

9 September 2005

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Corporate Law and Governance Directorate  
Department of Trade and Industry  
5<sup>th</sup> Floor  
1 Victoria Street  
London SW1H 0ET

Dear Sirs

### **COMPANY LAW REFORM – JULY CLAUSES**

The IMA is the trade body representing the UK asset management industry. IMA Members include independent fund managers, the asset management arms of banks, life insurers, investment banks and occupational pension scheme managers. They are responsible for the management of approximately £2 trillion of funds (based in the UK, Europe and elsewhere), including institutional funds (for example, pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK-authorized investment funds (collective investment schemes).

In managing assets for both retail and institutional investors, IMA Members are major investors in companies whose securities are traded on regulated markets. They engage with those companies, enter into an active dialogue and decide how these shares will be voted on the principals' behalf. It is from this standpoint that we have an interest in the proposals in the consultation on Company Law Reform.

The IMA welcomes the draft clauses published in July and the opportunity to comment on further details on the planned Company Law Reform Bill. That said, as we noted in our response dated 14 June to the DTI's White Paper, Company Law Reform, the current framework of company law was founded a long time ago and since then there have been numerous additions and amendments resulting in a patchwork of regulation which lacks coherence. We believe that Government should take the opportunity of the current reform to rewrite and consolidate the Companies Act into a coherent, single statute. We are concerned that the current approach may result in more piecemeal legislation that remains inaccessible and the preserve of lawyers. Indeed as noted in the Government's White Paper, "Modernising Company Law" "a thorough overhaul is needed to make the law clearer and accessible"<sup>1</sup>.

Our main reservations about the specific proposals and other matters are set out below, and our other observations are set out in Annex 1 attached.

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<sup>1</sup> Page 8.

## ***Specific proposals***

### *Auditor reforms and the "true and fair view"*

In summary, although we do not believe there is any evidence that the current liability regime interferes with the proper operation of the market, limits competition or is a major threat that could cause one of the global four accountancy firms to fail, in principle, we accept that auditors should be able to enter into agreements to limit their liabilities and support draft clause Q65. That said, our Members attach great importance to the quality of the audit, to developments in accounting and auditing standards, and to the maintenance of the "true and fair view" and the override. We, therefore, would like to be satisfied on the issues summarised below and set out on pages 13 to 16 before measures to limit liability are introduced.

- We are concerned that the new audit opinion in draft clause Q27(4) - a "true and fair view *in accordance with the relevant financial reporting framework*" - is changing the form of the audit opinion on the accounts into a statement of compliance with that framework. The term "reporting framework" also confuses or obscures the fact that the auditor should look at issues of accounting and control, and not just verify disclosures according to IAS. In summary, we do not believe that a reference to the reporting framework should be included in the opinion and would wish to see the phrase "in accordance with the relevant financial reporting framework" removed. In addition, the word "opinion" needs to be added to clause Q27(4) as only giving a "statement" as required by the proposed text of Q27(4) could have different connotations to the current position under Section 235.
- Whether the 8<sup>th</sup> Company Law Directive will still allow the International Standards on Auditing (UK and Ireland) to include requirements/explanations in the existing UK standards and not undermine case law. Thus it should enable the UK to maintain standards that cover all aspects of what is currently regarded by the courts as incumbent in the "true and fair" audit opinion.
- Whether the "true and fair view" of Companies Act accounts and "present fairly" of IAS accounts are equivalent in substance - the accounts are being prepared to present fairly the position whilst the audit opinion is that they are a "true and fair".
- Although we have yet to see the draft clauses that will succeed sections 226 to 227 on the directors' duties to prepare accounts, it is important that the "true and fair view" override will be able to continue in its current form. A statement from the ICAEW states "around one quarter of listed companies invoke the statutory true and fair override" and that "overrides under IAS are likely to be far less common...Examples of the use of the override amongst European companies that already use IAS are almost unknown".

Our other observations on the clauses in relation to the auditor and audit reporting are set out in the attached. In particular, just as directors' responsibilities are being enshrined in statute the purpose of the audit and the responsibility of the auditors,

based on the Law Lords ruling in the Caparo Case<sup>2</sup>, should be incorporated in the Bill. Furthermore, we are concerned that the liability provisions in Q61 to 69 refer to auditors doing what is required under professional standards - again this would seem to confer a requirement for compliance and remove the more subjective judgments that auditors make under the existing framework.

### ***Other matters***

#### *A poll on all resolutions*

Under regulation 46 of Table A to the Companies (Tables A to F) Regulations 1985, a resolution voted at a company meeting is decided on a show of hands (one vote per member for each shareholder actually present or represented in the case of a corporate shareholder, but not proxies unless the articles provide) unless a poll (a ballot of one vote per share) is called. Common law clarified the chairman's duty to: "ascertain the true sense of the meeting"<sup>3</sup>. Where the chairman as proxy is aware that if a poll was called the outcome would be different from that reached on a show of hands, then he has a duty to demand a poll, if able to do so under the company's articles of association. Guidance from the Institute of Chartered Secretaries and Administrators re-emphasises this duty.

In this respect, we were concerned to learn that at the annual general meeting in July of Goshawk Insurance Holdings, the reinsurer, an advisory resolution on the remuneration of the chairman was decided on a show of hands when a poll would have defeated it. We understand that Goshawk's lawyers had advised that, as votes on remuneration are advisory and not binding on the company, the chairman was not obliged to call a poll.

We consider it important that the law in this area is clarified and that the current Company Law Reform is an opportunity to address this. At the minimum, it should be clarified that the chairman's duty is always to demand a poll when he is aware that the outcome would be different from that reached on a show of hands, regardless of whether the vote is binding on the company. Furthermore, the situation at Goshawk's annual meeting strengthens the case for considering a requirement in law for all resolutions to be voted on a poll in that:

- voting is more exact and equitable in that one vote per share is counted – on a show of hands each shareholder has one vote and it is possible for a group of shareholders owning in aggregate a very small proportion of a company's outstanding capital to influence the outcome;
- voting is more transparent;

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<sup>2</sup>Law Lords ruling in Caparo Industries Plc v Dickman and others [1990] 1 All ER 568 [1990] 2 WLR 358: "It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order: first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital); and secondly, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided."

<sup>3</sup> Second Consolidated Trust Ltd v Ceylon Amalgamated Tea & Rubber Estates Ltd 1942, 2.E.R.567

- overseas shareholders would be more inclined to vote UK shares as currently some are discouraged by the belief that the result is in most cases determined by a show of hands taken at the meeting; and
- although a show of hands is believed to involve or “enfranchise” the private shareholder, the majority cannot and do not attend the meeting, for reasons of geography or timing, but they do complete proxy cards which they may reasonably expect to be counted.

In this respect, the Company Law Reform paper stated in paragraph 4.48 “we propose to consider further the case for a regulatory rule requiring listed companies to proceed directly to a poll on any business likely, on the basis of proxies lodged, to prove contentious”<sup>4</sup>.

### *Improving voting disclosure*

Although not raised in this consultation, we understand that Government is considering requiring institutional shareholders to disclose publicly how their voting rights have been exercised. In this respect, we agree with the comment in the Government’s White Paper, “Modernising Company Law”, which recognised that there would be difficulties with company law requiring this<sup>5</sup>.

Our Members invest in companies in their capacity as agents of the beneficial owners. In practice, beneficial owners frequently give their investment managers discretion to engage with investee companies and issue voting instructions on their behalf. This has a number of implications for managers disclosing how they have exercised their voting rights.

- *Votes may not be exercised.* As noted above, under existing law, resolutions can be decided on a show of hands at the meeting and unless a poll is called votes may not be exercised. Thus although a manager may give an instruction to vote that instruction may not be exercised.
- *Managers do not know if their voting rights have been exercised.* Managers issue voting instructions, however, the chain these must go through, in that there is the custodian, custodian’s nominee, registrar and possibly a proxy voting service make it difficult for managers to determine whether these are exercised. Certain of our Members will seek to ensure that their instructions have been acted on by undertaking sample tests. However, registrars and custodians will sometimes maintain that they do not have the authority to give them this information in that they are only accountable to their own clients, the company or the beneficial owners, respectively.
- *It is not the manager’s information to disclose.* How managers vote is the subject of contractual arrangements with clients, the beneficial owners. There would be sensitivities if managers were required to disclose their votes publicly as it is not their information to disclose.
- *A manager may vote different tranches of a block of shares different ways.* Although in the majority of instances, clients delegate voting decisions to their investment manager, some clients will give specific voting instructions or may ask the manager to follow the recommendations of a particular voting service. Thus

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<sup>4</sup> Company Law Reform, Modern Company Law for a Competitive Economy, Developing the Framework, Volume 5.

<sup>5</sup> Paragraph 2.47.

as they act for different beneficial owners, investment managers may vote a particular block of shares different ways according to their clients' instructions.

Although there are difficulties with public disclosure, managers attach great importance to voting and it is normal practice for them to disclose to their clients details on how they sought to vote where they have been given discretion to do so. The IMA's annual survey in 2004 of leading fund managers engagement with investee companies<sup>6</sup> asked 34 managers whether they report to their clients. In this respect, 32 of the 34 participants report quarterly, mainly details of how they have voted, notably resolutions voted against the board or consciously abstained, together with the reasons. This accords with the ISC's Statement of Principles on the Responsibilities of Institutional Shareholders and their Agents which states "those that act as agents will regularly report to their clients details on how they have discharged their responsibilities. This should include a judgment on the impact and effectiveness of their engagement. Such reports will be likely to comprise both qualitative as well as quantitative information."

The IMA believes that the Statement's recommendation helps ensure that the disclosures are informative and helpful whereas a requirement in law for voting decisions to be disclosed is likely to result in page upon page of statistics and tables which could be confusing and of limited use. Some investment managers already disclose publicly how they have voted; treating it as an integral part of the service provided (seven of the managers surveyed in 2004 made their voting records public by putting them on their web sites and it is expected that this will increase in 2005). However, we do not believe that managers should be required to disclose publicly how they have voted. Indeed, as managers act as agents of the beneficial owners and issue voting instructions on their behalf, the onus to disclose should be on the beneficial owners, for example, the pension trustees, as the owners of the vote – albeit there would be similar practical difficulties.

Please do call me on 020 7269 4668 if you would like to discuss any of the points in this letter or the attached or if you would like to discuss any issues further.

Yours faithfully

Liz Murrall  
Senior Adviser – Corporate Governance

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<sup>6</sup> The Investment Management Association's Survey of Fund Managers' Engagement with Companies to year ended 30 June 2004. In aggregate, as at 30 June 2004, these managers managed £552 billion of UK equities or 55% of all UK equities managed.

## IMA'S DETAILED OBSERVATIONS ON THE DRAFT CLAUSES

The IMA's detailed observations on the draft clauses are set out below.

### 1. The Registrar – part L

#### *New draft clauses*

The draft clauses seek to:

- widen the registrar's powers to stipulate the form and manner in which documents must be delivered and provide that any such rules are publicised (L8 to L12);
- give the Secretary of State power to provide for electronic delivery of classes of documents (L10);
- allow information to be filed electronically and give the registrar power to make agreements so that information is only delivered electronically (L11);
- clarify what information will appear on the register and be made public (L13);
- enable the registrar to correct information informally by telephone as opposed to rejecting forms formally (L14);
- clarify that requests for information can be delivered in electronic or paper form and that search fees should not exceed administrative costs (L25 to L31);
- enable the registrar to remove from the register items placed there in error or unnecessary material (L33);
- where information on the register is found to be inaccurate or misleading, allow a simple court procedure to remove it (L34);
- create a new offence of knowingly or recklessly delivering to the registrar information that is misleading, false or deceptive (L47); and
- give the Secretary of State power to provide by Statutory Instrument for notices to be published in a manner from time to time approved by the registrar as opposed to having to be in the London or Edinburgh Gazettes (L48).

The majority of the clauses proposed are outside the IMA's remit in that they relate to the system for companies to file information with Companies House. That said, we welcome the changes in that they will help improve the efficiency of the system and encourage electronic communication. In particular, we support searchers of the register being able to receive information in electronic or paper form and that search fees should not exceed the administrative cost of the service.

## 1.2 Company names – part M

### *New draft clauses*

The draft clauses:

- broaden the circumstances when prior approval is required to cover not only names that give the impression of connection to Government or a local authority but also to Parliament and the Scottish, Welsh or London assemblies (M2);
- provide that regulations can specify what letters, symbols etc. may be used in a name (M5);
- implement the CLR's recommendation that a name has to be changed if it was chosen to exploit another's reputation and goodwill (M16 to M20); and
- extend the provisions on change of name so that it can be done by any means provided in the articles as well as by a special resolution (M23-M25).

The IMA welcomes the draft clauses on company names as these will help ensure that names do not mislead third parties.

## 1.3 Control of political donations and expenditure – part N

### *New draft clauses*

The Government is not proposing to make any major changes to the regime covering political donations. In relation to shareholders' authorisation of political donations in excess of £5,000, it is clarified that:

- the provision of a meeting room for trade union officials is not caught (N13) (although paid time-off for local councilors is not exempt as it does not constitute a political donation under current requirements);
- a holding company can seek authorisation of donations and expenditure in respect of itself and one or more of its subsidiaries through a single resolution (N6(1));
- authorisation is required for donations to independent election candidates (N2(3) and N3(3)); and
- companies can seek separate authorisation for donations to political parties and to other political organisations (N6(2)).

The IMA welcomes the fact that it will be sufficient for a company and its subsidiaries to obtain a single authority to donate to a particular political party and that it will not be necessary to obtain a separate authority for each subsidiary. Existing requirements for separate authorisations tie up time at meetings which is not necessary.

In addition, from the DTI's White Paper, Company Law Reform, March 2005, we understood that the Government intended to increase the threshold for disclosure of

political and charitable donations to £2,000<sup>7</sup>. We support this proposal on the basis that donations below this threshold will generally be considered to be immaterial. However, it is not clear from the current draft clauses whether this is being taken forward.

#### **1.4 Derivative claims – part O**

##### ***New draft clauses***

The draft clauses put derivative actions on a statutory footing as opposed to leaving them to case law (O1 to O4).

The IMA supports derivative actions being put on a statutory footing as opposed to leaving them to case law. Derivative actions are an important mechanism whereby a company can hold directors to account for the proper exercise of their duties. We also welcome clarification in draft clause O4 of the circumstances when the court must refuse permission and the considerations to be taken into account for permission to be given.

#### **1.5 Company investigations – amendments – part P**

##### ***New draft clauses***

The draft clauses give the Secretary of State powers:

- to direct the subject matter of an investigation or require inspectors take certain steps (P1);
- to stop an inspection unless the inspection is one that the Secretary of State is obliged to make in which instance it can only be stopped if it appears a criminal offence has been committed and the matter is referred to the prosecuting authorities (P1);
- to secure that any report:
  - includes the inspectors' views on a specified matter,
  - does not include any reference to a specified matter,
  - is made in a specified form or manner, or
  - is made by a specified date (P1);
- to appoint replacements on the resignation or death of inspectors (P2); and
- to require information and documents to be given to him (P3).

The Company Directors Disqualification Act 1986 is extended so that decisions on whether to disqualify directors can be taken on the basis of information obtained during an investigation (P4).

The IMA welcomes the Secretary of State being given powers to end an investigation when it is no longer in the public interest to continue it and to issue directions to control the scope of the investigation, its duration and certain other matters.

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<sup>7</sup> Page 51

## 1.6 Auditors – part Q

### *Draft clauses – where no change*

The draft clauses include provisions that relate to the audit. The areas where there are no substantive changes are as set out below.

- The requirement for audited accounts other than for companies that are exempt (Q1, Q3 to Q5).
- Exemptions for dormant companies (Q6 and Q7) and charities (Q8 to Q13).
- The right for members holding not less than 10% in nominal value of issued share capital, or if there is no share capital, 10% of the members, to require an otherwise exempt company to have an audit (Q2).
- Requirements for companies subject to public sector audit (Q14).
- Provisions covering the appointment, reappointment and removal of the auditor of private (Q15 to Q19) and public (Q20 to Q23) companies. There is no real difference from the current position except that for private companies the auditors will automatically be re-appointed unless appointment was by the Directors; or the company articles require re-appointment; or the members have given notice that they should not be re-appointed; or the last accounts did not require an auditors' report and the Directors have resolved that an auditor need not be appointed (Q18).
- Provisions on the fixing of the auditors' remuneration (Q24) and disclosure of services (Q26).
- Specifying that provisions protecting auditors from liability to the company are in general void (Q61) – although see below on liability limitation agreements.
- Companies allowed to purchase and maintain indemnity insurance for auditors against any liability arising from negligence, default, breach of duty or breach of trust (Q62).
- Companies allowed to indemnify auditors against costs of civil or criminal proceedings and applications for relief (Q63).

The clauses, which introduce new requirements and our observations on them, are as set out below.

### *New draft clause - publication of audit engagement letters*

A new power is introduced for the Secretary of State to make regulations to secure the disclosure of the terms of the audit engagement letter (Q25). The Explanatory Material notes that the Government has asked the FRC to consider this proposal in its review of the Combined Code announced on 14 July<sup>8</sup> as its preference is that this proposal is taken forward via a non-statutory route.

The IMA does not support the Government's suggestions that a requirement for engagement letters to be published is given a non-statutory footing and is subject to the "comply or explain" basis under which the Combined Code operates. We believe that it should be given a statutory footing.

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<sup>8</sup> <http://www.frc.org.uk/press/pub0738.html>

In addition, the FRC's call for evidence on its review of the Combined Code states "in April 2005 the Audit Quality Forum produced a report on the contractual terms on which auditors were engaged by quoted companies. The report recommended that audit firms and directors should be encouraged to agree that the engagement letter relating to the report given in respect of the UK statutory audit should be publicly disclosed on the company's website within 21 days of the terms of engagement being agreed by the board, and that this should be achieved by amending the Combined Code".

We consider it would be more helpful if the terms of engagement were made available to shareholders in advance of the vote to reappoint the auditors so that shareholders better understand the scope of the audit and the terms under which it is undertaken before they vote on the auditors' appointment.

***New draft clauses - right of a member to raise audit concerns at the accounts meeting***

Shareholders representing not less than 5% of voting rights, or not less than 100 shareholders holding paid up shares of not less than £100 each, will be able to require the company to publish on its web site a statement relating to the audit or the circumstances connected with an auditor ceasing to hold office that they propose raising at the next "accounts meeting" (Q58). ("Accounts meeting" is new and relates to a meeting of a public limited company at which the company's annual accounts are laid.)

The business at the accounts meeting must include any statement received from the requisitionists at least five working days before the meeting. The company in its notice of the meeting must mention the possibility of such a statement appearing on its web site, and if a requisition is received must place it on its web site within three working days, and forward a copy to the auditors. In the event of non-compliance, an offence is committed by every officer of the company in default (Q59).

Q60 makes provision for non-publication on the company's web site if on application to the court; the court considers that these provisions are being abused.

We support members being able to raise concerns about the audit at the accounts meeting. However, for this to be effective, we consider that auditors should be required to attend and be heard at public companies' annual general meetings. This should apply in particular where the board has "removed" the auditor or the auditor is retiring/resigning. (Although auditors do tend to attend such meetings, they are currently not required to do so.)

In addition, we do not believe that these proposals go far enough and consider that the requirements for the appointment and removal of auditors should be reviewed. The present notification and disclosure arrangements are ineffective and the level of directors' control over the appointment and removal of auditors can give rise to issues, particularly where fee income is significant (the current procedure where shareholders vote on the re-appointment of the auditors at the AGM is not really effective). Improved arrangements should enable shareholders to engage with the

company on the appointment and removal of auditors in a timely and efficient manner, where appropriate.

***New draft clauses - the audit lead partner to sign and print their name on the audit report***

The audit report will now have to state the name of the senior statutory auditor (Q36 and Q37) as opposed to simply the name of the audit firm. However, the senior statutory auditor will be exempt where personal security would be threatened provided notice is given to the Professional Oversight Body for Accountancy (Q38). It is an offence for a person aware of the senior statutory auditor's exemption to disclose the auditor's name unless the disclosure is made for the purpose of facilitating a public function (Q39).

We welcome the audit lead partner being required to sign and print their name on the audit report. For the majority of shareholders, the audit report is the only output they receive from the audit process and it is helpful if they know who is responsible.

***New draft clause - offences in connection with the audit report***

It will be a criminal offence for an auditor to knowingly or recklessly cause a misleading, false or deceptive audit report to be made. The offence is directed at individuals working on the audit (Q40).

The IMA has concerns over the proposed changes that will effectively criminalise auditors "knowingly or recklessly" reporting matters that are misleading, false or deceptive in a material particular. Whereas we do not object to the criminalisation of fraudulent behaviour, "recklessness" could potentially include honest misinterpretation or incompetence and could have unintended consequences in that:

- auditors adopt a "box ticking" mechanistic approach along the lines of the US model to reduce the risk of being accused of knowingly or recklessly omitting to make a statement about proper accounting records; and
- the FRRP's current methods of operation are destroyed in that companies and auditors will no longer volunteer information but will become more legalistic in their approach on the basis that the information they divulge could ultimately lead to a criminal charge.

***New draft clauses - liability limitation agreements (Q61 to 69)***

Shareholders will be able to agree to limit the auditors' liability to the company in respect of "any negligence, default, breach of duty or breach of trust occurring" during the period specified in the agreement (Q64). Approval must be secured by company resolution either before or after the company enters into the agreement (private companies may resolve to waive the need for approval). If before, the company must approve the agreement's principal terms. If after, the company must approve the agreement (Q65). Other points to note are:

- the agreement must be disclosed in the annual accounts or directors' report as required by regulations (Q67);

- the agreement cannot limit liability to less than an amount that is fair and reasonable having regard to: the auditors' responsibilities under this part; the auditors' contractual obligations; and the professional standards expected of him (Q66);
- the Secretary of State can make regulations to limit the duration of agreements (Q68) - it is envisaged that initially such agreements will be limited to single financial years (i.e. a new agreement and resolution will be needed each year); and
- members can terminate the effect of a limitation agreement.

As noted in our response in June, although we do not believe there is any evidence that the current liability regime interferes with the proper operation of the market, limits competition or is a major threat that could cause one of the global four accountancy firms to fail, in principle, we accept that certain steps to limit liability might be appropriate and we support the proposal in Q65. That said, our Members attach great importance to the quality of the audit, developments in accounting and auditing standards, and the maintenance of the true and fair view and the override. We are concerned to ensure that making IAS explicit in law does not undermine the "true and fair" view, which is the cornerstone of financial reporting in the UK. We, therefore, would like to be satisfied on the issues as set out below under "revised audit report" and "accounts preparation". Secondly, we would welcome some clarification on the drafting of the text on liability limitation agreements as follows.

- In accordance with Q66 we understand that the limit on liability should not be less than an amount that is "fair and reasonable" for the outcome, taking into account the auditors' legal duties. We believe this does not differ greatly from the relief already available under Section 727 except that this section also requires that the auditor acted "honestly and reasonably". We assume the term "professional standards" in Q66(c) is equivalent to this but would welcome clarification. In addition, we assume the standards are not taken as relating solely the accounting and auditing standards, otherwise liability agreements may exacerbate the "compliance" problem noted below.
- There is a need for clarification on how liability limitation agreements will affect groups, as it would appear that shareholders only approve the liability limit for the parent company.
- Q68 enables the Secretary of State to prescribe financial years to which a liability agreement will not apply. It is not clear whether this would only be effective for future years or whether, as we would prefer, could also be effective for earlier years if it is found that the liability agreement has been abused.

The Explanatory Material specifically asks for views on whether it would be desirable to place an obligation on auditors to provide the oversight body with a list of companies with which they have limitation of liability agreements. We believe this would be sensible as it would enable an independent body to monitor the position to ensure that the provisions are not being abused. In addition, in this context and just as directors' duties are being codified in statute, in the interests of clarity, the

purpose of the audit and the responsibility of the auditors, along the lines articulated in the Law Lords ruling in the Caparo Case<sup>9</sup>, should be incorporated in the Bill.

### ***New draft clauses - revised audit report***

Currently auditors are required to report whether the accounts have been properly prepared in accordance with the Act and whether in their opinion they give a true and fair view (235(2)).

Following the introduction of the Modernisation Directive which amended the 8th Company Law Directive, the audit report will now have to state clearly whether in the auditor's opinion the annual accounts have been properly prepared in accordance with the requirements of this Act and Article 4 of the EU Regulation (consolidated accounts in accordance with International Accounting Standards (IAS)). The report must also state whether the annual accounts give a true and fair view, in accordance with the relevant reporting framework, and identify the audit standards under which the audit was conducted (Q27).

*True and fair view "in accordance with the relevant financial reporting framework".*

The IMA is concerned that the new clause Q27 is changing the statutory audit in legislation into something that is no longer an opinion as such but a statement whether the accounts give a true and fair view in accordance with the relevant financial reporting framework. In addition, it is not clear what constitutes that framework.

Recital 10 of the Modernisation Directive states "the fundamental requirement that an audit opinion states whether the annual or consolidated accounts give a true and fair view *in accordance with the relevant financial reporting framework* does not represent a restriction of the scope of that opinion but clarifies the context in which it is expressed".

There are concerns that if this were the case, the text would have read "having regard to" or "in the context of" as opposed to "in accordance with". The term "reporting framework" confuses or obscures the fact that the auditor should look at issues of accounting and control, and not just verify disclosures according to IAS. In summary, we do not believe that a reference to the reporting framework should be incorporated into the opinion and would wish to see the phrase "in accordance with the relevant financial reporting framework" removed, or placed so that it does not encumber the opinion in any way. In addition, the word "opinion" needs to be added to clause Q27(4) as only giving a "statement" as required by the proposed text could have different connotations to the current position under Section 235.

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<sup>9</sup>Law Lords ruling in Caparo Industries Plc v Dickman and others [1990] 1 All ER 568 [1990] 2 WLR 358: "It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order: first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital); and secondly, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided."

### *Retention of the International Standards on Auditing (ISA) pluses*

The International Federation of Accountants' ISAs, developed by the IAASB<sup>10</sup>, have been introduced into the UK by the Auditing Practices Board (APB). In so doing, the APB incorporated requirements/explanations in the existing UK standards into the revised ISAs as highlighted text - ISAs (UK and Ireland) or ISA pluses.

We are concerned that the 8th Company Law Directive, which is likely to be implemented in two years time, may mean that this has to be reversed. We understand that although the Directive is minimum harmonisation, there are some elements that are maximum harmonisation - for example Article 26.4, which says that "Member States can impose additional requirements relating to the statutory audit of annual and consolidated accounts for a period of two years after the transposition period in Article 53(1) has elapsed".

This would seem to mean that the UK has four years at least to get its standards in order, and then they are frozen. In addition, Article 26.1 states that "Member States may apply a national auditing standard as long as the Commission has not adopted an international auditing standard covering the same subject matter". However, there is still a risk that, as the ISAs do not appear to cover true and fair view, the UK is not able to adopt its own supplemental standards that do. We would welcome confirmation that this is not a likely scenario and that the UK can adopt a standard that covers all aspects of the true and fair audit opinion.

### ***Accounts preparation***

In accordance with the Companies Act, directors had to prepare accounts to show a true and fair view (section 226). The accounts also had to state whether they were prepared in accordance with accounting standards and if not, why not. Accounting standards were not rules but were an authoritative source of accounting best practice and it was not necessarily assumed that following the standards gave a true and fair view. Thus where the standards would not result in the best reporting outcome:

- additional information was required to be given where the standards were not sufficient; or
- they could be departed from to the extent necessary to give a true and fair view and the departure, the reason for it and the effect had to be disclosed – the true and fair view override.

In particular, under FRS 5, Reporting the Substance of Transactions, an entity's financial statements had to report the substance of the transactions it had entered into.

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<sup>10</sup> The IAASB (International Auditing and Assurance Standards Board) is established by and under the auspices of the International Federation of Accountants (IFAC), the international representative organisation of the accountancy profession.

The EU Regulation was introduced into the Companies Act by statutory instrument and requires EU listed companies to prepare their consolidated accounts in accordance with a single set of accounting standards (International Accounting Standards (IAS)) from 2005. Neither the Regulation nor the relevant provisions in the Companies Act refer to the "true and fair view" that applies to those companies that continue to prepare their accounts in accordance with UK GAAP – unlisted companies and those that do not have to produce consolidated accounts.

Thus for IAS accounts, IAS 1 has to be referred to which requires that the financial statements "present fairly the financial position, financial performance and cash outflows". This is as opposed to the true and fair view in the Companies Act and in FRS 18, Accounting Policies, that an entity should adopt those accounting policies that are most appropriate for the purpose of giving a true and fair view, within the constraints of other accounting standards and companies legislation.

*Companies Act accounts that show a "true and fair view" and IAS accounts that present fairly the position*

We are concerned whether the basis of preparation of Companies Act accounts that must show a "true and fair view" and IAS accounts that must "present fairly the position" are the same in substance. Furthermore, whereas directors have to prepare accounts that "present fairly the position" under the new requirements the auditor has to report whether those accounts show a "true and fair view in accordance with the relevant financial reporting framework".

A new section in the Act (262(2A)) on changes to definitions states that references to accounts giving a "true and fair view" are the same as the requirement under IAS that accounts achieve a fair presentation. One of our Members has obtained a legal opinion on this section which has reservations as to whether 262(2A) is an accurate statement of the Regulation, the Directives and IAS.

In summary, there are uncertainties whether "true and fair view" and "present fairly" are equivalent that need clarification.

*Departures from accounting standards*

As noted, for Companies Act accounts it is not necessarily assumed that following accounting standards gives a true and fair view. The EU Regulation on the other hand has made IAS "explicitly part of the law rather than implicit in the "true and fair" requirement" (FRC's legal opinion from Freshfields dated 24 June 2005).

We are concerned that making IAS explicit in law may mean that the true and fair override is lost. In this respect, under IAS 1 management can depart from a standard in "extremely rare circumstances" when it concludes that compliance would be so misleading and would conflict with the objective of the accounts. We believe this may be more stringent than the Companies Act provisions and the equivalent of FRS 5, Reporting the Substance of Transactions, does not exist for IAS accounts. A statement from the ICAEW states "around one quarter of listed companies invoke the statutory true and fair override" and that "overrides under IAS are likely to be far

less common...Examples of the use of the override amongst European companies that already use IAS are almost unknown”.

In conclusion, it appears to be a matter of uncertainty that needs clarification. There may be a conflict between having IAS that are maximum harmonisation achieving comparability between listed companies and to achieving the highest standard of reporting for specific companies.

## 1.7 Takeovers – part R

### *Draft clauses*

The draft clauses will provide for the matters set out below.

- The Panel to have regulatory functions in relation to takeovers - empowering it to do anything necessary or expedient and to arrange for functions to be carried out on its behalf (R1).
- Empower the Panel to make and amend rules by the Code Committee (R2) including:
  - the general principles for takeovers (article 3.1 of the Directive);
  - jurisdictional rules (article 4.2);
  - matters related to the protection of minority shareholders, mandatory bid and equitable price (article 5);
  - contents of the bid documentation (article 6.1 to 6.3);
  - time allowed for acceptance of a bid and publication of a bid (articles 7 and 8);
  - obligations of the management of the target company (article 9); and
  - other rules applicable to the conduct of bids (article 13).
- Enable the Panel to grant derogations and waivers (R3).
- Give the Panel powers to make rulings on its rules and directions to prevent breaches or to ensure compliance (R4 and R5).
- Require those involved in takeover actively to provide the Panel with the information it requires to carry out its functions (R6).
- Ensure information obtained by the Panel is restricted from onward disclosure (R7 and R8).
- Require the Panel to co-operate with other authorities within the EEA (R9).
- Ensure that the Panel has;
  - review and appeal procedures (R10);
  - powers to make rules on sanctions for breaches (R11) and provide for redress (R12); and
  - recourse to powers in legislation (R13).
- Ensure that the Panel continues to be funded (R15 to R17).
- Enable the Panel to bring proceedings and both it and those involved in carrying out its activities to have immunity (R18 and R19).
- Repeal section 143 of the Financial Services and Markets Act given that the Code will now have statutory force (R22).

The IMA responded to the DTI's proposals to implement the Takeover Directive and introduce a statutory framework for the operation of the Takeover Panel on 15 April 2005. In summary, we supported the proposals and a copy of our response is attached at Annex 2. One of the more controversial aspects in negotiating the

Directive was the extent to which it should address defensive measures which, in the interests of securing agreement, became optional. Our observations on these aspects, and on matters such as the information to be published by companies in their annual reports and squeeze-out and sell-out are set out below.

### *Articles 9 and 11*

Member States can choose not to apply article 9 and/or 11 provided that they have a legislative regime for companies to opt-in.

- The Government has decided to mandate article 9 for all UK listed companies to protect minority shareholders and provide that shareholders, not the management of a target company, should decide on a takeover bid.
- Whilst the Government recognises the importance of open structures – such as one share, one vote – it is not proposing to mandate article 11 which overrides a number of defenses that may be adopted in a takeover such as differential share structures; restrictions on the transfer of shares; and limitations on share ownership. The Government considers there would be few benefits in mandating article 11 and a number of drawbacks (for instance, there would be no flexibility to allow certain share structures and some companies may seek a listing outside the EU or in a Member State that does not impose article 11). Instead Government will put in place a legislative framework (clauses R24 to R31) for companies to opt-in voluntarily.

The IMA agrees that all companies registered in the UK and whose shares are admitted to trading on a regulated market should be obliged to comply with the requirements of article 9 and the protections it affords to minority shareholders. This includes the fundamental principle that it should be for the shareholders of the target company, not management, who should decide on the merits of takeover bid.

As regards article 11, we are disappointed that the negotiations on the Directive failed to settle the basic issue of shareholder rights and ensure that investors' rights to decide whether or not to accept a bid are in proportion to their investment throughout the EU, i.e. there is "one share one vote". We believe that "one share one vote" is key to promoting shareholder democracy and should be addressed.

Thus although the overall position is not satisfactory, given that Member States have the option of implementing article 11 we agree with the Government that there would be little benefit in practice in doing so in the UK. First, currently the UK has no restrictions on the way UK listed companies can structure their share capital and control but market pressures have ensured that there are now few UK listed companies with differential voting structures. Implementation could restrict the current flexibility that enables companies and shareholders to construct share structures as they see fit. Furthermore, given that the option will mean that differential share structures will continue to exist in other Member States, implementation of article 11 in the UK could result in companies moving their listing from the UK to another Member State that did not impose article 11 or outside the EU altogether. It is important, however, that any differential share structures that

exist are disclosed to the market and are addressed in R32 – matters to be dealt with in the directors’ report.

The Directive provides for “reciprocity” where opted-in companies can be exempted from the provisions of those articles when they are the target of a bid from a company which is not itself subject to those articles. The Government does not propose to exercise this option on the basis it could undermine the benefits of the UK’s current open regime.

We agree with the Government that the UK should not utilise the reciprocity provisions whereby a bidder may only benefit from articles 9 and 11 if they and/or any controlling company are subject to a similar regime. We believe reciprocity could potentially have adverse consequences, for example, UK companies could be ring fenced from takeovers by companies from third countries which could have unintended consequences.

#### *Disclosures in the directors’ report*

Article 10 of the Directive is to be implemented in R32. This requires companies admitted to trading on a regulated market to disclose in their annual reports their control and share structures, and to present an explanatory report to shareholders on such issues at the annual general meeting and also to include it in the directors’ report. Failure to do so could result in criminal sanctions under section 234(5) of the Companies Act 1985 (directors responsible for the failure to comply with provisions related to the directors’ report are to be liable to a fine). These provisions apply whether or not a company is involved in a takeover and to all companies registered in the UK which have shares traded on a regulated market, whether or not that market includes an official listing in London.

The IMA supports companies making an explanatory report to shareholders on share and control structures in the annual report as proposed to presenting it at the annual general meeting (AGM). This should minimise formalities at the AGM and in any event, not all shareholders can attend the AGM of every company in which they hold an interest. Asset managers typically invest in hundreds of UK companies (there are 850 companies in the FTSE All Share). Given that the vast majority of companies have 31 December year-ends, their annual general meetings fall in the same few months of the year and can be held at various locations throughout the UK depending on where the company is based. It would be impossible for asset managers to attend the AGM of every company in which they invest. We appreciate that the Government is seeking to minimise the costs of complying with the disclosure requirements under articles 10(1) and 10(2).

#### *“Squeeze out” and “sell out”*

“Squeeze-out” and “sell-out” address the problems of, and for, residual minority shareholders following a successful takeover bid. Squeeze-out rights enable a successful bidder to purchase the shares of the remaining minority shareholders. Sell-out rights enable minority shareholders to require the majority shareholder to purchase their shares. High thresholds apply to the exercising of such rights and there are protective rules on the share price and articles 15 and 16 of the Directive introduce EU-wide rules.

The Directive is broadly consistent with existing provisions under the Companies Act 1985 with the following modifications:

- squeeze-out threshold – a dual test in that the bidder must have acquired both 90% of the shares (or class of shares) and 90% of the voting rights as opposed to the current threshold of only 90% of the shares (or class of shares);
- sell-out threshold - a dual test in that the bidder must hold both 90% of the shares (or class of shares) and 90% of the voting rights as opposed to the current threshold of 90% of shares;
- squeeze-out must be exercised within a 3 month period following the time allowed for acceptance of the bid as opposed to the current provisions that it may be exercised within four months of the offer and must be within two months of reaching the 90% threshold - a longer period is allowed for bids not subject to regulation by the Panel, for instance takeovers of most private companies;
- sell-out may be exercised either three months from the end of the offer or, if later, three months from the notice given to the shareholder of his right to exercise sell-out rights (new section 430A (2C)). An extended period during which the sell-out right can be exercised where notice of such a right is only given after the end of the offer period is consistent with the Directive allowing more stringent provisions to be put in place (in this case to ensure the proper protection of minority shareholders).

The court will no longer be able to reduce the squeeze-out or sell-out consideration from that offered in the bid and minority shareholders will continue to be able to apply to the court to request that consideration higher than that offered in the bid be paid in exceptional circumstances.

The IMA agrees that the recommendations of the Company Law Review compatible with the provisions of the Takeover Directive should be adopted as set out above. These are uncontroversial and sensible amendments. We also agree that the proposed changes should apply to all companies and bids currently subject to Part 13A of the Companies Act 1985, regardless of whether or not the Takeover Directive applies to them.

15 April 2005

Peter Brower  
Corporate Law and Governance Directorate  
Department of Trade and Industry  
Bay 216  
Elizabeth House  
39 York Road  
London SE1 7LJ

Dear Mr Brower

**COMPANY LAW – IMPLEMENTATION OF THE EUROPEAN DIRECTIVE ON  
TAKEOVER BIDS**

The IMA is the trade body representing the UK asset management industry. IMA Members include independent fund managers, the asset management arms of banks, life insurers, investment banks and occupational pension scheme managers. They are responsible for the management of approximately £2 trillion of funds (based in the UK, Europe and elsewhere), including institutional funds (for example, pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, our Members manage 99% of UK-authorized investment funds (collective investment schemes).

In managing assets for both retail and institutional investors, IMA Members are major investors in companies whose securities are traded on regulated markets. Our interest in the European Directive on Takeover Bids is from the standpoint of institutional investors. In this respect, we are disappointed that the negotiations on the Directive failed to settle the basic issue of shareholder rights and ensure that, throughout the EU, investors' rights to decide whether or not to accept a bid are in proportion to their investment i.e. there is "one share one vote". We believe that "one share one vote" is key to promoting shareholder democracy and should be addressed.

The Directive is not completely silent on the matter but gives Member States the option of opting out of a key clause that provides that voting rights can be overridden if they distort the relationship between control and the amount contributed by way of capital. If a Member State chooses to opt out it will mean that management and those with entrenched interests will be able to protect their position. That said, given that the option exists, we believe that there would be little benefit in implementing the clause in the UK - differential share structures are rare and implementing the clause could mean that companies move their listing from the UK to a Member State that has not implemented it or outside the EU altogether. It is important, however, that any differential share structures that exist are disclosed to the market.

Whilst we are disappointed in the outcome of the debate at a European level, we welcome the Government's proposals for implementing the Directive as set out in the

consultation paper (CP). Although the Directive's scope is generally narrower than the Code, we agree that the Panel's regulatory authority under the proposed legislation should cover both companies and transactions covered by the Directive as well as those other companies and transactions not within the scope of the Directive but currently regulated by the Panel. However, where jurisdiction is to be shared with another Member State it is not yet clear how the shared jurisdiction provisions will work in practice. In particular, it remains to be clarified how the Code will be applied to non-Directive takeover transactions for companies registered in the UK but admitted to trading on a regulated market in one or more other EU Member States.

Please do call me on 020 7269 4668 if you would like to discuss any of the points in this letter or the attached or if you would like to discuss any issues further.

Yours sincerely

Liz Murrall  
Senior Adviser – Corporate Governance

**IMA RESPONSE TO THE CONSULTATION PAPER (CP) ON COMPANY LAW – IMPLEMENTATION OF THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS**

The IMA's detailed comments on the questions in the CP are set out below.

**Takeover regulatory framework and the Takeover Rules**

*Q 1 Do you agree that the Takeover Panel should remain responsible for regulating takeovers?*

The IMA agrees that the Takeover Panel should remain responsible for regulating takeovers. This will ensure that the flexibility, speed and certainty in decision-making afforded by the current regime are maintained.

*Q 2 If so, should the central objective of the implementing legislation be to preserve the flexibility, speed and certainty of the current regime consistent with meeting the requirements of the Directive?*

As noted above, the IMA agrees that the central objective of the implementing legislation should be to preserve the current regime's flexibility, speed and certainty and that its strengths should be built on.

*Q 3 Do you agree that the same regime should apply to all takeovers and other transactions currently covered by the Takeover Code whether or not they are covered by the Directive?*

*Q 4 Do you agree that the same regime should apply to all companies currently covered by the Takeover Code whether or not they are covered by the Directive?*

The IMA welcomes the fact that the scope of the Code is to remain largely unchanged so that the same regime will apply to those transactions and companies currently covered that are not within the Directive's scope. We also welcome the fact that the Panel will have the flexibility to make rules to deal with future developments in the area of takeovers as they arise.

However, as noted in the covering letter, where (under Article 4.2 of the Directive) jurisdiction is to be shared with another Member State it is not yet clear how shared jurisdiction provisions will work in practice. In particular, it remains to be clarified how the Code will be applied to non-Directive takeover transactions for companies registered in the UK but admitted to trading on a regulated market in one or more other EU Member States.

*Q 5 Do you agree that the Panel should retain autonomy to determine its own constitution consistent with the minimum requirements as to separation of executive, judicial and rule-making functions proposed to be laid down in the legislation?*

The IMA agrees that the implementing legislation should establish the basic elements of the Panel's constitution as to the separation of the executive, judicial and rule-making functions and that the Panel should determine the detail. This is important to enable the Panel to continue to be flexible in adapting its operations to meet changing needs within a legislative framework.

*Q 6 Do you agree that the proposed scope of the rule-making power is satisfactory?*

*Q 7 Have you any other comments on the proposed rule-making power?*

The IMA supports the proposed scope of the rule-making powers and that rules will continue to be made by the Code Committee. We also welcome the fact that the Code Committee intends to continue to promulgate changes to the Rules and SARs in accordance with its established consultation procedures.

*Q 8 Do you agree that the funding arrangements of the Takeover Panel should continue to reflect a balance between those parties directly involved in takeover activity and market participants more generally? If not, how would you change those arrangements?*

*Q 9 Do you consider that there are any reasons why the Takeover Panel should not be granted a power to enable it to charge fees for supervisory activity undertaken?*

*Q 10 Do you think that there should be a reserve power available to the Secretary of State to place the levy charge on a statutory footing? If not, how should the Takeover Panel make up any resulting shortfall in its finances?*

The IMA agrees that the funding arrangements of the Takeover Panel should continue to balance parties directly involved in takeover activity and market participants more generally. We believe that the proposed funding arrangements are appropriate and that the Panel should:

- be able to charge fees for regulatory activities;
- continue with the levy on contract notes on all chargeable transactions and that the Secretary of State should be able to put this on a statutory footing should the existing arrangements not work satisfactorily; and
- continue to charge for sales of the Code.

*Q 11 Do you agree that it is important to seek to minimise tactical litigation to ensure that the takeover bid process can proceed smoothly and efficiently? If not, what are your reasons?*

*Q 12 Do you think that the following measures are a proper and sufficient means of limiting the scope for civil litigation in the implementing legislation: exclusion of new rights of action for breach of statutory duty; protection of transactions; and parties to be bound by decisions of the Takeover Panel?*

The IMA agrees that tactical litigation, i.e. legal proceedings taken by parties to a bid with a view to frustrating or hampering the bid or the defence, must be minimised. Otherwise, say in the first instance, the litigation could defeat the objects of the bid and thus prevent shareholders in the target company being able to decide on the merits of the bid.

We believe that the combination of excluding rights of action for breach of statutory duty; protecting transactions; and binding parties to decisions of the Takeover Panel should be sufficient to limit the scope for civil litigation.

*Q 13 Do you agree that a limited immunity package should be conferred on the Panel and those involved in its regulatory activities? If not, how would you propose to overcome the problems outlined in paragraphs 2.41 and 2.42?*

The IMA agrees that those involved in the exercise of the Panel's regulatory functions should be granted immunity from being pursued for damages arising as a result of regulatory decisions made in good faith. This is important to ensure that the Panel can recruit and retain staff of sufficient caliber and expertise.

*Q 14 Do you agree that the formal information-gathering and enforcement powers should be extended to the Takeover Panel in the implementing legislation? If not, what, if anything, would you propose in their place?*

*Q 15 Do you agree that the proposed information-gathering power is appropriate?*

The IMA welcomes the fact that it is proposed to extend a number of specific statutory powers to the Panel to ensure that the parties to a bid comply with the Panel's rulings and to help the Panel exercise its regulatory functions. Whereas the current consensual approach has worked well, we believe the Panel should have recourse to statutory powers if necessary. As noted in the CP, central to this is that persons should be required to make any information available to the Panel that it needs.

*Q 16 Do you agree that the proposed rule-making powers in relation to enforcement are appropriate? If not, which powers do you consider are not appropriate or what additional powers do you consider should be granted?*

*Q 17 Do you consider that the proposed model for granting of the other powers to the Panel is the right one (i.e. through power conferred on the Panel to make rules in respect of such powers)? If not, what other model would you suggest?*

*Q 18 Do you consider that the summary court order enforcement mechanism proposed is appropriate? If not, how would you propose that the Takeover Panel should be able to enforce its rulings?*

As noted above, the IMA welcomes the Panel being given statutory powers to enforce its rulings. Thus where it is not possible to proceed by consent, we support the Panel being able to make a ruling on the application or interpretation of the Code and apply to the court for enforcement when a person fails to comply with a ruling, and that failure to comply with a court order will be contempt of court.

*Q 19 Do you agree that section 143 of the Financial Services and Markets Act 2000 should be repealed in view of the fact that the rules made by the Takeover Panel will be given statutory effect by the implementing legislation? If not, why do you consider section 143 should be retained?*

On the basis that the Financial Services Authority will continue to take into account any breaches of the Takeover Code in its assessment of whether persons are fit and proper to be authorised and in view of the fact that the rules made by the Takeover Panel will be given statutory effect by the implementing legislation, we agree that section 143 of the Financial Services and Markets Act should be repealed.

## Barriers to Takeovers

*Q 20 Do you agree that all companies registered in the UK and whose shares are admitted to trading on a regulated market should be obliged to comply with the requirements of article 9? If not, what advantages do you consider there are in allowing companies not to be bound by those requirements?*

The IMA agrees that all companies registered in the UK and whose shares are admitted to trading on a regulated market should be obliged to comply with the requirements of article 9 and the protections it affords to minority shareholders. This includes the fundamental principle that it should be for the shareholders of the target company, not management, who should decide on the merits of takeover bid.

*Q 21 Do you agree that companies registered in the UK and whose shares are admitted to trading on a regulated market should not be bound by article 11? If not, what advantages do you consider there are in imposing the requirements of article 11 on all UK companies.*

As noted in the covering letter, we are disappointed that the negotiations on the Directive failed to settle the basic issue of shareholder rights and ensure that investors' rights to decide whether or not to accept a bid are in proportion to their investment throughout the EU, i.e. there is "one share one vote". We believe that "one share one vote" is key to promoting shareholder democracy and should be addressed.

Thus although the overall position is not satisfactory, given that Member States have the option of implementing article 11 we believe that there would be little benefit in practice in doing so in the UK. First, few companies have differential share structures in the UK and implementation could restrict the current flexibility that enables companies and shareholders to construct share structures as they see fit. Furthermore, given that the option will mean that differential share structures will continue to exist in other Member States, implementation of article 11 in the UK could result in companies moving their listing from the UK to another Member State that did not impose article 11 or outside the EU altogether. It is important, however, that any differential share structures that exist are disclosed to the market.

*Q 22 Do you agree that the UK should not utilise the reciprocity provisions? If not, what advantages do you see in the UK allowing companies to make use of these provisions?*

The IMA agrees that the UK should not utilise the reciprocity provisions whereby a bidder may only benefit from articles 9 and 11 if they and/or any controlling company are subject to a similar regime. We believe reciprocity could potentially have adverse consequences, for example, UK companies could be ring fenced from takeovers by companies from third countries which could have unintended consequences.

*Q 23 Do you consider that, in implementing the opt-in under article 11, it is sufficient to rely on existing procedures and protections in relation to proposed changes in the articles of a company? If not, why do you think such procedures and protections are inappropriate and what further legislative provisions do you think are required?*

Although we do not believe that article 11 should be imposed on UK registered companies, in recognition of the fact that the UK has to have a statutory framework to enable companies to subject themselves to it voluntarily, the IMA believes that the existing procedures and protections in the Companies Act in relation to changes in the articles are sufficient.

*Q 24 Do you agree that it is not necessary to provide for equitable compensation for loss of shareholder voting rights as a consequence of breakthrough under the article 11 opt-in? If not, why not and how would you suggest compensation be provided for?*

The IMA agrees that it is not necessary to provide for equitable compensation for loss of voting rights as a consequence of the article 11 opt-in. As noted in the CP, the decision to opt in will have been taken in accordance with the usual rules for changing articles of association and it will be open to the parties to agree the terms, including rights to compensation.

*Q 25 Do you agree with the proposed compensation provisions in relation to override of contractual rights? If not, why not and how would you suggest compensation be provided for?*

The IMA agrees that compensation for contractual rights that are overridden should be determined in the first instance by the bidder and that the party whose rights are removed should be able to apply to the court if the compensation was insufficient or inappropriate.

*Q 26 Do you consider that the requirement for companies to make an explanatory report to shareholders on share and control structures should be met by requiring such information to be included in the annual report? Alternatively, do you think a report on this matter should be required to be made at the annual general meeting?*

The IMA supports companies making an explanatory report to shareholders on share and control structures in the annual report as proposed to presenting it at the Annual General Meeting. This will minimise formalities at the Annual General Meeting and in any event, not all shareholders can attend the AGM of every company in which they hold an interest. Asset managers typically invest in hundreds of UK companies (there are 850 companies in the FTSE All Share). Given that the vast majority of companies have 31 December year-ends, their annual general meetings fall in the same few months of the year and can be held at various locations throughout the UK depending on where the company is based. It would be impossible for asset managers to attend the AGM of every company in which they invest. We appreciate that the Government is seeking to minimise the costs of complying with the disclosure requirements under articles 10(1) and 10(2).

### **Squeeze-out and Sell-out**

*Q 27 Do you agree that all the recommendations of the Company Law Review (Annex C) compatible with the provisions of the Takeovers Directive should be adopted? If not, please state which recommendations you consider should not be implemented and set out your reasons.*

The IMA agrees that all the recommendations of the Company Law Review compatible with the provisions of the Takeover Directive should be adopted. These are uncontroversial and sensible amendments.

*Q 28 Do you agree that the proposed changes should apply to all companies and bids currently subject to Part 13A of the Companies Act 1985, regardless of whether or not the Takeovers Directive applies to them?*

The IMA agrees that the proposed changes should apply to all companies and bids currently subject to Part 13A of the Companies Act 1985, regardless of whether or not the Takeover Directive applies to them.