect of building confidence in the EU capital markets and reduce malpractice, as well as facilitating cross-border investments and improving EU-wide comparability.

[20] The consolidated text of the 4th Directive can be found on: http://europa.eu.int/eur-lex/en/consleg/main/1978/en_1978L0660_index.html. The consolidated text of the 7th Directive can be found on: http://europa.eu.int/eur-lex/en/consleg/main/1983/en_1983L0349_index.html.

[21] Available at http://europa.eu.int/cgi-bin/eur-lex/udl.pl?REQUEST=Service-Search&LANGUAGE=en&GUILANGUAGE=fr&SERVICE=all&COLLECTION=com&DOCID=503PC0284

2.2 The proposal contains 4 revisions to the Accounting Directives to achieve the overall objective:

(a) Clarification that all Board members are collectively responsible for the accounts and key non-financial information.

Applicable to: All limited companies

(b) Enhancing transparency about related party transactions.

Applicable to: All limited companies. Qualifying small companies as defined in section 247 of the Companies Act 1985 can be exempted from this requirement in relation to their individual accounts. Qualifying small and medium-sized groups as defined in Section 249 of the Companies Act 1985 are exempt from the obligation to prepare group accounts.

(c) Enhancing transparency about off-balance sheet arrangements, including Special Purpose Entities.

Applicable to: All limited companies (qualifying small companies and small and medium-sized groups can be exempted, as above)

(d) Introducing an annual corporate governance statement.

Applicable to: Publicly traded Companies[22] (although Article 2 (2) seems to have the effect of requiring the internal control disclosure in the consolidated accounts of all classes of company required to prepare group accounts)

2.3 The changes required by the proposal will apply to the UK.

3. BACKGROUND TO THE PROPOSAL

3.1 The EU Action Plan published in May 2003 contained the Commission's intention to come forward with legislative measures in the area of collective responsibility of board members for annual accounts and reports, financial statement transparency and corporate governance statements. These measures were part of a broader programme of company law reform.

[22] Companies whose securities are admitted to trading on a regulated market within the meaning of Article 4(1)(14) of Directive 2004/39/EC. A list of regulated markets is contained on the Europa website: http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_072/c_07220040323en00030007.pdf.

3.2 The current proposal focuses on the linked objectives of increasing confidence in corporate governance frameworks and restoring investor confidence through increased transparency and better information on companies. In the Action Plan the Commission took the view that the creation of a European Corporate Governance Code would not add value to the action being taken at national level in individual Member States to develop effective Codes. However, it did not believe that a self-regulatory approach, based on non-binding recommendations, would be sufficient to ensure that sound corporate governance practices would be adopted (and help to increase investor confidence).

4. ASSESSMENT OF RISK

4.1 The Commission is concerned that investors have reduced confidence in the trustworthiness of companies, following recent corporate scandals. They are trying to reduce the risk of future corporate scandals in Europe by making more transparent financial arrangements and requiring companies to give information relevant to good corporate governance. These measures will not be sufficient to guarantee prevention of another Enron but the Commission hopes that placing additional targeted disclosure requirements on companies will make it more difficult and unlikely that corporate malpractice will be possible and/or tolerated by existing or potential investors.

4.2 It is difficult to quantify the risk of poor investor confidence across Europe and also globally. Companies involved in corporate scandals lose significant market value and are often forced to restructure, with consequent job losses.

4.3 However, from informal discussions with a number of UK stakeholders both prior to and following formal publication of the Commission proposal, it is considered that the proposal as drafted contains some potential risks to the effective and efficient achievement of its objectives. These need to be further explored and managed through the consultation and negotiation phases:

- Much of the information currently identified as being required in the corporate governance statement is already produced by companies in their annual report. Transferring the information from other parts of the annual report risks fragmentation of the annual report. However, this must be set against potential benefits to users of the report, particularly shareholders, from having certain information about the corporate governance of the company set out in an easily accessible format;

- The financial transparency requirements go slightly beyond IAS, adding cost but with no clear case as to incremental benefits;

- Although the content of the corporate governance statement is minimal, there is a risk that other Member States or the European Parliament will seek to add to it;

- Consideration will need to be given to problems that may arise from companies seeking to "pick and choose" between national corporate governance codes.

5. HOW THE PROPOSALS WILL WORK, THEIR COSTS AND BENEFITS:

5.1 Collective Responsibility of Board Members for Financial Statements and Annual Report

Impact: Member States must ensure that board members are collectively responsible towards the company with the option left to Member States of extending this responsibility to shareholders and other stakeholders.

Costs: The proposal appears to reflect the current UK position at common law, although it is anticipated that legislation will be required to implement this obligation. No additional costs to business are anticipated.

Benefits: Some member states do not yet provide for all directors/board members to be collectively responsible for the financial statements and the annual report. In the light of recent corporate scandals, it is clear that confidence in the EU markets and the corporate governance of their companies will be enhanced by clear allocation of responsibility for the financial statements and annual report.

5.2 Financial information – Related Party Transactions (RPTs) and Off Balance Sheet Arrangements, including the use of Special Purpose Entities (SPEs) and offshore centres

Impact: Related parties of a company include parties which the company controls, parties that have control, joint control or significant influence over the company, parties subject to common control with the company, key managers of the company and their immediate family, and the company's associates and joint ventures.

Qualifying small companies will be able to be exempted from this requirement in relation to their individual accounts. Qualifying small and medium-sized groups are exempt from the obligation to prepare group accounts.

The Accounting Directives require disclosure of certain information concerning affiliated companies and of loans and advances to members of the management board (Articles 43 (2) and 43 (13) of the 4th accounting directive). These RPT disclosures are not, however, as broad as under International Accounting Standards. IAS 24 deals with transactions with related parties. Publicly traded companies must, for financial years beginning on or after 1st January 2005, apply IAS (as adopted for use in the EU) when preparing consolidated accounts. The proposal will have the effect of extending the legal requirement to disclose certain RPTs to companies not reporting under IAS.

In order to identify related parties, the Commission proposes to integrate the definitions set out in IAS 24, as endorsed under the IAS-Regulation[23]. The proposed disclosure requirements are similar to IAS 24 but differ in three respects:

- The proposal requires disclosure only of transactions conducted other than on an "arm's length" basis whereas IAS 24 does not include this limitation;
- The required disclosures include the business purpose of such transactions, which is not explicitly a requirement of IAS 24; and
- The proposal requires disclosure only of material transactions. IAS 24 is silent on materiality although IAS 1 deals with this subject in general terms.

The proposal will potentially affect the annual accounts of medium and large companies, with the exception of those companies that are required or decide to prepare their accounts under the IAS Regulation[24]. In accordance with UK accounting standards issued by the Accounting Standards Board, such accounts currently present information concerning related parties in accordance with Financial Reporting Standard (FRS) 8. In most cases, the disclosures required under FRS 8 would appear likely to meet the proposed new requirement in the draft directive. However, under FRS 8, transactions with other members within a group of companies need not be disclosed in:

- the parent company's individual and consolidated accounts; and
- subsidiaries' accounts where 90% of the voting rights are controlled within the group.

[23] EC Regulation No.1606/2002 of the European Parliament and of the Council of 19th July 2002 on the application of international accounting standards .OJ L243/1 of 11 September 2002.

[24] The Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004; S.I. 2004/2947. Those regulations specify all companies that must comply with IAS and those that may voluntarily choose to do so.

Given the position under FRS 8, the primary effect of the proposal will be to extend the existing disclosure requirements in the accounts of companies which are members of a group.

In accordance with the ASB's strategy of progressively converging UK standards with IAS, it is expected that in due course FRS 8 will be replaced with a standard based on IAS 24. This would, inter alia, eliminate any differences in definition of related party between existing UK practice and the Commission's proposal.

Costs: The new requirements are not expected to have a significant impact going beyond existing UK practice in most circumstances. Where the proposal does require additional disclosure, the information should be readily available from the accounting records. The proposal is most likely to have an impact on companies that are part of a group, in situations where such companies enter into material transactions with other group members on non-arm's length terms. We do not have any reliable data on the prevalence of such transactions. Minor additional costs will be incurred by some companies in compiling and presenting the information and in its audit.

Benefits: Enhanced disclosure of transactions that have not been conducted on an arm's length basis will improve transparency and facilitate a better understanding of companies' financial position and results. It is assumed that this will contribute to investor confidence in the market being strengthened. How damaging poor investor confidence can be has been well analysed with respect to the two largest American bankruptcies (Enron and WorldCom in July 2002) stemming from corporate mismanagement. It has been estimated that the loss in stock market wealth as a result of these scandals has been at least 9%.[25]

5.3 Transparency in the use of off-balance sheet arrangements

Impact: Certain arrangements a company enters into may have a material impact on the company but may not be included in the company's balance sheet. Consequently, there is a public policy desire on the part of the Commission to ensure that the "true and fair view" principle is better and more clearly implemented at European level. IAS and the Accounting Directives provide for some disclosure of off balance sheet arrangements. For example, disclosure of financial commitments not included in the balance sheet is required by Article 43 (7) of the 4th accounting directive. IAS (and UK accounting standards) require disclosure of lease commitments, contingent assets and contingent liabilities.

[25] See Graham Carol/ Litan Robert/ Sukhtankar Sandip (2002) The bigger they are, the harder they fall: an estimate of the costs of the crisis in corporate governance. Working paper. Economic studies/ Governance studies programme. Brookings Institutions (2002).

A particular objective of the Commission is to achieve greater transparency over the use of so-called Special Purpose Entities (SPEs). These are entities set up by a company (usually financial institutions) to pursue a narrow and well-defined objective such as a securitisation transaction. SPEs are often established in such a way that, whilst they can give rise to potential risks, they do not meet the definition of a subsidiary undertaking and are not therefore included in the sponsoring group's balance sheet. SPEs are currently captured in the balance sheet if they qualify as subsidiary undertakings, and then only in the consolidated balance sheet of the parent.

The proposal is that disclosure should be improved by imposing a specific disclosure requirement in the notes for material off-balance sheet arrangements. To the extent that this disclosure goes beyond what is required under IAS, the Commission maintains that EU companies applying IAS would also have to comply with this disclosure through an amendment to the Accounting Directives. The Commission justify this position based on the overarching principle that financial statements must present a true and fair view of a company's financial situation and as the best way for ensuring transparency.

There are issues of scope and definition given that the proposal refers to "off balance sheet arrangements "without specifying particular types of arrangement. The intention however appears to be to capture arrangements of a financing nature, where such arrangements have removed assets or liabilities from the arranger's balance sheet or give rise to actual or potential benefits or obligations that are not recognised. Nonetheless, the proposal as drafted will require the use of judgment by companies to identify material arrangements whose disclosure will be of assistance in assessing the financial position.

Costs: Arrangements of the type that would need to be disclosed, and whose disclosure is not required under existing generally accepted accounting practice, are not expected to be in common use by most companies. In the cases where additional disclosures are required to be given, the cost of providing such disclosure is expected to be modest.

Benefits: Enhanced disclosure of off balance sheet arrangements will improve transparency and facilitate a better understanding of companies' financial position and results. It is assumed that this will contribute to investor confidence in the market being strengthened. How damaging poor investor confidence can be has been well analysed with respect to the two largest American bankruptcies (Enron and WorldCom in July 2002) stemming from corporate mismanagement. It has been estimated that the loss in stock market wealth as a result of these scandals has been at least 9%.[26]

5.4 Corporate Governance Statement by publicly traded companies

Impact: The current proposal will require all publicly traded EU-companies to provide a specific "Corporate Governance Statement" in their annual report. This will require a reference to the corporate governance code the company is required to apply or which it decides to apply and application of the "comply or explain" principle. It will also require the inclusion of the following information:

- risk management and internal control systems (this requirement appears to extend to unlisted companies that prepare group accounts)
- composition and operation of the board and its committees
- operation of the shareholder meeting and its key powers, a description of shareholder rights and how they can be exercised
- certain information on major shareholdings and related matters currently required by the Takeover Directive[27] (agreed by Member States in April 2004).

As drafted, the proposal would require companies to provide additional specific information to the comply or explain declaration in annual reports.

Costs: Much of this information is currently required of listed companies in the UK in their annual reports. If the scope of the requirement cannot be limited to listed companies, other publicly traded companies will also need to comply. For listed companies there is, therefore, unlikely to be any additional costs in terms of collecting the required information. Depending on how the individual company structures its accounts currently, there might be some additional costs in terms of replicating information or moving it from elsewhere. The scope of the requirement for information about risk management and internal control systems is unclear, as is the requirement to provide information about shareholder rights, and could result in additional disclosure requirements which would add costs.

[26] See Graham Carol/ Litan Robert/ Sukhtankar Sandip (2002) The bigger they are, the harder they fall: an estimate of the costs of the crisis in corporate governance. Working paper. Economic studies/ Governance studies programme. Brookings Institutions (2002).

[27] Article 10 (1) (c) (d)(f)(h) and (i) of Directive 2004/25/EC OJL 142/12 of 30 April 2004.

Benefits: An annual corporate governance statement, together with the establishment of a "comply or explain" rule in relation to national corporate governance codes will improve EU standards of corporate governance. Common standards here will also contribute to giving confidence to investors to invest across borders, and make it easier for companies to access capital across borders; investors might be deterred from providing capital by differing or unknown standards. A statement that sets out clearly shareholder rights should help to enable shareholders to participate more fully in the company's affairs.

6. SUBSIDIARITY AND PROPORTIONALITY

The Commission's Explanatory Memorandum states that the proposal does not fall under the exclusive competence of the Community. The objective of the action is to improve public confidence in financial statements. To achieve this, financial statements must be comparable across the EU to benefit integration of capital markets. In ensuring equivalent transparency, and thereby contributing to completion of the internal market, the proposed measures are in line with the subsidiarity principle. The proposal continues the Community's principle based approach to EU-Accounting regulation. This ensures proportionality and leaves flexibility to authorities and economic operators on how to fulfil the objectives while minimising their financial and administrative burden.

7. OPTIONS

7.1 Do Nothing: The Directive will be applicable throughout the EEA and will require implementation once agreed. It is not possible therefore, to take no action.

7.2 Reject the Proposal: The proposal contributes to several of the aims the Government believes important, namely:

- increasing financial stability and market confidence
- extending investment opportunities across the EU
- improving access to capital by companies across borders

We therefore support the thrust and objectives of the proposal.

7.3 Clarifying/Improving the Directive: Aspects of the Directive require clarification and contain risks as identified in Section 4. We will want to clarify issues of scope and definition. We believe that the introduction of the corporate governance statement across the EU is right but will be considering after further engagement with stakeholders whether the requirement for a corporate governance statement could be dealt with more effectively through best practice in the EU Corporate Governance Forum established under the Netherlands Presidency. **DTI would welcome views on this proposal.** In addition, the DTI will seek to keep what is in the statement as minimal as it is currently. There is an option of simplifying the financial statement disclosure element of the Directive given the move by publicly traded companies to IAS in 2005 balanced with the recognition of need for proportionate action at EU level on corporate governance. **Comments are welcomed on preferences for other non-legislative approaches.**

8. WHO WILL BE AFFECTED?

8.1 EU publicly traded companies will have to comply with all aspects of the new proposals. All other companies that are not qualifying small companies will have to comply with the enhanced financial information and collective responsibility aspects. Small companies will only have to comply with the collective responsibility of directors.

8.2 Therefore, the effect of the proposal is that any extra burden to companies is based upon a sliding scale. Publicly traded companies will need to conform to all 4 of the new requirements. Small companies will only be affected by the collective responsibility requirements.

8.3 All business sectors will be affected by the proposal.

9. ISSUES OF EQUITY AND FAIRNESS

9.1 Shareholders, and investors should benefit from the proposals. Companies might have some additional costs as a result of additional disclosure but these could be outweighed by increased investment.

10. CONSULTATION WITH SMALL BUSINESS: THE SMALL FIRMS' IMPACT TEST

10.1 None of the corporate governance statement disclosure requirements will apply to small companies or groups. Therefore, there is unlikely to be a significant impact on small business. Accounting directive requirements may have an unintended consequence on small business who are intending to go for an initial public offering. It is unlikely, however, that this will be a significant deterrent factor as the benefits of a public offering will outweigh the costs.

10.2 Small companies can be exempted from disclosing any off balance sheet arrangements and related party transactions. The ASB's Financial Reporting Standard for Smaller Entities does however require disclosure of RPTs.

10.3 Therefore the sole certain impact on small business will be the collective responsibility requirement by directors to the company.

11. COMPETITION ASSESSMENT

11.1 The competition filter has been applied. It has been concluded that the Directive has a potential impact on all UK companies and all market sectors. It is considered that the Directive will not give rise to disproportionate costs of entry or administrative costs for either small or large business. The Directive is not anticipated to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services.

12. IMPLEMENTING THE DIRECTIVE: When the Directive is finalised and adopted, it will be implemented into GB law, either by primary legislation or by using existing powers in section 257 of the Companies Act or section 2(2) of the European Communities Act 1972. Responsibility for company law matters lies with the Secretary of State for Trade and Industry. Company law is a reserved area under Scottish and Welsh devolution legislation, and therefore any resulting changes to company legislation will also apply in Scotland and Wales. In Northern Ireland, matters arising from the proposal would normally be the responsibility of Northern Ireland Executive Ministers. Whilst the Northern Ireland Assembly and Executive are suspended, these functions will be discharged by the Northern Ireland Departments, subject to the direction and control of the Secretary of State for Northern Ireland.

13. ENFORCEMENT AND SANCTIONS

13.1 The bodies which are currently responsible for monitoring and enforcing sanctions for the different requirements of the proposal are as follows:

- **Disclosure in the accounts and reports and Collective Responsibility**

For criminal sanctions: DTI

Enforcement by way of revision of defective accounts: DTI and the Financial Reporting Review Panel

Civil liability: the courts

- **Corporate Governance statement**

For listed companies: Financial Services Authority / UK Listing Authority (to the extent that the proposal covers other publicly traded companies, the bodies responsible would be DTI and the FRRP as above)

13.2. We believe that these arrangements are adequate to ensure enforcement of, and compliance with, the Directive's provisions and do not envisage making changes.

14. CONSULTATION

14.1 Within government

DTI has discussed the draft Directive with HM Treasury.

14.2 Regulators and Public Bodies

DTI has consulted the Financial Services Authority and the Financial Reporting Council.

14.3 Public consultation

Prior to the proposal, DTI consulted informally with a range of stakeholders during the Commission's pre-proposal web-based consultation (April to June 2004).

The views of key stakeholders on the three elements of the Directive are as follows:

(a) **Corporate governance statement.** Most stakeholders believe that there is a case for all listed EU companies being required to produce an annual statement containing key corporate governance information based on the comply or explain principle. Their view is that this will give investors across the EU the same basic information about the companies in which they are investing. Other respondents have been more negative, believing, with some force, that this should be left to national Codes. The DTI will endeavour to keep the statement to a minimum.

(b) **Financial statement transparency.** The concern expressed by all stakeholders on the group transparency proposals was that they would add an extra layer of financial reporting on top of International Accounting Standards. Some requirements covered by IAS would also be extended to large and medium unlisted companies. Confidence in the financial statements is linked to who has responsibility for drawing up and publishing them.

(c) **Collective responsibility.** Stakeholders agree that directors should be collectively responsible for the financial and key non-financial statements to the company and believe this to be the position in the UK.

14.4 The DTI has established a small working group of stakeholders to advise on negotiating objectives and to offer an expert view throughout Council negotiations.

14.5. A formal public consultation exercise on the proposed Directive is being carried out in spring 2005.

15. SUMMARY AND RECOMMENDATIONS

15.1 The DTI is committed to working closely with UK stakeholders and the Commission to ensure that each element of the proposal brings economic benefits that justify legislation.

15.2 The DTI will endeavour to ensure that the final proposal offers business options for flexibility that keep extra bureaucracy to an absolute minimum.

This assessment estimates the costs and benefits of the European Commission proposal for a Directive concerning amending the Accounting Directives (document reference number 14119/04, COM (04) 725).

Jacqui Smith
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DEPARTMENT OF TRADE AND INDUSTRY

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Annex B

PROPOSED DIRECTIVE TO AMEND SECOND COMPANY LAW DIRECTIVE

Partial Regulatory Impact Assessment

1. PROPOSAL

1.1 On 29 October 2004 the European Commission published its proposal for a Directive of the European Parliament and of the Council amending Council Directive 77/91/EEC, as regards the **formation of public limited liability companies and the maintenance and alteration of their capital**. This will amend the Second Company Law Directive agreed in 1976. The proposal will now be discussed in Council Working Groups and in the European Parliament.

1.2 The full text of the proposal can be found at: http://europa.eu.int/comm/internal_market/company/capital/index_en.htm

1.3 The proposal arises in the context of wider EU company law reform as outlined in the EU Company Law and Corporate Governance Action Plan of May 2003[28]. The measures contained in the proposal were identified as short-term priorities in the Action Plan.

2. OBJECTIVE OF THE PROPOSAL

2.1 The current proposal is described by the Commission as "moderately deregulatory".[29] It seeks to amend the Second Directive so that it is easier, in terms of time and cost, for public limited companies in the EU to take certain measures affecting the size, structure and ownership of their capital. The Commission anticipates that these changes will allow companies to react more promptly to developments in the market thus promoting their efficiency and competitiveness. The proposal contains safeguards to ensure that the changes do not reduce the protection offered to shareholders and creditors under the current regime.

[28] Available at http://europa.eu.int/cgi-bin/eur-lex/udl.pl?REQUEST=Service-Search&LANGUAGE=en&GUILANGUAGE=en&SERVICE=all&COLLECTION=com&DOCID=503PC0284

[29] Preliminary Impact Assessment Statement, Annex 1 of the Proposal for a Directive amending Council Directive 77/91/EEC, as regards the formation of public limited liability companies, 29 October 2004

2.2 The specific simplifications and changes to the capital maintenance regime contained in the proposals are a mixture of provisions that have to be transposed into national legislation on a compulsory basis and a number of optional modifications, and are as follows:

a) Relaxation of requirements concerning valuation of non-cash consideration for the allotment of shares

Applicable to: All public limited companies

b) Relaxation of requirements concerning acquisition by a company of its own shares

Applicable to: All public limited companies

c) Relaxation of prohibition on financial assistance

Applicable to: All public limited companies

d) Relaxation of procedures governing waiver of pre-emption rights

Applicable to: All publicly traded companies[30]

e) Enhancing standardisation in all Member States of creditor protection in reductions of capital

Applicable to: All public limited companies

f) Squeeze-out and sell-out rights

Applicable to: All publicly traded companies[31]

[30] Companies whose securities are admitted to trading on a regulated market within the meaning of Article 4(1)(14) of Directive 2004/39/EC.

[31] Companies whose securities are admitted to trading on a regulated market within the meaning of Article 4(1)(14) of Directive 2004/39/EC.

3. BACKGROUND TO THE PROPOSAL

3.1 The EU Action Plan published in May 2003 set out the Commission's intention to come forward with an amending directive to streamline companies' capital maintenance requirements. This was part of a broader programme of company law reform. The Commission also indicated in its Action Plan that it proposed to carry out a study into the feasibility of more radical reform in this area, possibly allowing for a solvency based approach to creditor protection. The tender for this study is due to be launched in 2005 and the work should begin in late 2005/early 2006.

4. ASSESSMENT OF RISK

4.1 The Commission has brought forward this proposal to improve the ability of companies to react quickly to market developments which might require changes in share ownership. It is one of a number of actions in the Commission's "Better Regulation" initiative of June 2002 which seeks to improve the regulatory environment in which businesses operate to enhance competitiveness (one of the goals of the Lisbon Strategy).

4.2 The Government supports the objective behind the proposal but believes that the modest changes contained in the proposal are unlikely to make a radical difference to the way companies operate when wanting or needing to re-structure their capital. The proposed changes still contain administrative hurdles for a company to overcome and the relaxation of some of the provisions, although welcome, could bring a degree of uncertainty in terms of interpretation. The Government hopes that the study to be carried out by the Commission in 2005/2006 will lead to more deregulatory reform.

4.3 Member States might, in the course of negotiating the current proposals, seek to introduce additional changes to the existing capital maintenance regime which would not necessarily be significantly more deregulatory but which might delay adoption of the proposal.

5. HOW THE PROPOSAL WILL WORK, THEIR COSTS AND BENEFITS

5.1 Relaxation of requirements concerning valuation of non-cash considerations for the allotment of shares

Impact: if a company wishes to issue shares for a non-cash consideration e.g. for assets, there will no longer be a requirement, under certain circumstances, for it to obtain a valuation by one or more independent experts.

Costs: this measure should reduce costs in clear-cut situations by removing the need for a new valuation. For uncertain situations, professional advice could be needed to determine whether the need for a valuation can be dispensed with e.g. when trying to define "exceptional circumstances" under which revaluations might be needed, potentially adding to overall costs. In any event, a minority of shareholders (holding not less than 5% of the issued share capital) may require a revaluation and if such shareholders exercise such rights, this could delay the timing of the new issue of shares.

Benefits: for clear-cut cases, allotments of shares for non-cash consideration will be easier and cheaper.

5.2 Relaxation of requirements concerning acquisition of its own shares by a company

Impact: currently, a company wishing to purchase its own shares must be authorised by its shareholders and the duration of that authority may not exceed 18 months. The proposal is to extend that period to 5 years. In addition, where Member States have opted to permit companies to hold their own shares in treasury following a repurchase, rather than cancelling the same, currently such holding is subject to a limit of 10% of issued share capital.[32] The proposal is to replace this with a limit up to the amount of the company's distributable reserves. Under the Companies Act 1985, the right to hold up to 10% of issued share capital in treasury is limited to listed and AIM companies[33]. Any other company which buys back its own shares must cancel the same. We are seeking to clarify with the Commission whether such provisions would constitute "conditions"and therefore be prohibited under new Article 19(1).

Costs: there should be time and cost savings if a company does not have to go back to shareholders for agreement within a five-year period.

Benefits: the company will be able to purchase a greater number of its shares if it wishes (assuming the application of the Member State option to introduce a distributable reserves limit) and thereby take even greater advantage of the flexibility offered by treasury shares.

[32] The right of certain companies to hold their shares in treasury following a repurchase was implemented by the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 SI2003/1116 as from 1 December 2003. Such shares may be subsequently sold by the company for cash, transferred to an employee's share scheme or cancelled.

[33] Section 162(4) and section 162A.

5.3 Relaxing Prohibition on Financial Assistance

Impact: providing financial assistance to a third party for the acquisition of a company's own shares is prohibited under the current regulatory framework. The proposed Directive is relaxing this prohibition: if a company wishes to grant financial assistance to a third party for the acquisition of its own shares it may do so up to the limit of its distributable reserves. However, the assistance may only be given in certain circumstances and provided the company follows specific procedures.

Costs: the conditions subject to which such financial assistance may be given are onerous and complex and it is anticipated that if a company were to consider giving such assistance it would be likely to incur professional fees in the process of satisfying such conditions. These burdensome conditions, however, would only apply to those companies voluntarily choosing to take advantage of this option.

Benefits: the benefit to companies of permitting the granting of financial assistance for the acquisition of their shares up to the limit of the company's distributable reserves appears to be outweighed by the onerous conditions with which companies will need to comply.

5.4 Relaxing Procedures governing waiving of pre-emption rights

Impact: if a publicly traded[34] company wishes to issue new shares disapplying the operation of the pre-emption requirements (new shares to be offered first to existing shareholders in proportion to their existing share holding) when seeking shareholder approval, there will no longer be a requirement for the board to submit a written report to shareholders[35] where the shares are to be issued at the relevant market price. However, the shareholders may still request a report. Because of the institutional investors' concerns about disapplying pre-emption rights, plus the added emphasis (following Paul Myners' report) on engagement between shareholders and directors whenever pre-emption rights are to be disapplied, it seems highly likely that some sort of written report will still be requested by shareholders before they are prepared to give the authority for a disapplication in all but routine cases. Additionally, the provision that removes the requirement for a written report only applies when shares are to be offered at market price. This will not always be the case – the Investor Protection Guidelines suggest that up to 5% discount to market price will normally be acceptable to institutional investors.

[34] Companies whose shares are traded on a regulated market as defined in Article 4(1)(14) of Directive 2004/39/EC.

[35] The wording in the current proposal appears to be inconsistent with the original 2nd Directive. We think there may be a drafting error.

Costs: in those cases where a report will no longer be required costs could be saved in terms of staff time. The production of a report for a general meeting whenever the disapplication of pre-emption rights is requested, however, is only one small part of the process required by law and by the Listing Rules (for carrying out a non-pre-emptive rights issue). Nonetheless there should be a small saving for companies as a result of this measure in cases where a report is no longer required – it is one less bit of paper to prepare.

Benefits: the paperwork involved in getting approval for issuing new shares on a non pre-emptive basis should be reduced in some cases. However, since the report is only one small part of the process required by law and by the Listing Rules (for carrying out a non-pre-emptive rights issue) there would only be a limited benefit and only in cases where shareholders do not request a report.

5.5 Enhancing standardisation of creditor protection in reductions of capital in all Member States

Impact: the circumstances in which creditors will be able to apply to court to object to a reduction of capital will be limited to where they can demonstrate that the reduction will prejudice the satisfaction of their claims and the company has provided no adequate safeguards.

Costs: currently, creditors have the right to object to a reduction in capital and to either demand security for their claims or to have their claim settled notwithstanding that the reduction will have no impact on the company's ability to satisfy such claims. Consequently, companies routinely provide undertakings to secure the consent of creditors (frequently in the form of bank guarantees to cover the amount owing to non-consenting creditors) or will pay them off. The proposal establishes that a creditor must now demonstrate that the reduction will adversely impact on the satisfaction of his claim before he is entitled to object. It is envisaged that this will enable companies to reduce their capital without routinely incurring the cost of providing such undertakings or settling debts before they have matured.

Benefits: the introduction of a harmonized legal procedure for creditors under certain circumstances across the EU is to be welcomed. It will remove the right of veto which creditors currently can wield in relation to capital reductions where there is no economic reason for such veto.

5.6 Squeeze-out and sell-out rights

Impact: these rights are intended to address the problems of, and for, residual minority shareholders in a company. Essentially, rights are conferred on significant majority shareholders (holding 90% of the share capital) to compulsorily purchase the shares of the remaining minority ("squeeze-out rights") and parallel rights ("sell-out rights") are provided to minority shareholders to require the majority shareholder to purchase their shares. This concept will be new to the Second Directive. However, the Takeovers Directive agreed in April 2004 for implementation by Member States in May 2006 already lays down an EU squeeze-out and sell-out rule – but only following a successful takeover. The new proposal would apply to all companies traded on a regulated market in situations where the majority ownership threshold had been passed even other than as a consequence of a successful takeover[36]. Member States can opt to raise this 90% threshold to 95%.

Costs: So far as corporate entities (companies) are concerned this facility could result in cost savings as a result of reduced shareholder structures.

Benefits: Squeeze-out and sell-out rights, addressing difficulties and costs associated with small minority shareholders, will be more widely available than at present and not just following a takeover.

6. SUBSIDIARITY AND PROPORTIONALITY

6.1. The Commission explanatory memorandum states that action at the EU level is necessary as provisions governing the ability of public limited liability companies to modify their capital are set out in Community law through the Second Directive. Any proposals to simplify the process for the affected companies therefore require Community action.

7. OPTIONS

7.1 Do Nothing: The Directive will be applicable throughout the EEA and will require implementation once agreed. It is therefore not possible to take no action.

7.2 Reject the proposal: The majority of the provisions in the proposal constitute a relaxation of the current requirements in the Second Directive, do not appear to add any new burdens to business in the UK and do introduce more flexibility into the existing system, albeit moderate. There would only be merit in trying to persuade the Commission not to move ahead with it if there were a majority of Member States in agreement with us and this is not the case.

[36] Companies whose shares are traded on a regulated market as defined in Article 4(1)(14) of Directive 2004/39/EC.

7.3 Clarifying/Improving the Directive: The proposal to introduce compulsory general squeeze-out and sell-out rights is not a deregulatory measure. There are also potential negative impacts which need careful consideration. We are challenging inclusion of this provision in this Directive. Clarification is required in terms of:

- whether the conditions Member States may impose on buy-back of shares constitutes an exhaustive list
- the scope of the provision relating to squeeze-outs and sell-outs and pre-emption rights (listed or publicly traded)
- following exploration with stakeholders, the necessity for the conditions attached to the circumstances in which financial assistance for a purchase of own shares may be given
- basis on which a fair price in relation to squeeze-out rights and sell-out rights can be arrived at.

8. WHO WILL BE AFFECTED?

8.1 Public limited liability companies across the EU will be able to take advantage of the new proposals regarding valuation of shares for non-cash consideration, purchase of own shares and financial assistance and will be affected by any changes to the creditor protection arrangements relating to restrictions of capital. There are 11,700 public companies in the UK as at 31 March 2004.[37]

8.2. Publicly traded companies with a shareholder owning 90% (or 95% if this upper limit is chosen in the UK) will be subject to the new provisions for squeeze-outs and sell-outs where the majority shareholder will be able to buy the shares of the minority shareholder at a fair price and the minority shareholder will be able to require the majority shareholder to acquire his shares.

8.3. Publicly traded companies will be able to take advantage of the proposal relating to pre-emption rights.

9. ISSUES OF EQUITY AND FAIRNESS

9.1 Companies should be able to benefit from the relaxations introduced by the proposal whilst the interests of shareholders and creditors appear to have been safeguarded.

[37] Companies House, Companies in 2003/04, July 2004.

10. CONSULTATION WITH SMALL BUSINESS: THE SMALL FIRMS' IMPACT TEST

10.1 There are around 2,000 small firms that are public companies (requiring a share capital of £50,000) who will be able to take advantage of the proposals. Initial soundings with trade associations have shown that while the objective behind the proposals is welcomed, there is a belief that there may be scope in this area for further deregulatory measures in the future. We will now be actively seeking the views of other trade associations, in particular those who only represent small firms, during the formal consultation to ensure that the full impact, together with any unintended consequences on small business are identified. We have consulted with the Small Business Service who are content with this approach.

11. COMPETITION ASSESSMENT

11.1 Initial assessment has concluded that the Directive will not affect competition, either positively or negatively. It will apply to all UK public companies in all market sectors (save where it is limited to publicly traded companies) and will not give rise to disproportionate costs of entry or administrative costs for either small or large businesses. The Directive is not anticipated to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services.

12. IMPLEMENTING THE DIRECTIVE

12.1 Depending on the progress of the negotiations it may be possible to use the Company Law Reform Bill to implement in Great Britain the changes required by this proposal. The alternatives will be either to use powers in the Bill itself or the regulations under section 2(2) of the European Communities Act 1972. Parallel changes will be required for Northern Ireland Act 1972. The Secretary of State for Trade and Industry has primary responsibility for the proposal which will require amendment of company legislation. Company law is a reserved area under Scottish and Welsh devolution legislation, and therefore any resulting changes to company legislation will also apply in Scotland and Wales. In Northern Ireland, matters arising from this proposal would normally be the responsibility of Northern Ireland Executive Ministers. Whilst the Northern Ireland Assembly and Executive are suspended, these functions will be discharged by Northern Ireland Departments subject to the direction and control of the Secretary of State for Northern Ireland.

13. ENFORCEMENT AND SANCTIONS

13.1 DTI is currently responsible for monitoring and enforcing sanctions for the provisions governing capital maintenance. This responsibility will not be affected by this proposal.

14. CONSULTATION

14.1 Within Government

DTI is keeping HM Treasury informed about the proposals.

14.2 Public Consultation

Prior to the formal proposal, DTI took soundings from key stakeholders on the likely direction of the changes and took these into account when discussing the Commission's plans at Company Law Experts Groups in 2003 and 2004. Stakeholders are in agreement that they would like to see the Commission move ahead with its study into more radical reform. A concern expressed by a number of stakeholders has been the potential impact of International Accounting Standards (IAS) (or UK accounting standards based on IAS) on the amount available to companies for distribution to shareholders.

Stakeholders have also already expressed views on pre-emption rights as part of a study carried out by Paul Myners to examine whether the application of pre-emption rights when new shares are issued may hinder certain public companies from raising finance flexibly for innovation and growth (see section 5.4). A formal consultation on the proposal is being carried out in spring 2005.

15. SUMMARY AND RECOMMENDATIONS

15.1 The DTI is committed to working closely with UK stakeholders and the Commission to ensure that the proposal has as substantial a deregulatory impact as possible whilst looking ahead to securing more radical long-term benefits through the proposed Commission study.

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Annex C

ANTICIPATED EUROPEAN DIRECTIVE PROPOSAL TRANSFER OF REGISTERED OFFICE OF COMPANY

Partial Regulatory Impact Assessment

1. THE PROPOSAL

1.1 At present, the Commission is considering a draft proposal for a Directive of the European Parliament and of the Council concerning the cross-border transfer of a company's registered office.

1.2 This Proposal arises in the context of wider EU company law reform as outlined in the EU Company Law and Corporate Governance Action Plan of May 2003[38]. The introduction of a framework for cross-border transfer of a company's registered office was considered as short-term priority in the Action Plan implying that action should be undertaken before end 2005.

1.3 No formal proposal has yet been made. The Commission, however, has consulted on the issue in March 2004 outlining its proposed approach. Accordingly, the content of this RIA is based on the content of the Commission's consultation document and when referring to "the proposal" this RIA basically refers to the approach set out in the Commission's consultation document.

2. OBJECTIVES OF THE PROPOSAL

2.1 This assessment estimates the costs and benefits of the European Commission proposal for a Directive concerning the transfer of a company's registered office from one Member State to another.

2.2 The proposal seeks to establish a coherent legal framework for the cross-border transfer, by way of freedom of establishment, of the registered office of a limited company already formed under the law of a Member State. The proposal also seeks to address the issue of employee participation rights where they exist in the transferring company or under the law of the Member State to which the company is to transfer. The proposal furthermore envisages permitting special protection of the rights of shareholders and creditors.

[38] Available at http://europa.eu.int/eur-lex/en/com/cnc/2003/com2003_0284en01.pdf

2.3 A cross-border transfer of registered office refers to the move by a company of its registration from the Home Member State to the Host Member State. Home Member State means the Member State in which the company that plans to transfer is situated. Host Member State refers to the Member State in which the company wishes to relocate.

2.4 This transfer would include a change in the law applicable to the company effective as from its registration in the Host Member State. This transfer would not, however, give rise to the winding up of the company in the Home Member State or the incorporation of a new legal person in the Host Member State.

2.5 The Commission intends to limit its intervention to a framework Directive governing the transfer of registered office. Measures concerning the transfer of the head office of a company, however, are not envisaged being undertaken. This is because the Commission considers that the most common circumstances in which a company may wish to transfer its head office can already be resolved in favour of freedom of establishment by reference to existing case law of the European Court of Justice.

2.6 The Directive permitting the transfer of a company's registered office would introduce a framework for cross-border transfer of a company's registered office that did not exist before. Currently, a company can migrate (move from one State to another) from the UK to another country in a number of different ways including a private Act of Parliament, by forming a company overseas to make a takeover offer for the emigrant, by a reconstruction (typically involving the formation of a foreign holding company that acquires the share capital of the British company), or by putting the company into voluntary liquidation.

2.7 Presently, the only type of company for which there is a fully comprehensive framework to transfer its registered office from one Member State to another is the Societas Europaea (SE) governed by the European Company Statute Regulation (ECS) that took effect in October 2004.

2.8 The proposed Directive would seek to extend this possibility of cross-border transfer without the need for a company to be wound up and re-incorporated to types of companies other than SE. It is intended that the proposal would apply broadly to limited companies incorporated within the EU. With respect to the UK this would include all public and private limited companies. Currently, there are about 1.3 million such companies.

2.9 Overall, the Commission believes that the adoption of a proposal for a Directive on transfer of registered office could have the following two advantages for a company:

a. "To be able to adapt its location both to market changes and to changes in its position in those markets"[39]

b. "To be relieved of the obligation, when carrying out such adaptation, to go through liquidation proceedings"[40].

2.10 Since there currently does not exist a coherent legal framework for the transfer of a company's registered office without the need for a company to be wound-up and re-incorporated there is little quantitative data available analysing this process of moving registered office (e.g. the Insolvency Service does not identify voluntary closures for the purpose of re-starting in another EU member state). Accordingly, this Regulatory Impact Assessment mainly relies on qualitative analysis.

3. BACKGROUND

3.1 The EU Action Plan on modernising company law and enhancing corporate governance of 21 May 2003 contained the Commission's intention to come forward with legislative measures facilitating the transfer of a company's registered office from one Member State to another. These were intended to be part of a broader programme of company law reform.

3.2 Prior to this the Commission carried out two public consultations in 1997 and 2002 that, according to the Commission, "highlighted a pressing need on the part of market operators for legislation at EU level allowing companies to transfer their registered office (…) without first having to be wound up"[41].

3.3 A High Level Group of Company Law Experts appointed by the Commission to look into wide ranging issues of company law recommended in its final report of 4 November 2002[42] that the Commission should consider adopting a proposal for a Directive on the transfer of a company's registered office.

[39] Press Release IP/04/270.

[40] Press Release IP/04/270.

[41] IP/04/270.

[42] IP/02/1600.

3.4 At the same time, the independent Company Law Review sponsored by the Department of Trade and Industry also considered the possibility of having a legal framework that would enable British companies to migrate. Based on the findings of this consultation the Review recommended in its final report that there should be a legal framework that permits companies to migrate:

- to any EU or European Economic Area (EEA) jurisdiction and to any non-EU or non-EEA jurisdiction individually approved for the purpose by the Secretary of State;
- from any overseas jurisdiction; and
- between England and Wales and Scotland.[43]

4. EFFECTS OF THE MEASURE

4.1 The main purpose of the Directive is to introduce a legal framework for the transfer of a company's registered office covering all limited companies. The Commission proposes that companies be defined to include "the fact that they have legal personality and separate assets that alone serve to cover their debts, provided that national legislation requires safeguards"[44] such as those laid down by the First Company Law Directive (e.g. registration and filing of documents). Transfer of registered office, however, would remain a voluntary activity. Thus, only those companies that actually chose to transfer their registered office would have to comply with the procedures set out in the Directive.

4.2 Rules would be included governing specific elements of cross-border transfer such as the role of the general meeting as well as the roles of Host Member State and Home Member State. The general meeting would have to decide, in accordance with the formalities and procedures for altering the memorandum and articles of association, on the cross-border transfer of a company's registered office. The general meeting's decision to transfer its registered office should be publicised appropriately in advance. The Home Member State would be expected to supervise the validity of the decision taken by the general meeting whereas the Host Member State would be expected to supervise the substantive, formal and national procedural requirements for the company to be given legal personality under its law and to be registered. The transfer would take effect once the company had completed registration procedures in the Host Member State and had acquired

[43] Company Law Reform. Modern Company Law. For a Competitive Economy. Final Report. Volume 1, p. 301.

[44] The Commission's Consultation Document relating to the planned proposal can be found on the Commission's website: http://www.europa.eu.int/comm/internal_market/company/seat-transfer/2004-consult_en.htm#frame.

legal personality there. To be able to register the company would have to ensure it had transformed itself into a form of company recognised by the Host Member State. Home Member States could take specific measures to ensure special protection of minority shareholders and creditors.

Employee participation (ie “employees on the board”) would be governed by the legislation of the Host Member State. However, where employee participation is ”more firmly enshrined” in the Home Member State, such participation rights should be maintained or re-negotiated. The Home Member State could implement its own rules governing these negotiations where it considers this to be necessary. It should be noted, however, that companies migrating under current regulation also have to meet the employee participation requirements of the Host Member State.

5. RISK ASSESSMENT

5.1 Currently, there is no coordinated European legislation governing transfer of a company’s registered office from one Member State to another. Member States’ laws take a variety of approaches on this issue. In Great Britain, such a transfer is normally done by means of a private Act of Parliament. This inhibits companies from adapting their location both to changes in the markets and changes in their position in those markets. The Directive would provide a new legal framework for enabling cross-border transfer of registered office. This could lead to a more efficient allocation of commercial activity.

6. OPTIONS

6.1 **Do nothing**: It would be possible to do nothing. But taking no action would result in no framework for transfer of a registered office being agreed upon at EU level. This would mean that the freedom of companies to move within the EU would remain restricted.

6.2 **Informal co-ordination**: Informal co-ordination could introduce rules governing the cross-border transfer of a company’s registered office by means of bilateral or multilateral agreements with other Member States. This would not impose any costs on companies since transfer of registered office would remain an option for companies but not an obligation. However, informal co-ordination could result firstly, in a rather slow and complex way of decision-making and secondly, in different sets of rules applying to transfers into and from different Member States. Accordingly, informal co-ordination would be anything but a predictable route towards putting in place a workable framework for transfer of a company’s registered office. At the same time informal co-ordination might only provide legal certainty in some cases (i.e. transfer from UK to France and vice versa). It is unlikely, however, that a coherent legal framework providing legal certainty for all transfers within the EU would be agreed upon.

6.3 European legislative instrument: A European legislative instrument would not impose any costs on companies since transfer of registered office would remain an option for companies but not an obligation. At the same time there would be no need for additional informal co-ordination since there would be a legal framework in place providing legal certainty for all transfers of registered office within the EU.

7. BENEFITS

7.1 Since the transfer of registered office would be voluntary only those companies would transfer their office that expect real commercial benefits. However, even though the reasons would differ between companies there are two main areas where benefits could be generated from a transfer of registered office:

a. The legal framework in the Host Member State may be more favourable to a company than the framework in the Home Member State.

b. A company whose main trading activity takes place in a Member State that is not its Home Member State may consider it as positively contributing to its image and client base to be also registered in that Member State.

7.2 Currently, there is no EU regulatory framework governing cross border transfer of a company's registered office without the need for a company to be wound-up and re-incorporated. It is therefore assumed that the principal benefits likely to arise from the Directive would be through encouraging cross border migration activity.

7.3 Thus overall, the proposal may contribute to a more efficient allocation of business activity by making the transfer of a company's registered office easier.

7.4 The likely take up of the transfer of registered office activity by UK companies is not known at this point. Since currently there is no framework in place governing cross-border transfer of registered office without the need for a company to be wound up, it is difficult to estimate the likely number of companies that would transfer their registered office to another Member State.

8. EQUITY AND FAIRNESS

8.1 The transfer of registered office Directive would be voluntary and only those companies which perceive that there was an advantage to them would consider transferring their office across borders.

8.2 It is recognized that a consequence of introducing the Directive might be an alteration in the current pattern of migration. Companies, for example, may no longer choose to liquidate in one Member State and incorporate in another. However, in appropriate cases, the simple transfer of a registered office is expected to be far less costly than transfer via the means currently available to companies and it is assumed that any company that would decide to transfer its registered office would do so as they anticipate real commercial benefit.

8.3 Special measures could ensure that creditors and minority shareholders are protected appropriately. A creditor's ability to bring any claim against the company resulting from action arising prior to the transfer should not be frustrated as a result of the transfer. At the same time, minority shareholders holding insufficient voting rights to oppose a potential transfer could have the possibility to withdraw if a transfer had been agreed upon by the general meeting.

9. COSTS

9.1 It is too early to identify detailed financial implications since final publication of the Commission proposal is pending. The key issues concern the scope of the Directive (the types of company to which it should apply) and employee participation. As the directive would be voluntary, no company would be obliged to use the procedure provided by it and consequently there would be no mandatory costs imposed on business.

9.2 In the event that a company chose voluntarily to adopt the cross border transfer procedure, the resulting anticipated benefits such as being governed by a more favourable legal framework and enhanced competitiveness due to being registered in the country where the company's main commercial activity is taking place should outweigh the costs involved. These expected costs, however, would include legal costs, administrative costs, costs of creditor and shareholder protection, and in some cases costs of implementing a new or different system of employee participation. It should be emphasized, however, that the proposed measure would not add any regulatory costs to those currently occurring when a company transfers its registered office across borders. On the contrary, it is assumed that the overall costs – compared to the status quo – would be reduced.

Legal costs and administration costs

9.3 There appear to be three stages in deciding to proceed with a transfer of registered office. Firstly, a senior employee would decide whether a transfer of registered office would be a viable option. The company board would then consider the options and draw up draft transfer terms. Thirdly, the general meeting would have to approve the decision to transfer the company's registered office in accordance with the arrangements laid down. Legal advice would probably be sought throughout this process but particularly in stages one and two.

9.4 Any attempt to cost the above exercise is fraught with difficulties. However, in respect of the first stage, the cost of a manager spending two days (sixteen hours) considering whether there was a case for transferring the registered office is estimated to be around £400[45]. In respect of the second stage, a company board of 12 members considering the issue for two hours would represent a further 24 hours of costs with an estimated total cost of £600[46]. Trying to assess legal costs is even more difficult since they would clearly vary on a case-by-case basis. However, the cost of a solicitor spending one day (eight hours) considering transfer terms and conditions is estimated to be £2,400[47]. If a transfer of registered office resulted in greater flexibility or benefits, in single market terms, it is likely that the procedure would be adopted.

9.5 There may also be costs involved in completing the registration procedure in the Host Member State. These again are very difficult to estimate since they would clearly differ on a case-by-case basis depending for example on the degree of adaptation necessary for the company to transform itself into a form of company recognised by the Host Member State.

9.6 It should be noted, however, that administrative and legal costs currently arise when moving. Since the main purpose of the Directive is to simplify the transfer procedures it is not assumed that it would add any administrative or legal costs compared to the status quo. On the contrary, legal and administrative costs are likely to be smaller.

[45] In 2002, the average hourly pay, excluding overtime, of a manager in Great Britain was £17.93. The cost of a manager's time, including non-wage costs and overheads is estimated at 30% of wage costs. The hourly cost of a manager's time is, therefore, £17.93 x 1.3 = £23.31. Source: New Earnings Survey (NES) 2002.

[46] The same figures as denoted in footnote 4 above have been used in estimating the costs of members of the board.

[47] This is based on a very rough estimate of hourly fees of £300 (excluding VAT).

Shareholder protection:

9.7 Costs may also arise to protect minority shareholders. Since the transfer has to be approved by the majority required to amend the memorandum and articles of association under the legislation of the Home Member State, minority shareholders may oppose the transfer but have insufficient voting rights to prevent the transfer from taking place.

9.8 The proposal would allow Home Member States to take specific measures to ensure appropriate protection of minority shareholders. In general, shareholder protection would probably be governed by similar rules as set out in the ECS (including requirement for reports to be drawn up by the management of the company explaining the consequences for shareholders, creditors and employees; such reports must be made available to shareholders).

Creditor protection:

9.9 The proposal would allow Home Member States to take specific measures to ensure appropriate protection of creditors. In general, creditor protection would probably be governed by similar rules as set out in the ECS (e.g. as for shareholder protection, management reports must be made available).

Employee participation[48]:

9.10 There may be some costs involved with the employee participation aspects of the Directive. In its consultation document in spring 2004, the Commission suggested that employee participation rights under the Directive on the transfer of the registered office of a company should be governed by the legislation in the Host State (ie the State to which the company will transfer). However, where employee participation rights are "more firmly enshrined" in the Home Member State, they should be maintained upon transfer or be negotiated with representatives of the employees. It should be noted, however, that companies migrating under current regulation also have to meet the employee participation requirements of the Host Member State.

48 Employee participation is a system that exists in some Member States (such as Germany, Austria, Netherlands and Sweden) which gives employees the statutory right to involvement at Board level. GB does not have such a mandatory system. In Article 2(k) of the European Company Statute, 'participation' (of employees) is defined as the influence of the body representative of the employees and/ or the employees' representatives in the affairs of a company by way of:

i. The right to elect or appoint some members of the company's supervisory or administrative organ, or

ii. The right to recommend and/ or oppose the appointment of some or all of the members of the company's supervisory or administrative organ.

Part (i.) of the definition intends to cover employee participation systems like those found in Germany, Sweden and Austria, while part (ii.) intends to cover the type of participation rights existing in the Netherlands.

9.11 There are a variety of approaches amongst Member States to employee participation issues. Some Member States in general terms have no mandatory employee participation provisions (such as Italy, Spain, Ireland and UK) whereas others only require that larger companies have participation arrangements or limit application of such provisions to certain types of company and/or have a minimum employee threshold (for instance, Poland, Germany, Sweden and Denmark).

9.12 The Commission's proposed approach means that employee participation would only apply to companies choosing to register in a Member State whose domestic law requires participation, or where a company wishing to re-register already has participation. It is, therefore, assumed that the costs associated with the employee participation provisions would only apply in some transfers under the Directive as, in many cases, there would be no participation arrangements in the Host Member State or, even though the Host Member State had participation arrangements, they would only apply to larger companies and hence the participation provisions would not be triggered.

9.13 Cost issues on employee participation aspects were dealt with in relation to the ECS and the accompanying Directive on employee involvement. The details set out below are assisted by insight gained from previous calculations based on provisions governed by ECS. Further information can be found in the Regulatory Impact Assessment contained in the European Company Statute consultation document published in October 2003 by the Department of Trade and Industry ("Implementation of the European Company Statute: The European Public Limited-Liability Company Regulations"). The consultation document is available at the DTI website: http://www2.dti.gov.uk/cld/condocs.htm.

9.14 Costs associated with the ECS Directive mainly stem from the election or appointment of a Special Negotiating Body (to negotiate participation arrangements) and costs associated with setting up meetings with the negotiating body. However, based on the Commission's proposed approach in this Directive, it seems likely that any UK company choosing to transfer its registered office would almost always become subject to the Host State's law on participation. The requirement to negotiate would not apply, and therefore there should be no costs associated with this aspect of the legislation.

9.15 Thus, any additional costs are likely to arise only when implementing requirements regarding employee participation at board level, upon transferring to a Member State with mandatory participation. Based on calculations used in implementing the Employee Involvement Directive accompanying the ECS, annual costs of setting up participation arrangements for a company with 25,000 employees are roughly estimated to be £15,000 (assuming 2 new representatives attend board meetings). There might be further costs to companies if a complaint is made to the Central Arbitration Committee or an Employment Tribunal as to the operation of these provisions.

9.16 It is sometimes argued that worker participation on boards can slow down decision-making and hence reduce companies' competitive edge. However, evidence from Japanese companies with works councils in Germany does not show this to be the case.[49]

9.17 It must be stressed that the employee participation provisions would only apply where the Host Member State required the company to implement new employee participation arrangements or change existing arrangements.

Enforcement costs:

9.18 Enforcement of existing legislation dealing with company law and employee participation (such as European Works Councils) is the responsibility of the Department of Trade and Industry. There would also need to be enforcement of the procedure and review and confirmation of the legality of a transfer of registered office.

10. WHO WILL BE AFFECTED?

10.1 Since the Directive would be voluntary only those companies which perceive that there was an advantage to them would consider transferring their registered office across borders.

10.2 The Directive could apply to all limited companies (public and private). Currently, there are 1.3 million limited companies in the UK. Since a similar framework does not exist, it is difficult, however, to estimate how many companies would transfer their registered office within the framework provided by this Directive.

10.3 The Directive would apply to all business sectors.

[49] Source: S. Nakano "Management Views of European Works Councils: A Preliminary Survey of Japanese Multinationals" 1999 European Journal of Industrial Relations Volume 5 Number 3 pages 307-326.

11. MONITORING AND REVIEW

11.1 The Department has consulted on the implementation of the ECS, which came into force on 8 October 2004, and allowing for SEs to transfer their registered office. Additionally, the independent Company Law Review sponsored by the Department of Trade and Industry reported in 2001 and concluded that there was a need to provide a legal framework for company migration. The recommendations are still under consideration as part of the Department's wider consideration of company law reform.

12. SMALL FIRMS' IMPACT TEST

12.1 The key point is that transfer of registered office would be voluntary and no costs would be imposed on small firms unless they opt to use the transfer procedure provided by the Directive. As part of stage one of the small firms impact test, we have carried out initial soundings with a number of trade associations representing small firms. We have been unable to identify any negative or disproportionate impacts on small firms and as a result do not intend to carry out stage two of the test. The DTI intends to consult with small business on the likely uptake of the Directive and should any negative impacts on small firms be identified stage two of the impact test will be carried out and these impacts fully examined. DTI small business services have been consulted and they are content to proceed with the consultation on this basis.

12.2 Although estimating costs for a small business planning to transfer is difficult, in deciding whether or not to proceed with a cross-border transfer transaction, we have estimated that the likely legal costs would be £2,400 based on a solicitor spending one day (eight hours) considering draft transfer terms and conditions, and administrative costs would total £400 based on a director reviewing and deciding to proceed in 2 days. **Comments are welcomed on the estimated anticipated costs to small business if they proceeded with a transfer of their registered office.**

13. COMPETITION ASSESSMENT

13.1 The competition filter has been applied. It has been concluded that the Directive would have a potential impact on all limited companies in the UK and all market sectors. It is not envisaged, however, that the Directive would have an effect on distribution of market shares within those sectors. It is considered that this Directive would not give rise to disproportionate costs of entry or administrative costs for either small or large business. As the Directive would be voluntary, only companies who perceive real business advantage would elect to use the procedures. The Directive is not anticipated to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services.

13.2 The proposed Directive would affect all markets since the companies that may consider a transfer of registered office are not restricted to any particular sector. This Directive would not, however, restrict the ability of companies to choose the price, quality, range or location of their products. It is anticipated that the legislation would not affect competition, either positively or negatively.

14. SUMMARY AND RECOMMENDATIONS

14.1 The proposed Directive seeks to establish a framework for transfer of registered office where such a process is not provided for. The overall impact of the proposed Directive is unlikely to have significant consequences for business. However, it would provide a useful additional tool for freedom of establishment within the internal market. The Government supports the objective of agreeing a transfer of registered office Directive and remains committed to extending the opportunities for freedom of establishment across the EU as crucial to the Single Market. It is imperative that the Directive, once agreed, offers practical solutions to the issues of cross-border transfer for business within the EU, provides legal certainty and avoids unnecessary burdens and constraints on business.

14.2 The DTI intends to use the views expressed on this RIA (together with those expressed on the corresponding consultation document) to inform its approach to the EU negotiations in order to ensure that the finally agreed Directive brings economic benefits that justify legislation.

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Annex D

CODE OF PRACTICE ON CONSULTATIONS

The Consultation Code of Practice Criteria

1. Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.

2. It should be clear who is being consulted, about what questions, in what timescale and for what purpose.

3. A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.

4. Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others) and effectively drawn to the attention of all interested groups and individuals.

5. Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation.

6. Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and the reasons for decisions finally taken.

7. Departments should monitor and evaluate consultations, designating a consultation coordinator who will ensure the lessons are disseminated. The complete code is available on the Cabinet Office's web site, address http://archive.cabinetoffice.gov.uk/servicefirst/2000/consult/code/_consultation.pdf

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