

# Outline of EU harmonization program

## *EU Company Law*

### Exam question

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Outline the harmonization program of the European Union with respect to primary and secondary legislation.

### Introduction

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#### Intention of the EU

Art. 12

- Discrimination is forbidden.

Fundamental free movement

- Harmonization of legislation
  - Required if there is a need to
    - eliminate obstacles to trade (despite mutual recognition principle) due to different levels of protection between MS,
    - assure a minimum degree of protection (employee protection, shareholder protection, etc).

#### Approaches to harmonization

- Harmonizing rules relating to company law and corporate governance
- Objectives include:
  - providing equivalent protection for shareholders and other parties concerned with companies;
  - ensuring freedom of establishment for companies throughout the EU;
  - fostering efficiency and competitiveness of business;
  - promoting cross-border cooperation between companies in different MS;
  - and stimulating discussions between MS on the modernization of company law and corporate governance.

### Legal basis for harmonization

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It has been deemed necessary to harmonize through secondary legislation. (Directives etc).

- Harmonization in this area seeks:
  - to prevent distortions due to non-economic factors,
  - to ensure appropriate protection of all parties (shareholders, creditors, etc.) and
  - to facilitate business throughout the internal market.

Art 7. Good starting point. - Legal basis?

Art. 44 (2) (g)

- Council and commission must do what is required to reduce restriction on freedom of establishment.
- Directives can be adopted with the procedure laid down in art. 251.

- => Council (as a main rule) can act by a qualified majority.
- Directives adopted under art. 44 must concern companies right of establishment.

#### Art. 94

- Opens up a wide area of discretion (skøn) for EC legislation.
- Adoption of any directive
  - “for approximation (indbyrdes tilnærmelse) of such laws, regulations or adm. Provisions of the MS as directly affect the establishment or functioning of the common market.”
    - “directly affect” → merely requires that measures have to be useful for European integration.
      - Seen together with art. 3 (h) → both leaves extensive interpretation possibilities.
- Art. 94 requires **unanimity** of the Council.
  - Art. 95 → softens the requirement → qualified majority
    - In the period up to 31. dec. 1992. (Art. 14)

#### Art. 293

- Provides that the **MS shall enter into negotiations** with each other with a view to securing for the benefit of their nationals, e.g.
  - the mutual recognition of companies or firms
  - the retention of legal personality in the event of transfer of their seat from one country to another,
  - and the possibility of mergers between companies or firms governed by the laws of different countries.

#### Art. 308

- May only be applied if “this Treaty has not provided the necessary powers”.
- Unanimity by Council.
- E.g. in the case of the SE company.

## Legal instruments

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### Regulations (Forordninger)

- “A regulation shall have *general application*. It shall be binding in its entirety and directly applicable in all Member States.” → art. 249 EC
- EU regulation has a general scope, and is obligatory in all its elements and **directly applicable** in all MS of the EU.
- Any national laws contrary to the regulation are overruled, as EU Law has supremacy over the laws of the MS.
- New legislation enacted by MS must be consistent with the requirements of EU regulations.
- For these reasons regulations constitute the **most powerful or influential of the EU legislative acts**.

### Directives

- “A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods.” → art. 249 EC
  - A directive fixes the objectives to be pursued by the EU member states, but leaves freedom of choice for the ways of obtaining them (maintaining an obligation to achieve the result).
  - Choice of form and methods lies with the MS.
- **Main legal instrument** in the area of EU Company Law.

- Vertical direct effect (Marshall-case)
  - **No horizontal direct effect** (But an individual who has suffered loss as a result of the Member State's failure to implement a directive may claim damages from the state (so-called "state liability", cf. Francovich (1991))
- Different legislative techniques:
  - Detailed provisions focusing on safeguards,
  - Setting minimum standards,
  - Removing obstacles to cross-border transactions,
  - Etc.

## Recommendations

- Recommendations
  - "Recommendations and opinions shall have no binding force." → art. 249 EC
  - Serve as guidance at the interpretation of national or EC law.

## Case law

- Art. 220 EC requires the Court to ensure that the law is observed in the interpretation and application of the Treaty.
  - Judicial power of the ECJ
    - Such as preliminary ruling procedure (234 EC).
- Company law
  - Interpretation of secondary legislation and Treaty provisions.
  - Led to several landmark judgments.
    - Centros, Überseering, Cartesio, Sevic, etc.

## Company Regulations

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- The SE Company Regulation
- The European Co-operative Society Regulation (SCE)
- The Draft Regulation on the European Private Company

## Harmonization Directives

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- Cover a number of disparate (helt forskellige) areas of law + implementation by MS (except the 6th Directive).
- Art. 48 EC
  - But legislations often cover primarily companies limited by shares or otherwise having limited liability.
  - Activities of these companies compared to e.g. partnerships.
- Public companies
  - Quite intense regulated.
- For example:
  - 1st, 4th, 7th, 11th, 12th & 14th directives → applicable to **public & private** companies.
  - 2nd, 3rd & 6th directives → applicable **only to public** limited companies.
- Distinction because activities of public companies predominate in the economy of MS.
- Critique?

## Harmonization Directives: Overview

- 1<sup>st</sup> Directive (1968) Disclosure Directive
- 2<sup>nd</sup> Directive (1977) Capital Directive
- 3<sup>rd</sup> Directive (1978) Merger Directive
- 4<sup>th</sup> Directive (1978) Annual Accounts Directive
- 6<sup>th</sup> Directive (1982) Directive on Division of Companies
- 7<sup>th</sup> Directive (1983) Consolidated Accounts Directive
- 8<sup>th</sup> Directive (1984) Auditor Directive
- 10<sup>th</sup> Directive (2005) Cross-Border Merger Directive
- 11<sup>th</sup> Directive (1989) Branch Directive
- 12<sup>th</sup> Directive (1989) Single-Member Company Directive
- 13<sup>th</sup> Directive (2004) Take-Over Directive
  
- SE Directive (2001) “supplement to statute on SE”
- SCE Directive (2003) “supplement to statute on SCE”
- Shareholder Directive (2007)

### 1<sup>st</sup> Company Directive - the Disclosure Directive

- Purpose: To coordinate the Regulations concerning
  - disclosure
    - Of memorandum of association, articles / statutes, who is authorized, accounting, etc.
    - MS must keep a register.
    - Also regulates how the authorization documents can be relied upon against 3<sup>rd</sup> parties.
  - organs’ powers of representation
    - Actions carried out before company was formed. → persons acting are liable.
      - Company can take over the obligations.
    - 3<sup>rd</sup> parties can rely on organs publicized power, despite irregularities in the appointment.
  - the nullity of companies with limited liability.
    - Nullity must be ordered by the court, publicized and result in winding up.
- Legal basis: Art. 44(2)(g) EC
- Applies to: public and private companies.

### 11<sup>th</sup> Company Directive - the Branch Directive

- Purpose: A technical implementation of the Treaty-based right of establishment. (The Centros judgement relied upon this directive together with the Treaty based right of establishment).
- It regulates the disclosure, when a company opens a branch.
  - Activities of the branch must be disclosed along with the name and register.
  - People authorized to represent the company must be disclosed.
- Legal basis: Art. 44(2)(g) EC

### 2<sup>nd</sup> Directive – the Capital Directive

- Purpose:
  - Harmonisation of public liability companies in the EC,

- Providing **minimum capital requirements** for public limited companies.
  - 25.000 EUR, min 25%, cash or in-kind.
- As well as the **maintenance** and **alteration** of their capital.
- Protecting shareholders and creditors.
  - Making information available about the capital composition.
  - E.g. preemption rights on share increase.
  - Restrictions on buying own shares
- Legal basis: Art. 44(2)(g) EC

### **3<sup>rd</sup> Company Directive – the Merger Directive**

- Applies only to public companies in same MS. Not cross-border mergers.
- Purpose:
  - Imposes duty on the MS to have rules on merger, regulation on merger procedure.
  - MS must provide for merger by acquisition and by formation.
  - To some extent cross-border merger has been implied from this → Sevic
- Regulates: What happens, with assets, employees etc.
- Legal basis: Art. 44(2)(g) EC

### **10<sup>th</sup> Company Directive - the Cross-Border Merger Directive**

- Purpose:
  - Allows cross-boarder merger between the EU and EEA.
- Apart from the international aspect, the Directive is in all material respects modeled on the 3<sup>rd</sup> Company Directive.
  - Provides for additional requirements.
    - Synchronization of drawing up
  - Each merging company must draw up common draft terms, which must be published.
    - Must include saying on repercussions on employment.
  - Report on legal and economic aspects must be drawn and available to shareholders and employees.
- Legal basis: Art. 44(2)(g) EC

### **6<sup>th</sup> Company Directive - the Directive on Division of Companies**

- Related to 3<sup>rd</sup> directive.
- Purpose:
  - To lay down rules concerning divisions of public limited liability companies from the same MS.
  - The opposite of a merger. Assets and liabilities goes from one company to more companies.
  - MS is not required to introduce division procedure into their legislation.
- Legal basis: Art. 44(2)(g) EC
- Employee participation:
  - A division could have impact on the participation rights. This depends on the thresholds of the national participation laws.
- Regulates: What happens with the assets, shares etc.

### **13<sup>th</sup> Company Directive - the Takeover Directive**

- Purpose: To achieve greater legal certainty with regard to takeover bids, while protecting the interests of

shareholders (and particularly minority shareholders), employees and any other interested parties.

- Legal basis: Art. 44(1) EC
- Employee participation:
  - employees or their representatives of the offeree and the offeror company must be informed about the bid;
  - employees or their representatives have the right to draft an opinion relating to the takeover.

#### **4<sup>th</sup> Company Directive - the Annual Accounts Directive**

- Purpose: Rules on annual reports, principle of clarity, principle of reliability, explanatory notes, etc.
- Legal basis: Art. 44(2)(g) EC

#### **7<sup>th</sup> Company Directive – the Consolidated Accounts Directive**

- Purpose: Defines when a parent company and a subsidiary has to “consolidate” (i.e. combine) their accounts to provide a fair view of the economic entity in the group.
- Legal basis: Art. 44(2)(g) EC

#### **8<sup>th</sup> Company Directive - the Auditor Directive**

- Purpose: Requirements for auditors: independence and decorum requirements.
- Legal basis: Art. 44(2)(g) EC

#### **12<sup>th</sup> Company Directive - the Single-Member Company Directive**

- Purpose: Sole traders may form limited liability companies.
- Legal basis: Art. 44(2)(g)

#### **SE Directive**

- Purpose: To complement the Statute on the European Company with regard to the involvement (participation) of employees in the European company.
- Legal basis: Art. 308 EC
- Employee participation:
  - Several models of participation by agreement are possible, the most important being the board-level representation of employees. If there is no satisfactory arrangement, a set of standard rules on participation becomes applicable.
  - Mandatory information and consultation standards.

#### **Rights of shareholders in listed companies**

- Purpose: to ensure timely access of shareholders to all information relevant to general meetings, and to facilitate the cross-border exercise of voting rights by correspondence and by proxy.
- Legal basis: Art. 44(2)(g)

#### **Company Directives - that have not been passed**

- The Draft 5<sup>th</sup> Company Directive - the Structural Directive
  - The structure of public limited companies. The Draft contains a mandatory employee representation on the boards of companies with more than 1000 employees (this has been fiercely opposed by the UK). Companies will have a choice between a 2-tier and single-tier management system. Proposal for A and B shares and a ban against limitation of voting rights (only a maximum of 50% of the share capital can have reduced or no voting rights) (this proposal has also met significant opposition).
- The Draft 9<sup>th</sup> Company Directive - the Group Directive on substantive group law

- Controversial attempt at establishing uniform group rules. Proposes that a group agreement may be made in the form of a control agreement (German: Beherrshungsvertrag) between a parent and a subsidiary so that the parent takes over management of the subsidiary. The “price” for this agreement will be an indemnification of the main shareholders in the subsidiary.
- 14<sup>th</sup> Directive – Crossborder Transfer of the Registered Offices of Limited Companies
  - Will make it possible for companies to transfer their registered offices – their legal headquarters – to somewhere else in the EU.
  - Until now such an action was either not possible at all or required the company to be liquidated in its country of origin before it could be re-founded with its registered office in the new country.
  - The Directive would make it possible, for example, for a German GmbH to transfer its registered office to the UK, and at the same time transform itself into a UK Ltd. That means that after the transfer of the registered office the company is organized by UK company law and no longer by German company law.

## **Setting up a company (briefly)**

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- 1<sup>st</sup> Directive - Disclosure
  - Publication of company matters, public access to national register with information on company capital, the company’s management accounts etc. and from which documents such as articles of association, memorandum of association and accounts can be obtained.
  - Regulates public and private companies.
- 2<sup>nd</sup> Directive – Capital
  - Minimum requirements in respect of articles and formation documents, rules on minimal capital and capital increase and reduction, restriction concerning acquisition of own shares, dividends, duty to react against capital losses, preferential rights, equal treatment of shareholders, etc.
  - Only regulates public companies.

## **Company operation (briefly)**

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- 1<sup>st</sup> Directive - Disclosure
  - ensures the validity of the company’s undertakings towards third parties acting in good faith.
- Directive 90/435/EEC (amended by Directive 2003/123/EC) on the common system of taxation:
  - applicable in the case of parent companies and subsidiaries of different Member States introduces tax rules which are neutral from the point of view of competition for groups of companies of different MS.
  - It abolishes the double taxation of dividends distributed by a subsidiary in one MS to its parent company in another.

## **Company restructuring (briefly)**

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- 3<sup>rd</sup> Directive - Merger Directive,
- 6<sup>th</sup> Directive - Directive on Division of Companies &
- 10<sup>th</sup> Directive – cross-border mergers
  - to give shareholders and third parties the same guarantees during restructuring;
- 13<sup>th</sup> Directive - Takeover Directive
  - to establish minimum guidelines for the conduct of takeover bids for the securities of companies governed by the laws of MS, where some or all of those securities are admitted to trading on a regulated market.
  - Aims to provide adequate protection for shareholders within the Community by establishing a framework of common principles and general requirements which MS are to implement through more detailed rules in accordance with their national systems.

## **Guarantees concerning the financial situation of companies (briefly)**

- 2<sup>nd</sup> Directive – Capital
  - Contains provisions to ensure that authorized capital is available throughout a company's existence.
- 4<sup>th</sup> (Annual Accounts) Directive, 7<sup>th</sup> (Consolidated Accounts) Directive and 8<sup>th</sup> (Auditor) Directive
  - To ensure that information provided in accounting documents is equivalent in all MS, these Directives require company accounts (annual accounts, consolidated accounts and approval of persons responsible for carrying out statutory audits) to give a true and fair view of the company's assets, liabilities, financial position and profit or loss.
  - Removal of barriers to company development on a Community scale
  - Aim: to make it easier for companies to operate in MS other than their country of origin.
- 10<sup>th</sup> Directive - the Cross-Boarder Merger Directive
  - Intends to facilitate cross-border mergers between companies with share capital.
  - Introduces a simple framework which is strongly derived from rules for national mergers and which will avoid the liquidation of the company being taken over.
  - Specifies the minimum content of the common cross-border merger project and in order to protect the interests both of shareholders and of third parties.
- Directive (2007) on shareholder rights
  - Abolishes the main obstacles to a cross-border vote in listed companies which have their registered headquarters in a MS, by introducing specific requirements for a certain number of share-holder rights at the General Meeting.

## **The operation of European-scale companies**

- Not much development on tax and social rules.
- 11<sup>th</sup> Directive - Branch Directive
  - enables persons resident in a country where a branch is established to obtain a minimum amount of information on branches in other MS.
- An international bankruptcy convention was signed on 23 November 1995, under which European-scale undertakings will be declared bankrupt at European level, instead of undergoing the multiple bankruptcies that were hitherto the case.

## **Community statutes**

- AIM:
  - To allow companies that want to act or establish themselves beyond their national frontiers the option of being subject to one set of legislations and not several as is the case at present.
- SE Company
  - A company may be set up within the territory of the Community in the form of a public limited-liability company → 'Societas Europaea' (SE).
  - The SE will make it possible to operate at Community level while being subject to Community legislation directly applicable in all MS.
- SE Directive
  - Ensuring that the establishment of an SE does not entail the disappearance or reduction of practices of employee involvement existing within the companies participating in the establishment of an SE.

## **Action Plan (European Commission)**

- Proper protection to members and third parties
- Fostering efficiency and competitiveness of business