The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

COMPANY LAW COMMITTEE RESPONSE TO THE EU GREEN PAPER: THE EU CORPORATE GOVERNANCE FRAMEWORK (COM (2011) 164)

The City of London Law Society (***CLLS***) represents approximately 14,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees and in this case the response has been prepared by a working party of the CLLS Company Law Committee comprising senior and specialist corporate lawyers.

We welcome the Green Paper and its recognition that financial institutions are a special case and the solutions appropriate for them in a corporate governance context are not necessarily appropriate for other listed companies. We also welcome the Commission's desire to consider how to encourage more shareholders to take an interest in the longer-term performance of companies, whilst recognising that shareholders are free to chose their approach to investment.

We also welcome the recognition that corporate governance guidelines formulated for larger listed companies are not always appropriate for smaller listed companies and unlisted companies. We think further thought should be given to which corporate governance principles are appropriate to smaller listed companies and some unlisted companies. We agree with the observation in this context (see page 4) that putting excessive burdens on listed companies could make listing less attractive (which could be contrary to the interests of ultimate investors) but do not believe that the need to avoid too great a differential between regulation of listed and unlisted companies is a good reason to increase regulation for unlisted companies – rather it should be a matter of ensuring that the level of regulation for listed companies is proportionate and not excessive.

We would be happy to discuss our responses if that would be helpful.

General questions

(1) Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

Yes, we believe any EU corporate governance measures should take into account the size of listed companies. The size of listed companies varies enormously from one Member State to another and from one market to another. If any measures are to be taken at EU level for small and medium-sized listed companies a differentiated approach will be needed. We believe that the costs and burdens of full compliance with a corporate governance code can impact small and medium-sized listed companies more significantly than larger listed companies. For that reason, any obligations to be placed on SMEs need to be proportionate and to be tested against the benefits they will bring. Given differences in the size of companies in different markets and differences in the profile of their shareholders, we would be in favour of leaving it to each Member State or relevant market to set the relevant threshold for that State or market, rather than adopting a single EU-wide approach.

In the UK, the corporate governance code identifies specific provisions which large companies, but not others, are expected to meet, by reference to their position in the FTSE index. This approach provides flexibility in the application of the governance standards, adapting automatically to changes in the size and status of each listed company. Such an approach, targeted and appropriate for a particular market, would not be possible if a single EU-wide standard were to be adopted.

We are not in favour of using the number of employees as a criteria for applying (or not applying) a corporate governance code as the number of employees in a group may reflect the type of business rather than whether it is reasonable to expect it to meet certain governance standards or not.

(2) Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

We think the Commission needs to differentiate different types of unlisted companies in deciding its approach to corporate governance for them. There are unlisted companies whose shares are widely traded on an established market and may therefore be similar to listed companies and there are unlisted companies whose shares are not traded. In this latter group there is an enormous range which includes small companies whose directors and shareholders are the same (where corporate governance codes are unlikely to be necessary or appropriate), companies owned by families, companies owned by private equity investors (who normally will have nominated directors on the company and have contractual rights to control the company's activities), companies owned by shareholders who are different from the directors and not-for-profit companies. A one size fits all approach would be wholly inappropriate.

There are already various initiatives on corporate governance codes for unlisted companies. Whilst we can see a role for the EU in publicising these initiatives or where such initiatives do not exist in a particular jurisdiction, promoting some general principles, we do not think there is a need for EU legislative measures – and such measures could be counterproductive because the range of unlisted companies is so diverse. We believe strongly that any measures in respect of unlisted companies should only be on the basis of voluntary codes which reflect the nature and size of the company.

The main focus of the EU's efforts should be on proportionate measures to encourage good governance among traded and listed companies.

Boards of directors

(3) Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

We would not be in favour of an EU legal requirement e.g. in a directive to divide the functions and duties of the chairperson and chief executive because we believe that would be too prescriptive. We also think that views on whether the functions and duties must be divided may be influenced by the company's board structure, the legal framework within which the board operates and the profile of the company's shareholders. However, we do support corporate governance code principles requiring that the functions, duties and the roles should generally be divided, which apply on a "comply or explain basis". We think it would be helpful for the EU to promote, through guidance, a better understanding of the differing functions, duties and roles of the chairman and of the chief executive, as this will help to explain the reason why it is not generally desirable to combine the roles in a single individual. If action is to be taken at EU level, we think it should only be by way of a Recommendation.

(4) Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

We believe it is important for companies to look at the skill set, experience and diversity of the board as a whole. It may be helpful for companies to disclose in their corporate governance statement the mixture of skills, experience and abilities they consider desirable on their board.

Companies could also be encouraged to disclose information about the skills and experience of the whole board and proposed directors to shareholders in a manner which allows shareholders to assess how that mix addresses the company's own aspirations.

(5) Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

We believe that a requirement for listed companies to disclose whether they have a diversity policy and to report on progress towards implementing that policy would lead, over time, to an increase in diversity and this might be an appropriate subject of an EU Recommendation. However, we have concerns about requiring listed companies to describe the main content of their diversity policy as we think it would be unclear how much detail a company would be expected to provide and this could result in the provision of a lot of information which is not necessarily of significant value but which will add to companies' costs and contribute to the information overload that shareholders complain about. We think a requirement to report annually on whether the objectives set by the policy are being achieved or not (and, if not, what is being done to address this) is more likely to be of value.

(6) Should listed companies be required to ensure a better gender balance on boards? If so, how?

We are not in favour of a legislative solution that would require listed companies to ensure a better gender balance at board level. We are, however, in favour of encouraging listed companies to achieve a better gender balance, both at board level and among senior executives as well as more generally in listed groups.

At present, there is strong pressure in some Member States on this issue to take action – and different Member States have adopted different approaches. We think it is important that listed companies are aware of the reasons why this is important and the Commission can play an important role in making sure that research on the benefits of diversity and the dangers of groupthink are widely disseminated. We would support an EU Recommendation that listed companies should report annually on their approach to ensuring a better gender balance at board level and more generally in their group. We think it would be helpful for Member States and the Commission to monitor progress and publish information annually on trends in this area.

(7) Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

We are not in favour of a measure at EU level limiting the number of mandates a non-executive director may hold. We assume it is only proposed that any EU measure should apply to listed companies' non-executive directors. We think it would be difficult to design a measure that would work well in practice, given the many types of commitments that directors may have, including private interests, employment, consultancies, directorships of public or private companies, trusteeships, or other positions with not-for-profit organisations – all of which may be very variable in terms of the amount of time that they absorb. If "mandates" was defined too widely or the permitted number set too low, it could prevent many directors from having other commitments that they currently carry on satisfactorily alongside their listed company directorships. On the other hand if the definition was too narrow or the number set too high it would not achieve the objective of ensuring that directors can devote sufficient time and attention to their position.

We would support an EU Recommendation that listed companies should publish the terms of appointment for non-executive directors, which should include the company's expectation of the time commitment for the role. Companies should be encouraged to take into account whether a director has devoted sufficient time to their role and made an effective contribution as part of the board evaluation process and when deciding whether to recommend the director for re-election. When a company makes a recommendation to re-elect a director, it would be helpful if the company stated, when appropriate, that it has taken this into account.

(8) Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

It is generally recognised that periodic external facilitation of board evaluations is beneficial as it provides objective independent input into the process. However, we are aware that this can be costly and that, in some Member States, it may not be easy to find appropriate people who are qualified and independent to undertake such facilitation. Where an external facilitator is employed, any association between the external facilitator and the company or the directors should be disclosed. It would be appropriate for corporate governance codes to recognise that smaller listed companies may feel the cost of a regular three yearly externally-facilitated evaluation is not justified.

We think it is important that listed companies are not required to disclose the evaluation report itself to shareholders or others outside the company. Unless this is the case there is a real risk that those participating in the evaluation will not feel able to make a frank contribution. In some cases the report may need to be legally privileged (to avoid disclosure in legal proceedings). However, we think companies should be encouraged through national corporate governance codes to disclose to shareholders how an externally-facilitated evaluation has been conducted.

(9) Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

We assume that this question only relates to listed companies. We are in favour of a mandatory requirement for listed companies to disclose the group's remuneration policy and a report on how the remuneration policy was implemented in the past year. We are aware of differing attitudes in Member States to the disclosure of the individual remuneration of executive and non-executive directors. Disclosure of individual remuneration is already required in the UK and by Recommendation 2004/913/EC and our experience is that disclosure of individual remuneration levels often leads to considerable focus on remuneration, sometimes to the apparent detriment of focus on other areas which may be more important. There is also a view that such disclosure encourages an upward trend in remuneration levels, as listed companies do not want to be seen to be paying remuneration at a level below the average and there can be pressure from executives to match pay levels at competitors. Given that this is dealt with in Recommendation 2004/913/13/EC, we are not in favour of further action being taken at EU level on this.

(10) Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

We assume a mandatory vote requirement would only apply to listed companies. If a mandatory vote requirement is adopted, it would be important to be clear about the consequences if a resolution is not passed. In the UK, although it is mandatory for shareholders to have the opportunity to vote on the remuneration report, the vote is only advisory and there are no legal consequences if the resolution is not passed. In practice, shareholders regard their ability to vote against as an effective means of signalling unhappiness with the Board's approach and, even where a resolution is passed, companies often feel obliged to make changes when a significant minority vote against a report. Any other approach may conflict with the contractual arrangements the company will have with its directors who are also employees. If it is mandatory to put the report and policy to the vote and the result of any vote is binding, the result of a vote against the policy or report might be either to constrain the board's power to enter into binding contracts with directors or to expose the company to claims for damages from affected directors and employees. We think this might inhibit shareholders wishing to express dissatisfaction with a board's approach to remuneration.

We would be in favour of this being left to national corporate governance codes and continuing to be being dealt with by way of an EU Recommendation.

(11) Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

We do not think there is any consensus as to what is meant by a company's "risk appetite". If there are to be any obligations relating to risk appetite, it is important that there is a common understanding of what this means, in particular for non-financial companies.

We would expect that the national laws relating to directors' duties would mean that it is part of a board's responsibility to consider the sorts of risks the company (and its group) may encounter or wish to take in carrying on business and to have systems to monitor these risks (as it is in the UK). The Fourth Company Law Directive (which applies to all companies) already requires companies to describe the principal risks and uncertainties the company faces (Article 46). If the EU wishes to impose a further obligation on listed companies to report meaningfully on "risk appetite", it will need to explain how this differs from the existing obligation. It may be that it would be better for the EU to give guidance or examples of good reporting on risks, rather than imposing further requirements. Some work is already taking place on risk management, including a consultation paper by the Institute of Risk Management (http://theirm.org/publications/risk_appetite.html). It would be sensible for any EU measure to take account of such initiatives.

We assume the reference to disclosure of "key societal risks" is a reference to risks that significantly affect society as a whole, such as risks related to climate change, to the environment, health, safety, human rights etc. The Commission has already issued a consultation on non-financial disclosure by companies and will put forward a new framework later this year. We think any disclosures by companies should be considered as part of this initiative. When a company discloses the principal risks it faces, this may include risks which may significantly affect society (e.g. the risk that a drug produced by a company may have unforeseen side effects). However, in reporting on the principal risks a company faces (as opposed to making certain required disclosures in specified areas), we believe the primary users of annual reports, expect to be informed of risks from the company's perspective (i.e. what principal risks does the company face in implementing its strategy) rather than from society's perspective (e.g. what risks does society face as a result of the company's strategy or the way it is implemented). A requirement to include such societal risks in a company report will increase the clutter and length about which shareholders complain, for little discernible benefit to the shareholders.

(12) Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

We believe that executives in a company are responsible for proposing and implementing the risk management arrangements and that the board is responsible for overseeing the arrangements, monitoring the way in which they work and overseeing changes when appropriate. It is not possible to "ensure" that arrangements are effective – this sets the board's responsibility too high. We believe their responsibility is to take reasonable care to ensure that the arrangements are appropriate, work well in practice and change as necessary to reflect the group's risk profile. We think that existing directors' duties, which are set by national law, are likely to make directors responsible for overseeing risk and we therefore are not in favour of a separate EU legal requirement on this. We are in favour of national corporate governance codes reminding directors of the importance of this aspect of their role. We also think that the existing requirement on companies to disclose the company's principal risks encourages directors to meet their obligations to oversee risks.

(13) Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

We think that there are many complex issues here, and note the recent announcement by the UK government of a review into the effect of the UK equity markets on the competiveness of UK business. The review (the Kay Review) is expected to give particular emphasis to the ability of managers to focus on the actions needed to enhance the long term competitiveness of UK based firms and achieve the best long term returns for UK savers. While this review is UK focused, we believe that many of the observations and recommendations it is likely to make will also be relevant to the wider EU market, and that it would be appropriate for the EU Commission to take into account the findings of this review in formulating its policy.

Investors are, and should be, free to adopt the approach that suits their needs and the judgment of whether any behaviour amounts to "inappropriate short-termism" is difficult. We believe that the pressure on listed companies to produce improving results on a progressive basis (rather than an acceptance that economic growth will not always be smooth) is driven more by the pressures on fund managers and ultimate investors to produce returns than by particular legal rules. However, we think that investors could be encouraged to take a longer term view if listed companies were more open, and clearer, in their forward-looking disclosures. By focussing attention on the longer term trend, companies should be able to avoid the problems caused by quarter on quarter comparisons. In this regard, we think the current CESR guidance on profit forecasts that requires any profit forecast made by an issuer prior to publication of a prospectus to be repeated (and reported on) or disclaimed, is a significant discouragement to companies to provide forecasts as part of the normal reporting. We suggest this guidance be re-examined with a view to formulating a safe-harbour for ordinary course forecasts.

(14) Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

We believe that institutional investors should be entitled to receive information about the incentive structures for, and performance evaluation of, the asset managers managing their portfolios. We think this should apply whether or not the investor is long-term. However, we think this should be a matter for the contract between the institutional investor and the asset manager, rather than being subject to an EU measure. If, contrary to this view, it is decided to adopt an EU measure, we think any EU measure should be framed as a right for the investor, rather than an obligation on the asset manager to provide the information, whether or not requested, and should be considered in the light of the existing requirements under Mifid on the duties of asset managers to disclose certain information. We think the Commission could play a useful role in encouraging more investors to ask for such information and take it into account in deciding on mandates.

(15) Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

We think it would be better to use corporate governance codes to promote more effective monitoring of asset managers, rather than EU Law. The European Fund and Asset Management Association has recently published its Code for External Governance, and the UK Stewardship Code, which is similar, is still relatively new. These codes and the level of compliance with them will no doubt develop over time, and they should be allowed to do so, in the same way as corporate governance codes aimed at listed companies have done. Disclosure by institutional investors of their approach to monitoring the strategies, trading and engagement activities of asset managers employed by them and the costs involved may encourage more efforts in this direction, if their clients evidence a willingness to differentiate between their products as a result. Different investors have different views as to what approach by asset managers is appropriate and whether the costs incurred are matched by appropriate benefits. We are in favour of steps, on a voluntary basis, to encourage institutional investors to monitor the activities of their asset managers. We think a flexible approach is desirable.

(16) Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

There are already certain requirements in Mifid as to an asset manager's independence and any consideration of further measures on asset managers' independence should take account of the existing requirements and an informed view as to whether any existing problems point to a need for better enforcement of the existing requirements rather than for further legislation. An asset management company that is part of a group will have contractual duties to its clients and regulatory duties. The duties of the directors will be set by national law, but broadly speaking we believe these duties will require directors to have regard to the interests of the company's shareholders (and may, depending on the relevant national law, also require them to have regard to or take account of the interests of other stakeholders). If there are concerns that an asset management company that is part of a group with other relationships with an investee company may not always exercise its shareholding information rights in that investee company, we think the best way to address such concerns is for the relevant regulatory bodies to ensure that information barriers or Chinese walls are correctly maintained and that disclosure of potential conflicts is specific where there is no Chinese wall in place. We doubt whether requiring independence of the asset manager's governing body would significantly improve any concerns about this point.

(17) What would be the best way for the EU to facilitate shareholder cooperation?

We agree that concerns about whether certain action would amount to acting in concert can sometimes inhibit shareholder co-operation. It is important that the national bodies that interpret whether an action amounts to acting in concert or not provide as clear guidance as possible on this. We believe this needs to be done at national, rather than EU, level to take account of the different national approaches to control. However, we think the EU can promote the giving of such guidance and that ESMA can facilitate discussions between the national bodies to encourage a consistent approach as far as possible. It may then be possible to give some general guidance at EU level as to what behaviours would not be likely to constitute acting in concert. In the UK, the Takeover Panel has provided guidance on this topic. The FSA has also provided guidance on shareholder co-operation in relation to the controller test for regulated entities and on related market abuse considerations.

We recognise the importance of listed issuers providing information to their shareholders, and with information available on the issuer's website, we think this problem is significantly less than it has been. If further requirements are to be imposed on making information available to ultimate investors who hold their investments through a chain, we think any obligation should be limited and proportionate so that either information is only provided where the investor requests it (and not in all cases) and at the investor's cost (not the issuer's) or the ultimate investor is given a right to notify the issuer that information is to be provided to it direct, rather than to the person to whom it would otherwise be provided.

In the UK, the Stewardship Code has now been in place for a year. One of the key principles in the Code is that shareholders be willing to act collectively where appropriate - and the clarification on concert party analysis referenced above was designed to ensure this can take place. The large number of signatories to the Code is indicative of the level of support amongst UK institutional shareholders. We feel that this momentum is encouraging and provides a good model for adoption throughout the EU, rather than running parallel or potentially duplicative initiatives.

If the EU wishes to consider other ways to facilitate co-operation, it should consider any costs and burdens (e.g. regulatory) to be imposed on listed companies as a result of what is proposed (e.g. of setting up a shareholder forum on the company's website). We think it is relatively easy for shareholders to do this themselves if they want to.

We are not sure exactly what the Commission has in mind when it refers to an EU proxy solicitation system. In the UK, it is not difficult for shareholders to identify and make contact with other shareholders if they want to, or to propose resolutions or circulate statements. We do not know if it is more difficult in other Member States for shareholders to take action (although, because of disclosures made pursuant to the Transparency Directive, we would have thought it should not be difficult to identify other larger shareholders). If any further action is proposed on this, we would want to review what is proposed and to see evidence that it would not impose disproportionate costs and administrative burdens for listed companies without there being a commensurate benefit for shareholders

(18) Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

We would prefer standards for proxy advisers to be set by way of a code against which proxy advisers would comply or explain, rather than dealing with this by EU law. We think it is desirable for proxy advisers to be more transparent about their analytical methods, any conflicts of interest they have and how they manage these. In particular, we think more information is needed on whether, and how, proxy advisers liaise with fund managers or institutional investors who use them, when the proxy adviser's general policy is against a particular course of action by companies, but the company has explained to the fund manager or investor's satisfaction why the course of action is appropriate in the particular case.

If EU action is proposed, which proxy advisers would it apply to – e.g. those in the EU only or all proxy advisers that provide services in relation to EU companies? Some proxy advisers are based outside the EU and it would be undesirable to put requirements on EU proxy advisers to such an extent as to encourage investors and fund managers to use non-EU proxy advisers or to encourage proxy advisers to relocate outside the EU. If EU action is proposed, we do not think it should extend beyond a requirement on the proxy adviser to publish a statement on its website as to which code it is subject to (or has voluntarily decided to apply) and the extent to which (if at all) it departs from the relevant code and the reasons for doing so (similar to Article 46a of the Fourth Company Law Directive).

(19) Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

We do not believe EU legislative measures are needed e.g. restricting proxy advisors' ability to provide consultancy services to investee companies. We are in favour of specific disclosure of such conflicts of interest to investee companies and to fund managers and investees. An appropriate code should deal with this point.

(20) Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

Although the UK already has a mechanism that works well in practice to enable issuers to identify the investors behind registered shareholders, we are aware that this is not the case in all Member States and that, in some Member States, issuers can only request information at certain times (typically before an AGM or a corporate action). There may be in problems with potentially alerting some sections of the market to a possible corporate action if the power can only be used at such times. We understand that many European issuers would welcome more extensive rights to information about the beneficial owners of their shares.

We suspect that if a mechanism is to work well in practice it will need to reflect the mechanisms used for holding shares in the different Member States. If issuers have access to this information there would need to be a way of publishing it if other investors are to be able to benefit from it.

If further EU action is proposed, it will need to address who is to pay the cost of obtaining the information – which we think should be the issuer if it is seeking the information. It would also need to address difficulties that arise as a result of data protection and secrecy issues (so those required to provide information do not find themselves caught between conflicting requirements). If shareholders or third parties are to be given access to the information the issuer obtains, thought should be given to whether safeguards are needed as to the purpose of the requesting party and the ways in which they can use the information (e.g. to prevent a third party requesting information for marketing purposes unconnected to the issuer).

(21) Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

The legal protections already available to minority shareholders differ from one Member State to another. There may, for example, be provisions under national law that require shareholder approval for certain transactions between the company and directors or persons connected to them (including the majority shareholder, if appropriate). Even if a protection is already available in theory the position in practice may be different if the court process is slow or difficult for a shareholder to take advantage of. Before taking a decision as to whether minority shareholders need additional rights, we think the Commission needs to study the current position. The position is also different for listed and unlisted companies. In some cases, minority shareholders in an unlisted company may have protections by virtue of a shareholders agreement.

The protections for minority shareholders in the UK include an ability to seek court redress for certain unfair actions taken by the company as well as, for listed companies, the requirement for independent shareholder approval for certain "related party" transactions. In some cases, companies with a substantial shareholder enter into an agreement to set out how the relationship between the company and that shareholder will work and any constraints or safeguards to be put in place. We believe that these work well in most cases.

Where a company comes to market with a controlling or dominant shareholder an investor will have decided to invest knowing this. The position is different where a shareholder becomes a controlling or dominant shareholder after others have invested, particularly if this happens without the investor being able to sell their shares. Any proposals would need to take account of these differing situations.

An ability for minority shareholders to appoint a director to the board who is independent of the majority or controlling shareholder may give minority shareholders some comfort that their interests will be voiced at board level. The director's duties will be governed by national law and may be owed to shareholders as a whole – which may limit the ability of the director to protect the interests of a particular minority. However, there may be other provisions under national law that offer minority protection.

(22) Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

We assume that the question is posed in relation to listed companies. We think that all shareholders (and not just minority shareholders) would benefit from protection against related party transactions. If action is to be taken it will be important for it to work well in practice which will require a significant amount of detailed rules e.g. as to who is to be treated as a related party, which transactions are to be covered and require independent shareholder approval, and which exempt (such as revenue transactions in the ordinary course of business). The UK Listing Rules contain provisions on related party transactions, with detailed rules on exemptions and the ability to consult the FSA on the application of the rules. We suggest that any action on related party transactions should allow significant flexibility for the Member States' regulatory authorities to set the detail of any rules and give guidance on their operation. For this reason we think any EU action should be by way of Recommendation.

(23) Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?

We doubt whether encouraging employee share ownership will make a significant difference to the balance of long-term-oriented shareholders in a company. [We think employee share ownership should be considered as a means of incentivisation and not as a corporate governance lever.]

Monitoring and implementation of Corporate Governance Codes

(24) Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

Under Article 46a of the Fourth Company Law Directive, a listed company is already required to explain which parts of the relevant corporate governance code it departs from and the reasons for doing so. We agree that, in some cases, the quality of the reason given is poor e.g. the company does not think it is appropriate to comply with this provision (without explaining why). We believe, however, that the principle of "comply or explain" is fundamental and important, with more encouragement required to improve the quality of explanations provided by companies.

We do not think it would be advisable to define the corporate governance statement as regulated information for the purposes of Directive 2004/109/EC. We think it is better for an organisation in each Member State to encourage a better standard of explanation by reviewing a random sample of the statements made and highlighting examples of good and bad explanations. We do not think there should be a regulatory requirement to do this.

We agree strongly that authorities should not express views on whether the explanations given by companies are (or should be) acceptable to shareholders. (See also our answer to (25) below).

In the UK, the corporate governance code contains principles which the company must apply and detailed provisions which the company may chose not to comply with. It must, however, explain how it applies the main principles and, if it does not comply with the detailed provisions, explain why. The UK code also encourages (but does not require) companies, where they do not comply with a provision, to explain what alternative measures have been put in place to apply the related main principle. Other corporate governance codes may adopt a different approach and we do not think it will always be appropriate to require a company to describe the solution it has adopted if it has not complied with a particular provision of the code.

We agree that there is potential to improve and extend the current exchange of best practice and would welcome steps to do this particularly as regards the quality of explanations given for non-compliance.

(25) Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

We would not be in favour of authorising monitoring bodies to check the quality of explanations given by every listed company and require them to complete explanations where necessary. As explained in our answer to question (24), we do support voluntary measures to improve the standard of explanations given.

We believe that explanations are given for the benefit of shareholders, who should be responsible for taking up inadequate or unsatisfactory explanations with the company concerned. We believe the Fourth Directive already provides a sufficient requirement for companies to explain their reasons for departing from a corporate governance code requirement. As set out in our response to Question 24, we are in favour of improving the exchange of best practice and the steps already taken to highlight examples of good and bad practice.

Date 20 July 2011

THE CITY OF LONDON LAW SOCIETY
COMPANY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

W. Underhill (Slaughter and May) (Chairman)*

R. Brown (Hogan Lovells International LLP)

M. Curtis (Simmons & Simmons LLP)

L. Fergusson (Linklaters LLP)*

S.A. Griffiths(Addleshaw Goddard LLP)

M.E. Hatchard (Skadden Arps Slate Meagher & Flom (UK) LLP)

N. Holmes (Ashurst LLP)

S. Jay (Cleary Gottleib Steen & Hamilton LLP)

Ms E. Kelliher (Allen & Overy LLP)

Ms V.J. Knapp (Freshfields Bruckhaus Deringer LLP)*

J.E. Palmer (Herbert Smith LLP)*

C.C. Pearson (Norton Rose LLP)*

D.J. Pudge (Clifford Chance LLP)*

R. Spedding (Travers Smith LLP)

P. Speller (Nabarro LLP)*

K. Stella (Berwin Leighton Paisner LLP)

M. Webster (Pinsent Masons LLP)*

Miss V. Younghusband (SJ Berwin LLP)*

T. Carey (Slaughter and May) (Secretary)

(* Denotes member of the working party which prepared this response.)