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**RESPONSE TO THE EUROPEAN COMMISSION'S CONSULTATION ON
THE FUTURE OF EUROPEAN COMPANY LAW**

EUROPEAN COMPANY LAW EXPERTS

Peter Böckli, Paul Davies, Eilis Ferran, Guido Ferrarini, José Garrido, Klaus Hopt, Alain Pietrancosta, Katharina Pistor, Rolf Skog, Stanislaw Soltysinski, Jaap Winter, Eddy Wymeersch*

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1. Introduction

This paper contains the views of the European Company Law Experts (**ECLE**) on the future of European company law. The paper accompanies the responses of the European Company Law Experts to the European Commission's Consultation on the future of European Company Law of spring 2012. In the first part of the paper we set out our views on the objectives of European company law and in the following parts we discuss how the European Commission should proceed with rule making in the field of company law.

2. The Objectives of EU Company Law and the Role of Harmonisation at EU Level

The original objective of the involvement of the Community in the regulation of company law was, following the express wording of art. 50 of the TFEU, to co-ordinate the safeguards, which, for the protection of the interests of members and others, are required by member states of companies and firms with a view to making such safeguards equivalent (as a condition for the freedom of establishment for the companies within the EU). As the High Level Group of Company Law Experts indicated in its report of 2002, this narrow scope for Community involvement in company law has not kept up with developments, in particular the creation of the single market which companies and their investors wish to use to the optimum, the development of European securities markets and their European regulation, the development of modern information and communication technologies and the development of corporate governance practices and standards. The High Level Group concluded that the primary purpose of EU policy in the field of company law should be to develop and implement company law mechanisms that enhance the efficiency and competitiveness of business across Europe. After the financial crisis we should add to the policy deliberations to what extent company law and corporate governance regulation should play a role in stimulating growth and supporting financial stability.

Although the scope of the objectives of EU involvement in company law may have increased, our overall view is that the EU Commission should put in place only a selective programme of harmonisation of the company laws of the member states. This is different from capital market

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law which is directly relevant for the internal market and from financial regulation which concerns the stability of the financial system in the EU. We have three main reasons for thinking that, with the exception of certain parts that are relevant for the single market, company law is likely to be made more effectively at the level of the member states (see *infra* section a). The first and principal reason is based on the argument that, in principle, spontaneous harmonisation ‘from the bottom’ is likely to produce a more efficient result than harmonisation ‘from the top down’. We consider this to be a better general rule-making policy valid also for the Community legislature. The second argument is related to, but not identical with the first. It is subsidiarity as the basic rule-making principle in the EU. The third concerns the still unsatisfactory procedure for making legislation at Community level, which leads to disparate outcomes.

These arguments do not exclude a role for Community legislation. Indeed, some Community legislation is necessary to make the process of harmonisation ‘from the bottom up’ operate in an acceptable way. However, these arguments do imply a limited, but important, agenda for Community harmonisation of member states’ company laws (see *infra* section b). A structure similar to the Lamfalussy structure of rulemaking as designed for financial regulation could be usefully put to work in the field of company law for listed companies. Rulemaking power could be delegated to the Commission, possibly acting on the proposal of the European Securities and Markets Authority. (see *infra* section c).

a) Limited scope for Community legislation

Acceptance of the view that some level of convergence of the company laws of the member states will facilitate the functioning of the internal market of the EU does not lead to the conclusion that such convergence is best achieved through Community legislation. From the point of view of integration of the markets, one may alternatively aim at giving companies the freedom to choose the member state company law system which best suits their needs. Freedom of choice for companies puts pressure on member states to reform their company laws so as to move towards the rule which has shown itself to be most efficient. This does not necessarily mean convergence on an identical rule, as the impact of the member states’ reform of minimum capital rules in the wake of *Centros* shows. But, it does generate pressure on member states to remove restrictions on entrepreneurial activity for which there is no longer a functional justification. The initiatives taken by several member states to reduce the minimum initial capital to 1 euro illustrates this thought.

The traditional objection to this way of proceeding with convergence within the Community is that it will lead to a European ‘Delaware’, which is taken to mean convergence on a single legal system which, however, is not optimal (in the Delaware case because it is alleged to favour management over all other interests in the company). It is unlikely that freedom of choice for companies within the EU would lead to a ‘European Delaware’ because the financial incentives for member states to compete for incorporations are much less strong than they are in the case of Delaware, a small state where the revenues from incorporation constitute a large part of the

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state budget. What is more likely is that freedom of choice for companies will reduce the blocking power of entrenched incumbents when reform of company law is put on the national agenda. Thus, the impact of company choice might show itself, not so much in the gross numbers of companies choosing a new company law, but in the more rapid reform of member states' company laws. Member states should compete for the most efficient company law system in order to support business activities and economic growth.

However, if convergence 'from the top down' could do a better job at achieving an optimal company law than regulatory competition, it would be sensible to embrace it. Harmonisation 'from the top down' depends crucially on the ability of the Community legislature to identify a single rule that is efficient across the whole of the Community. We think that in many cases such a single rule does not exist. This is because of differences especially in the economic environments in the member states to which company laws have to be adapted. For company law, the two most important are probably whether shareholdings in a particular jurisdiction are concentrated or dispersed and whether company law, especially board rules, plays a central role in the regulation of relations between the company and its employees. Shareholder structure determines whether, with regard to shareholders, the protection of shareholders as a class vis-à-vis management or protection of minority shareholders vis-à-vis a controlling shareholder is the main task of company law. Measures that protect minority shareholders are likely to aggravate the agency problems of shareholders as a class and vice versa. Equally, company law rules that advance the interests of employees are likely to make the management of the company less sensitive to the interests of shareholders. Along both dimensions, trade-offs need to be made and different trade-offs will fit particular member states better. Of course, Community legislation can seek to deal with this problem by offering options to member states, but in that case it is difficult to see what advantages Community legislation has over regulatory competition. By contrast, Community legislation could perform a role in providing options to those more immediately concerned by the regulation, i.e. companies, shareholders and creditors. A prime illustration is the Takeover Bids Directive, where we believe that, if it is determined that an optional regime is the preferred route, the balance between options for member states and options for companies should be re-assessed in favour of the latter.

Our second reason for proposing that Community harmonisation of company law should occupy a limited scope is the legal principle of subsidiarity as laid down in the Treaty. Companies in member states differ considerably, most notably in terms of ownership: in some states, companies with dispersed ownership dominate, in others companies are mainly based on controlling shareholders, or block holders. This difference has considerable impact on the markets in company shares, one of the core points of attention of company law. Other differences relate to their governance, with two-tier boards, one-tier boards or other more complex structures, boards with employee representation and boards without. All this pleads for a differentiated treatment, which can only be achieved at the national level. Moreover, Member

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states should be entitled to experiment with new forms, structures and rules, as has been done successfully with the Economic Interest Grouping, or with the Société par Actions Simplifiée.

Our third reason concerns the current nature of the Community legislative process. Community legislative instruments normally require qualified majority approval of the member states and in some cases – EU legal forms, for example – unanimity is required. The result is that legislative initiatives in this area often have failed or have resulted in rather inadequate legislative compromises, because there is such large scope for the particular interests of the member states to hold up agreement on a better law. The product of the Community's legislative process is therefore regularly a watered down compromise, often lacking clarity and consistency. This leads to difficulties with the implementation of directives and member states implementing directives very differently. We believe that regulatory competition is quite often likely to be more effective in reducing the blocking powers of individual member states.

b) Freedom of choice and harmonisation

For the above reasons, we believe that the Community's legislative programme for the harmonisation of member states' company laws should be limited, without going so far as to believe that it should not exist. We suggest there are two important roles that the Community and only the Community can perform, and one other potential role that it could perform.

First, regulatory competition can occur only if companies have freedom of choice of the applicable legal system. This needs to be guaranteed by Community law. The Court of Justice of the European Union (CJEU) has already taken important steps to make this choice available to companies and seems likely to take more in the future. However, case law on the basis of an interpretation of the TFEU cannot solve all the issues in this field. As with the Court's decision in *SEVIC* and the cross-border mergers Directive, the Court's decisions on freedom of establishment of companies identify the role for Community secondary legislation rather than remove the need for it. In particular, in order to make the process of choice of law acceptable and to remove any risk of one interest group within the company distorting the decision to change the applicable law, the process by which these decisions are taken needs to be set out in Community legislation. It may be argued that, for the same reasons as given above, the Commission will be unable to secure member state agreement on corporate mobility. However, here the Commission has the great advantage of the support of the CJEU's decisions. The principle of mobility, it can be argued, has already been established through the Court's decisions, so that the role of Community legislation is to clarify the modalities of its implementation.

As an aside, we offer a word of caution regarding another development in the CJEU's case law. The case law on free movement of capital has recently moved away from cases in which a member state retained some form of right to protect its interests in a privatised company to cases where there was no direct state interest in the companies concerned. In the cases C-531/06 (*Italian Pharmacies*), C-81/09 (*Tipou*) and C-89/09 (*French Bio-Medical Laboratories*) the CJEU found

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infringements of the free movement of capital in purely private situations, without any state involvement in the relevant companies. The three cases involved sector specific regulation that, arguably, dissuaded investors from investing in companies in these sectors. Scholars speculate on whether the recent judgements of the CJEU could mean that also general rules of company laws of member states could become subject to review by the CJEU on the basis of the free movement of capital. The cases mentioned provide little comfort that general rules of company law could not be reviewed on this basis. However, this would be highly problematic. Company law does not only seek to protect the interests of investors, but has a broader scope, at least covering also the interests of creditors and, in some member states, employees. Furthering these interests would almost by definition have the effect of "being liable to dissuade investors", the test the CJEU applies to assess whether there is an infringement of the free movement of capital. The same would arguably occur when national company law gives certain decision rights exclusively to boards of directors. The scope of the justifications acceptable for infringements of the free movement of capital is too narrow to deal with the objectives company law seeks to further. We therefore believe that the CJEU should avoid reviewing general rules of company laws of member states in light of the rules on the free movement of capital.

Second, harmonisation may be needed for the functioning of the internal market. This is mainly true for topics that raise cross-border issues with which the member states are incapable or not best suited of dealing. The following categories should be considered, though others may exist:

- (1) Cross-border issues that by their nature go beyond the jurisdictional powers of member states. Examples include the transfer of seat across member states, cross-border voting by shareholders and cross-border mergers. The first topic requires that the work on the 14th Directive be taken up again. The latter two topics are in need of further reform, beyond what has been achieved by the Shareholder Rights Directive and the Cross-Border Merger Directive. We believe these topics should be the first priority for the EU to deal with.
- (2) Issues of clarification with cross-border relevance. An example is liability in cross-border group relations.
- (3) Measures to stimulate the EU economy by simplifying existing rules and curbing unnecessary national burdens on business. An example is the Second Directive on Capital Maintenance, which is in need of a fundamental and comprehensive review.

In addition to these roles for the Community, there is a potential role for the Community to stimulate reform at national level by offering companies a form of company law incorporation alternative to the national forms. Already now the SE, though still with cross-border requirements, puts pressure on member states to make reforms since it is hard to explain why certain features that show to be attractive for the company or the investors in the SE should be withheld to shareholders and/or creditors of other national company forms. An example is the choice between a one tier- and a two-tier board that several member states have already accepted

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or are in train to accept also for national company forms. The removal of the cross-border access arrangements for the SE might put more pressure on member states to reform their national laws in order to preserve their utility. It is true that member states will be reluctant to agree (unanimity is necessary) to features of the SE which significantly undermine their command of their national laws. The history of the negotiations over the SE and more recently the SPE demonstrates this phenomenon. But progress, even if limited and slow, is better than outright acceptance of member states' protectionism and national lobbyism. Even if no progress is reached for the moment, the argument should be made for the sake of future development of the internal market.

c) Improved legislative process for company law, in particular for listed companies

Part of the disadvantages of the long winded legislative process and the difficulty of changing directives once they are agreed could be overcome by applying a multi-tier legislative process similar to the process developed in the Lamfalussy structure. Future – but also past – directives could contain well defined delegation arrangements allowing implementing measures to be adopted by the Commission. We are sensitive to the concern that such a delegation may not be appropriate in case where in private company law rights and obligations are created. Implementing measures however could be possible and useful at a procedural level for example relating to the shareholder voting process, proxy solicitation, disclosures with respect to branches and/or processes for cross-border mergers. Further delegation to ESMA could only apply to that part of company law that applies to listed companies, companies the securities of which are traded on regulated markets. For the part of company law applying to unlisted companies, the absence of national regulatory authorities in charge of company law in general would make it impossible to delegate legislative powers to a European body in which they would be represented. Delegation beyond the Commission to ESMA should therefore be restricted to company law matters directly relevant to listed companies. Delegation of regulatory powers to ESMA would be severely restricted as it would not cover policy or strategic decisions, and hence not be of a discretionary nature (Meroni doctrine). A three-tier legislative process for company law for listed companies could help to ensure coherence of European regulation, not only between the company law directives, but also with the directives on financial regulation. Uniform terminology and substantive coherence is to be strived at. While taking into account the differences in the financial markets and the structure of ownership, distortions due to lack of coherence between different national measures – also with the financial directives - should be avoided, for example with respect to the acting in concert rules relevant for disclosure of significant shareholdings and for the mandatory public offer.

3. High Priority

We believe that the European Commission should give the highest legislative priority to certain issues with a clear cross-border aspect that can only be solved at EU level. These are (a) the

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transfer of seat (fourteenth directive), (b) further harmonization of cross-border mergers and divisions, (c) cross-border voting and (d) branches. Below we will discuss each of these topics in more detail.

(a) Company mobility 14th directive

Company mobility is directly derived from the Treaty's provision on freedom of establishment and allows companies to opt for another legal order than the one to which they are subject. The CJEU in several ground-breaking decisions has recognised that companies have the right to establish themselves in another jurisdiction and a legal system cannot refuse a company to register in another member state. The Court rulings, however, have only stated the principle, without elaborating on specific steps to be undertaken to move to the other jurisdiction and has left some doubts about the consequences of some of its rulings. Company mobility is a corner stone in the completion of the internal market and in the absence of a specific set of provisions, causes considerable administrative burdens, and creates unnecessary social and tax disadvantages. Company mobility has recently been the subject of a Motion of the European Parliament "Requesting the Commission swiftly to submit, on the basis of Article 50(1) and (2)(g) of the Treaty on the Functioning of the European Union, a proposal for a directive on the cross-border transfer of company seats..."

Mobility can be pursued by either an outright decision to transfer the company's seat, or registered office, into another member state, or by the more elaborate indirect process of merging a company with another one from another member state, in accordance with to the provisions of the Cross-border Merger Directive.

Although the CJEU guarantees mobility, there are several aspects restricting it or even making it impossible in practice. First the administrative provisions for registering a company in another member state have to be adapted precisely to those of the exit state, in the absence of which questions about the continuing legal personality may arise. Moreover company registrars are not well acquainted with this process and might refuse to accept the transfer in the absence of clear instructions. As the process may affect the 27 member states, multiplied by two, there is a clear need to have this matter spelled out in an EU instrument, binding on all member states.

One aspect that has drawn ample attention is whether mobility might be contrary to the public interest in cases where it would upset the social balance, especially in the field of employee co-determination. This objection should not stand in the way of company mobility, on the one hand as it does not affect the great majority of companies in the EU that are not subject to co-determination rules, on the other hand as mobility would not prevent the co-determination rules to be respected by introduction a system of negotiation, as has been provided for in the Directive on Employee Involvement in the European Company. Companies not subject to any form of employee participation should be free to use all mobility mechanisms that after harmonisation would allow for cross-border mobility. If due to objections raised on the basis of employee

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participation member states would be unable to reach agreement on a generally applicable mobility scheme, it might be useful to limit the scope of the mobility provisions to smaller companies, below a certain threshold. In any case, mobility should be guaranteed for smaller and medium sized companies, especially those active in high technological sectors, where changing objectives or conditions should not be halted by company law restrictions.

As to the substance, a proposal has been made public by the Commission staff in 2001, known as the draft proposal for a 14th company law directive on the transfer of the legal seat of a company. The resolution of the European parliament referred to above also contains an outline of a possible organisation of the transfer, and other related issues.

Some basic principles must certainly be met:

- the transfer should not affect the legal personality of the company;
- the transfer should not affect the contractual relationships of the company;
- the transfer should not imply that the main business activity also be transferred; and
- minority shareholders should be protected.

Moreover, the tax consequences of the transfer should be addressed at EU level in order to ensure that effective use can be made of the mechanism to transfer the corporate seat.

(b) Cross-border mergers, divisions and conversions

Cross-border mergers can be effected on the basis of the Cross-Border Merger Directive 2005/56. This is a key mechanism facilitating cross border mobility for companies in the EU. However, a number of years of experience with cross border mergers has shown that the Directive creates problems in the practical application that hinder an effective use of the cross border merger.

The Directive seeks to address the position of three key stakeholders who are affected by the departure of companies that are dissolved in the merger into a company in another member state, i.e. shareholders, creditors and employees. For the protection of shareholders and creditors, the Directive basically refers back to the mechanisms applied at member state level for national mergers. These mechanisms are different in member states and have not been harmonised for the cross-border merger by the Directive. This results into shareholders and creditors of the different parties involved in a cross-border merger enjoying different types of protection, creating confusion and legal uncertainty as to validity and terms under which the merger can be executed and completed, as practice has shown in the past few years.

The Reflection Group set up by the Commission in preparing the work on the future of EU company law has identified a number of these problems, among which are the lack of harmonised rules on valuation of shares included in the merger on types of protection afforded to creditors (including the possibility to suspend the merger as long as creditors of some of the

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merging companies have not been offered appropriate comfort that their claims can be satisfied after the merger), and on the different time lines used in the various procedures applied to protect shareholders and creditors. In practice there are more difficulties, such as determining which expert(s) should be appointed in a cross-border setting to determine the fairness of the exchange ratio and the risk that different experts in different member states involved come to different views. We support the suggestion of the Reflection Group that the Commission should invite practitioners and experts to provide a clear overview of the difficulties experienced in practice in order to assess what elements of the arrangements for protection of shareholders and creditors need to be harmonised further for cross-border mergers to be executed effectively in practice.

The protection of employees in case of cross-border mergers has been copied from the consultation and negotiation processes designed for the Societas Europea. Leaving the political desirability of these protections aside, the results in practice are at best complex and often contradictory and unworkable. The rules of the Cross-border Merger Directive in combination with the rules in the Directive on Employee Involvement with the SE are difficult to understand from the wording in both Directives. Member states have given different interpretations of the wording of the Directives and have implemented the rules differently. This again creates confusion and legal uncertainty. The effectiveness of the merger process would benefit enormously if this confusion and legal uncertainty would be reduced, by clarifying the existing texts and where necessary by setting out in more detail how the process should work. We understand that addressing the employee co-determination rules in cases of cross-border mergers of national companies and SEs in order to create clarity and effectiveness might result in further political dead-locks that could stop any improvement of the regulation of cross-border mergers. On the other hand, by continuing to accept the unworkability of these rules we acquiesce in a situation that in practice very often prevents cross-border mergers from happening when companies are involved in member states with strong co-determination regimes.

Finally, we agree with the recommendation of the Reflection Group that national companies should have the right to engage in cross border divisions and conversions. It would complete the EU framework for cross border mobility. It should be relatively easy and uncontroversial to create effective regimes for cross-border divisions and conversions based on the Cross-Border Merger Directive if improved on the basis of an analysis of the difficulties experienced in practice with the various protection mechanisms applied in member states so far.

(c) Cross-border voting

The problem of cross-border voting was already identified by the High Level Group in 2002 as a problem that warrants urgent EU regulation. Shareholders have important rights in the EU for example in the field of capital extension and reduction and dividend distribution, mergers and divisions and, potentially, takeover bids. Additionally, the primary regulatory tool in the field of corporate governance is the national corporate governance code that is either to be complied

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with or explanations are to be provided for deviation. This system relies heavily on shareholders willing to engage with boards and using their rights as shareholders.

In today's world ownership of companies is becoming more and more international. In a number of member states a majority of investors is even based outside the state where the company is located. In such situations, shares are typically held in electronic book-entry trading systems through long and complicated chains of securities intermediaries in different jurisdictions. This creates two problems:

1. When shares are held in cross-border chains of intermediaries there is no legal certainty as to which accountholder has the right to exercise the voting rights attached to the shares. It is clear that the investor who runs the economic risk related to the shares should be entitled to vote rather than any intermediary in the chain of intermediaries who are merely holding the shares for an accountholder down the chain. We can refer to such investor as the ultimate accountholder in the chain, i.e. the first accountholder who is not a securities intermediary himself. However, legally, under the laws of the various member states, the accountholder in each member state typically is entitled to exercise the voting rights, leading to an accumulation of voting rights in the chain.
2. Partly as a result of this legal problem, there is no effective infrastructure created by securities intermediaries in the EU ensuring that the ultimate accountholder can exercise the voting right. There is no system ensuring that either proxies or voting instructions are passed on through the chain or ultimate accountholders are provided with evidence of entitlement on the basis of which they can participate in general meetings and exercise their voting rights in or prior to those meetings.

As a result of these problems, shareholders located in another jurisdiction than the jurisdiction in which the company is located often cannot effectively exercise their voting rights. This is unacceptable in light of the great reliance European company law and corporate governance pose on the engagement of shareholders and the exercise of voting rights by them. Any attempt at EU level to improve a balanced corporate governance system and engagement of shareholders is futile and lacks credibility if the legal infrastructure necessary for exercising voting rights across borders simply does not exist. It is also clear that member states cannot solve this problem individually, as the problem itself, by definition, is of a cross-border nature.

The Shareholders Rights Directive was supposed to solve these problems but failed to do so. Some obstacles for voting have been removed, but the Directive fails to address the legal problems caused by the cross-border chain of intermediaries. Since then a working group of members of the EU Corporate Governance Forum, the EU Commission and delegates from organisations of listed companies and securities intermediaries, has worked on finding solutions for the problems. The most effective solutions appear to be relatively straightforward:

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1. Securities intermediaries in the EU are required to facilitate the exercise of voting rights by ultimate accountholders on whose behalf they hold shares, either by providing proxies to them, or by passing on voting instructions from ultimate accountholders up the chain and voting according to these instructions, or by providing evidence of entitlement to the ultimate accountholder that allows the ultimate accountholder to directly exercise voting rights. Of these three mechanisms for voting, we believe the third is in all likelihood the most effective and least costly.
2. Securities intermediaries in the EU are not allowed to exercise voting rights themselves unless on the basis of specific instructions from ultimate accountholders.
3. Companies in the EU are required to put all relevant information regarding general meetings in which shareholders can vote on their website so that each shareholder can get access to all relevant information without costs. Securities intermediaries are required to pass on, as a matter of default by electronic means, any notification of the company related to general meetings or other corporate actions that require action from the ultimate accountholder.
4. Companies are required to accept as valid the evidence of entitlement of ultimate accountholders provided by EU securities intermediaries and to give access to their general meetings to ultimate accountholders and accept as valid the votes exercised by such ultimate accountholders

A consultation document that was prepared in 2010 for a proposed Directive on Legal Certainty of Securities Holding and Dispositions included the basics of these solutions. We strongly believe the EU should pursue this matter urgently and recommend that a solution along the lines as set out above is included in a Directive on Legal Certainty, the Shareholders Rights Directive or otherwise.

(d) The regime of the branches of companies – 11th directive

This directive governs the disclosures to be made upon the opening of branches by EU companies on a cross-border basis. It imposes a considerable number of initial and ongoing disclosure duties on companies, including the particulars about the legal representatives and audited annual accounts. These documents often have to be translated in the local language and be certified by a sworn translator, causing considerable delay and expense.

Without putting in doubt the need to organise disclosure in case of opening of a branch in another member state, the way these disclosures are organised date back to pre-internet times. Today, most of this information is available at the company's head office, along with many other useful elements, such as the location of subsidiaries or other agencies of the company. The information is, or could be made available by the issuer in several languages. Interested third parties could easily consult the home database and obtain all information needed for safely transacting business with the company.

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Therefore, the Commission may usefully consider to adapt the 11th Directive, by providing that the information to be disclosed in accordance with the directive could be made available by the company on its website, and this in the languages used in the jurisdictions where its branches are located. At the registry in the home state, a standardised mention would be made in the home state registers, identifying the company, the location of the branches and referring to the website of the company.

It should be provided that liability of the company for its disclosures will be dealt with according to the rules of the host state.

4. Medium Priority

The topics which in our view should have a medium priority are issues with a cross-border effect such as (a) group law (protection of subsidiary creditors and shareholders including wrongful trading and IPL issues), (b) a review of the Second Directive on Capital Maintenance and (c) simplification of national laws. Below we will discuss each of these topics in more detail.

(a) Group Law

The benefits of Community intervention in this field

Groups of companies form today's typical pattern of companies with cross-border trade. Among listed companies practically all belong to groups that have subsidiaries in other countries. Insofar as the EU harmonizes company law with an emphasis on cross-border effects, it essentially deals also with groups. While harmonization of other rules may have priority (see *supra* II 1-4), certain rules for groups of companies are necessary in light of this business reality and may bring clearly identifiable benefits. This does not mean that the enactment of an autonomous body of law specifically dealing with groups like the German Konzernrecht should be recommended at EU level. Rather, particular problems of groups should be addressed in the light of subsidiarity. This evaluation is in line with previous legal and economic research (see for example Forum Europaeum Group Law in 1998, The High Level Group of Company Law Experts in 2001/2002, Company Law Action Plan of the European Commission of 2003, and Reflection Group on the Future of EU Company Law 2011).

The candidates for Community measures

We see a need for limited high level intervention in this field and identifies three main candidates for EU measures are (in line with our answer to the specifications under question 19 of the Questionnaire): (1) The EU should require groups to provide information on their structure in a consolidated, investor-friendly and easy-to-read document, but also on a company by company basis identifying the intra-group relationships; (2) The Commission should recommend the recognition of group interest; and (3) A special inquiry mechanism under court control might be

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useful. All three measures enhance investor confidence across borders and promote cross-border commerce and investment in the form of cross-border groups.

- (1) According to the consultations held by the High Level Group the most important candidate for EU intervention with regard to groups is transparency. Transparency is particularly necessary for equity investors in groups as well as for creditors. We believe that more disclosure with regard to a group's structure and its group relations, in particular intra-group transactions, are needed. Having a more company by company description of group relations would be helpful since consolidation evens out much useful information, especially for solvency risk purposes. The parent company should be responsible for disclosing coherent, accurate and clear information. Existing accounting rules and scrutiny by auditors would help to identify some of these relations (see OECD, Related Party Transactions and Minority Shareholder Rights, April 2012). The Commission should review the provisions of the Seventh Company Law Directive in view of better financial disclosure, consistent with International Accounting Standards. Companies could be required to provide specific information when they enter into or exit from a group.
- (2) Some member states do not recognize the interest of the group as such. As a consequence the directors of the subsidiaries in these countries face contradicting requirements, on the one side by the national law which obliges them to act only in the interest of their company and on the other side by the more or less explicit expectations of the (foreign) parent that wants to steer the group in the overall interest of the group and may be forced to do so by global competition. While in many cases the directors of the subsidiary may cede in an opaque way to the parent's expectation, they may face the threat of legal sanctions, sometimes even of penal law. In this situation they should get some high level guidance on how to behave in the interest of the subsidiary and the group. This is a long observed obstacle for cross-border groups, both for the parent and for the subsidiaries. In several other member states a transaction made for the benefit of the group is legitimate, if the prejudice suffered by a particular company is justified by other advantages or compensation (cf. for example the French Rozenblum doctrine). But national company laws differ greatly as to the kind of advantages and the time and procedure of the compensation. Cross-border trade would be enhanced if there were a European framework rule for groups that allows those concerned with the management of a group company to adopt and implement a coordinated group policy, provided that the interest of the company's creditors are effectively protected and that there is a fair balance of burdens and advantages over time for the company's shareholders.
- (3) Irregularities, tunneling and outright looting is typically hidden and difficult to detect and even more to prove. Particularly in transnational groups minority shareholders of the subsidiaries (and in certain cases also those of the parent) as well as creditors face serious and sometimes insurmountable difficulties to find out whether transactions between members of

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the group have been effectuated according to the law. The information gathered by a special inquiry mechanism could help. It should be granted and controlled by a court at the request of the minority shareholders, and possibly under certain circumstances also the creditors, and exercised by independent professionals, for example a special auditor. The digging out of information by such a mechanism might often be a precondition for restitution and damages. The information needed is primarily for the subsidiaries towards the parent, under certain circumstances possibly also for the parent from the subsidiaries. The availability of such a mechanism in each member state would enhance the confidence of investors and creditors in groups that in today's reality are cross-border. Particularly relevant are the procedural difficulties in this context, among them cooperation and recognition.

These and further proposals have been brought forward and explained by the Forum Europaeum Group Law in 1998, the High Level Group of Company Law Experts in 2002, in the Company Law Action Plan of the Commission in 2003 and by the Reflection Group in 2011. The analysis and recommendations in these various documents remain relevant and should be considered in any future work on groups.

The appropriate European instruments

The various proposals that have been made in the past, including the Company Law Action Plan, plead for directives. This is appropriate for the disclosure and for the special inquiry procedure, cf. supra (2) and (3), both instruments need the backing of the law. The Company Law Action Plan foresaw a possible directive also for a framework rule for groups, allowing the adoption at subsidiary level of a co-ordinated group policy. We do believe that an EU measure could help to clarify the conditions under which the Rozenblum doctrine could justify specific transactions. However, since some member states do not yet have specific rules for groups (apart from financial and tax law), the EU might content itself here, at least for the time being, with the more flexible instrument of a Commission recommendation. This could be a recommendation on rights and duties in the context of a group of companies, possibly also in the form of a high level guidance for the directors of the group members. In addition, the Commission could promote self-regulation, for example private codes of conduct, as done by the United Nations for transnational enterprises. Such code of conduct on the co-ordination of group policy could be adopted by the board of the parent, alternatively by the general meeting, and would have to be disclosed. It could be considered to add a comply or explain mechanism whereby the board would state how it has applied the code throughout the group and on which point it has derogated.

(b) Formation and Maintenance of Capital - Second Directive

We are of the view that the case for the a fundamental and comprehensive reform of the system of formation and maintenance of legal capital in the Second Directive remains compelling

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notwithstanding that fears about the threat to dividend-paying capacity from the combination of accounting changes and the Second Directive have receded.

Whilst the KPMG Feasibility Study on Capital Maintenance provided a useful examination of the impact on profit distribution of the new EU accounting regime, its evaluation of alternatives to the Second Directive was unconvincing. That Study examined the feasibility of an alternative system by measuring the burdens for EU businesses of the current regime but this narrow focus meant that the main issue – whether the current regime actually delivers a level of shareholder and creditor protection that is commensurate with ‘the needs of the society of today and to the evolution of the economic environment’ – was largely overlooked.

It is clear to us that the legal capital regime has not kept pace with modern developments. Nowadays creditors tend to look to aspects other than capital, such as cash flow, as being more relevant to solvency than the reserves stressed by the Second Directive. The recent turmoil in the financial markets has taught us that an effective regulatory framework that seeks to protect the interests of creditors must address liquidity risks yet the Second Directive is wholly deficient in this respect. From today’s perspective, the obligation in Article 17 to hold a general meeting of shareholders on a serious loss of capital appears naïve with respect to both the timing and nature of the likely steps that a company in severe financial trouble will need to take with a view to ensuring its survival. Recent experience has also shown that for companies in serious financial difficulties, the current legal capital regime (in particular for urgent capital increases as regulated in Article 25 and Article 29) may hinder efforts to secure urgently-needed rescue financing or otherwise to effect an emergency restructuring. A further reason why a wide-ranging review of Second Directive is needed is that many apparently mandatory requirements that are part of the legal capital regime can be bypassed through the use of structures that neutralize their effects. This makes the legal capital regime a source of costs for companies that are not outweighed by countervailing benefits, and a trap for the unwary who do not have access to sophisticated professional advice. The many different arrangements that practitioners have developed to work around the Article 23 ban on the giving of financial assistance for the acquisition of own shares provide an apt illustration of this phenomenon.

Moreover, whilst it can be accepted that the concerns about the impact of accounting changes under IFRS have not materialized, it is still pertinent to note that highly technical guidance from accounting bodies on the identification of profits available for distribution has mushroomed in length and in complexity in the past few years. For instance guidance from the Institute of Chartered Accountants in England and Wales published in 2010 runs to 168 pages. The equivalent guidance from 2003 was just 25 pages long. This rapid growth is troubling and illustrates that the Directive approach is naïve and vain. Ultimately it is the responsibility of directors to propose the results as the basis on which distributions can be made.

Recalling the disappointingly under-ambitious amendments to the Second Directive that were introduced by Directive 2006/68/EC, our strong preference is for a fundamental and

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comprehensive review of the Directive rather than a selective examination that may lead eventually to piecemeal and quite modest changes to particular provisions. The alternative of rephrasing shareholder and creditor protections in terms of director's duties wherever possible should be pursued. The ramifications of shifting the focus of EU company law away from the public/private distinction towards listed/unlisted (Q7) need to be carefully considered as part of this review. Modern EU company law should strive not to duplicate regulatory requirements (such as with respect to equal treatment of shareholders, or in relation to the potential for share buyback powers to be used for market manipulation) that are already enshrined in EU capital markets law. As a minimum, an alternative system should be developed to protect creditors not on the basis of legal capital and reserves, but on the basis of prospective solvency test.

(c) The simplification of national law for SME's

In the different European directives, the scope has been calibrated taking into account the public interest issues that are pursued by the directive's provisions and taking into account historical factors, such as differences in the use of the two basic types of companies limited by shares. The following table gives a shorthand overview of the scope of the different company directives as have been adopted to today:

- 1st, 7th, 11th: applicable to both public (SA, AG, Plc, NV) and private company forms (SaRL, GmbH, Ltd, BV)
- 2nd, 3rd, 6th: applicable only to public company forms
- 4th: applicable to all company forms, including Offene Handelsgesellschaft and Kommanditgesellschaft
- 12th: applicable to all company forms with a single member
- IAS/IFRS: applicable to all publicly traded companies
- Shareholders Rights Directive: applicable to all publicly traded companies
- 8th: applicable to all company forms, with specific rules for auditors auditing public interest companies (listed companies, bank, insurance)

This overview indicates that most EU measures – and especially the most critical ones - are not applicable to small companies. Notwithstanding the absence of a European requirement, many national legislators have extended the regime of the directives to all companies with limited liability of the shareholders. By so doing they have imposed significant burdens and restrictions on these companies which were not justified by their size, nor by the nature of their activity. The clearest example is the Second Directive some provisions of which have restricted smaller companies to be created or to expand. The prohibition of contributions of future services or labour limits the founding of firms that are essentially based on the knowledge of their founders (e.g. high tech companies). Other provisions like the restriction to par value shares, or the prohibition to issue new shares under par, are unnecessary complexities that are the less apparent as they have now been adopted in most of national regulations.

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The debate about the need to draw up annual accounts in accordance with the full directive provisions has now been concluded by stating that national authorities have to decide how much simplification they will introduce into their system, amounting generally to leave things where they stood.

The development of a positive policy addressed to the smaller firms, often the most creative, requires the European Union not only introducing additional requirements, but also determining whether existing national requirements meet the standards of better legislation. A simpler legislation in the internal market initiative might be usefully considered.

We believe that in order to make not only the creation but also the running of smaller business firms more attractive, the regulatory and administrative obligations of these Small and Medium Sized firms should be put on the agenda. These include not only the provisions deriving from the EU legislation but also the numerous provisions that national legislators have adopted in order to protect shareholders or creditors, mostly along the same lines as applicable to their larger equivalents (listed companies or large unlisted SAs). In numerous cases companies are composed of one or two shareholders, in which case the conflicting interests between parties are usually absent and where most of the applicable obligations are disproportional to their actual needs. For other companies, one might consider that these provisions apply unless the shareholders - with a qualified majority – would deem them inappropriate in light of the specific needs of their business, whereby individual shareholders' interests could be safeguarded by allowing him to recall the waiver.

The existing legislation in many member states should be reviewed in to order to identify the provisions that at present constitute undue burdens on the activity of SMEs. Apart from the requirements flowing from some of the directives, addressed elsewhere in this paper, one can mention some of the rules on holding general meetings that in small companies are considered senseless ceremonies, followed because the law imposes them. Decisions adopted by these bodies could simply be laid down in signed documents, as is already the case in some member states. The same applies to proving ownership of shares, usually based on their registration in company registers; these companies know who their shareholders are and no further formalities should be needed.

The requirements about the simplification of annual accounts and financial reporting for micro entities, part of the Commission's Responsible Business package (see IP/11/1238), which as has now been adopted is fully supported but should be made mandatory in the member States as the optional regime will lead to distortion in competition among business firms located in different member states. As is already the case in several member states, the need to call on a notary to document statements that have been approved beforehand by the shareholders should also be scrutinised with a view of simplification.

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5. Low Priority

The topics that in our view should have the low priority are (a) alternative European legal forms, (b) the SPE and (c) the development of alternative legal instruments such as model acts. Below we will discuss each of these topics in more detail.

(a) Alternative European legal forms

The benefits of European legal forms, in particular the SE

The main EU company legal form is the SE. It is a compromise reached in 2001 after a most difficult process which took more than four decades. The split into a regulation covering the legal form and a directive concerning labour co-determination is part of this compromise. The ECLE is of the opinion that the EU company legal forms are not among the top priorities for EU intervention (see supra II 1-4), but that it may have clearly identifiable benefits for business. This is particularly true for the SE.

EU intervention is justified by the fact that the SE may promote cross-border commerce. It is a genuinely European legal form that offers the founders the option of a European alternative to the various national forms which may have legal and/or practical shortcomings. National company law forms are path dependent, sometimes outdated and occasionally not well developed. Some of them contain rules that may function as obstacles to cross-border commerce. Conflict of laws is sometimes an answer, but not the only one and certainly not always the best. The SE does not need recognition by member states, it promotes competition between legal forms in the EU, both vertically and indirectly also horizontally, and it is useful in fighting national protectionism as to legal forms. The success of the SE, while originally questionable, is today undeniable in a few member states such as Germany (the latest major example are Porsche and Bertelsmann) and the Czech Republic (though mostly with shelf SEs). In some other member states the success is very minor, while ten member states had no SEs in 2009.

Ernst & Young identified the following main benefits of the SE in their Study carried out for the European Commission:

- The European image of the SE and its European label („SE“)
- The possibility to carry out operations, like cross-border transfer of seat (as long as there is no 14th directive) and, not superseded the possibility to organize a cross border merger
- Savings in costs of cross-border transactions (SE instead of many national subsidiaries, but see infra as to the shortcomings)
- Workable alternative at least to existing company law forms existing in some member states
- The possibility not to be subjected to compulsory national requirements (for example, the SE allowing public limited-liability companies to choose between one-tier and two-tier management structure, useful new choice for German companies, cf. Allianz)

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- Labour law reasons (viable and more flexible alternative to the German mandatory labour co-determination at parity).

As to other company legal forms see b) and c).

Shortcomings and possible improvements of Community legislation introducing EU company legal forms, in particular the SE

The main shortcomings of the SE regulation and directive are, again based on the Ernst & Young Study:

- The complexity linked to frequent cross-references to relevant national legislation, this is probably the main handicap. As a result there are 27 different SEs, English, German, French, Italian, Polish and so on. The differences in the way EU company law forms are understood and used at national level, i.e. the uncertainties of what rules apply for the SE which result from the rudimentary EU rules and their interface with the applicable national law.
- The costs of the SE. The formation of an SE and in particular the negotiation process under the directive concerning labor co-determination are generally considered to be expensive and time-consuming.
- There is no tax neutrality in the case of transfer of the registered office and transfer of the actual activity, but maybe some progress can be made as to some unification of the tax base.
- Access to the SE is at present limited. Private limited companies are not among those who can form an SE (without prior conversion into a national limited-liability company) and there is a requirement of explicit transnationality. The latter can function as protectionistic in favour of home company forms. It hinders competition of legal forms by making it more difficult for founders and capital to EU-widely cross national borders.

The possible improvements of EU legislation on the SE follow directly from these shortcomings. Specific points to be reformed would be inter alia:

- the requirement that two companies from two EU states be involved;
- the prohibition of a direct creation of an SE;
- the requirement to have the seat and principal place of business in different states; until further directive change, one method for seat change, but to be simplified.

We realize of course that for the time being the tax issues can hardly be solved. The burden resulting from the directive might be alleviated, even without substantially weakening the national co-determination systems.

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Should existing EU company legal forms (apart from the SE) be reviewed or other forms be offered?

cost of creating these forms bears no relations to their advantages: it is more about symbols, while the effective shortcomings in the company law field remain unaddressed.

The EEIG has not been very useful, apart from certain business sectors such as cooperation of lawyers and other professions and some other applications. The reasons are obvious: the EEIG has been subjected to many restrictions in order to protect national company legal forms.

The lack of success is even more obvious for the SCE (European Cooperative Society). According to a study made for the European Parliament, until 2010 only 17 such companies have been created with a workforce of 32 in total.

(b) The SPE

In seeking to avoid the referencing back to member state law on the issues where member states do not agree on a single arrangement for the European legal form, the drafters of the SPE Statute have developed the interesting idea of referring a wide number of company law issues to an Annex, proposing that the incorporators of the SPE lay down their own solutions in the Articles of Association of the SPE. In combination with the absence of a cross-border element as a requirement for incorporation of the SPE, this creates an extremely flexible company law form that directly competes with national legal forms used by small and medium sized enterprises. Creative though it may be, we doubt whether such European legal form can truly function without a substantial company act providing itself for a comprehensive set of rules on all relevant aspects of the regulation of a company. In cases of conflict or lack of clarity regarding the provisions in the Articles of Association, a national court will have little choice but to refer to the national law of the state of the registered office of the SPE to find a legal basis on which to found a decision. More importantly, we question whether there is a true need for such a flexible EU legal form in competition with national legal forms. The SPE in this shape and form will not provide a uniform EU legal form for SMEs, which was the rationale for developing a statute for the SPE in the first place. The variety of SPEs will not limit itself to 27 forms but will extend to endless private choices made by those who incorporate an SPE.

(c) The European Foundation

In a feasibility study commissioned by the European Commission a group of expert has convincingly shown that foundations in the Community are exposed to specific civil law and tax law problems the costs of which are substantial and that severely restrict the ability of foundations to operate across borders in the EU. The group came to the conclusion that harmonization of member state foundation law would not be an appropriate way forward as the nature and use of foundations is very different across member states. The group has suggested to develop a Statute for a European Foundation instead, see for the extensive report: http://ec.europa.eu/internal_market/company/docs/eufoundation/feasibilitystudy_en.pdf. The

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Commission has followed this up with a first draft for a European Foundation Statute in February 2012, for foundations with cross-border activities and that can be created ex nihilo. We believe that this should be pursued taking into consideration the above-mentioned shortcomings of other European company legal forms.

(d) The appropriate European instruments – EMCA

The European Model Company Act (EMCA) is an ambitious enterprise, but only limited benefits can be expected. The EMCA, whatever its final form will be, cannot compete with a fully developed company statute like the UK Companies Act of 2006 (1300 art., 700 p.) or the German Stock Corporation Law (410 articles, revised since 1965 70 times, many large commentaries, Großkommentar 5th ed. scheduled for 16 vol.) or the detailed French company law with the many special French legal company forms. Also the impact on EU member or accession states with a less developed company law is doubtful since most of these states have modernized, or are modernizing, their company law in the process of acceptance of the *acquis communautaire*.

Nor does the ECLE expect that the EMCA will live up to the ambitious model of the restatements US style. While the EMCA will hardly be relevant for the European and national practice (apart from transition countries outside the EU), it may have some merely academic interest, but only insofar as it does not only strive for a mere dogmatic norm catalogue, but addresses the problems functionally and from a law and economics perspective.

In contrast to this prognosis, other optional instruments may very well be useful, provided that they are not meant as an alternative to other European or national company forms and traditional harmonisation, but as supplementing them on specific fields and issues. For example a code on corporate social responsibility or on a gender quota for company boards might be useful instead of mandatory EU rules.

A European Corporate Governance Code is not advisable for the reasons given by the High Level Group of Company Law 2001/02 and the Company Law Action Plan of May 21, 2003. But an action to support the effective implementation of the existing codes might be useful.

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