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Implementation of the corporate governance codes

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Abstract

Corporate governance codes have been developed in all European States. These instruments often reflect a different economic and political background. This factor can play an important role as to their self nature. Implementation of the codes is generally left to the companies themselves. However, are there other enforcement instruments and should external parties - such as securities supervisors - have a role to play in this matter? A comparative overview outlines the state of affairs in a selected number of EU jurisdictions.

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Implementation of the Corporate Governance Codes
Eddy Wymeersch[1]

Codes on Corporate Governance have by now been developed in most of the EU states[2]. This wave has been strongly supported by the recommendations of the High level Expert group on Company Law, by recommendations of the European Commission, and is now increasingly anchored in specific legislative proposals of the EU Commission. Therefore it seems useful to dwell on the way these codes fit into the overall legislative framework of the EU and of the member states.

Several issues will be touched upon: how do these codes relate to market practice? Who makes the codes, who supervises their implementation? What about the rights and liabilities of the company and its officers and directors flowing from the code's provision? These are questions that arise at the sidelines of the phenomenon but are nonetheless of great importance as drivers in the corporate governance movement.

1. Who is setting the rules?

It is important to identify with some precision who is drawing up the national corporate governance codes. This analysis may help to understand the national political and legal environment in which these codes have been issued, and the relationship of the self regulatory instrument with the drive for more legislative intervention**.**

Generally speaking the corporate governance codes have been drawn up by committees, usually chaired by a leading business person. The codes are therefore usually referred to by the name of that person. The composition of these committees and the political environment in which they have been set up is quite different and not always easy to understand from abroad**.**

In the earlier stages, when corporate governance was considered as a somewhat less relevant issue, the codes were drawn up by the market itself, often with the support of academics, or other experts. The stock exchanges had a direct interest in developing a governance code and support the reputation of their market place, especially as some scandals had dented the reputation of some of the listed companies. Institutional investors from abroad often asked to identify to applicable code. Although at that time some of the exchanges could actually impose the code by introducing listing condition, most refrained from doing so, in order to preserve their competitive edge.

The governance rules applicable to the now defunct NASDAQ Europe (previously Easdaq) have been the work of the EASD, or the association of European Association of Securities Dealers, assisted by academic experts. The first Belgian governance code was also based on an initiative of the Brussels stock exchange, although the committee in charge of drafting the code had a wider composition, including, businessmen, academics, consultants, and so on. Often the stock exchange linked with the business associations, as this would enhance the

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[1] Professor at the University of Ghent, Chairman of the Banking, Finance and Insurance Commission, Brussels.

[2] The codes can be consulted at the Website of the European Corporate Governance Institute: http://www.ecgi.org/ . Luxembourg was one of the last of the original 15 states to announce the drawing up of a corporate governance code.

acceptance of the codes. It is not clear whether the supporting associations also have the power to require their member to abide by the code: most of the time, their “endorsement” has had a moral, or political value, not a legal one. An example of this technique can be found in the Swiss code, which was drafted by a committee of legal experts, some of which have high academic standing, by with the support of the stock exchange. The code was explicitly endorsed by the principal business associations in Switzerland.

A second series of codes are more clearly linked to business, more precisely are the result of initiatives taken by the business associations. The French Viénot and Bouton codes, that are essentially statements of good practice, are published under the aegis of the Medef, the French employer’s association[3], and the AFEP[4]. The moral authority of the business leaders involved contributed to the recognition of these statements as good practice.

A comparable, but more broadly based model lies at the basis of the Cadbury Code on “the financial aspects of corporate governance.”[5]. The committee was set up by the Financial Reporting Council[6], the London Stock Exchange and the accountancy profession. The Committee itself was composed of a broad selection of leaders of the different professions, with responsibility in the overall functioning of the London financial world. To be noted: the DTI send an observer while an advisor to the Bank of England’s governor was part of the committee. One of the objectives of this committee was clearly to restore confidence in the financials system, after BCCI, a case to which the Cadbury code expressly referred

The Swedish Code, which was proposed in October 2004, is described as a joint effort of the Government Commission of Business Confidence and of the Swedish business associations. It was drawn up by a panel, chaired by a former minister of finance, who also chairs the said Government Commission, and is further composed of representatives of the business associations[7]. The code is based on a comply or explain approach. The annual report has to state whether the report has been audited or not[8].

The Dutch code was established at the invitation of the minister of finance and the minister for economic affairs. The Tabaksblat committee was composed of representatives of the main professional organisations in the Netherlands. The ministries were not part of the committee, but played an significant role at the level of the secretariat of the committee The code was given a statutory basis in 2004.

The public authorities seem to pay increasing attention to the corporate governance movement, without – at least up to now – officially intervening. None has taken the step to insure enforcement by way of government measure. Developments in corporate governance should however not only be measured by looking at the implementation of the codes, but should also take into account the changes in the law, that have taken in place in parallel. In many jurisdictions, there have been quite significant changes in company law, whereby important corporate governance changes were facilitated, rather than mandated. Changes in

3 Mouvement des enterprises de France.

4 Association française des enterprises privées.

5 In its version of 1 December 1992.

6 About which more infra. p. xxx

7 The code seems to be quite demanding on specific points, and for SMEs, see FT, December 2, 2004.

8 One of the members of the commission published an additional opinion, underlining the self regulatory character of the instrument and regretting deviation from internally accepted standards.

the composition of the board were introduced in Belgium, France, Netherlands, Italy to name but a few. In each of these cases, the existing regime has been relaxed, rather than tightened.

2. The Codes are self regulatory

The corporate governance codes are essentially not mandated by the law, but the result of self regulation. There are different degrees of self regulation, going from self proclaimed rules of behaviour to rules that are rooted in the law, but of which the detailed compliance is not supervised by a public body.

Voluntary compliance with the codes has been generally quite satisfactory, a few sensitive provisions – e.g. on disclosure of directors' remuneration - excepted. Compliance overviews have been published by academics, business consultants and ratings organisation. These reviews are based on the disclosures in the annual reports. In fact, compliance has often taken the form of changes of articles of incorporation, leading to a stronger juridification of the recommendations of the codes.

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A comparative analysis, e.g. comparing the late nineties to today, would reveal probably in all jurisdictions, that some of the cornerstone provisions of the codes, e.g. the rules on audit committees or on independent directors, have largely been complied with. In parallel, the information disclosed about internal governance has increased significantly: where in the 1990s, the annual reports contained almost no mention of governance matters, voluminous sections of annual reports these days are documenting and analysing governance matters. Few listed companies would dare these days to ignore the subject. Although there may be some lip service in these disclosures, there remains the greater consciousness about the overall purpose of the exercise.

Why have companies voluntarily complied with these self regulatory instruments? It is undeniable that the codes are being implemented under the pressure of the "markets". From a subject that was barely mentioned in academic circles ten years ago, corporate governance has become a popular notion, used even in the wider press. The theme is not restricted to the financial markets: in all large transactions, including those that do not directly affect the securities markets, e.g. those relating to government owned entities, governance is considered at the heart of the matter. Even universities have discovered the virtues of better governance.

As the securities markets have gained importance in Western Europe, an astonishing sensitivity to governance issues has developed The success of the governance codes is largely linked to a market phenomenon. This notion should be further analysed: it can be compared to a continuous voting system, whereby the management is continuously assessed and the future results predicted. By referring to the markets, one should first directly refer to price evolutions that may be measured by using event studies and statistical regressions. There is ample anecdotal evidence that governance events have affected the prices of listed securities. Also, good governance practices are widely considered to have a positive influence on the price evolution. But nothing is mathematical: some of the most successful companies simply refuse to follow the governance precepts, without negative effect on their financial results or their market valuation. Also, governance rules and especially codes – differently from practices- may not have the same effect: only indirectly by offering a yardstick against which "good governance " can be measured will a code have a positive effect on price formation[9]. One understands why institutional investors generally require that there should be a governance code applicable in each jurisdiction. The EU Commission has endorsed this idea by requiring companies to refer to the "applicable governance code".

The phenomenon of market influence is broader than the direct impact on price formation. It also relates to opinion building through the media, but also the ratings agencies or the financial analysts should be mentioned.. Here also there is remarkable difference with the late nineties: the press frequently refers to governance issues, including governance codes especially when special event have disturbed public opinion. Academic opinion should also be mentioned: academics have contributed significantly to opinion building, generally endorsing the need for good governance, and its main principles. Some comparative studies have highlighted the degree of compliance with the codes[10]. The role of consultants should not be underestimated: they play a first line role in advising on the right governance practices to be developed. Usually they adhere to US standards, and develop governance practices are based on a dispersed ownership model. This explains why in companies with concentrated ownership, models have been proposed that are at odds with the prevailing model of concentrated ownership. It is one of the striking features on the European debate why provisions adapted to one model have so readily been received in a substantially different model. To mention one example: the concept of an independent directors is almost incompatible with a position of a board member who can be revoked "ad nutum" by a controlling shareholder. Nevertheless, controlling shareholders are sometimes willing and even eager to accept independent directors on their boards as they contribute to better monitoring of the management. This sometimes results sometimes in substantial conflicts between these shareholders and the company.

3. Ambit of the Governance Codes

To whom should the Codes be applied? There is little doubt that they should apply to listed companies, here in the meaning of companies whose securities are widely traded on organised markets. There may be some discussions about the definition of the publicly traded company, but these are borderline issues.

More controversial is the application of the codes to large non-listed companies. One may argue that due to the social impact of these companies, they should be held to the same principles. The interest of creditors and of employees – normally outside the scope of the governance rules – may also be served by better governance practices.

In some jurisdictions special attention is drawn to the governance of closely held, family owned businesses. There is undoubtedly a strong need for better governance in this field, whether in the interest of the firm, or to defend the rights of the minority shareholders.

In some jurisdictions special codes have been developed addressing the unlisted family held businesses. They serve more as a model for inspiration.

A difficult subject is that of governance of state owned firms. A difference should be made whether the business firm is the legal form for organising a public interest function, or

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[9] See the plan of the FT to develop a FTSE/ISS index which aims to calculate which markets have the most well-governed companies FT, Special Report Corporate Governance, December 15, 2004

[10] See for comparative studies; also progress reports are regularly published: see VON WERDER, Berlin Center of Corporate Governance.

whether the firm is part of the competitive economy, in which case the same safeguards should apply. However, one sees that the states are unwilling to abandon their influence on the last-mentioned group of firms, sometimes until market competition brings it down. Good governance ought to be a guarantee for insuring the survival of the enterprise.

4. Enforcing the Corporate Governance Codes.

As more and more corporate governance codes are being developed and as their application attracts wider attention, questions about their enforcement have become increasingly poignant. In some jurisdictions as principles of good governance have been blatantly violated, public opinion and politicians have questioned the value of instruments that entirely rely on the willingness of business leaders not only to adhere to the codes but also to put them into practice. Enforcement of self regulatory instruments in an increasingly legalistic environment poses some interesting challenges: a more refined analysis, especially focusing on the gradual character of the enforcement techniques, is necessary. Indeed, between pure self regulation, government supported self regulation and full or partial government enforcement, there are numerous steps and shades, that can only be captures in a detailed analysis. As they are embedded in the legal and social culture of the jurisdiction in which they are being practised, any analysis is limited to the outsiders' view: the latter is not irrelevant as it often is also the view adopted by the markets .

4.1. Self regulation.

In the original approach to self regulatory codes of corporate governance, codes – were developed by the business leader as a guide for their own correct behaviour. There was no reference to any form of external monitoring, neither by a self regulatory panel, nor by government. Within the firm, the board was responsible, and it was the role of the chairman of the board to watch over adequate compliance. Sometimes, there was a governance committee at board level, or special meeting were devoted to governance issues. Some external monitoring of the code's implementation was based on comparative analysis, undertaken by academics, consultant's firms, or even market supervisors. But these only take stock of the state of implementation, pointing to or to the progress achieved or to the most visible shortcomings. The entire implementation of the codes is based on disclosure and on market monitoring: if the code is insufficient, or is not sufficiently implemented, the investors will sanction the market by refusing to invest in the equities on offer.

Market monitoring is by some considered very weak: it is invisible, often clearly contrary to the manifest shortcomings, and in general difficult to capture. However,

To the extent that most of the existing codes are based on disclosures in the annual accounts, it should be reminded that untrue or false statements in the annual reports may expose the board members to civil liabilities – towards third parties, creditors, investors relying on the information in the report on in the prospectus, and so on – and that in some cases even criminal liability may not be excluded. Whether these sanctions would be applicable very much depends on the national legal regime. The European Commission has called for a stronger regime of liability for directors. Whether this includes statement in the annual accounts, even after these have been approved by shareholders, could be the subject of further analysis. The basis of liability is not the provisions of the governance code, but the false or misleading character of the disclosures in the annual report, or in other company publications.

4.2. Self regulatory monitoring

The self regulatory code could be monitored by a self regulatory panel, composed of business representatives originating in the same associations or interest groups that have drawn up the code. The panel's action would essentially be based on disclosure: it would identify the cases in which the code has not adequately been implemented, and invite the firm to state its reasons for not implementing the code. The panel could support the code's implementation by publishing from to table comparative tables of implementation, exercising peer pressure to the firms that stay behind. In defined cases, the panel could even be authorised to publish its individual findings, using some technique of "name and shame".

The designation of a monitoring committee raises the question what will be monitored: will this only relate to determine whether the different items of the code have been filled in, or will the panel also look into the content of the disclosures. In the latter case, one could further distinguish between cases in which the explanation is manifestly insufficient, obscure, contradictory with other statements, and so on. Or should the monitoring also go into the substance, determining whether the factual data are true (e.g. is the remuneration published correspond to the internal figures) or also to the more substantive issues ("adequate control mechanisms have to be in place") in which case a parallel system of external controls, parallel to the regular financial auditor would be introduced. At a certain moment, the monitoring panel runs the risk of substituting itself to the board of directors: this cannot not be the purpose and therefore clear lines have to be agreed, limiting the panel's intervention to the formal compliance with the code.

4.3. External monitoring by the company's auditor

An alternative to external monitoring could be to extend the statutory auditor's brief to the verification of the compliance with the code. There a certain advantages to this approach: it maintains the self regulatory, internal nature of the monitoring process, allows the board to make to necessary corrections where needed, or if no changes are needed, to adopt the explanations that are called for in the codes. The auditor is already present in the firm, is familiar with the internal functioning of the firm, and has to verify the internal control mechanisms supporting his review of the financial statements. In case of shortcomings he would have direct access to the appropriate company bodies, such as the audit committee or the chairman of the board. Changes will, if necessary, be submitted to the board, who remains in charge of the implementation of the self regulatory code.

There are some drawbacks to involving the auditors: apart from their limited expertise in governance matters, auditors should restrict themselves to controlling financial information. Reviewing governance matters may be considered as non-audit services, especially as it may lead to advising the board or the management on developing techniques to improve governance or change disclosures as called for by the code.

In certain jurisdictions, the auditor already reviews part of the annual report. His intervention is limited to very specific items, most of the time reflecting specific transactions that have been registered in the accounts (e.g. date on repurchases of own shares). His review does not extend to management issues or items for which there are no underlying data.

In other jurisdictions, the entire annual report is reviewed by the auditor: therefore it would also include those items that have to be included in the report. This is the case in the Netherlands: however it is accepted that the auditor's intervention is limited to external review of the code mandated items, i.e. whether there is a statement that a code is applicable and has been complied with, and where applicable, the explanation about item on which the firm did not comply. It would in no case include review of the substantive issues[11]

4.4. External monitoring by the securities market supervisor.

Should the securities market supervisor be involved in the monitoring of the corporate governance code and of what would a possible monitoring action consist? The issue has been raised in several states, and the answers remain far from clear[12]. Especially in the Netherlands, this matter has recently been discussed in the Parliament, leading to a rather clear delimitation. Similar tendencies exist in the other states where the subject has been officially discussed.

If there would be monitoring by the securities market supervisor, one will have to determine what is the nature of this supervision. One could, theoretically at least, device a whole range of different types of supervision, ranging from a maximum to a minimum.

The maximum hypothesis – which would be very difficult to implement – would consist of the supervisor verifying in substance whether the code's provisions have been met. This would require an in depth analysis of the internal functioning of the company, with still an insecure outcome. In other fields, such as accounting, or mandatory statement in the annual report, the supervisor does not go through the account, but relies on the statements of the board and the auditors. There is no reason to require a stricter system of supervision, in a field where the rules remain less perspective than in accounting, of company law. Moreover by so doing, the nature of the codes would be changed: from mere self regulatory, they would become public policy instruments, that have neither been conceived that way, nor been approved by the competent public authorities. This action would not be monitoring of the code anymore, but of the governance practices. It might result in subjecting the firm to a regular corporate governance review, under the guidance of the public supervisor. Would this review be undertaken by a third party – e.g. a specialised governance consultancy – or give rise to on direct monitoring of the supervisor, including on site inspections? The risks and liabilities could be unfathomable.

As in many respects, there is no single best, generally accepted approach, supervisors – and regulators as well - are very unwilling to intervene in the field of enforcing the substantive rules that are contained in the governance codes.

An intermediate step could consist of the supervisor verifying whether the strictly defined legal obligations have been met. The subject is far from theoretical: corporate governance statements will – at least according to a proposed EU directive - become a mandatory part of the annual reports of listed firms. In many jurisdictions, market supervisors have some powers to review annual reports, and in case of deficiency, to mandate additional or corrective disclosures. Hence in the future, there should be a clear understanding about the extent of the supervisors' intervention.

In some jurisdictions, the legal obligations addressed to the company, relate to the designation by the board of a certain governance code, to his review whether the different provisions of that code have been met, in the sense that the company declares whether it is complying, or where not, that it states the reasons for doing so. In this case the monitoring

[11] See further p. xxx

[12] See H. MERKT, Selbstkontrolle und Staatsaufsicht bei der Corporate Governance, in HOMMELHOFF, HOPT & VON WERDER (eds), Handbuch Corporate Governance, Cologne, 2003, 715.

role of the supervisor can be called “external”: he will ascertain whether the board has adhered to the applicable code, and has disclosed the necessary information mandated by the code, stating the reason for which the board, for specified items, has diverged from complying with the code. In exceptional cases, where there is clear unwillingness of the company, or where the information is manifestly inconsistent or misleading, could the supervisor require additional disclosures or changes to the proposed disclosures. In fact this approach is not very different from the type of supervision that already today is exercised on the annual reports in some jurisdictions. It does not delve in depth into the substance of the disclosures, but points to inconsistencies, or to misleading information.

According to a third scheme the supervision would intervene only by exception, when specific facts have been brought to its attention, and in that case, it could recommend the company to adopt to the applicable standard as contained in the governance code. It would also monitor the implementation of the code by all market participants as a whole, identifying the fields in which business practice and code provisions diverge.

In each of these cases there will also be a question about which enforcement instruments can be used. In the strongest hypothesis, the supervisor would be allowed to use the stronger instruments such as administrative fines, court injunctions, or “name and shame”. This is the case where legal provisions have been violated, and is already applied today. The “name and shame” is more indicated in the second hypothesis, while “moral suasion” through recommendations would be the approach in the third case, which relies essentially on market discipline.

4.5. Some comparative elements

At the moment of writing, the opinions about the different techniques of monitoring the corporate governance codes are still very much in a state of flux.

In most jurisdictions in Europe the model followed is that of self regulatory monitoring, relying on the market mechanism. In several cases market pressure has proved to be quite efficient: the governance structure of Royal Dutch/ Shell was radically overhauled due to criticism in the markets, leading to strong pressure in the market. Other examples relate to several (esp. Dutch) cases where anti-takeover protections were abandoned under the pressure of the markets.

The Italian code is designated as a point of reference but has no binding force[13] The Spanish code was introduced pursuant to a decision of the Spanish cabinet, and calls attention to the need of ethical behaviour, but in full respect of its self regulatory nature. It is based on the 1997 Olivencia report, delivered by a commission that was created by the government. The document makes three suggestions for government action: disclosure about the compliance or non compliance with the code, general duties of care and loyalty, and rules on the functioning on the board and of the general meeting

A somewhat stronger approach has been followed in France and in Belgium. In Belgium, the code refers to the market supervisor as lending moral support to the code, while envisaging a recommendation to listed companies to implement the code. Comparative analysis will also be published from time to time, as has been the case in the past. Important

[13] See: “Linee Guida per lla redazione dellle relazione annuale in material di corporate governance”, http://www.borsaitalia.it/opsmedia/pdf/8947.pdf

to note is that in both cases, the market supervisors do not claim competence to effectively monitor the substantive provisions of the code, and hence will not make use of their statutory powers to enforce it. Only to the extent that the code's provisions would run parallel to legal obligations could use of the statutory powers – including imposition of sanctions - be envisaged.

However, at least in Belgium, the discussion about the role of the securities supervisor in the implementation of the code is not closed: one expects the parliament to state its opinion early 2005. In the meantime, proposals to mandate disclosure of directors' remunerations by law have been tabled in Parliament.

The French situation is somewhat different to the extent that quite substantial changes in the governance rules have been introduced by two recent laws, the Loi sur les nouvelles regulation économiques in 2001, and the Loi sur la sécurité financière of 2003. The first has introduced important changes in the company law, i.a. mandating remuneration disclosure and allowing the split between chairman of the board and leader of the management (so-called pdg-regime) [14] According to the latter law, specific duties are imposed on the chairman of the board: in a report separate from the annual report, must report to the shareholders about the way the board meetings have been prepared and organised, what probably includes a significant part of what in other jurisdictions is referred to as corporate governance[15] Very important is his obligation to report, in this document, on the internal control procedures, and this section of his report is to be separately reviewed by the statutory auditors[16]. Both rules indicate that substantial part of corporate governance rules have been rooted in the law itself.

In addition, the Autorité des Marchés Financiers act in support of the implementation of the rules. According to the AMF's instructions, the information about the company's governance is published whether in the "document the reference" or in the annual report. In the former, one will find the overview of the governance practices, the internal control procedures, and the special report of the audit committee. The company will describe its governance system, and for each of the recommendations, indicate whether or not it complies, stating the reasons for non compliance. AMF recommends the companies to follow the governance codes and guidelines, as established by the ANSA for legal matters[17], and for internal control matters by other associations as well[18]. In addition, AMF has "called the attention to the following orientations" of the companies on a certain number of matters for which additional disclosures would be required. The AMF[19] must publish an annual report on the information thus published[20]. AMF, acting by way of recommendation, sees its role in the implementation

[14] G. RAMEIX, Orientations en matière de gouvernement d'entreprise et contrôle interne et Recommendations pour l'élaboration des documents de reference 2003, AMF, 23 January 2004; AMF, gouvernement d'entreprise et contrôle interne, obligations de publication des émetteurs faisant appel public à l'épargne, Doc. 5338_1.pdf.

[15] Art 117 LSF: "des conditions de préparation de d'organisation des travaux du conseil ainsi que des procédures de contrôle interne mises en place par la société".

[16] Art 120 LSF.

[17] Note du comité juridique d'Ansa, nr. 3267 of November 5, 2003.

[18] Medef and Afep.

[19] See Recommendations pour les document de référence 2002, applicable to 2003 as well.

[20] Art 122 LSF.

of the governance rules as one of support, inspiration and consensus building [21], and ensuring that the required information is made available to the market.

In Germany the Cromme code was imposed by § 161 of the Aktiengesetz, as modified by a law of . According to this provisions, management board and supervisory board of listed companies have to publish [22] annually that the Recommendations of the, "Regierungskommission Deutscher Corporate Governance Codex"[23] as published by the Ministry of Justice, have been complied with, or which parts of the code have not been complied with. The declaration has to be made accessible for shareholder on a continuous basis.

In the Netherlands, probably due to the fact that the code served as a response to the important cases that shook the Dutch stock market, the debate has always had a stronger legal flavour. This resulted in writing the "comply or explain" principle into the law itself, and specifying that a further implementing decree would contain the details about the follow up mechanism. The Dutch law has made it mandatory for listed companies to publish a statement about their compliance with the code. In the annual report, "the company will report on compliance with the code's principles and its best practice rules. If the company has not complied with the principles or with the best practice rules, or does not intend to do so during the current or the forthcoming year, it will have to state its reasons in the annual report" . The companies law was changed so as to enable the minister of justice to take an implementing decree[24]. At the moment of writing, this decree has not yet been adopted

End of 2004, a discussion was launched whether the market supervisor, the AFM ("Autoriteit Financiële Markten") , would have a role to play in the follow up of the code. The AFM chairman, in a public speech held on November 2004, announced that it was considering to exercise a "marginal review" of the application of the Code[25]. This was motivated by the fact that the code had been a "legal obligation", and this by virtue of art 391, §§ 4 and 5, of Book 2 of the Dutch civil code. This statement provoked an angry reaction from a member of Parliament, who considered that the code as a self regulatory instrument developed by the private sector, should not be the subject of government supervision. The supervision of the compliance with the code and of the information to be disclosed in the annual report is the task of the auditor, not of the markets' supervisor, according to the parliamentarian[26]. During a following parliamentary debate the Minister of Justice clarified the role of both the AFM and of the auditor[27]. The AFM should, according to the minister, limit itself to determine whether the company has mentioned in its annual report about the implementation of the code, and verify whether that mention is consistent with the remainder of the annual report. The auditor on the other hand will check whether the board had

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[21] See M. PRADA, Intervention au colloque de l'IFA "Contrôle interne et gouvernement d'entreprise, Point de vue du régulateur", 13 October 2004.

[22] § 161 as modified by the law of 19 July 2002.

[23] This is the so-called Cromme code: see http://investors.dpwn.de/en/corporate_gov/entsprech_corporate_governance_kodex_e.pdf

For a recent state of developments see Dr. G. CROMME, Stand und Entwicklungen Corporate Governance in Deutschland, 24 June 2004.

http://www.corporate-governance-code.de/ger/download/CGC_Konferenz_Berlin_2004_Dr_Cromme.pdf

[24] Art 391, §§ 4 and 5 of the Civil Code, Book 2.

[25] See A. Docters VAN LEEUWEN, Wie houdt het raam schoon?, speech 13 October 2004, see AFM website.

[26] See Financieele Dagblad, 1 December 2004.

[27] See "Meer uitleg over rol AFM en accountant bij naleving code", 1st December 2004, http://www.corpgov.nl/

mentioned in the annual report that it had complied with the code, and whether this mention is consistent with the remainder of the annual report and the financial statements[28]. It is, according to the minister, not the task of the auditor to check whether the firm has included all legally mandated information in whether the annual report or in the financials[29]. In case where the company would give no information on its compliance with the code, the auditor could mention this in his report [30]

Recently it was decided that the so-called Tabaksblat Code will be monitored by a "Monitoring Commission Corporate Governance[31], the eighth members of which have been designated by the ministers of finance, justice and economic affairs chaired by Prof. Fryns. The commission will review the usefulness of the Code, and its up to date character. It will follow up the implementation of the code by the Dutch business world. To that purpose it will make an annual inventory of the way Dutch firms have respected the code, will follow up on international developments and business practice, and identify lacunae or insufficiently clear provisions of the code. It may make proposals to amend the code, without being empowered to effectively change it. From this description follows that the commission has no mandate to ensure the individual follow up of the code, nor the power to investigate whether the code has been complied with, nor further impose any sanctions.

In the UK the Financial reporting Council will review the combined code and propose amendments to it.[32] In March 2004 the FRC set up a new committee to lead its work on corporate governance. The committee's terms of reference are:

- To keep under review developments in corporate governance generally, reflecting the FRC's objective of fostering high standards of corporate governance; to undertake reviews, either directly or by overseeing the work of others, and then to consider whether any actions by the FRC would be desirable; and to put proposals to the Council where appropriate.

- To monitor the operation of the Combined Code on Corporate Governance and its implementation by listed companies and by shareholders.

- Where significant doubts are raised about the appropriate interpretation of part of the Code, to consider the case for issuing a clarification, and if appropriate to do so, after any suitable consultation.

The Combined Code is annexed to the Listing Rules. Listed companies must include in their annual report a narrative statement about the way they have complied with the principles of the Code, allowing shareholders to evaluate how they have lived up to the code's principles. While as far as the provisions of the code are concerned, companies must make

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28 According to two planned laws, "wetsvoorstel toezicht accountantsorganisaties" en het "wetsvoorstel toezicht financiële verslaggeving".

29 See "Meer uitleg over rol AFM en accountant bij naleving code", December 1st 2004, website of the Dutch corporate governance commission.: http://www.corpgov.nl/

30 http://www.commissiecorporategovernance.nl/Nieuws#Nieuws_413

31 Composed of eigth members, selected from business, institutional investors, academia, the audit profession. The commission is chaired by prof. Fryns, CFO of the ABP, the largest Dutch pension fund. See December 8, 2004 "Monitoring Commissie Corporate Governance Code ingesteld", website of the Dutch corporate governance commission: http://www.corpgov.nl/

32 http://www.asb.org.uk/about/index.cfm and http://www.asb.org.uk/press/pub0583.html

clear whether or not they have complied and stating their reasons in case of non compliance. The FSA as listing authority makes no judgement about the accuracy or adequacy of the compliance statement: it is up to the board of the company and for the shareholders to make such evaluation. If a company fails to include a statement in the required form, the FSA has announced that it may use its powers, including its fining powers against that company. The FSA will use its compliance powers by sampling an number of annual reports on a routine basis.

5. European Company Law initiatives.

The proposed European directive amending the fourth Company Directive on annual accounts contains a specific arrangement addressing the position to be taken with respect to the national corporate governance codes[33]. According to the proposed new art 46 a of the 4th directive, the annual report of listed companies will have to contain in a separate section " a corporate governance statement"[34]. The content of the statement is defined in the directive: the company will have to refer to a corporate governance code that it will have decided to apply. The provision makes it clear that the governance code will not necessarily be the one applicable depending on the company's registered office. Indeed, market considerations may incite companies to adhere to stricter standards as applied on their principal place of listing: international companies may prefer to state that they are subject to the Sarbanes-Oxley Act and the NYSE governance rules. The code of its registered office will be applicable as a default option. The content of the governance statement in the annual report will conform at least with the following provisions:

- Identification of the applicable code
- Compliance statement, indicating whether an to what extent the company complies with the code
- The composition of the board and its committees
- Description of the internal controls and risk management system
- Description of the rules on the functioning of the general meeting its powers and the shareholders' rights
- Some of the information as required the take-over directive [35]
    - Significant direct or indirect shareholding including through pyramid structures
    - Holders of securities with special control rights and the description of these rights
    - Restrictions on voting rights, such as limitation on the number of votes that can be cast
    - Rules on appointment and replacement of board members and on amending the articles of association
    - The powers of board members especially the rules on issuing or buying back shares

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33 http://europa.eu.int/comm/internal_market/accounting/docs/board/prop-dir_en.pdfhttp://www.corporate-governance-code.de/ger/download/CGC_Konferenz_Berlin_2004_Dr_Cromme.pdf

34 The preamble underlines that there should not be a separate statement in the consolidated annual reports, but that risks management and internal control on a groupwide basis has to be considered.

35 Directive 2004/25 of 21 April 2004, OJEC 30 April 2004, 2004/25.

The comply or explain principle is stated in the following terms: to the extent that the company departs from the corporate governance code it shall explain from which parts of the code it departs and the reasons for doing so.

Art 50 b would impose collective liability for the members of the boards towards the company for ensuring that the annual report is drawn up according to the provisions of the directive**.**

The proposed directive contains little information about the way the codes have to be enforced: this will be left to the member states and to the overall regime of supervision on the annual report: art 67 of the directive 2001/34 states that the annual reports must give a true and fair view of the assets and liabilities , the financial position and profit or loss, and if not, that additional information must be provided. All other aspects, such as whether the data on governance will have to be audited, what will be the extent of this audit, or of any other type of external monitoring, are left to the member states. Therefore the directive's regime correspond by and large to what is the rule that is applied today in most of the member states.

5.**The effects of the governance rules. Risks and liabilities.**

To what extent will corporate governance rules and principles as embodied in self regulatory governance codes becoming part of the legal system? Will soft law become hard, and how is this likely to happen? Are the efforts that are made to keep these instruments out of the legal sphere not futile, as the law will sooner or alter incorporate them? The issue of is that of "juridification", a phenomenon that applies to all types of soft law.

The legal system will in one way or another incorporate the essential findings stemming from the corporate governance debate, as this has cristallised in the governance codes. As with other soft law instruments, the legal system has a tendency to incorporate the standards of the codes as the normal benchmark against which conduct in a specific case will be measured. In terms of liability, of interpretation of contract clauses and son on, it does not seem unlikely that the rules as adopted in the code will be considered the standard.

If the disclosures about governance rules or practices are false or misleading, they may lead to liability on that ground. In addition, they may offer evidence of unlawful or negligent conduct. One may imagine liability of boards resulting from violations of the duty of care if the board had not developed the risk control mechanisms that would be considered prevalent in large groups. The same reasoning may be applied to conflicts of interest. Therefore it is very important that the code clearly distinguished between the principles that are binding and for which no derogation would be considered acceptable, and the provisions, for which "comply or explain" applies. In the latter, liability would be much more difficult to apply, as the rule, as incorporated in the code, accept that there is no single way of dealing with the matter. The designation of an audit committee may be considered such an elementary precaution against accounting fraud or violation, that the board may be considered negligent if had not constituted such a committee. In the absence of independent directors, liability for conflicts of interest may be increased.

A factor of further complexity is likely to be the differences in the liability regimes in the different European jurisdictions: this especially applies with respect to liability to third parties, where mere negligence will be held sufficient in some jurisdictions, while only qualified shortcoming will have to be proved in others.

The relationship to substantive provisions should also be mentioned: especially in connection with related party transactions, self dealing provisions and the like, one may expect the criteria used for defining independent directors to have spill over effect in defining conflicts of interest.

The subject of external effects of corporate governance codes deserves further analysis[36].

Conclusion

The phenomenon of the Corporate governance code raises a number of new issues in company law. Some of these are related to the application of the code: will these codes be applied on a voluntary basis or is some form of legal support necessary? The comparative overview indicated that states have already given ample attention to this question, and that up to now most have come out for a prudent approach, leaving it to the companies and the financial markets to ensure that the codes are applied. At the same time one sees increasing legislative activism in issues that without directly dealing with the core issues dealt with in the codes, move in parallel to them: obligation to apply a code, requirements on annual reports, mandatory statements on risk management, and so on. Is this a case of intra-regulatory competition?

[36] See P. HOMMELHOFF and Martin SCHWAB, Regelungsquellen und Regulungsebenen der Corporate Governance: Gesetz, Satzung, Codices, unternehmensinterne Grundsätze, at 51 and W. GOETTE, Haftung, at 749, in HOMMELHOFF, HOPT & VON WERDER (eds), Handbuch Corporate Governance, Cologne, 2003.

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