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Fostering an Appropriate Regime for Shareholders' Rights
Consultation document of the Services of the Internal Market Directorate General of
Sept. 16, 2004

Sir,

the German Notaries' Association is the federal association of German civil law notaries who exercise the notary's profession solely (i.e. without being admitted to the bar). We represent over 90 % of these notaries. Providing a wide scope of services in corporate law, including services in preparation and holding of General Meetings (hereinafter "GM") of listed and non-listed stock corporations, we are grateful for the opportunity to comment on the consultative paper mentioned above (hereinafter referred to as "Consultative Paper").

I.

The approach of the Consultative Paper is based on several premises which deserve being highlighted:

- (1) IT is presumed to have reached a standard which permits (i) dissemination of substantial information to a multitude of persons in real time, (ii) reliable authentication of licensed attendants to a GM even without them being physically present in real time, (iii) reliable authentication and certification for voting in absentia in a GM in real time and (iv) reliable means of retrieval for confirmation purposes.
- (2) The average investor is presumed to be 100 % "IT-literate".
- (3) Share blocking and chains of "intermediaries" are presumed to be the main obstacles to cross-border voting.
- (4) It is presumed that the question how to convene and to hold a GM does not need to be linked to the more general issue of shareholders' rights in the Member States with regard to the board and to the company (e.g. rights to claim damages or to avoid resolutions of the GM) or to the issue how to fight shareholders' "*rational apathy*".
- (5) The issue of cost of a GM (including pre-GM and post-GM stage) and its allocation may be disregarded.

II.

These premises may be partly true, but this is just evidencing that the Commission's approach is biased under several aspects.

1. Transaction Cost

The first cardinal weakness of the Consultative Paper lies in premise (5) above. Even nowadays a GM of an average German medium sized listed company costs more than € 200,000.00.

Main cost factors are:

- (a) Cost of drafting, printing and mailing pre-GM information to shareholders or their depositary banks (app. 50 %);
- (b) cost for IT-services for the GM (app. 25 %);
- (c) cost of legal advice, if the company does not want to rely on the notary's advice – whose fees are capped at a level of EUR 5,000.00 (app. 15 %);
- (d) other cost like expenses for the hall, catering a.s.o. (app. 4 %);
- (e) costs of publication in the electronic Federal Gazette (app. 3 %);
- (f) fees for notarial minutes and registration with the Commercial Register, if any (app. 3 %).

For a big listed company e.g. a company being member of the DAX, the total cost may exceed EUR 1 Million, in particular due to the factors (a), (b) and (c).

This level of cost is unbearable and a deterrent for newcomers to the capital market. European legislation could be helpful by addressing especially factors (a) and (b). If a company does not want to use the notary's advice being included in the fee for the minutes, it should blame itself for not being able to handle cost factor (c).

As we know from our clients, the impact of the US *Sarbanes-Oxley* Act has, due to the increase in documentation, reporting and disclosure, blown up the transaction cost for listed corporations considerably. For a medium-sized US-listed corporation, the increase amounts to about US-\$ 1 - 1.5 Million. Hence today in the US an IPO is only an option for a corporation with sales proceeds of more than US-\$ 50 million per year. Therefore the side effects of *Sarbanes-Oxley* suggest the conclusion that instead of fostering investors' rights Congress again fostered the "legal arms race" generating large windfall profits both for law firms and for accountancy.

EU and several Member State legislations seem to focus on the US model disregarding transaction costs as well. This creates a barrier for Small And Medium Enterprises ("SME") to

access the capital markets and forces listed companies to think about their position in comparison to their competitors being listed in stock exchanges outside the EU. It seems that the legislator's reaction to *ENRON* and *Parmalat* follows the old NATO doctrine of "*Massive Retaliation*" – you might win the war on intransparency at the price of destruction of capital markets by regulatory overkill.

Instead, questions of capital market and corporate law should be addressed following the more elaborate NATO doctrine of "*Flexible Response*". Otherwise the intention to foster shareholders' rights might end up in merely fostering bureaucracy as well as IT and consulting business. The collateral damage to the capital market by increasing transaction cost will be considerable.

It should not be overseen that fostering entrepreneurship is probably the best way to "create wealth". However, this approach does not seem quite a popular one at the moment.

Transaction cost should be very carefully addressed when setting up standards for a shareholders' right to confirmation how the right to vote by his/her proxy-holder has been exercised. It is not acceptable that the cost for this confirmation shall be borne by the company.

In the Member States where minutes of GMs are to be kept by a notary, confirmation and information of shareholders is no problem even by no. Such minutes are to be made available to the public, e.g. by filing them with the Commercial Register of the respective company. Moreover, one may find these minutes on many websites of companies. From these minutes, drafted by an umpire official, information may be gathered on the exact wording of resolutions passed by the GM and on the results of the vote.

2. Focus on Shareholders' Need

The second crucial weakness of the Consultative Paper consists in its failure to focus its proposals to the need of the average shareholder.

The attendant of an average GM at least of a German listed company is in most cases beyond retirement age. Attending GMs in Germany is a spare time occupation of the middle class pensioner.

However, the average investor in shares is full-time employed and has no time to attend to a GM. The normal European worker even can not afford to follow up a GM disseminated by electronic means or to vote by mouse-click during his/her working day. He/she has to focus on his/her work.

Hence only efficient proxy-voting systems meet the needs of the average investor. Other means of voting *in absentia* - as smart and innovative they may be – are just IT hogwash.

3. IT and IT-literacy

A third weakness of the Consultative Paper lies in its overestimation of technology as a means to enhance shareholders' rights.

The Consultative Paper merely asserts that IT has reached a standard that premise I. (1) above has come true. The Commission seems to assume that it is technologically feasible to hold a GM of a big listed company with several hundred thousand shareholders online using secure connections for everybody. All these attendants have to authenticate themselves for every poll and every question and thousands of answers have to be dispersed to them. Nevertheless the GM should be over after a few hours.

At the moment it seems that we have only reached the level sufficient for (expensive) polling by phone in TV talk shows answering silly questions.

Moreover, the Consultative Paper does not mention the cost of this technology at all. Even if all this were technologically feasible the cost would reach the level of a space mission. Therefore this approach of the Commission is no option for European enterprises. Instead of chasing after technological chimeras the Commission should analyse the fundamental principal-agent-conflict resulting from getting information primarily from IT-focussed consultants.

Furthermore, the Commission assumes that the average European, at least the average European investor is 100 % IT-literate. This presumption is highly questionable. At the moment it rather seems that the gap between an IT-literate minority and an IT-illiterate majority is widening.

4. Chains of Intermediaries

The Consultative Paper assumes that restrictions for cross-border-voting result from share blocking as well from chains of intermediaries. This does not seem to be based on thorough empirical research. Our professional experience suggests a slightly different view.

The fact is obvious: it is difficult for shareholders to attend to a GM abroad. But what are the reasons?

- (a) The language problem may be bridged by a proxy. Of course, provisions restricting foreign shareholders from proxy-voting are unacceptable.
- (b) It is true that share blocking seems strange to many investors, especially to investment funds which rather waive the opportunity to attend to a GM in favour of the ability to dispose quickly of their stock. As to our practical experience at least in the German share blocking system it is possible to dispose of one's stock even during the blocking period. However, these dispositions are to be reported to the company.

Depository banks abroad often do not know what to do with share blocking and do not want to disclose their shareholding to the bank acting as the company's agent in the organisation of the GM. At least the latter gap can be bridged by issuing a certificate of blocked deposit directly to the company. However, we support the switch from share blocking to a record system in general. A record date system will especially be very helpful in case of companies with registered shares with restricted transferability.

- (c) It may be concluded from (b) that beside the problem of share blocking the speed of communication among depository banks and between depository banks and the company should rather be addressed. Improving communication between intermediaries will facilitate cross-border voting much more than the adoption of a record date system (which we appreciate as well). Despite the switch from share blocking to a record date system: if mere message passing lasts too long this may impede the shareholders' attendance to a GM. Time is of the essence when shareholding has to be evidenced to attend to a GM, not the decision between share blocking and record date system.

It is not quite clear what the Consultative Paper means by the term "intermediary". Intermediary could be a depository bank, the entity acting as the company's agent in preparing the GM as well as a stock lender, a stock borrower or a trustee. One may speak of intermediaries also in case of depository receipts or in case of shareholding by investment funds. In all of these cases except investment funds, the legal relations between the shareholder/trustor/beneficiary and the "intermediary" (depository/trustee/legal shareholder) are governed by agency law, not by company law. It should be basically up to the parties of the agreement (i) to define who shall be deemed formal and material shareholder and (ii) to determine who may exercise the right to vote upon whose instructions.

There is no need to disclose the name of the shareholder/beneficiary to the company. If a company wishes to know more on its shareholders, it may opt for registered shares. A bearer share system permits shareholders to remain anonymous. However, a shareholder must disclose his/her name and address when wishing information on the company.

5. Linking Shareholders' Rights to Other Legal Issues

Another crucial weakness of the Consultative Paper consists in its failure to link the question of shareholders' rights to the more general issue of the legal relationship between the shareholders and the company/the board.

Enhancing shareholders' rights is not a value *per se*, for before enhancing someone's rights one must ask whether this person will be able to do good or evil with these rights. We have seen too much of blackmailing companies by filing actions of avoidance of shareholders' resolutions based on the mere assertion that a question has not been answered properly. Even the delay in registration of such resolutions with the commercial register can cause

considerable harm, not to forget the enormous cost incurred by the companies to prepare the case for the defendant.

The extent of a shareholder's right to ask questions depends on the legal consequences of a question which the shareholder does not consider to have been answered properly. Does this imply the right to sue the answering member of the board or the whole board for damages or does this entitle the shareholder to avoid resolutions of the GM or at least to impede their registration with the Commercial Register and therefore their effectiveness ? Is a competitor of the company also entitled to a complete answer or may the company refuse answers which would do harm to business opportunities ?

III.

Therefore we recommend the following for fostering shareholders' rights:

1. GMs shall be convened with a uniform minimum term (e.g. one month, only for a GM in case of a bid under the Takeover Directive, the term may be shortened to two weeks).
2. GMs shall be convened by publication of date, time, place, agenda and postal address/website for supplementary information for download in one central official electronic publication organ, e.g. the German *Bundesanzeiger*, the Austrian *Wiener Zeitung*, the *Moniteur Belge*. These organs shall be notified to the Commission and published on the Commission's website. At least for big companies (e.g. members of indices like EUROSTOXX), a publication in a central European organ might be desirable. Such organ should be determined by invitation to tender.
3. From the day of publication of a convention to a GM the company shall offer for download on its website:
 - proxy statement of the board (proposed resolutions covered by the respective topic of the agenda);
 - eventual counter motions (size of data may be limited) plus relevant comments of the board;
 - information on application for attendance and proxy voting;
 - in case of an ordinary GM: annual financial statements and directors' report.
 - any other information required by the laws of the Member State depending on the agenda.

This information should also be available by snail mail, however at the expense of the shareholder (cost price).

4. Countermotions of shareholders may be filed to the Company. If filed within a fixed term upon publication of the convention of a GM, countermotions must be published on the company's website unless they are too extensive or if their content is offensive under penal law.
5. The right to vote shall be linked to legal shareholding. However, holders of depositary receipts or trustors of shareholders should be in the position to give instructions how to vote. Beyond that minimum standard, this issue should be left to the legal relations between the parties of such a "chain of intermediaries". The legal relations between the parties of a stock lending agreement shall be left completely to agency law. In case of bearer shares there is no need to enforce disclosure of the personal data of shareholders vis-à-vis the company. Beneficiaries' data shall not be disclosed at all.
6. The right to vote shall be evidenced by a record date system, the date being not older than 2 weeks before the GM. Evidence of every licensed share depositary in a Member State shall be sufficient. A uniform template (same form, several languages) is advisable to speed up cross-border communication.
7. Questions of shareholders may be filed in writing before the GM and may be asked during the GM. Answers shall be given either pre-GM or – in case of FAQ on the company's website or during the GM. An answer may be denied for cause giving the reasons for denial.
8. It seems only logical to link the right to table resolutions to the threshold for a squeeze-out (e.g. 5 %).
9. The right to vote *in absentia* shall in any cases be possible by proxy-voting. The form of proxy shall be in writing (also by fax), but the company's articles may set additional standards (e.g. electronic form with authenticated signature). Provisions for voting *in absentia* must not be discriminating to shareholders from other Member States.
10. The issue of confirmation of vote execution should be a matter of the legal relation between agent and principal (i.e. between proxy-holder and shareholder).
11. Recording of the minutes of a GM by a notary should be recognised as an exemplary means to objective information of shareholders.

IV.

You may find our answers to the questions of the Consultative Paper in the **Appendix**.