

**PRINCIPLES FOR AN EU APPROACH TO COMPANY LAW AND CORPORATE GOVERNANCE**

**UNICE STATEMENT**

**INTRODUCTORY REMARKS**

Corporate governance and company law are currently subject to intense debate at national and international level. National law and corporate governance codes have recently been reviewed or adopted in order to restore investors' trust in the financial markets. The USA has adopted the Sarbanes-Oxley Act and implementing rules, and the OECD recently adopted a revised version of its Corporate Governance principles.

At European level, further to its Company Law and Corporate Governance Action Plan (21 May 2003), the European Commission has now embarked on frantic consultations and has presented a number of different proposals in the area of company law and corporate governance<sup>1</sup>.

After a careful assessment of the above consultations and proposals, UNICE believes that the Commission is losing sight of one of its originally stated objectives: "*foster the global efficiency and competitiveness of businesses in the EU*"<sup>2</sup>.

Good and efficient company law and corporate governance are of utmost importance to companies and their stakeholders. Any action in these areas must pursue the objective of increasing competitiveness while respecting the legal environment in which they evolve. Excessive regulatory burdens may ultimately restrict the freedom of companies to do business, thereby holding them back from releasing their potential. This is detrimental to business, to company shareholders and more generally to the EU as a whole.

For this reason, UNICE proposes that the principles set out below serve as reference criteria for intervention in the areas of company law and corporate governance.

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<sup>1</sup> The Commission has undertaken consultations on future Recommendations on directors' remuneration and on the role of independent directors, on future proposals for a 14<sup>th</sup> Company Law Directive on cross-border transfer of seat and modifications to the 4<sup>th</sup> and 7<sup>th</sup> Company Law Directives to cover board responsibilities, financial and corporate governance information. Furthermore, the Commission has issued proposals in the area of company law (10<sup>th</sup> Company Law Directive on cross-border mergers and amendments to the 8<sup>th</sup> Company Law Directive on statutory audit).

UNICE response to these consultations and position papers regarding afore-mentioned proposals can be consulted at [www.unice.org](http://www.unice.org)

<sup>2</sup> See the Action plan: COM(2003)284, 21.5.2003, Commission Communication "*Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*"

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**Subsidiarity** – The EU should only intervene when it is proven that the foreseen objective cannot be reached by national action. EU action should not disrupt the delicate balance found at national level, which takes into account national traditions and cultures.

**Principle-based approach** – In light of the subsidiarity principle, in any EU intervention, a general principles-based approach should prevail over a rules-based approach. This would allow a degree of flexibility necessary for companies to develop the governance model best suited to them.

**Market-driven approach** - In UNICE's view corporate governance is better served by flexible self-regulatory initiatives as opposed to regulatory interventions. Over-regulating is a disincentive for companies to go beyond legislation and adopt corporate governance best practice.

**Comply or Explain** – When a corporate governance code is applicable, companies should either conform to the provisions of that code, or provide an explanation as to why the principles have not been followed. As stated in the 1992 Cadbury Report, the Comply or Explain route should enable companies to “*strike the right balance between meeting the standards of corporate governance expected of them and retaining the essential spirit of enterprise... Raising standards of corporate governance cannot be achieved by structures and rules alone (...)*”. This ‘Comply or Explain’ approach has been in operation for over 10 years and the flexibility it offers has been widely welcomed both by company boards and by investors. The spirit of the principles is important, not a mere formalistic ‘box ticking’ approach.

**Transparency and disclosure** - Transparency is an essential ingredient for any form of outside monitoring. It is very important for the shareholders and investors to see the manner in which a company follows the recommendations on corporate governance. Transparency enhances confidence in a company.

**Global orientation** – EU policy should be oriented towards and take into account the global environment in which European companies inevitably evolve. Adding an additional and possibly contradictory EU layer of regulation would be a hindrance to achieving the goals of corporate governance.

**Competition** – should be encouraged between national systems so that society can benefit from an emulation effect. Competition in the field of legal systems stimulates legal innovation. In this context, the EU should ensure that Member States mutually recognise each other's legal systems.

**Better regulation** – Impact assessments and proper consultations<sup>3</sup> are the basis of good regulation. Consultation remains one of the basic principles of participatory democracy but consultation needs to be carried out in the right conditions: sufficient time for considered responses and a weighted analysis of responses received are fundamental ingredients for successful consultations.

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<sup>3</sup> As highlighted by the High Level Group of Company Law Experts that largely inspired the afore-mentioned Commission Action Plan “for both primary legislation and any alternatives, proper consultation is necessary”. See “A modern regulatory framework for Company Law in Europe” presented on 4 November 2002, available at the following page of the Commission website: [http://europa.eu.int/comm/internal\\_market/en/company/company/modern/](http://europa.eu.int/comm/internal_market/en/company/company/modern/), p. 4.

In addition to the above-mentioned principles, UNICE would like to provide additional comments on company law and corporate governance and their relationship.

UNICE believes that clarification is needed regarding the realm of company law, the boundaries between company law and corporate governance, as well as the interests that underlie intervention in each area. One of the main difficulties is to strike the right balance between the principles of mutual recognition, subsidiarity and minimum requirements harmonisation.

## **COMPANY LAW**

An effective Internal Market in the area of company law is not yet a reality. This is an obstacle for companies operating in Europe. Companies operating at EU level need a more, cost-effective and flexible legal framework to improve their competitiveness at both EU and global levels. In particular, the need for further action in company law at EU level should concentrate on the elimination of mobility constraints on companies within the Single Market, in particular concerning cross-border mergers (10<sup>th</sup> Directive) and transfer of seat (14<sup>th</sup> Directive). In this context, UNICE deeply regrets that the Commission initiatives on these two topics do not meet users' needs, as consistently advocated by UNICE. Creating tools that do not meet users' needs is a waste of time and effort of all stakeholders, and a missed opportunity, to the detriment of the competitiveness of European enterprises.

UNICE fears that the proposal for a 10<sup>th</sup> Directive and the direction indicated in the consultation for a 14<sup>th</sup> Directive would delay necessary changes in companies' structures and undermine their competitiveness. Although UNICE acknowledges that there may be a need to address matters of worker participation in the context of legislation like the 10<sup>th</sup> and 14<sup>th</sup> directives, it believes that the present approach (which builds on compromise solutions devised in the context of the European Company Statute, an optional instrument), is ill-suited to the purposes for which it is now proposed to be used and is not conducive to the stated aim of increasing the competitiveness of European business. Instead of sticking to existing and ill-suited worker participation models, the Commission should contemplate new rules flexible enough to enable arrangements for companies while not restricting or hindering the needed competitive business environment.

Proposing solutions which could lead to the compulsory import/export of different systems of worker involvement in countries where such a system does not exist could act as a disincentive to cross-border mergers.

Where EU harmonisation action is deemed necessary, UNICE supports the use of framework Directives, setting the general principles for harmonisation but leaving the final choice for implementation to Member States. This is not the case with the latest Commission proposals on company law that are much too detailed.

Speed should not take precedence over quality and added value of the Commission proposals which should be conducive to EU business attaining and retaining a competitive edge in a global environment.

In doing so, the Commission must act coherently and should take utmost care to avoid confusion. For instance the modifications as envisaged in the consultation on the 4<sup>th</sup>-7<sup>th</sup> Directives do not seem to take into account the ongoing work on International Financial Reporting Standards (IFRS) and what already exists in the area of financial reporting.

## CORPORATE GOVERNANCE

Corporate governance is “*the way in which companies are managed and controlled*” and should focus mainly on the relationship between companies and their investors or the problems arising from the separation of ownership and control. Corporate governance encompasses the full range of principles directed towards shareholders’ interest, and seeking a good balance between direction, decision-making, control and transparency. Corporate governance is also about ensuring sustainable growth.

Companies’ corporate governance is the product of a complex system, which has its roots in the political, cultural and institutional background of each country in which these companies are incorporated (i.e. so-called “path dependency”). It is a system that derives from a combination of laws, regulations, self-regulation, accepted practices and, more generally, of the legal framework and, above all, the economic culture prevailing in each country. Companies need to adapt their structures and procedures to their specific legal environment, their business activities and their specific economic situation. There is no one-size-fits-all approach to the challenges enterprises are faced with. Flexibility is necessary for companies because they need to take into account their size, stage of development, shareholding structure, the complexity of the risks associated with their activities and their management practices.

Over-detailed regulation (at European or national level) unduly restricts the organisational freedom of business operators, hinders adaptation to changing situations and therefore undermines competitiveness.

The European Commission has repeatedly indicated that it is not appropriate to adopt a European Corporate Governance Code. According to the Commission, “*the adoption of such a code would not contribute significantly to the improvement of corporate governance in the EU*”<sup>4</sup>.

UNICE shares this view. However when assessing the above-mentioned proposals and consultations we question whether the Commission is delivering on its declared intention not to create a European Corporate Governance Code. If the Commission proceeds as intended, this will effectively lead to the adoption of a piece-meal European Corporate Governance Code, albeit without the official title. UNICE can see no need for such a development, and further believes that the EU is ill-positioned to undertake action in this area. It calls on the Commission to stay true to its original view that the introduction of a European Corporate Governance Code is both unnecessary and undesirable.

In light of the convergence of national codes, we additionally have strong reservations concerning the need for a European Corporate Governance Forum. If, ultimately, it is found that creation of such a Forum is indeed required, it should be strictly limited to an exchange of best practice in corporate governance. Furthermore, we urge the Forum to function strictly on an ad hoc basis. Its membership should mirror the composition of the High Level Expert Group on Company Law with an extension to the chairpersons of national corporate governance codes commissions.

Efficient corporate governance also implies that all parties involved respect the rules. In that context it is important that all parties involved respect the tasks devolved upon them, be it management or control.

UNICE urges public authorities to resist pressure to include in corporate governance issues which do not belong there. For example, broad notions such as ‘high ethical standards’ are

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<sup>4</sup> See footnote 2, in section 3.1 of COM (2003) 284, 21.5.2003

largely undefined and could lead to linking corporate governance, a well-known concept, with corporate social responsibility (CSR) that is still an emerging issue. Corporate Governance deals with listed companies whereas CSR is much broader. Such proximity between the two should be resisted otherwise the concept of corporate governance will be undermined.

Finally, UNICE would like to reiterate its considered opinion that imposing a board responsibility regime at EU level, as indicated in the Commission consultation on this issue, is unnecessary. For further information, UNICE's response to the afore-mentioned Commission consultations and our position papers regarding afore-mentioned proposals are available at [www.unice.org](http://www.unice.org)

#### **CONCLUDING REMARK**

UNICE believes that the above-mentioned principles have not sufficiently been taken into account in the measures implementing the Company Law and Corporate Governance Action Plan. In this context, we urge the Commission to reconsider their related proposals in the light of these principles and the competitiveness objective, which is to the benefit of all.

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