

# Corporate Governance in the European Union - An Action Plan and Some Recent Recommendations



**By Marc Babinski**

Given the impact of the Sarbanes Oxley Act (“SOX”) on capital markets and their regulators worldwide, it is tempting to assume that corporate governance initiatives in other jurisdictions are mainly motivated by the need to harmonize existing rules with the SOX régime and raise the bar with respect to the integrity of financial information.

Concern with financial integrity and corporate governance, however, are not new in Europe. As part of its financial services action plan initiated in 2001, the European Commission (the “EC”) has issued recommendations on quality assurance and independence for auditors and (as part of a separate initiative) launched a comparative study of the forty corporate governance codes relevant to the EU<sup>1</sup>.

In May 2003, the EC released a document entitled “Modernizing Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward” (the “Plan”) which has served as a guiding document for all subsequent company law reform initiatives in the EU. The principal elements of the Plan as it relates to corporate governance consist of objectives to (1) enhance corporate governance disclosure, (2) strengthen shareholder rights, (3) modernize the board of directors, and (4) coordinate corporate governance efforts of member states.

The Plan proposes that a listed company will be required to include in its annual reports an annual corporate governance statement providing a description of the key elements of its corporate governance structure and practices, including reference to a code of corporate governance. Also proposed are requirements that institutional investors disclose their policy with respect to the exercise of voting rights in the companies in which they invest and a framework permitting shareholders to ask questions, table resolutions, vote in absentia and participate in shareholder meetings via electronic means. To enhance director responsibility, the Plan contemplates the introduction of a right of shareholders holding a certain percentage of the share capital to request that a court or administrative authority authorize a special investigation of the issuer and impose director disqualification across the EU as a sanction for misconduct.

In October 2004, the EC issued two Recommendations<sup>2</sup>. The first, with respect to remuneration of directors of listed companies, includes the proposal that the annual report contain a remuneration report which should also be posted on the Company’s website. The remuneration report would include a statement of remuneration and other benefits granted to directors over the relevant financial year. Any change to the remuneration policy is proposed to be an item on the agenda for the company’s annual general meeting.

The second Recommendation, dealing with independent directors and board committees, includes the proposal that the board of a listed company include independent directors with an oversight role in the remuneration of senior management and the audit process.

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<sup>1</sup> In March 2002, the EC came to the conclusion that the development of a European corporate governance code as a supplement to international and national codes would offer little or no benefit to the EU.

<sup>2</sup> A Recommendation is made pursuant to Article 211 of the Treaty establishing the European Community and, although of no binding force, can be referred by a national court to the European Court on a question of interpretation or validity.

At the same time as it issued these recommendations, the EC (in keeping with the Plan) announced the creation of the fifteen-member European Forum on Corporate Governance which is expected to harmonize the various national corporate governance codes. The Forum, which will have a three year mandate, is expected to provide an annual report and meet two or three times a year.

The challenge to the EU in implementing the Plan will undoubtedly be significant. There are currently twenty-six members of the Federation of European Securities Exchanges including capital markets as large as London and as small as Bratislava. It appears, however, that the EC is committed to the process and will continue to devote the necessary resources to its fulfillment.

What remains to be seen is the extent to which the Plan will be implemented in such a manner as to harmonize EC corporate governance rules with SOX.

Monitoring the implementation of the Plan and the resulting articulation of European corporate governance standards should be of interest to Canadian counsel representing issuers considering a listing on an EU exchange or advising as to corporate governance standards in multiple jurisdictions.

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