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SHAREHOLDER RIGHTS DIRECTIVE

RELATED PARTY TRANSACTION

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Summary:

Our main concerns are:

1. **Corporate governance systems in Europe are very different and are tailored to companies' national environment. No single model from any jurisdiction for the respective roles of boards and shareholders should be imposed on others. In this respect, the proposal may transfer too many powers from boards to shareholders;**
2. **Transactions within groups of companies should be exempted (not just 100% subsidiaries) as otherwise companies' operations would be blocked;**
3. **Involvement of shareholders in the general meeting should be on an exceptional basis only, in the case of a prior negative opinion on a related party transaction by a board committee of non-executive directors;**
4. **Requirement for the independent valuation of transactions by an independent third party should be removed;**
5. **Market-equivalent or standard terms should be exempted;**
6. **"Significant impact" is unclear and could generate uncertainty, particularly for smaller companies, who will be harder hit by the additional costs.**

1. Introduction

EuropeanIssuers agrees with the objective of enhancing transparency and shareholder oversight on important related party transactions. However, we believe that the Commission's proposals go too far in transferring responsibility from boards to shareholders, which runs counter to the principle of subsidiarity and may result in unintended consequences.

2. Roles of the board and shareholders

Corporate Governance systems in European countries have a long and grand tradition. They are built upon practices and mechanisms that have been proven to work equally well in their respective jurisdictions. Unfortunately, we fear that certain provisions of the current Commission proposal may distort the balance of power and roles' division between the boards and shareholders. Therefore, we believe that the respective roles of the board and shareholders need more thought.

The involvement of the general meeting should be an "extrema ratio" due to structural problems. Shareholders are not able to supervise the management of a company alone. Transaction costs and information gaps are too high. All company law systems have therefore invented a second organ that helps them. This may be the board with non-executive directors or the supervisory board (e.g. Aufsichtsrat) or special forms like the collegio sindacale (Italy) etc. Members of those organs supervise and act on behalf of shareholders and/or in the interest of the company

The **binding involvement of the AGM should be required only where the supervisory board or a board committee made up of non-executive directors has given a prior negative opinion on a related party transaction**.

Therefore, we think that the Commission should give more importance to the role of non-executive directors and the supervisory board who are representing the interest of all shareholders. As a result, this would also mean that trade secrets would remain confidential.

The investor side should be considered as well. Given the potential lack of knowledge and high transaction costs (especially for institutional investors with a diversified portfolio), shareholders will suddenly face the problem that they must take important and informed decisions. The problem grows in significance with the complexity of the decision.

Related party transactions may be and often are complex contracts etc. Institutional investors already have to vote at 200 AGMs per week during the proxy season. Resolutions concerning Related Party Transactions will have to be analysed on a case by case basis.

By accepting or declining the transaction, investors influence directly the companies' business and therefore should study those contracts thoroughly. Given that the management would be released from its responsibility, it is questionable whether the proposed regulation lies within the interests of shareholders or whether they would be better off relying on the expertise and control of the supervisory board and non-executive directors.

3. Exemption for intra-group transactions

EuropeanIssuers agrees with the objective of enhancing transparency and shareholder oversight on important related party transactions, but it is important not to block companies' operations.

Companies perform a large number of intra-group transactions that are necessary from the operational point of view and awaiting shareholders' approval could cause problems. This will not only be the case from an operational point of view (loss of time while waiting months until the AGM or costs for a time-consuming extraordinary general meeting) but it may be necessary to disclose trade secrets in order for the shareholders to make an informed decision. The details will not only be interesting for shareholders but also for competitors.

Therefore, all **transactions within groups of companies should be exempted by the proposed regime, not only in case of 100% holdings**.

4. Independent valuation of transactions by an independent third party

The mandatory confirmation of substantial transactions with related parties by an independent advisor (in addition to the supervisory body) would considerably increase costs and would seem to demonstrate a lack of confidence in the supervisory bodies (non-executive or independent directors) which normally supervise these transactions and ensure the principal protection against mispriced transactions. We would rather **suggest approval by the non-executive directors instead.**

The proposals would otherwise impose a very heavy burden especially on smaller quoted companies. We estimate that the costs may easily be 10 times the amount estimated in the Commission's impact assessment[1]; i.e. nearer 25.000€ – 50.000€. This will place a huge and disproportionate administrative cost burden on smaller issuers for transactions which are, by definition, going to be small.

By contrast, the current UK statutory position requires shareholder approval for the acquisition or disposal of assets to related parties which exceed a value of £100,000 or 10% of the net asset value (Section 190 Companies Act 2006). There is no requirement for a fairness opinion under that legislation.

In terms of the purpose, given the diversity of shareholders' goals and their often high rotation, not to mention the different company laws in different Member States, it would be more feasible and appropriate **to confirm that the transaction is fair and reasonable from the perspective of the company**.

5. "Significant impact" unclear

The procedure proposed gives an important role to shareholders not only if the transaction is above a specific threshold, but also if it has a "significant impact". It is very difficult to understand what "significant impact" means; this approach could therefore generate considerable uncertainty.

There should be no doubt as to whether a shareholder vote is necessary or not. If the term stays as unclear as it is, a responsible and prudent management will have to hand over any larger transaction with a related business partner to the AGM in order to avoid the nullity of the transaction and their own accountability. This will cause problems especially for smaller or younger companies as transactions may more likely have a significant effect on their turnover.

We suggest the following modification to **article 9c para 2:**

"Member States shall ensure that transactions with related parties representing more than 5% of the companies' assets ~~**or transactions which can have a significant impact on profits or turnover**~~ are submitted to a vote by the shareholders in a general meeting. Where the related party transaction involves a shareholder, this shareholder shall be excluded from that vote. The company shall not conclude the transaction before the shareholders' approval of the

[1] EC impact assessment provides an estimate of approximately 2500 - 5000 € (page 59)

transaction. The company may however conclude the transaction under the condition of shareholder approval."

6. Exemption for market-equivalent or standard terms

The exemption under Article 9c, paragraph 4, of the Proposed Directive should be extended also to regular transactions settled in "market-equivalent or standard terms", meaning terms which are similar to those usually applied to unrelated parties for transactions of the same nature, entity and risk, or which are based on regulated tariffs or fixed prices, or applied to entities with which the company is legally bound to transact at fixed price.

In the above transactions, there is no actual risk that managers or controlling shareholders can extract (tunnel) wealth from firms, since the transactions would be at the same terms with any counter party. The transaction fairness, in other words, is assured by the existence of market or standard terms and by the fact that the transaction itself is carried out in the course of the regular business and related financial activity.

An example could provide further clarification. A company such as Enel, dealing with the distribution and sale of electricity, enters into a huge number of contracts to provide electricity to companies directly or indirectly controlled by the Italian State, the Group controlling shareholder, and that, for this reason, are deemed as Enel's related parties.

All those transactions are carried out on normal market terms and conditions, which in some cases are determined by the Authority for Electricity and Gas. If cash flow tunneling involves transfer pricing, where the firm either sells outputs (either goods or services) to insiders for below-market prices, or purchases inputs from insiders at above-market prices, the example above shows that no cash flow tunneling would occur in this case.

7. Calculation of thresholds

Last but not least, we would like to point out that the thresholds, if any, should be calculated on the "consolidated" assets.