A Modern Regulatory Framework for Company Law in Europe:

A Consultative Document
of the High Level Group of Company Law Experts

Chapter 1:
Introduction

1. In September 2001, the European Commission set up a Group of High Level Company Law Experts with the objective of initiating a discussion on the need for the modernisation of company law in Europe. To this end, the Group was given a dual mandate (http://europa.eu.int/comm/internal_market/en/company/company/news/01-1237.htm): first, to address the concerns expressed last year by the European Parliament during the negotiation of the proposed take-over bids Directive ("13th Company Law Directive") and, secondly, to provide the Commission with recommendations for a modern regulatory European company law framework. At the beginning of this year, the Group presented its conclusions on the issues relating to take-over bids (http://europa.eu.int/comm/internal_market/en/company/company/news/02-24.htm). Since then it has concentrated on the second part of its mandate, in order to produce its final report later this year.

2. The mandate for the second part includes the following issues:

- The creation and functioning of companies and groups of companies, co-operatives and mutual enterprises, including corporate governance;
- shareholders' rights, including cross-border voting and virtual general meetings;
- corporate restructuring and mobility (for instance, the transfer of the corporate seat);
- the possible need for new legal forms (for instance, a European Private Company, which would be of particular relevance for SMEs);
- the possible simplification of corporate rules in light of the SLIM-report on the Second Company Law Directive of 13 December 1976 on the formation and capital maintenance of public limited liability companies (http://europa.eu.int/comm/internal_market/en/update/slim/slim4en.pdf).

3. In this consultative document the Group invites all parties interested in and concerned with company law in Europe to comment on the issues specified in the mandate of the Group. The Group has also identified a number of general themes which appear to be of importance for the future development of company law in Europe and would like to invite parties to comment on them as well. This consultative document does not pretend to present a full and exhaustive discussion of all of these issues. Nonetheless, the Group would hope that it gives sufficient material to allow respondents to indicate what they believe to be priority matters for reform of company law in Europe and which direction such reform should take. The Group will take in these comments when reviewing these issues more widely in its final report.

4. The work undertaken by the High Level Group of Company Law Experts essentially deals with company law issues, covering both publicly traded companies as well as others. On publicly traded companies, the Final Report of the Committee of Wise Men on the Regulation of European Securities Market, chaired by Baron Lamfalussy, was taken into account.

5. The High Level Group of Company Law Experts would like to draw the attention of the public to consultations launched by the European Commission on a revision of the Investment Services Directive (second consultation document published on 25 March) and the ongoing and periodic transparency requirements for publicly traded companies (second consultation document to be launched very soon). The recently created Committee of European Securities Regulators also started technical groundwork on the basis of Commission requests for technical advice on prospectus and on market abuse (published on 27 March). The present consultation paper therefore is not intended to duplicate these consultations.

6. Following this introductory chapter, the consultative document contains the following chapters with the main topics of the consultation:

Chapter 2: General Themes

Chapter 3: Specific Topics

3.1. Corporate Governance

3.2. Shareholder Information, Communication and Decision-making

3.3. Alternatives to Capital Formation and Maintenance Rules

3.4. The Functioning of Groups of Companies

3.5. Corporate Restructuring and Mobility

3.6. The European Private Company

3.7. Co-operatives and Other Forms of Enterprise

Annex 1: List of existing European Company Law instruments

Annex 2: List of proposed European Company Law instruments

7. In order to submit your comments or suggestions on any of the above mentioned chapters, please respond by using the space provided in the online version (http://europa.eu.int/comm/internal_market/en/company/company/modern/index.htm) of this consultative document and send your contribution to us using the "send"-function at the end of the relevant chapter(s). Please complete also the space "your profile" at the beginning of each chapter to make sure that your contribution reaches us.

8. Alternatively, you may choose to send your comments or suggestions in written form either by E-Mail (markt-modernising-company-law@cec.eu.int), or by regular mail to:

The Secretariat of the High Level Group
c/o Mr. Karel Van Hulle
European Commission
Office: C107 - 3/4
B-1049 Bruxelles

For reference a "Word"-version in connection with a PDF-version of this consultative document is also available.

Written submissions should be accompanied by your name, your contact details, an indication of the character of your company or organisation, and your country.

9. French and German versions of the consultative document will be made available later on.

10. Please note that the deadline for submissions is 21 June 2002.

Chapter 2:
General Themes

1. For the second stage of its mandate the Group has been asked "to provide recommendations for a modern regulatory European company law framework designed to be sufficiently flexible and up-to-date to meet companies' needs, taking into account fully the impact of information technology." The following chapters of this consultation document will each deal with a specific key area of the total EU company law framework. The mandate given to the Group also raises a number of general issues that we explore in this chapter.

I. Facilitating efficient and competitive business in Europe

2. The mandate denotes a distinct shift in the approach the European Union could take to company law. Until now this approach has been mainly 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 throughout the Community (art. 44 (2) g) EC Treaty). Nine Company Law Directives have resulted so far.[1] "Meeting companies' needs" has not been a prominent feature of this harmonisation exercise. The exercise has been much more driven by establishing a proper level of protection, based on co-ordinating the existing national regulations and entrenching them at Community level, throughout the Union for those who are involved in and affected by the affairs of the company, in particular shareholders and creditors, with a view to preventing a "race to the bottom" by the Member States. Whether this effect actually has occurred or would have occurred in the absence of harmonisation is unclear and some would argue that in some areas we have actually seen a "race to the top".

3. In adopting this approach we may have lost sight of what the Group believes to be the primary purpose of company law: to provide a legal framework for those who wish to undertake business activities efficiently, in a way they consider to be best suited to attain success. Company law should first of all facilitate the running of efficient and competitive business enterprises. This is not to ignore that protection of shareholders and creditors is an integral part of any company law. But going forward the Group believes the primary focus of the European Union should be to develop and implement company law mechanisms that enhance the efficiency and competitiveness of business across Europe. Part of the focus should be to eliminate obstacles for cross-border activities of business in Europe. The European Single Market is becoming more and more of a reality and business will have to become competitive within this market. In order to do so it will have to be able to efficiently restructure and move across borders, adapt its capital structures to changing needs and attract investors in many Member States. These themes will be addressed specifically in later chapters. The Group believes they are priority matters on the agenda of company law reform in Europe.

4. Proper mechanisms for the protection of shareholders and creditors to some extent add to the efficiency of company law regulation, as they reduce the risks and

---

[1] First, Second, Third, Fourth, Sixth, Seventh, Eigth, Eleventh, Twelfth; for full citations see Annex 1 or http://europa.eu.int/eur-lex/en/lif/reg/en_register_1710.html

costs involved for those who participate in and do business with companies. But the effectiveness of the mechanisms to protect shareholders and creditors that have been established so far, for example in the area of capital maintenance and corporate restructuring, has been questioned and some of them appear to be real impediments for efficient financing and restructuring of business in Europe. Where possible and appropriate these mechanisms should be replaced by ones that are more effective and less cumbersome.

Question 1:
a) Do you agree that the European Union moving forward in the area of company law should primarily focus on establishing new and amending existing company law mechanisms with a view to facilitate the efficient and competitive operation of business across the Union?
b) If so, can you identify other areas of company law than those specifically dealt with in this consultative document where progress could and should be made as a matter of priority?

II. Modern company law making

5. Various commentators have argued that the system of harmonising company law through directives that have to be implemented by the Member States has led to a certain "petrification". Once Member States have agreed to a certain approach in an area of company law and have implemented a directive accordingly, it becomes very difficult to change the directive and the underlying approach. Simultaneously however, there is growing need continuously to adapt existing rules in view of rapidly changing circumstances and views. The "shelf life" of law tends to become more limited as society is changing more rapidly and this is particularly true of company law. Fixed rules in primary legislation may offer the benefits of certainty, a reduced risk of rules that are changed as soon as an accident occurs, democratic legitimacy and usually strong possibilities of enforcement. This comes at the cost of little or no flexibility and loss of the means to keep pace with changing circumstances.

6. We can see a movement in Member States to use alternatives for primary legislation by government and parliament, which alternatives allow for greater flexibility. Such alternatives include:

- **Secondary regulation** by the government, based on primary legislation in which broad concepts and fundamental principles are laid down; the secondary regulation can be amended more quickly when circumstances require change.
- **Standard setting** by market participants, or in partnership between government and market participants, through which best practices can be developed and adapted. Monitoring on the basis of a "comply or explain"-rule could replace enforcement.
- **Preparation of model laws**, which can be used voluntarily and varied where the circumstances warrant this, e.g. where different types of companies are concerned (see also section IV below). A high level of uniformity in company law has been achieved by such use of models in the United States of America, offering the benefits of greater adaptability and scope for development and variation.

7. Where the efforts of the European Union in the area of company law have so far been limited to primary legislation through regulations, or directives to be implemented in formal company law in the Member States, the Group believes the Union should consider a broader use of these alternatives to primary legislation when going forward. In many areas company laws in Member States can be modernised without agreeing on specific detailed rules in directives. The Lamfalussy procedure now agreed for the development of securities regulation through primary legislation of concepts and principles in directives, secondary implementing legislation and co-ordination between the securities regulators with respect to interpretation and enforcement, is an example of an effort to introduce more flexible law making in an area closely related to and to some extent overlapping with company law. The European Union could also consider the introduction of mechanisms for standard setting or co-ordination of standard setting in such areas as corporate governance (chapter 3.1.) and the operation of the general meeting of shareholders (chapter 3.2.) in order to encourage the development of best practice. Where Europe would consider the introduction of new legal forms, the model approach may offer an alternative through which an informal convergence may be achieved (chapters 3.6. and 3.7.).

Question 2:
a) Should the European Union in future initiatives in company law make use of alternatives as indicated to primary legislation in directives?
b) What areas of company law and which alternatives are particularly suited for such an alternative approach?

III. Disclosure of information as a regulatory tool

8. Requiring disclosure of information can be a powerful regulatory tool in company law. It enhances accountability for and the transparency of the company's governance and its affairs. The mere fact that for example governance structures or particular actions or facts have to be disclosed and therefore will have to be explained, creates an incentive to renounce structures outside what is considered to be best practice and to avoid actions that are in breach of regulatory norms or could be criticised as being outside best practice, unless a convincing case can be made to justify such a course. For those who participate in companies or do business with companies, information is a necessary element in order to be able to assess their position and respond to changes which are relevant to them. It is for these reasons that the Group has recommended that capital and control structures of listed companies should be disclosed comprehensively and such disclosure should be updated continuously.[2]

9. Information and disclosure is an area where company law and securities regulation come together. It is a key object of securities regulation in general (see e.g. Directive 2001/34/EC, in particular the initial, ongoing and periodic disclosure requirements for issuers, and Directive 89/298/EEC on public offers of securities, and Directive 89/592/EEC on insider dealing) to ensure that market participants have sufficient information in order to participate in the market on an informed basis. Where the relevant security is a share in a company, the information required from a securities

[2] See the Report on Issues Related to Takeover Bids, p. 25-26.
(http://europa.eu.int/comm/internal_market/en/company/company/news/02-24.htm)

regulation point of view overlaps the information to be provided from a company law perspective.

10. Disclosure requirements can sometimes provide a more efficient regulatory tool than substantive regulation through more or less detailed rules. It creates a lighter regulatory environment and allows for greater flexibility and adaptability. Although the desired regulatory effect may be more indirect and remote than with detailed rules, enforcement of disclosure requirements as such is normally easier and the reaction of the markets may be a more effective and subtle enforcement mechanism than formal legal sanctioning of a substantive legal provision. The Group believes that the European Union in considering new and amending existing regulation of company law should carefully consider where disclosure requirements are better suited to achieve the desired effects than substantive rules.

Question 3:
a) Do you agree that disclosure requirements can sometimes provide a more efficient regulatory tool than substantive rules?
b) In what areas of company law should the emphasis be on disclosure requirements rather than substantive rules?

IV. Distinguishing types of companies

11. Company law in the Member States usually distinguishes between two types of company: the public company and the private or "closed" company. The existing company law directives in most instances also use this distinction to determine the scope of the directives. The distinction between public and private companies in practice, however, is often highly artificial. In some Member States the regulation of the private company is merely a copy of the regulation of the public company with little real distinction. Very often a vast number of public companies in fact have a closed character, with a limited number of shareholders and restrictions on the transferability of shares.

12. In today’s reality we see three basic types of companies:

- **Listed companies** of which the shares are listed on one or more stock exchanges. Listed companies are not only subject to company law but also to securities regulation (laws, secondary regulation, supervision, stock exchange regulation) which to some extent overlaps company law. They tend to have dispersed ownership or at least dispersed minority shareholders and the markets on which their shares are traded provide an external disciplinary mechanism.
- **"Open" companies** of which the shares are not listed, but whose internal structures would allow for listing, free transferability of shares and dispersed ownership outside a securities market.
- **"Closed" companies** of which the shares are not freely transferable and therefore cannot be admitted to listing on a stock exchange and for which dispersed ownership outside a securities market is inconceivable.

13. There may be good reasons why the regulatory approach in company law for these three types of companies should be different. For listed companies a certain level of compulsory, substantive rules may be required to sufficiently protect both shareholders and creditors. On the other hand, disclosure requirements and market forces may provide powerful alternative disciplinary instruments. For genuinely closed companies generally speaking there should be a wider scope for the parties autonomously to determine the structure of the company and the rights, responsibilities and obligations of those participating in them. The balance of the regulatory approach for open companies may have to be somewhere between listed companies and closed companies, or it may be argued that the potential of open companies to tap the markets makes it justifiable to regulate them as if they were listed in some or all cases.

It should be noted that the proposed distinction and classification is without prejudice to the existing and new Community acquis on securities regulation based on the notion of "regulated markets", such as in the future directive on prospectus, the forthcoming revision of the investment services directive, and the forthcoming upgrade of ongoing and periodic transparency requirements for security issuers.

Question 4:
a) Should the European Union in devising new company law regulation and amending existing company law regulation distinguish more between listed companies, open companies and closed companies?
b) In which areas of company law is this distinction most relevant, and what, in general terms, should be the difference in regulatory approach there?

V. Increased flexibility vs. tightening of rules

14. If we see company law first of all as providing for a framework for competitive business, this calls for flexible rules and forms of rulemaking, for light regulatory regimes where possible, scope for party autonomy and for less cumbersome and burdensome procedures. However, there is a tendency to use the traditional field of company law to achieve all sorts of other regulatory purposes, for example to combat tax fraud. Lately there is an understandable urge to suppress commercial and financial activities by terrorists and other criminals who use companies. This development leads to quite the opposite of company law as a framework for competitive business: more compulsory rules, heavier monitoring and enforcement regimes and more cumbersome and burdensome procedures for all. We do not limit the right of all to acquire and use a mobile telephone because criminals use mobile telephones. Similarly we should be very careful about burdening company law with detailed and cumbersome rules because some criminals make use of companies. The Group believes that the general object of combating fraud and abuse of accepted legal forms (whether it be a bank account or a company) should be achieved through specific law enforcement instruments outside company law and should not be allowed to hinder the development and use of efficient company law structures.

Question 5:
Do you agree that company law should not be changed to include more compulsory rules, monitoring and enforcement regimes and procedures to achieve such

regulatory objects as combating fraud and terrorism, but that such objects should be achieved by specific law enforcement instruments outside company law?

VI. Modern technology

15. Modern information technology and communication technology have a profound impact on our society. Law should adapt to this in that, on the one hand, it should ensure that legal norms and values are also applied in a digital or virtual environment, and, on the other hand, it should facilitate the new possibilities modern technology offers. In the area of company law basic concepts and goals may not necessarily change as a result of modern technology. Modern technology, however, may offer new and more efficient means to achieve these concepts and goals.

16. In company law modern technology can have an impact in various areas:

- The **form** of legal acts in company law, of shares and of disclosure and filing of company information;
- the **time** within which information has to be produced and disclosed, actions have to be taken etc.;
- the **place** where the company is located through the concept of the corporate seat, in order to establish jurisdiction over the company, both in terms of applicable law and competent courts;
- the **function** that existing company law mechanisms perform. This may be particularly relevant in the area of financial reporting and the relationship with capital maintenance requirements and the process of information of, communication with and decision-making by shareholders.

17. As to **form** most Member States have already implemented or started processes of implementing new rules which facilitate the use of electronic means to replace the paper form of legal acts in company law and to dematerialise shares. There does not seem to be a need for the European Community to take specific steps in the company law area, besides the more general initiatives it has already taken or planned following up the Financial Services Action Plan. As to time the Group believes the European Community should not take general initiatives to shorten periods specified in the company laws of Member States although there may be a case for shortening legal time requirements to reflect the greater speed potential of the new technologies in some areas – e.g. the deadline for publication of accounts. Generally, law should not force citizens to act quicker now that modern technology allows speedier actions and decisions. We may even wish to have the law protect citizens against overhasty actions and decisions that are prompted by faster communication methods. In any event this does not seem to be an area of priority. As to **place** the impact of modern technology on the concept of the corporate seat is discussed in chapter 3.5. As to **function** the consequences of modern technology for the rules on capital maintenance and the information of, communication with and decision-making by shareholders are discussed in chapters 3.2. and 3.3.

18. The impact of modern technology on disclosure and filing is an area where the European Community could take initiatives. This is the scope of the first and fourth company law directive, on the basis on which companies are required to file certain

documents and other information relating to the company in a single register which is accessible to the public. An initiative to amend the first directive in order to facilitate electronic filing and to ensure electronic access to such registers is underway. Similarly, in the field of securities legislation, there exist several Commission initiatives to introduce electronic filing and disclosure through electronic means (e.g. Commission proposals for a directive on a single prospectus, for a directive on market abuse as well as a forthcoming proposal on periodic and ongoing disclosure). Clearly, modern technology can offer benefits in such areas as:

- **The company's website:** Information which in particular companies with stock exchange listings have to file and disclose is currently scattered over various places: commercial or trade registers, notifications in newspapers, and filings with stock exchanges or securities regulators. Some, but not all of the information thus filed and disclosed is accessible to the public, but normally at certain costs and usually the public must make at least some effort to obtain the information. Efficiency, both for the company concerned and for those seeking information about the company, could be enhanced tremendously if the company would put the information it is required to file and disclose on its own website. The company could be required to maintain a specific section on its website containing all legal and other information it is required to file and disclose and to continuously update this information. The website would be easily accessible to the public at low costs. Regulation would be required to ensure the quality of the content and the display of information in such a section on the website and to provide that third parties relying on such information would be protected, as foreseen in the first company law directive. The company could also be required to maintain two-way links with public registers that contain the relevant types of information. The European Community could consider requiring at least all stock exchange listed companies to maintain and continuously update such a company information section on its website for the information they are required to file and disclose under company law and securities regulations. It could also consider at least allowing other types of companies to fulfil their filing and disclosure obligations under company law by including such information on their website, if appropriate links with public registers are established.[3]
- **Linking of companies registries:** there are private initiatives to link the various registries which now contain formal company information, like the European Business Register which companies registries join in order to exchange information (www.ebr.org) and crXML, a project to develop a document exchange standard for data in respect of enterprises (www.crxml.org). The European Community could consider co-ordinating and supporting these initiatives, and where necessary facilitating them in the process of amending the first company law directive.
- **Central electronic filing system:** central electronic filing systems are operated by securities regulators and stock exchanges, where all information to be filed

[3] The Group has already suggested in its first Report on Issues related to Takeover Bids (http://europa.eu.int/comm/internal_market/en/company/company/news/02-24.htm) that companies should be encouraged to use their websites as an efficient and effective medium for providing information on their capital and control structures (p. 25 of the report). The company's website can also play an important role in information for, communication with and decision-making by shareholders, see chapter 3.2. here below.

by companies listed on stock exchanges is filed electronically and to which the public has electronic access (e.g. the EDGAR-system in the USA). These systems offer the benefit that the relevant information of all stock exchange listed companies is stored and easily accessible in one specific electronic register. This may improve on the function that publication in the national gazette traditionally has: to provide for a central and chronological access to company information. Such a system could be filled and updated efficiently by links with the websites of the companies on which they put and update their relevant information. The European Community is about to launch a consultation[4] notably on the establishment of a central electronic filing system for listed companies in the Member States.

Question 6:
a) Taking into account the current and forthcoming Commission proposals in the field of securities legislation (e.g. prospectus, market abuse, periodic and ongoing reporting), should listed companies be required to maintain a specific section on their website as the single place where they publish all information they are required to file and publish, providing for two-way links with registers where such information should be filed and published, and to continuously update the information on this section of the website?
b) Should other companies be allowed to file and publish information on their website so long as they provide for two-way links with public registers where such information should be filed and published?
c) Should the European Union facilitate or provide for the co-ordination of public company registers in the Member States?
d) Beyond the current reflections at Community level on the establishment of a central electronic filing system for listed companies in each Member State, should the European Union, at some stage, promote the setting-up of a single European central electronic filing system for listed companies?

[4] See consultation of 11 July 2001 on transparency obligations of publicly traded companies. A further consultation is about to be launched very soon.

Chapter 3:
Specific Topics

3.1. Corporate Governance

I. The role of the European Union in corporate governance for European business

1. Corporate governance is discussed in all Member States in the context of the reform of national company laws and of setting up corporate governance codes in addition to company law. Corporate governance has also been a more or less explicit theme in many of the European Commission's activities both in company law harmonisation as well as in its endeavours relating to the 13th Company Law Directive on take-overs and to the promotion of the European financial markets. At the Barcelona European Council of 15 and 16 March 2002 it was stated that responsible corporate governance is the precondition for economic efficiency, and measures have been asked for in order to guarantee the transparency of corporate governance and corporate accounts and to better protect the shareholders and others concerned.[5]

2. The Group's task is to explore whether and, if so, how the EU should actively co-ordinate and strengthen these efforts in improving corporate governance for European business. In its first report, the Group has dealt with the market for corporate control. This is one of the most important parts of external corporate governance or outside control. Other market-oriented issues concern primarily securities regulation and are being dealt with in the Financial Services Action Plan of the Commission (http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm) and in the Lamfalussy report http://europa.eu.int/comm/internal_market/en/finances/general/lamfalussy.htm). The mandate of the Group for the second stage is to make recommendations for a modern regulatory framework of European company law (http://europa.eu.int/comm/internal_market/en/company/company/news/01-1237.htm). The first issue mentioned under this heading is "the creation and functioning of companies and groups of companies, co-operatives and mutual enterprises, including corporate governance". The latter refers to internal corporate governance or inside control. Of course, shareholders' rights as mentioned in the second dash of the Group's mandate are an important part of this. These and further key points of corporate governance have been raised in the discussion, particularly after the Enron debacle which has revealed major flaws in corporate governance, not only in the US, but also in Europe. Some of them have been mentioned in the US President's Ten-Point-Plan, some have been discussed under the French initiative between the Member States in preparation of the Oviedo Council.

3. In light of this discussion the Group wishes to set out for comments the following issues relating to corporate governance:

---

[5] The Barcelona European Council, 15-16 March 2002: Presidency conclusions, No. 18 of part III, SN 100/02 ADD 1(http://europa.eu.int/council/off/conclu/index.htm)

- Better **information** for shareholders and creditors, in particular better disclosure of corporate governance structures and practices including remuneration of board members except for transactions of board members in the shares of the company, an issue that is already addressed by the future Market Abuse Directive;
- strengthening **shareholders' rights** and minority protection, in particular supplementing the right to vote by special investigation procedures;
- strengthening the **duties of the board**, in particular the accountability of directors where the company becomes insolvent;
- need for a Europan corporate governance **code or co-ordination** of national codes in order to stimulate development of best practice and convergence.

4. In addition to these issues there seems to be a case for developing a stronger internal control system as well as a more independent audit system, including strengthening of the role and independence of the Audit Committee and of the external auditors. But since this is part of the European Commission's activities on accounting and auditing, the Group, while supporting these efforts, refrains from dealing with it.

Question 7:
Are efforts to improve or strengthen corporate governance necessary and important for efficient business in the EU and for an integrated European securities market?

II. Better information for shareholders and creditors, in particular better disclosure of corporate goverance structures and practices including remuneration of board members

5. In the Group's first report the pivotal role of disclosure and transparency has already been underlined (see also Chapter 2, section III, above). Listed companies should generally be required to fully disclose their capital and control structures. The idea behind this is that the investors should be informed about possible defensive structures established in the company. Then in theory the market would react by discounts and a high cost of capital. A similar argument could be made as to corporate governance in general. Listed companies should be required to disclose their particular corporate governance structures and practices. In some countries they are already required to do so, either by listing requirements or by stock exchange backed codes or by professional recommendation or even by legal provisions in company law. Usually these are "comply or explain"-requirements. In a few countries some of these requirements apply also to non-listed companies.

6. For structural and similar take-over impediments it has been said that disclosure does not encompass structures arising under general applicable law (cf. p.26 of the Group's first report on the issues related to take-over bids). It is doubtful whether this is the best solution also for disclosure of general corporate governance structures and practices. Transparency of companies' corporate governance is probably best served if companies are required briefly to describe the key elements of their corporate governance structure and practices, whether they arise from mandatory law, default provisions, articles of association or whether they are based on particular codes. Indeed, some corporate governance codes embody both rules on the board arising from

company law and additional voluntary code rules. Of course in this case the codes make it clear whether the particular rule is a legal rule or a code rule or a mere recommendation. In any case it seems to be useful to require companies to make reference to a code of corporate governance that has been followed, including an indication where and why the code has not been complied with ("comply or explain"-principle as already in use in a number of Member States).

7. In many Member States non-transparent, uncontrolled or excessive remuneration of board members has become a concern in corporate governance, in particular if it is linked to the share price performance. In preparation for the Oviedo Council the question has been raised whether there should be more transparency on board remuneration, in particular by requiring disclosure of the remuneration of individual board members. A number of Member States go beyond mere disclosure and attribute a role to the shareholders in fixing the principles of such remuneration. A similar desire for transparency has also been identified for transactions by board members in the shares of the company.

Question 8:
a) Should there be more disclosure on corporate governance structures and practices of companies in Europe?
b) If yes, should such a disclosure be given only by listed companies or by all "open“ companies or even by "closed" companies?
c) Should this disclosure include an indication whether a certain corporate governance code is followed and where and why the code is not complied with?
d) Should the remuneration of individual board members be disclosed, in particular if it is linked to the share price performance?
e) Should the shareholders have a role in fixing the principles and limits of board remuneration?

III. Strengthening shareholders' rights and minority protection, in particular supplementing the right to vote by special investigation procedures

8. Voting in the general meeting of shareholders is a key shareholders' right and, of course, central to corporate governance. Issues relating to the exercise of voting rights are dealt with in chapter 3.2. of this consultative document. Yet in many cases shareholders will refrain from participating in general meetings and voting, even if it is made easy for them by electronic ways and means. This well-known phenomenon of "rational apathy" is not only common for private shareholders, but also for many institutional shareholders (unless one goes so far as to oblige them to vote by law). In companies with one or more principal shareholders, minority shareholders have no real influence even if they vote. In groups of companies and particularly in multinational groups, the minority shareholders of the subsidiary and even those of the parent may just not know where the real problems are. In such cases what is needed for shareholders is to first find out the facts and then to consider the appropriate course of action, which could be a shareholders' resolution or even an action to hold directors or others liable.

9. Most of the Member States have recognized the problem and provide for a special investigation procedure, e.g. Germany, France, Great Britain, Belgium, the

Netherlands, Denmark and others such as Switzerland. The core provisions are rather similar, but the details vary considerably. In a number of Member States, special investigations are rare, in others, they are much more common. In most of them, it is recognized that the special investigation procedure, even if it is rarely used, is an important deterrent or "fleet in being".

10. Special investigation procedures are particularly relevant if the company structures are complex and not transparent as it is often the case in groups of companies and in transnational enterprises. In a number of Member States, there are specific investigation procedures for groups of companies. In other Member States, the normal investigation procedure can be used group-wide or at least without being restricted to the single independent company.

11. Where the standard rights of information of shareholders are not sufficient to clarify what the problems in a company are, shareholders, either in a general meeting or individually when holding, say, 5 or 10 per cent of the share capital, could be given the right to apply to a court or appropriate administrative body to order a special investigation. Such an investigation could be conducted by the court or administrative body or by a professional under its supervision. Such a special investigation procedure could offer an efficient and overall not too costly way of enhanced shareholder information. A European framework provision could be short and precise. Leaving the details to the Member States is necessary in order to enable them to make the rule compatible with the particular laws of procedure in their jurisdictions.

Question 9:
Should shareholders' rights and decision-making, including minority protection, be enhanced by European law, in particular by enabling the general meeting of shareholders, by resolution, or a qualified minority of shareholders to apply to a court or an appropriate administrative body for the ordering of a special investigation?

IV. Strengthening the duties of the board, in particular the accountability of directors where the company becomes insolvent

12. Corporate governance and shareholders‘ rights are about controlling the directors as the agents of the shareholders or, if control comes too late, about holding the directors accountable. The special investigation procedure mentioned above is a means for revealing information about what is going on in the company and what role the directors have played. Once shareholders have the information, they can react for example by replacing them, either directly or indirectly. Yet, this may not be enough, directors may have caused the company and its shareholders particular harm. In all Member States there are rules on directors’ liability. These rules are core company law. They differ very much from one Member State to another. In some Member States, for example in the UK, there is extensive reform activity in this area. An attempt to harmonise all this appears to be futile at this stage.

13. In a number of Member States, there are specific rules for holding directors accountable if the company becomes insolvent. The gist of the UK "wrongful trading"-rules, the French and Belgian "action en comblement du passif" or the German

directors' liability for not declaring the company insolvent in due time is similar. But again, the details may vary considerably. In some Member States, there are no specific provisions but a similar effect is achieved through general rules on directors' liability. The concept of wrongful trading applies both to independent companies and to companies within groups. In particular the directors of a subsidiary company will be subject to this principle, as will the parent and/or its board if they operate as de facto or "shadow" directors of the subsidiary. The beauty of the rule consists in the fact that the law does not interfere with the on-going business decisions of the directors. They can do what they think is useful for the company as long as the company does not become insolvent. Yet, they do this at a certain risk, namely on the arrival of the company at the crisis point, where the directors foresee that the company cannot continue to pay its debts, they must decide either to rescue the company (or the subsidiary) and ensure future payment of its creditors or to put it into liquidation. Otherwise, the directors of the company (and in appropriate circumstances the parent and/or its directors) will be liable fully or in part (as under the "action en comblement du passif") to the creditors for their unpaid claims against the company.

14. A European framework rule on wrongful trading could be a considerable improvement of the functioning of companies and groups of companies. It would protect creditors without restricting the companies and their directors too much, since they can and must make their own choice whether, in case the company becomes insolvent, they want to rescue it and continue its business or to put the company into liquidation. A "wrongful trading"-rule would enhance the confidence of creditors and their willingness to deal with companies. This is even more important in Europe since doing business across borders may be perceived to be more risky than internally where information on the business partner may be easier to obtain. Finally, a "wrongful trading"-rule would introduce an equivalent level of protection for creditors of companies across the European Union, without necessarily harmonising the whole body of directors' liability rules in each of the Member States.

Question 10:
Should the European Union introduce a framework rule which would hold company directors accountable for letting the company continue to do business when it can no longer pay its debts?

V. Need for a European corporate governance code or co-ordination of national codes in order to stimulate development of best practice and convergence?

15. As the recent Weil, Gotshal & Manges comparative study has evidenced, there is a host of corporate governance codes in Europe.[6] In some Member States there are not just one, but many of them. The co-existence of such codes might create problems. They may confuse investors, and companies with stock exchange listings in different Member States may have to comply with different, potentially conflicting codes. In Germany, for example, there have been two competing codes, the "Frankfurt code" and the "Berlin code". As it was felt that this competition was not beneficial for Germany, the two codes have now been replaced by one single code. This code should fulfil two

[6] Comparative Study of Corporate Governance Codes relevant to the European Union and its Member States (http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm)

tasks: first, to inform the investors about the key corporate governance rules in German company law; and secondly, to improve corporate governance by additional voluntary rules as agreed by business and finance.

16. The same concerns could exist for Europe. Indeed there are some who ask for the establishment of a European code of corporate governance. The two functions of the single German code of corporate governance could be extended also to the European Union. Nevertheless it might not be wise to recommend to the European Commission to create a European corporate governance code, at least not at the present stage. The following reasons for this have been brought forward:

17. First, a European code could not fulfil the task of informing institutional investors about key corporate goverance rules in European company law. There is not yet a fully-fledged European company law and national company laws are widely divergent.

18. But also the second goal, i.e. improving corporate governance by additional voluntary rules, is difficult to be reached by a European code. Such a code is by definition complementary. It goes beyond the basic company law rules on corporate governance and must be fine-tuned to the existing structure and peculiarities of each national company law. It suffices to mention the one tier- and the two tier-board systems which exist in the various Member States. A European code would be faced with the difficulty either to set up many alternative rules depending on the various company law systems or to confine itself to rules that are compatible with all of these systems. The latter would lead to very abstract, if not meaningless rules. Harmonizing corporate governance codes while leaving company law untouched is putting the cart before the horse.

19. Thirdly, it has been said that codes on corporate governance should be left to the market and the market participants. They are a means of building up reputation by voluntary compliance with rules of good behaviour. The market and the market participants know best what rules enhance reputation. Also, the state viz. the European Union should leave this to those who have an own market interest in such codes, i.e. companies, investors, stock exchanges and so on.

20. However, if one shares these views that a European corporate governance code is not necessary, it might still be useful if the European Union were more active in co-ordinating national codes on corporate governance. Rather than imposing a European regime, co-ordination between the makers of corporate governance codes in Europe is a lighter type of interference through which the development of best practice and further convergence of corporate governance codes can be achieved. In particular where such national codes are sanctioned for example by stock exchange regulations, such a convergence may be desirable in Europe. The European Union could consider facilitating such a co-ordination of national corporate governance codes.

Question 11:
a) Is there a need for a voluntary European corporate governance code in addition to or instead of the various national corporate governance codes?
b) If yes, please give examples of what rules and recommendations a European corporate goverance code should contain.

c) Should the European Union facilitate the co-ordination of national codes in order to stimulate development of best practice and convergence?

3.2. Shareholder Information, Communication and Decision-making

I. Introduction

1. It is important for companies and their shareholders, as well as other stakeholders, that shareholders have effective means to actively exercise influence over the company. Shareholders are the residual claimholders – they only receive payment once all creditors have been satisfied – and they are entitled to reap the benefits if the company prospers. Shareholders need to be able to ensure that management pursues and remains accountable to the interests of the shareholders. Shareholders focus on wealth creation and are, therefore, very suited to act as "watchdog", not only on their own behalf, but even on behalf of other stakeholders. There is a particular need for this in the case of listed companies where shares are widely held. From the viewpoint of a single shareholder it may frequently seem appropriate to dispose of his shareholding if he is dissatisfied with or lacks confidence in incumbent management, rather than try to change things within the company. However, this apathy may appear rational to the single shareholder but may prove very disadvantageous if adopted as a general attitude by shareholders.

2. Exercise of influence by shareholders presupposes that it is, indeed, possible to influence the company and, in addition, appears attractive for shareholders to do so. These matters, in turn, depend on the costs and difficulties attached to exercising influence. The more costly and cumbersome it is to exercise influence, the more shareholders are likely to elect not to attempt to do so. As things are now, it is a fact that for many listed companies a majority of shareholders neither attend nor are represented by proxies at the annual general meeting (or equivalent extraordinary general meetings) of the company. As shares of companies are increasingly held by foreign shareholders it is likely that fewer and fewer shareholders attend general meetings. This development is probably caused not only by legal restrictions and obstacles but also by structural and other, including technical, impediments.

3. This section focuses on the procedures for information of, communication with and between and decision-making by shareholders. Traditionally this evolved around the general meeting of shareholders as a mechanism for shareholders to be informed by the board, to exchange views with the board and other shareholders and to vote on resolutions put forward to the meeting. The general effort to create an integrated capital market in Europe will induce investors to invest more and more in companies in other Member States. It is therefore important that shareholders across the European Union have equivalent opportunities and facilities to participate in the information, communication and decision-making processes of shareholders. The focus of this chapter is on the participation of shareholders in listed companies, where the problems

are most prominent. However, non-listed companies could also benefit from the facilities developed for shareholders in listed companies.

4. The identification of shareholders entitled to vote and the process of communicating with and voting by such shareholders pose particular problems where shareholders hold shares through chains of securities intermediaries as nowadays is customary especially when investors invest in companies in other jurisdictions. The issues relating to cross-border voting are currently being reviewed by a group of experts, set up by the Dutch Minister of Justice. This group will conduct a separate consultation process and is due to report in June 2002. Two members of the High Level Group participate in this process. The report of the aforementioned group of experts will be submitted to the High Level Group.

II. Notice and pre-meeting communication

5. One set of issues relates to the preparation of general meetings of shareholders. A company's communication with its shareholders prior to a general meeting (including sending notices of such meeting) is frequently a one-way process whereby the company distributes information in written form with limited, if any, feedback from the shareholders. Where bearer shares have been issued, communication will have to take place through the public media by means of advertisements or other costly devices. Also, communication among shareholders is costly: Shareholders are not able to identify each other and therefore frequently have to use the public media to get their points across. The rights to ask questions and submit proposals for resolutions at the general meeting often have to be exercised in written form and are subject to restrictions.

6. Many of the issues touched upon here may be resolved, at least in part, by using electronic means of communication, including the company's website and the internet. Both E-mail and the use of bulletin boards or chat rooms at the company's website may allow the company to communicate with its shareholders, and the shareholders to communicate with each other, efficiently and at low cost. Shareholders can get access to the relevant meeting materials at their own initiative, rather than the company being required to push information to them. Shareholders can download proxy or voting instruction forms and submit them via E-mail. The website can also include a section where voting instructions or proxies can be lodged. Similarly, allowing companies to communicate electronically with shareholders, including with respect to notices of general meetings, questions and proposals for decision-making, is likely to be efficient and cost-effective.

7. An important question in the context of issues related to use of modern technology is whether companies should only be given the opportunity to use such technology, i.e. be enabled to do so, or if they should be required to do so. Making it a requirement for listed companies to use their website as an active form of communication in addition to the traditional means would probably give rise to some concern (see also Chapter 2, section VI, above). One could argue that it should be left to the shareholders of each company to decide whether that particular company should use modern tehnology and offer to them the advantages of modern technology. However, it will probably not take long before electronic communication between company and

shareholders, via the website of the company, becomes the standard, and the traditional means of communication become the exception. A separate question here is whether it should be optional for shareholders to use the modern means of communication, or if, at least at some point, they should be required to do so.

The Group is aware that these issues are addressed, at least in part, in a second consultation by the Commission services which is about to be launched on transparency requirements for publicly traded companies. Nonetheless, the Group would like to raise this issue in the specific context of the meeting of shareholders.

Question 12:
a) Should listed companies be required to establish on their websites devices (bulletin boards, chat rooms or similar devices) that allow for electronic communication between shareholders and the company and among shareholders prior to general meetings, including with respect to notices of general meetings, submissions of proposals and questions and solicitations of proxies ?
b) If listed companies are required to establish these or similar devices on their websites, should the shareholders then be required to communicate by electronic means and thus be compelled to abandon the use of traditional means of communication, or should electronic communication only be an alternative available to those interested?

8. The legal requirements or restrictions with respect to the right to ask questions and submit proposals for decision-making often prevent small shareholders from being active. In order to increase the participation of shareholders in the decision-making process it may be helpful to set minimum standards in Europe allowing shareholders with a certain holding of shares to raise questions and submit proposals for decision-making at the general meeting. Again, the website of the company could be instrumental as a medium through which shareholders can ask questions and suggest proposals for decision-making at the general meeting. If all individual shareholders could raise questions (and require answers) and submit proposals via the company's website, the company could be flooded with questions and proposals, which would make the whole process unworkable. A balance would have to be struck between these rights of shareholders and the ability of the company to conduct this part of the communication with shareholders without undue burden.

Question 13:
a) Is there a need, at the European Union level, to provide for minimum standards regarding the right for shareholders to ask questions and submit proposals for decision-making at the general meeting?
b) If so, what should these minimum standards be (minimum shareholding for raising questions and submitting proposals; time of submission of proposal for decision-making)?

III. The meeting, electronic access, proxy voting

9. Traditionally the general meeting of shareholders has been regulated and organised as a physical gathering of shareholders who debate and decide. In listed companies with thousands of shareholders, many of whom are foreign shareholders, this

is no longer a viable concept. For practical reasons (costs, time) most of the shareholders are unable to attend the meeting in person, or send personal representatives. In order for shareholders to be able to participate in the decision-making they must be able to vote in absentia, either by way of direct vote outside the meeting (cf. the "vote par correspondence" in France) or by way of a voting instruction and proxy to be exercised in the meeting by somebody else, sometimes the chairman of the board. We will refer to such voting in absentia with the common term "proxy voting". However, some Member States restrict the use of proxies, making this option less viable.

10. The shareholders who actually do attend the general meeting may find that this form of meeting may not be the best forum for exchange of views and decision-making. In many instances, the resolutions to be taken at the meeting have been pre-approved by key shareholders or, where proxy voting does take place, the vast majority of votes has already been cast. As a result, the meeting may appear as a mere formality where little can be changed by debate.

11. Again, the problems touched upon here may be resolved or reduced in importance by using electronic means of communication. Access for shareholders to participate in general meetings via a "webcast" on the internet or satellite connection could allow shareholders to “be present” at the meeting with little trouble and at low cost, and thus reinforce shareholder influence. Formal company law requirements as to the place where a meeting should be held may impede such developments. It should also be noted that this form of presence at the meeting cannot realistically be seen as equivalent to physical presence at the meeting itself. It is unlikely that through a webcast or satellite connection perhaps some thousands of shareholders could actively participate in the meeting, raise questions and debate with each other and the board. This form of access to the meeting will in all likelihood remain a passive form of participation.

12. The Group believes that shareholders of listed companies should always be given the opportunity to exercise their voting rights without physically attending the meeting, and that listed companies should offer their shareholders a facility for proxy voting. Again, modern technology allows companies to organise such a process of proxy voting efficiently and at low cost, via the company’s website or a dedicated site of a service provider.

13. The combination of efficient electronic information of shareholders and communication between the company and shareholders and among shareholders prior to the meeting and electronic proxy voting appears to offer a powerful alternative to the old-style physical meeting of shareholders. Modern technology thus can facilitate an efficient debate and informed decision-making by shareholders of listed companies at low costs for all in a way that the traditional general meeting never could. In this way modern technology has the power to replace the illusion of shareholder rights with the reality of it. This raises the question whether a physical meeting of shareholders can still play a beneficial role in this comprehensive process of electronic communication and decision-making. If it is felt that the physical meeting of shareholders is no longer an essential element in this process, listed companies who offer a comprehensive electronic process of information to, communication with and decision-making by shareholders could be given the option to abandon the physical general meeting altogether.

Question 14:
a) Should listed companies be required to provide facilities for proxy voting by all shareholders?
b) Should listed companies be enabled or required to offer to their shareholders electronic facilities for proxy voting or should they and their shareholders even be required to use electronic proxy voting and thus abandon the use of traditional proxies?
c) Should companies be enabled or even required to allow absentee-shareholders to participate in traditional general meetings via electronic means, including via the internet (webcast) and satellite?
d) Should companies which offer a comprehensive electronic process of information to, communication with and decision-making by shareholders be enabled to abandon the traditional type of general meeting?

IV. Voting by institutional investors

14. The increasing amounts of equity investments by institutional investors within the European Union has initiated a debate in certain Member States as to the role of institutional investors in the corporate governance of listed companies. Where traditionally in companies with dispersed ownership shareholders are offered little counterveiling power against the management, the rise of institutional investors may have changed this. Their sometimes substantial holdings make the exit strategy (selling on the market) less attractive to them and they are increasingly inclined to invest in internal control within the company. The question is whether the role of institutional investors in the companies in which they invest should somehow be formalised. This could be done by requiring them to disclose their policy regarding the investments they make, and how they exercise their voting rights with respect to companies in which they hold shares.

15. From a company law perspective there may be little reason to require certain shareholders (the institutional investors) and not others to disclose their investment policies and the way they vote in companies in which they invest. If it is felt that shareholders with certain shareholdings should be actively stimulated to participate in the company's governance, then from a company law perspective it would make more sense to impose such an obligation on all shareholders who hold a certain percentage. Institutional investors, however, are different from other shareholders in the sense that they are normally described as institutions who invest on behalf of others, their beneficiaries: pension funds investing premiums for pensions of employees, insurance companies investing premiums for the insured, mutual and other investment funds investing for the investors in the fund etc. Those who make investment decisions in these institutions to some extent, depending on the laws and contractual arrangements governing these institutions, owe a fiduciary duty to these beneficiaries. It could be argued that from an internal governance perspective of these institutions they should be required to disclose their investment policy and voting practices.

16. Even more far reaching would be a requirement for institutional investors to exercise the voting rights attached to shares held by them. Such a requirement exists for certain types of pension funds in the United States of America. For some institutional investors such a requirement may already follow from the particular duties they owe to

their beneficiaries. It is difficult to see how such a requirement could be generalised for all the different types of institutional investors in Europe. Also, it is doubtful whether such a voting requirement would substantially add something to a requirement for institutional investors or, more generally, certain major shareholders, to disclose their voting practices. Finally, from a company law perspective it does not make sense to compel shareholders to exercise their voting rights: one can take a horse to the water but one cannot make it drink.

Question 15:
a) Should institutional investors in Europe, or, alternatively, all shareholders holding a certain percentage of the share capital, be required to disclose their policy as regards the investments they make, and as to how they exercise their voting rights?
b) Should institutional investors be required to exercise voting rights with respect to shares they hold?

3.3. Alternatives to Capital Formation and Maintenance Rules

I. The functions of legal capital and the competitive effect of the current rules

1. The concept of legal capital serves, prima facie, fundamental functions in traditional European company law. These functions are the following:

- The concept of capital serves to **protect creditors' interests**. By establishing a legal capital, it is ensured that the company is unable to distribute dividends or to make other distributions to shareholders when the assets of the company would as a result be reduced below the legal capital as expressed in the company's balance sheet. To reinforce this protection, companies are not allowed to reduce capital if creditors who are not adequately protected oppose the reduction.
- There is a second fundamental function performed by legal capital: the **protection of shareholders** of the company. By establishing legal capital and fixing the value of shares by reference to that figure, it is possible to assign a value to every share (nominal value, or par value). It is normally not possible for the company to issue shares below par value. Thus, the notion of legal capital protects shareholders' interests against "stock watering", albeit in a limited way.
- In connection with the function of protection of shareholders' interests, there is another distinct function: the **measure of the shareholders' rights**. Legal capital serves, at least as a presumption, as the yardstick of shareholders' rights in a company. In a wide sense, the rights affordable to a shareholder are, prima facie, a function of the portion of legal capital held by that shareholder, unless special rules state otherwise.
- Finally, there is a controversy over the existence of a fourth function: legal capital as a means of ensuring the **adequacy of a company's assets for its enterpreneurial activity** ("capital adequacy"). However, it is difficult to defend

that a minimum capital requirement that amounts to 25,000 Euro (Article 6, Second Company Law Directive) is a sign of adequacy for most economic activities.

2. The rules on capital formation and maintenance are among those that influence the competitiveness of an economic and legal system, as they heavily influence the cost of capital and of credit. The Second Directive provides for rather strict rules which seek to ensure that companies only issue capital where this is actually paid for, and that they form and maintain at least a minimum capital. These rules have often been criticised. They fail to adequately protect creditors, who are not so much interested in the capital of the company (and certainly not the minimum capital) but much more in its ability to pay its short term and long term debts. The existence of capital as shown once a year in the company's annual accounts is a very inaccurate indication of the company's ability to pay its debts. The detailed and strict rules have on the other hand resulted in the company's capital being an inflexible primary source of equity funding for all companies subject to these rules. It can be argued that this puts European companies at a competitive disadvantage.

Question 16:
a) Do you believe that legal capital serves all of the functions listed above?
b) Are there possibilities of reaching the same results by means of other techniques?
c) Do you consider that European companies are at a disadvantage as against companies in jurisdictions with a more flexible capital regime?

II. Three approaches to the reform of legal capital in Europe

3. There are three alternative approaches to the reform of legal capital in the European Union. The first approach is based on the "SLIM" (Simpler Legislation for the Internal Market)-proposals. This approach does not imply a radical departure from the traditional system of capital regulation in Europe, but just an evolution to a more simplified and modern capital regime. The purpose of the SLIM exercise was to simplify the First and the Second Directive; the SLIM group could not contemplate further harmonisation. This is the reason why the SLIM group proposed measures such as the relaxation of the prohibition of financial assistance for the purchase of own shares, the reduction of mandatory experts' reports for valuations, and the use of redeemable shares to solve certain corporate law problems. The SLIM group stopped short of proposing the introduction of a rule allowing for the introduction of no-par value-shares, as this was outside the scope of the SLIM exercise. However, this could be considered a logical addition to the measures proposed in SLIM: in this way, the concept of legal capital would remain in its present form, with the possibility of issuing no-par value-shares.

4. The second approach to capital regulation could be based on the US experience. This is a revolutionary approach, from the EU perspective, and is based on the elimination of the concept of legal capital. In this approach shares would be just ideal fractions of the company's assets. The main features of a capital regime based on the American approach would be:

- The existence of fractional shares (no-par value-shares);
- freedom as regards the consideration for the issuance of shares;
- no mandatory valuations;
- competence to issue shares attributed (or attributable) to the board of directors;
- absence of pre-emptive rights;
- distributions and dividends based on solvency tests (it is necessary to show that, after the dividend or distribution, the company is still able to pay its debts as they fall due);
- freedom for acquisition of own shares and financial assistance for the acquisition of own shares;
- attribution of rights to shareholders irrespective of nominal or par value.

5. The third approach is also a revolutionary approach, as it also entails elimination of legal capital. However, this approach does not copy the US capital regime but rebuilds the regime from a European point of view, making use of some ideas coming from the US experience and from other legal systems. In this third approach, the elimination of legal capital is contemplated, along with the introduction of no-par value-shares. However, the power to issue capital could in principle remain in the general meeting of shareholders, and pre-emptive rights could also be kept as a general rule. The protection of creditors could come by means of a solvency test applied to distributions and capital transactions between the company and its shareholders. If more security *ex ante* is deemed to be appropriate it could be provided that a company intending to pay a dividend needs to have assets exceeding its liabilities at least by ten per cent. As for shareholders' rights, shares could give rights to shareholders in proportion to their fractional interest in the company.

6. The regulation of capital formation and capital maintenance is a complex topic, as the approach to legal capital has implications in a number of areas of company law, for example accounting. In particular for the second and third approach, the implications will have to be considered in much more detail than can be described in this short document, before a balanced judgement can be made. Nonetheless, the Group would be interested in receiving comments on these three approaches.

Question 17:
a) What is your general impression on the three approaches outlined here?
b) Which is the approach that you consider worth pursuing (if any)?

III. Specific topics

7. There are specific topics that have to be dealt with, irrespective of the general approaches outlined above. One of these is the requirement of a minimum capital in the Second Company Law Directive. It is obvious that the existing minimum capital requirement is not enough to ensure that companies have sufficient financial means to carry out substantial economic activities. The only real function the current minimum capital requirement appears to have is to deter individuals to light-heartedly start up a company. They will have to furnish a minimum capital before they can start. The question is if this is sufficient reason to continue to require a minimum capital. If not, the alternatives are to either abolish the minimum capital requirement or to raise the minimum capital considerably.

8. With regard to capital formation and maintenance rules as an instrument for creditor protection, other measures could be considered to achieve a more effective protection of creditors, especially for involuntary creditors and other creditors that are in special need for protection. There are two alternatives that are applied in various Member States: "wrongful trading"-liability for directors and subordination of insider claims. "Wrongful trading"-liability for directors exists in various Member States, albeit with technical differences (see chapter 3.1. above). As for subordination, in some Member States it is possible to subordinate insiders' (shareholders, directors) claims where the assets belonging to the company are deemed insufficient for the company's activities. Opponents suggest that subordination creates a disincentive for insiders' debt financing of companies. Opponents also believe that disclosure of a secured position of an insider should be enough to protect outside creditors. Those who defend subordination claim that subordination gives a response to situations where outside creditors are unfairly discriminated as against insiders (for instance, where secured credit is not disclosed, or where outside creditors are involuntary creditors), while recognising that subordination would force insiders to provide financial means to the company by way of capital increases.

Question 18:
a) Do you see the minimum capital requirement as an appropriate impediment to starting up a company?
b) Or would you abolish the minimum capital requirement or rather impose a stricter minimum capital requirement than the one presently in force?
c) Do you consider that "wrongful trading" is an effective instrument for creditor protection?
d) Do you consider that subordination is an effective and desirable way of enhancing creditor protection?
e) Are there any other possibilities worth considering?

9. In order to increase flexibility there is a case for allowing other forms of consideration for capital (including the provision of services) and for simplifying the regime dealing with the acquisition of own shares. The prohibition of giving financial assistance by the company for the acquisition of its shares by others, in particular, could be eliminated, or restricted to special situations. Financial assistance could also be allowed if it complies with the general rules for distributions to shareholders, meaning that the result of the financial assistance should never be a liability for the company in excess of the amounts allowed by the appropriate rules for distributions.

Question 19:
a) Do you believe that other forms of consideration, such as services, should be allowed as valid forms of consideration for capital?
b) Do you think the prohibition of financial assistance for the acquisition of own shares should be eliminated or at least that financial assistance should be allowed if it complies with the general rules for distributions to shareholders?

3.4. The Functioning of Groups of Companies

I. The existence of groups of companies as a useful and legitimate economic reality

1. In most if not all Member States corporate reality is no longer the single independent public company, but the group of companies. The group of companies as a legitimate form of doing business is not only recognized by Member State law, but also by European law, inter alia by the 7th Company Law Directive and by many sector-specific legal provisions, in particular in banking and insurance regulation, but also in competition and tax law. Groups may present specific risks for the shareholders and creditors of the subsidiaries as well as of the parent. Many Member States content themselves to regulate groups by transparency requirements. Many apply the general corporate and civil law also to group situations. Some Member States provide for special group rules. A number of legal issues dealt with in this report and our first report are pertinent also to groups. Examples are the mandatory takeover bid under the 13th Company Law Directive that would grant an early exit right for shareholders in case of a take-over (cf. generally the first report of the Group on the regulation of take-overs), the "squeeze-out"- and "sell-out"-rights (see also Chapter III of the first report of the Group; and further chapter 3.5. here below), the special investigation rights (see chapter 3.1. above), the accountability of directors (see chapter 3.1. above).

Question 20:
a) Are groups of companies frequent in your country?
b) What are in your view the specific advantages, disadvantages and risks presented by groups?

II. Transparency of group relations

2. The 7th Company Law Directive on group accounts provides for consolidated financial statements in a group. In these group accounts the financial situation of the individual companies belonging to the group is not reflected. This may be become a problem both for the shareholders and creditors of the parent as well as the subsidiary company. The shareholders and creditors of the parent may need additional information on the risks arising from the subsidiary for the parent since these risks may affect the parent (reputational risk; temptation to rescue the subsidiary with corresponding risks to the parent). On the other hand the annual report of the subsidiary may not adequately reflect the subsidiary's position as a dependent company in the group. More transparency of the group relations and possible risks arising from them both to the subsidiary and to the parent may therefore be required. This is even more acute after the Enron debacle and may be particularly urgent for banks and other financial institutions being members of a group and as such having a special role in reorganisations. Details of what such enhanced transparency should include still have to be discussed. Relevant information could concern the group structure, the managing system and the persons effectively entrusted with the power of direction, the existing intra-group transactions, the procedures and the activities through which the direction is exercised.

3. In a number of countries not only the parent company is listed, but also important subsidiaries. This may have sound economic reasons, but it is possible that the investing public is not aware of the fact that such a company is not independent, but

belongs to a group with negative and/or positive implications (restrictions, risks, group support etc).

Question 21:
a) Should the 7th Company Law Directive on group accounts be supplemented by rules that require greater transparency of group relations and of possible risks arising from them both to the subsidiary and to the parent?
b) What should such enhanced transparency include?
c) If not in general, should such group transparency rules at least apply to listed companies?
d) Are special rules for banks and other financial institutions needed?

III. Problems for the creation and functioning of groups of companies: tensions between the interests of the group and its parts

4. In many Member States, the creation and functioning of groups of companies is complicated by the fact that the management of the subsidiary may not take into consideration the economic interest of the group as a whole unless this is in the own particular interest of the subsidiary. Violations may make the directors liable both under criminal and private law. The result seems to be a clear impediment to the formation and functioning of groups of companies, nationally as well as within the European Union.

5. The fact that despite this impediment there are many groups does not prove that there is no difficulty. At the most, it can be said that the economic advantages of forming a group are such as to overcome costs and risks arising from the non-recognition of group management. The economic reality is usually some sort of an uneasy compromise. Often the directors of subsidiaries do take into consideration the interest of the group either by following instructions of the parent or without such instructions by subservience or by following economic rationality. If they do not, they face difficulties imposed by the parent or caused within the group. In more extreme cases, they are dismissed, whether the disregard of the interest of the group is legally prescribed or not. Sometimes the parent avoids these difficulties by forming a 100 %-subsidiary and avoids the subsidiary going bankrupt.

6. This leads to considerable costs and legal uncertainty regarding the limits of what directors of a subsidiary are still allowed to do, i.e. whether an action that is in the interest of the group but may be harmful to the subsidiary in the short run, could be justified for being in the long-term interest of the subsidiary. If the interest of the group is pursued and even if a risky compromise between the subsidiary's and the group's interest is found, this is at a considerable risk for the directors of the subsidiary and, in case of instructions or under the concept of aiding and abetting, also for the directors of the parent. While in many cases the conflict may not appear at the surface, it is becoming a real problem in cases of insolvency or if directors' liability towards individual shareholders is recognised. It then may turn out that a court holds the directors personally liable or may even convict them penally. This risk is particularly difficult to evaluate in case of cross-border groups of companies.

7. There is also a more general problem. The fact that in reality the interests of the subsidiary are often sacrificed to the interest of the parent or the group as a whole, amounts to a wide-spread disregard of corporate law which has elements of hypocrisy and may weaken the authority and credibility of corporate law more generally.

8. The German "Konzernrecht" shows one way of dealing with the problem. The parent and the subsidiary may conclude an enterprise contract and form a so-called contractual group. The law of groups allows steering a group independently of the interests of the subsidiaries, but only at the price of specific protection of the shareholders and creditors of the subsidiary by regular compensation of disadvantages incurred by the subsidiary. On the other hand France, and similarly some other Member States, have shown a less burdensome and complicated way to solve the problem: the so-called "Rozenblum"-concept. This concept has been developed by French penal courts in order to mitigate the severity of the criminal law on the breach of trust ("abus de bien sociaux") . It strikes a reasonable balance between the interest of the individual companies within a group and the overall interest of the group. Under certain conditions it is considered to be legitimate for the directors of subsidiaries as well as for those of the parent and of other members of the group to act in the overall interest of the group as such. The conditions for such a safe harbour under French law are: (1) firm structural establishment of the group, (2) coherent group policy, and (3) balanced distribution of benefits and burdens. It is true that these conditions must be concretised either by the legislators or by the courts. However, the French example shows that this is feasible.

9. A third approach is represented by the law of the UK. Because companies formed under the law of these Member States are to be run in the interests ultimately of their shareholders as a whole, it follows that wholly owned subsidiaries are to be run in the interest of the parent company. This means that the directors, subject to their duties towards creditors (notably the law on wrongful trading, see chapter 3.1. above) are bound to ensure that the subsidiary is operated to serve the parent company's objectives. Where a subsidiary is only partly owned by the parent, the directors must however still ensure that they run the company fairly for the benefit of the shareholders as a whole, taking full account of all the circumstances, including the balance of advantage which comes inter alia from membership in the group. If a fair balance is not maintained in their favour, the minority, or outside shareholders have remedies for breach of this duty, by derivative action to enforce the fiduciary duty to act fairly on their behalf, or through the general "oppression" remedy. The Modern Company Law Review undertaken in the UK in recent years considered whether these rules required change in the group context but concluded that they provided the appropriate balance between freedom to operate the group enterprise and the protection of creditors and outside shareholders.

10. If the European Union wants to facilitate the creation and function not only of single, independent companies, but also of groups of companies, it seems that the before-mentioned impediment should be set aside. Otherwise, businessmen and groups might hesitate to set up and run subsidiaries in other Member States where the rule of disregard of the interest of the group does not only exist, but is really enforced, be it only in case of financial difficulties or bankruptcy. European law might give the companies and groups of companies viz. their directors the option to legalize group management with appropriate safeguards (protection of shareholders and of creditors of the subsidiary, in case of single-member companies of course only creditor protection).

There would be no need for lenghty European law rules. The details would and could be left to the Member States in order to fit the option into their specific company laws.

Question 22:
Is it desirable to require Member States to provide for a "safe harbour" which allows those concerned with the management of the companies within a group to adopt a coordinated policy provided that the interests of creditors of the companies within the group are effectively protected and that there is a fair balance of advantage for shareholders over time?

IV. Pyramids

11. A group pyramid can be defined as a group structure characterized by a more or less long chain of control using several holding companies. The ultimate shareholders control each company in the chain by majority or controlling minority interests, leaving minority shareholders at each level. The result is that the ultimate shareholders may control the whole chain up to and including the company at the bottom on the basis of a small total investment. If, for example, the ultimate shareholders would own 50% at each level, in a chain of six companies including the company at the bottom only a total investment by the ultimate investor equivalent to 1.56% in the capital of the company at the bottom is required to have full control over the whole chain. This effect is created by having minority shareholders at each level finance the controlling stake of the ultimate shareholder in the level below. In order to facilitate this, often a number of the companies in the pyramid have separate stock exchange listings.

12. Pyramidal structures are widespread in some Member States, in others they occur only infrequently. Usually they are not transparent. They may or may not be economically efficient. This depends on the given circumstances and the economic and legal environment. Pyramidal structures present specific problems. Pyramids are a source of agency costs in that they increase the private benefits of control and conflicts of interest and therefore may came at an expense for the non-controlling shareholders. The lack of transparency of the ownership structure may have a number of problematic effects:

- The market price of the shares of the listed companies that belong to such groups may not be a reliable proxy of the firm's value.
- Subsidiaries belonging to a group may hardly be contestable.
- The market for corporate control and in particular the rules on mandatory bids may not function as in independent companies (see the first report of the Group on issues related to take-over bids).
- Rules aimed at preventing disadvantages for minority shareholders and conflicts of interest may not work properly or may be difficult to enforce.

13. A number of legal reactions have been discussed among academics and regulators, among which:

- Transparency of pyramids, particularly an obligation to disclose the identity of the shareholders, including the ultimate controller, the latter possibly as precondition for listing;

- disclosure of shareholders' agreements, in particular agreements not to sell and not to acquire shares, and right of withdrawal of them under specific circumstances;
- piercing the corporate veil in specific situations such as tort liability;
- requirement for each company in the chain to subject the exercise of voting rights in the general meeting in the company below it to a vote in its own general meeting, and to exercise such voting rights in a way reflecting the votes cast in its own general meeting;
- limitation of the stock exchange listings of companies belonging to groups, for example by limiting the number of listings of group companies and/or limiting the time during which such multiple listings of group companies can exist.

Question 23:
a) Are pyramids of companies frequent in your country?
b) Are they useful or harmful or indifferent?
c) If you consider them to be harmful, what are the specific risks they present?
d) Are specific measures beyond group transparency appropriate and desirable for pyramids of companies?

3.5. Corporate Restructuring and Mobility

I. Introduction

1. Rules to facilitate corporate restructuring enable corporate assets to be reallocated in cases where this requires a change in the legal relationships between a company and the participants in it (mainly shareholders and creditors). European Union provision on this is particularly important for cross-border restructuring. Restructuring transactions may be of one or more of various types, of which the most important appear to be:

- New issues, reductions and repurchases of capital (see chapter 3.3. above);
- alterations within the corporate framework of rights of shareholders, or creditors (arguably matters for domestic law and practice and is not considered further here);
- migration ("transfer of registered office") of a company, domestic or European (SE) - changing its internal law/corporate status from that on original formation (or already acquired by migration) to a new one – this is covered by a draft 14th Company Law Directive;
- transfers of the whole of a company's undertaking to another company, or division of it between companies, with dissolution of the transferor and its shareholders becoming shareholders in the transferee - known as domestic mergers by fusion or divisions where the companies are formed under the law of the same Member State (provided for by the 3rd and 6th Company Law Directives respectively);

- such mergers across borders (“international mergers”), i.e. of companies formed under the law of different Member States (covered by a draft 10th Company Law Directive; a new draft of this Directive is expected shortly);
- formation of an SE (or possibly an EPC - see chapter 3.6. below) by international merger, or by transformation of an existing public company;
- “squeeze-outs” (compulsory buy-outs) of a minority by a majority shareholder and corresponding "sell-outs" (for post-takeover cases already dealt with in the Group's first report on issues related to take-over bids).

2. Where a company moves its “head office” or “central administration” across frontiers, some Member States require it also to change its law of incorporation, requiring a type of restructuring; other member states allow this without such change, so that the migration does not constitute a restructuring at all. This is discussed below.

3. These transactions all raise similar shareholder and, in appropriate cases, creditor protection concerns and demand a common EU approach. Take-overs do not constitute a restructuring but their economic effect is very similar, particularly if done by share for share offer resulting in a 100% subsidiary (by squeeze-out or otherwise). Within its limited scope this section focuses on 5 main problems in this field:

- Changes of corporate “seat”, or domicile;
- the formalities required for an acquiring company in a merger, particularly an international merger;
- acquisition of a wholly owned subsidiary in such a merger, particularly an international merger;
- the possible need for harmonisation of creditor protection provisions in this field;
- squeeze-outs and sell-outs.

II. Change of corporate seat, or domicile

4. Some Member States adopt the **incorporation doctrine** - a company may be formed and governed under their law on the basis of registration under that law, with notification of a “registered office”, mainly for receipt of legal proceedings, within the jurisdiction. No further connection with the territory is required. The company’s business may be conducted anywhere, and its main or central administration (whatever that may mean) conducted, and any governing organ convened, always or sometimes, outside that territory. Similarly, companies formed under foreign law will be recognised if the law of claimed incorporation confers validity on them. A foreign company will be regarded by such a state as validly formed and constituted under another law wherever its business is carried on and its affairs controlled, whether in the territory of such (“host”) state, or a third state.

5. Other Member States adopt the **real seat doctrine** - the validity of incorporation and legal status of a company are recognised by reference to the law of claimed formation only if it maintains its “real seat” (“siege réel, effectif”, etc.) within that jurisdiction. The meaning of “real seat” varies; generally, if there is no substantial connection between the “central", or “controlling” operations (particularly the place where the governing organs meet) and the jurisdiction of formation, then recognition by reference to that law is denied. Thus if a company is formed under the law of one

Member State and moves its undertaking or central functions to another (which applies the real seat doctrine) without re-incorporation within that other, its legal security will be undermined. Similarly, if a company, which has been formed in a real seat doctrine state, makes a similar move to a second state but needs to maintain legal relations in the state of formation, then even if the new host state would apply the incorporation doctrine, its position will still be unsatisfactory, since its status in the formation state will be impugned. This will apparently be so even if the new host state would recognise the company's status and validity subject to the law of its original state of origin, thus applying the policy of the latter state (which is presumably what the real seat doctrine is designed to protect). Finally, even if both a state of origin and a host state apply the incorporation doctrine, the corporation's status may be nullified in a third state, if that third state applies the real seat doctrine.

6. Thus, because the real seat doctrine seriously inhibits the movement of certain kinds of corporate activity, the case for restructuring provisions will be stronger where companies migrate from, or to, territories which apply the real seat doctrine. But even where companies migrate between "incorporation" states there may be dangers if they need legal security within "real seat" states.

7. Both incorporation and real seat doctrines inhibit freedom of movement. The former, in requiring a place for service of process and maintenance of public documents within the territory of formation, is very arguably proportionate. But the latter prevents companies from moving their undertakings between states without serious risk of being seriously disabled in law by way of sanction. This raises questions as to consistency with treaty rights of freedom of establishment. Also "central administration"/"real seat", etc., is an unsatisfactory connecting factor: does this refer to the place of operation or meeting of the management/supervisory board, or both, or to the location of the staff who support those operations, or provide "central" functions (e.g. secretariat, financial, strategic)? What if those operations or functions are done in different states (frequently done within groups of companies), or in more than one, using modern technology? In particular there may be major uncertainties for the integrated operation and control of international groups within the internal market.

8. On the other hand, certain Member States rely on internal company law (lex societatis) to ensure that companies closely connected with their territories are bound by governance provisions which meet high public policy objectives, now recognised in EU law, probably most importantly employee participation, which requires certain structures for company boards. If companies founded in incorporation states can migrate freely into such countries while maintaining their foreign governance structures these policies could be evaded.

9. In 1997 the Commission prepared a draft 14th Company Law Directive to enable EU companies "to transfer their 'registered office or de facto head office' to another Member State," which was to "involve a change in applicable law"[7]. The intended policy appears to have been (recognising the legitimacy of both real seat and the incorporation doctrines) to allow any EU company to transfer its registered office or

[7] Article 3.

its de facto head office, together or separately, but that any such transfer must change its governing law. This is in many cases unnecessary and produces anomalies[8].

10. The European Company Statute is more consistent, adopting the real seat doctrine for all SEs, regardless of place of registration (preamble paragraph (27); Articles 7, 8). But the effect is that an SE will be required to reregister if it moves its "head office" from the state of formation even if that and the host state are both incorporation doctrine states. Again, if an SE moves from a real seat state to an incorporation state and the incorporation state would otherwise recognise it by reference to its law of origin, both states will be obliged to deny recognition even though the legitimate interests of both states will be satisfied and no discernible policy issue appears to arise. The sanction is compulsory winding up by the authorities of the Member State of registration, but that Member State is required to provide an interim sanction (unspecified). It seems to be unclear whether this sanction can include nullity, or what the effect is to be on the company's status in other member states which might also be inclined to impose nullity in accordance with the practice of "real seat" jurisdictions[9].

11. The real seat doctrine has recently been under examination by the European Court of Justice ("ECJ"), see in particular cases 212/97(*Centros*) and 208/00 (*Überseering*); it is possible that it will be held inconsistent with the Treaty. If the result is to require acceptance of the incorporation doctrine throughout the EU the case for EU level restructuring provisions would be much reduced, but it seems that there will still be a good case for enabling companies to change their legal domicile as well as their central operations within the EU.

12. Even if the ECJ does not rule that the real seat doctrine is wholly contrary to community law, the case for harmonising Member States' laws on the basis of incorporation and thus reducing the need for migrating companies to adopt new laws is for consideration. The ECJ ruling in case 212/97 and Advocate General's opinion in Case 208/00 indicate that refusal to recognise a company's corporate status is a disproportionate sanction for the mere transfer of the real seat. The Group is inclined to agree (but would welcome views). The Group is also inclined to believe that where a company moves its real seat from one incorporation doctrine jurisdiction to another, or from a real seat jurisdiction to an incorporation jurisdiction, that should have no effect on its validity or the operation of its internal law anywhere in the EU. However, Member States which would apply to a foreign company their policies on employee participation or other legitimate mandatory policies, were the company formed there, have a legitimate interest in requiring, without discrimination and with proportionality, such compliance where the company establishes the appropriate connection with their territory.

---

[8] For example, apparently: a company which moves its head, but not its registered, office from incorporation doctrine state A to a similar state B will be required to change its governing law - not at present required and serving no discernible purpose; a company which is formed in state A with its de facto head office in state B will be subject to A's law, yet a company formed in state A but moving its head office to B will be subject to B's; and a real seat doctrine company may (it seems) move its registered office to another state and change its law, leaving its de facto head office in its state of origin (thus escaping local mandatory rules) or may transfer its de facto head office while leaving its registered office where it is, requiring a change of law but no change of registered office.

[9] See European Company Statute Article 43, particularly paragraph (4).

Question 24:
a) Do you agree that Member State laws which automatically deny recognition to any company which has its real seat in a state other than that of its formation should be abolished under EU law, as disproportionate inhibitions of commercial freedom and legal security?
b) If so, do you agree that Member States should be free to apply mandatory internal company law requirements, which are proportionate and non-discriminatory, to companies substantially based within their territories, and how should such connection be defined?
c) If so, should other Member States be bound to recognise such provisions?

III. 3rd Directive Mergers - position of the acquiring company

13. The 3rd Company Law Directive seeks to ensure harmonised standards of protection of members and third parties in the case of domestic mergers by fusion, also providing a necessary common basis to enable mergers by fusion to take effect between companies formed under the laws of different Member States. The Commission has proposed a Directive to achieve such international mergers (10th Company Law Directive).

14. The 3rd Directive requires certain formalities and safeguards for members and creditors, including, inter alia, approval by general meeting of each company involved on the basis of four published documents (terms of merger, board report, expert valuation, accounting statement) and 3 years annual accounts and “an adequate [undefined] system of protection” for creditors of each company[10]. These requirements (except the special creditor protection) may (but need not) be relaxed for the acquiring company, but all the documents must be prepared and made available and a 5% or greater majority of shareholders must be entitled to demand a meeting[11].

15. There is clearly great value, in many states at least, in the merger facility with its universal succession effect, but the need for a mandatory requirement of this kind in the case of an acquiring company seems questionable. The proposed 13th Company Law Directive on take-over bids made no equivalent provision for formalities in an acquiring company even though the economic effects, at least for shareholders of the acquiring company, are arguably similar and, according to the scale of the transaction, capable of being more significant. It is also questionable whether it is necessary or desirable for governance issues concerning the decision by the acquiring company board to be subjected to EU level regulation. In many jurisdictions acquisitions by merger are matters for the general rules allocating powers between the board and the general meeting. If within the board’s powers they require no special authorisation, formalities, or minority protections. Similarly, so far as creditors are concerned, acceptance of liabilities is normally within the operational powers of the board; mergers present no special problems. There seems to be a strong case for relaxing these requirements to *allow* Member States to follow that approach. There is also a liberalisation case for *requiring* Member States not to insist on special provision of this kind for mergers, at least for international mergers where the law applicable to the acquiring company adopts the more relaxed approach.

---

[10] Articles5,7, 9, 10, 11 and 13 respectively.
[11] Article 8, noting in particular article 8(b) which invokes article 11.

Question 25:
a) Should the EU requirements for special provisions governing merger decisions in acquiring companies be removed?
b) Should the Member State of an acquired company be bound to accept any such relaxation in respect of an acquiring company in an international merger, or should that relaxation be made mandatory for all international mergers, or even for all mergers?

IV. 3rd Directive - acquisition of a wholly owned subsidiary

16. For mergers by acquisition of a wholly owned subsidiary the same requirements apply, except that in the absence of a separate shareholder constituency in the company acquired, some are inapplicable, and a general meeting of the acquiring holding company need not (but may) be required so long as the draft terms of merger are duly published, the shareholders are entitled to inspect the merger terms, the 3 years' accounts and accounting statement at least a month before the merger takes effect and holders of 5% or more can demand a meeting[12]. Thus even in the case of acquisition of a 100%-subsidiary much documentation and the standard minority protection is required[13].

17. The case for removal of such requirements is particularly strong in acquisitions by a 100% holding company; particularly in the case of an international merger. Member States should arguably not only be permitted, but also required, to remove them to facilitate the cross frontier formation and operation of groups of companies.

Question 26:
a) Should Member States be permitted to relax the directive requirements in the case of acquisitions of 100%-subsidiaries?
b) Should the Member State of the acquired subsidiary be required to accept such relaxation by the Member State of the holding company in an international merger?
c) Or should such requirements be removed in all such international cases, or in all cases, international or not?

18. The 6th Directive regulates the division of public companies on lines very similar to 3rd Directive mergers, to prevent evasion of the 3rd Directive. Any decision to amend the 3rd Directive should presumably apply to the 6th, mutatis mutandis, though some detailed issues arise. However if it is accepted that there is no need to make provision for cross frontier divisions the case for requiring liberalisation in relation to holding companies will be less strong here.

---

[12] Articles 25(c) and 8(c)
[13] Special rules apply to acquisition by the parent of its 90% subsidiary - these are beyond the scope of this paper.

V. Creditor protection in restructuring

19. The 2nd Company Law Directive lays down minimum standards of creditor protection for creditors in reductions of capital in the shape of a right to apply to the court before the reduction takes effect for satisfaction or “adequate safeguards”[14]. We have noted that in mergers and divisions member states must provide an “adequate system of protection” but this is not defined. In fact Member States’ practice varies widely, some allowing only court applications, others requiring approval in meetings of creditors, others court endorsement of any schemes of variation, and others a combination of these. There is an arguable case, particularly in international mergers and migrations for a liberalised common standard of creditor protection, perhaps based on the right to apply to the court for protection pending completion.

Question 27:
a) Should the creditor protection requirements for reductions of capital, mergers and transfers of registered office be aligned as proposed above?
b) If so, should such alignment be confined to international mergers and transfers of corporate domicile or should it apply to all EU restructuring provisions?

VI. Squeeze-outs and sell-outs

20. In our first report (on issuess related to take-over bids) we recommended that where a bidder acquired a large majority (to be set at not less than 90%, nor more than 95% of the share capital, or alternatively not less than 90% of the shares bid for) in a listed company the bidder should have the right to buy out the minority ("squeeze-out"). In companies with more than one class of shares we proposed that this should apply on a class by class basis. There was to be a corresponding right for minority shareholders to be bought out on a 90-95% of capital basis ("sell-out"). We proposed that there should be a presumption that a price accepted by 90% of offerees by value was fair, but with a right of appraisal as a fall-back.

21. The case for such "squeeze-out"- and "sell-out"-rights rests on the desirability of enabling those with an overwhelming majority control to exercise such control without the encumbrance of a small minority and correspondingly allowing small minorities to escape being locked in. Very arguably there is a case for this whenever such a situation arises and not only where it is achieved as a result of a take-over bid (or, as is possible in some countries, is part of a merger transaction). However, unless there was an exception for take-over bids, the effect of this wider rule would be to override the 90% of acceptances provision which operates in some Member States as the threshold for the squeeze-out right. This is because the result would be that wherever a shareholder held 90-95% he would be able compulsorily to buy out the minority, even if he had attained that position without persuading 90% of the offerees of the fairness of his offer. It would appear however that such a provision would need to operate on a class by class basis, like our earlier proposal.

---

[14] Article 32.

Question 28:
a) Should Member States be required to introduce provisions enabling a majority shareholder (the majority to be set at not less than 90% nor more than 95%) in a company to buy out the minority for a fairly appraised price?
b) Should minority shareholders have a corresponding right to be bought out where the 90-95% threshold has been reached?
c) In companies with more than one class of share should the rule operate on a class by class basis?

VII. Other issues

Question 29:
Is there a need for legislation at the EU level providing for restructuring in ways not already discussed above?

3.6. The European Private Company

I. An initiative to establish a European Private Company

1. Last October, the "Societas Europaea" (SE) finally became a reality. The Statute of the SE and the corresponding directive on the rights of employees of SEs were adopted by the Council of Ministers and the European Parliament. The SE represents a major breakthrough especially because it makes it possible for European companies to merge across borders and to transfer their seat from one Member State to another. Moreover, it may be important for a company to do business as a European company and not as an Italian, German or French company. This latter objective of the SE however is only partly achieved, as the Statute often refers to the law of the Member State of incorporation and as a result different types of SEs may come to exist depending on where they have been incorporated.

2. The SE has been designed for large enterprises and may not meet all the expectations of the business community and in particular small and medium sized enterprises (SMEs), both independent and group's subsidiaries, which are the most important constituents of the European economy. One of the recitals of the SE regulation is very explicit in that way; it says that the SE must be of a reasonable size. The minimum capital is quite high for SME's: 120.000 Euros. A private initiative of business, supported by academics in some Member States, has argued that there is a specific need for a European legal form of a private company, to facilitate SMEs in Europe. According to this initiative, the European Economic Interest Grouping (EEIG) only gives a partial solution, because its activity must be the continuation of its members' activity. The initiative has specifically argued that the SE does not meet the expectations of companies who desire to establish joint ventures, as the SE Statute leaves little room for structuring the joint venture as the parties to it wish.

3. The private initiative has resulted in a specific, detailed proposal for a European Private Company, complementary to the national forms of private companies in Member States and to the SE. The proposal has been presented by the Paris Chamber of

Commerce and Industry and the French business organisation MEDEF (formerly CNPF) in September 1998 (http://www.ccip.fr/etudes/dossiers/spe/index.html and http://www.medef.fr). This proposal has been drafted by a group of company representatives and specialists in company law from several nationalities and has been supported by the Union of Industrial and Employers' Confederation of Europe (UNICE) and EUROCHAMBERS.

More recently, in March 2002, the European Economic and Social Committee has unanimously adopted an opinion on a European Company Statute for SME's (own initiative opinion) stressing "the necessity for a European Company project for SME's".

The proposal for a private company statute is based on contractual freedom. This freedom covers the determination of corporate governing bodies, the organisation of relations among them, the shareholder's rights, which might be unequal or specific, and the manner of access, withdrawal or removal of a shareholder, subject only to the limits of those rights laid down by the regulation.

4. The Group would like to know if respondents feel that there is a real need for such an additional European legal form of private company. An argument could be made that European corporate environment should not be cluttered up with yet another legal form if there is no specific need for it. If it is felt that national forms of private companies are insufficiently geared to facilitate SMEs and joint venture activity, an effort could be made to infuse more flexibility in the laws of Member States relating to private companies. This would not necessarily have to take the form of harmonisation through directives, but could take a much lighter approach. Some think that the proposal for the European Private Company could be used as the starting point for a model for regulation of private companies in Europe. Such a model could be used by Member States to voluntarily amend their regulation of private companies. The European Union could consider to facilitate the adoption of a model for regulation of private companies in the Member States, including a mechanism to update the model if business needs so require.

Question 30:
a) Do you think there is a specific need for a new European legal form of company, complementary to the SE and national forms of private companies, the European Private Company as proposed?
b) If not, do you think a European model for regulation of private companies is a desirable and appropriate way to encourage Member States to adopt flexible regulation of private companies?

II. Incorporation of the European Private Company

5. The SE can only be set up in one of four ways:

- By the merger of two or more existing public limited companies from at least two different EU Member States;
- by the formation of a holding company promoted by public or private limited companies from at least two different Member States;

- by the formation of a subsidiary by companies from at least two different Member States;
- by the transformation of a public limited company which has, for at least two years, had a subsidiary in another Member State.

6. It has been noted that the requirement that only companies can thus incorporate an SE is particularly unhelpful for SMEs, many of which are incorporated and operated by individuals. It has also been noted that the requirement that companies from at least two Member States are to be involved in the incorporation of an SE is not suited for SMEs. A requirement of undertaking economic activities in at least two Member States could be sufficient to justify a European legal form.

Question 31:
Do you think that it should be possible for a European Private Company to be set up by both individuals and legal entities and by one or more nationals of one Member State, as long as the European Private Company undertakes economic activities in two or more Member States?

III. A genuine European company

7. As said above, the SE-Statute often refers to national laws of Member States applicable to public companies. The SE as a result only partly has a European character. The drafters of the proposal for the European Private Company intend that this legal form is only governed by the provisions of the regulation and the provisions of the articles of association which would not be inconsistent therewith. This assumes an autonomous and exhaustive interpretation of this regulation and these articles of association, ultimately by the European Court of Justice. Of course, the European Private Company would remain subject to the general rules of the Member States, regarding accountancy law, tax law, penal law and bankruptcy law.

8. The existing company laws in Member States are all embedded in national bodies of private law. Many concepts of private law are also applicable in company law, e.g. concepts of legal acts, good faith, power of attorney etc. It is difficult to see how a European Private Company could operate completely outside such a body of private law. In the absence of a European body of private law, for the proper operation of the company law applicable to the European Private Company some connection may still have to be made with the law of the jurisdiction of its incorporation.

Question 32:
a) Do you think that the European Private Company for the company law applicable to it could be exclusively governed by the provisions of the regulation and the provisions of its articles which are not inconsistent therewith, with autonomous interpretation ultimately by the European Court of Justice?
b) Or is it necessary to refer to the law applicable to private companies in the Member State of incorporation where a question is not answered in the regulation of the European Private Company or its articles of association?

3.7. Co-operatives and Other Forms of Enterprise

I. Regulation of the European Co-operative, European Association and European Mutual Society

1. One of the long-standing revindications of the co-operative movement is the adoption of a European Regulation introducing a European Co-operative, as a means to achieve effective participation of co-operatives in the transnational possibilities afforded by the single market in Europe. After years of debate and procedural uncertainty, it appears that the European Co-operative Regulation will be adopted in the near future. Other Regulations dealing with the European Association and with the European Mutual Society are also on the agenda. These regulations are modelled after the Council Regulation for the Societas Europea (SE)[15]. The proposed regulations are the following:

- Proposal for a Council Regulation on the European Co-operative Society (Societas Cooperativa Europea, SCE)[16]
- Proposal for a Council Regulation on the European Association[17]
- Proposal for a Council Regulation on the European Mutual Society[18]

2. These initiatives are aimed at institutions that represent “alternative” possibilities for enterpreneurial activity, as opposed to companies, and, especially, public limited companies. This is particularly clear in the case of co-operatives, but also for associations and mutual enterprises. In all of these cases the regulations try to create a framework for European-wide enterprises that adopt a legal structure alternative to that of companies. The proposed regulations share similar features, similar objectives and similar shortcomings. The proposals do not aim at giving all these legal institutions a harmonised regime; on the contrary, they refer frequently to national rules, following the approach taken in the SE-Regulation. These proposals, if adopted, could have a positive effect for the use of alternative legal vehicles in the European Union. The most immediate effect would be the creation of new legal institutions that could be used for transnational activities, whether the instrument be a co-operative, an association, or a mutuality. This may be particularly important for the co-operative movement as there are traditional complaints on the lack of competitiveness of co-operatives against multinational companies. The introduction of these new legal forms also allow other restructurings such as the transfer of seat within the European Union, and, in the case of co-operatives, the merger between enterprises establishing a European co-operative, the transformation of a co-operative into a European co-operative and the transformation of a European co-operative into a national co-operative. All of these rules would offer co-operatives new possibilities for taking advantage of the Internal Market.

Question 33:
a) Do you consider that the enactment of the proposed regulations is necessary or desirable?
b) What is your assessment of the potential these regulations have in the solution of the problems affecting co-operatives and other forms of enterprise in the European Union?

---

[15] For full citation see Annex 1.
[16] For full citation see Annex 2. There are revised texts under discussion.
[17] For full citation see Annex 2.
[18] For full citation see Annex 2.

II. Harmonisation of national laws on co-operatives, associations and mutual societies

3. The introduction of new European types of enterprise that will coexist with non-harmonised alternative forms of enterprise could possibly have the effect of introducing some *de facto* harmonisation by means of the use of European co-operatives, European associations, and European mutual societies where the rules of the Regulations will be better suited to specific needs than those afforded by national laws. The basic difference with the European Company, however, lies in the fact that there has not been a harmonisation effort aimed at the laws of the Member States relating to these forms of enterprise, whereas the law of public limited companies has been harmonised in some of its most important areas. There is a clear asymmetry in creating European entities without harmonisation of some basic rules for the national form of such entity, while the European Company is based on a long harmonisation experience in the company law area. The proposed regulations refer to the application of some Company Law Directives (1st Company Law Directive; 4th Company Law Directive (on annual accounts); 7th Company Law Directive (on consolidated accounts); 8th Company Law Directive (on auditors); and 11th Company Law Directive (on publicity of branches); for full citation see Annex 1). However, national co-operatives, associations and mutual societies will continue to be unaffected by those rules.

Question 34:
a) Do you think there should be harmonised rules in Europe for these alternative forms of enterprise?
b) Do you consider it to be satisfactory that the regimes in the proposed regulations are completed by application of the Company Law Directives, which do not apply to the national forms of these enterprises?

III. Foundations in Europe

4. Foundations are currently included in the draft Regulation for a European Association. Foundations are usually non-profit organisations with needs rather different from those of other entities. Some of them act as quasi-enterprises, which, according to some critics, in a way circumvent company and general enterprise law, because they are formally non-profit organisations but they operate or control enterprises, engage in commercial activities and have employees, just like companies. Since they do not have shareholders there is no 'corporate governance' in the traditional sense, neither internally nor externally through the market.

5. Apart from this, foundations may need a specific regime. Many foundations feel the need to operate in other Member States, both for being able to raise money from foreign donators for their (charitative) purposes and for being able to use their funds for doing non-profit work in other Member States. Some of them may even wish to transfer their seats across borders. In this context it has been suggested by some to draft rules for a European Foundation, either as a statute (along the lines of the Societas Europea) or as a model law.

Question 35:
a) Do you think there is a need for a specific regulation of the European Foundation?
b) Do you think that national rules of Member States relating to foundations should be harmonised to some extent (as for other forms of enterprise, see question 34)?

IV. Enterprise law

6. A different and complementary approach would imply the adoption of a Directive that would include some fundamental rules for all kinds of enterprises in the European Union, regardless of their legal form. EU-law lacks a general definition of "enterprise". Such a Directive could apply to all limited liability entities that carry out organised economic activities, whether an economic activity is the sole activity or an ancillary activity of sufficient importance, and whether it is for profit of shareholders or members or not-for-profit. This would include co-operatives, foundations, associations, and other entities, where their economic activity is organised and of sufficient importance.

7. In EU-competition law the concept of enterprise has been construed in a wide sense, so that "enterprise" for competition law purposes is any person, legal or natural, that operates in any product market. The definition is so wide that technically a consumer could also be an "enterprise", if certain qualifying circumstances apply. The point is that there has not been an attempt at defining "enterprise" for other purposes, and, naturally, a specific programme for enterprise law harmonisation has never existed. A definition of "enterprise" can still be broad and accurate, incorporating the elements of economic activity and organisation as fundamental features of the concept and applying only to limited liability entities.

Question 36:
a) Do you think a definition of "enterprise" in EU-law would be useful?
b) If so, do you agree on the elements of economic activity and organisation as the main elements in the definition?
c) Do you think basic harmonised rules should be applied only to limited liability entities?

8. An Enterprise Law Directive would have to deal with the issues that alternative forms of enterprise and those who deal with them face in the European Union. Not every aspect of the legal organisation of enterprises would have to be included in such a Directive. The focus should probably be on those features which involve the enterprise and third parties, leaving the internal organisation of these entities aside. As a first priority, a Directive could require the registration of enterprises that engage in economic activities and could ensure access to data regarding the enterprises on a unified basis, taking advantage of technological developments. Powers of representation could be required to be published. On a second priority level, it could be considered to include rules on annual accounts, consolidated accounts and auditing. The relevant Company Law Directives could be extended to enterprises generally, as is the case in some Member States, or a lighter regime of financial reporting could be developed. There is also a case for providing rules for setting up branches, groups of enterprises, and

transformation into other forms of enterprise. Enterprise mobility (transfer of seat) could also be included.

Question 37:

a) Do you think there is a need to introduce harmonised rules in Europe for registration, access to core data and powers of representation relating to enterprises as defined above?

b) Do you think other issues should be addressed in an Enterprise Law Directive (financial reporting, branches, groups of enterprises, transformation, transfer of seat)?