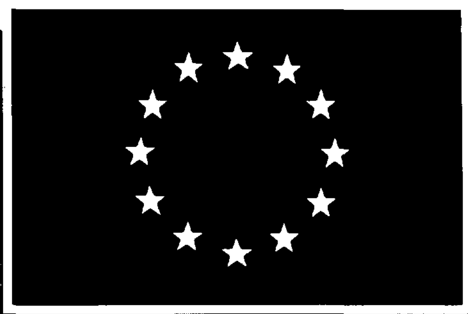

EUROPEAN FILE

Company law in the European Community

COMMISSION
OF THE EUROPEAN
COMMUNITIES

October 1989
14/89

Under the European treaties one of the principal aims of the European Community is the establishment and effective operation of a common market. The tasks assigned to the Community by Article 3 of the Treaty of Rome are of major importance in this regard. They define many of the fundamental freedoms accorded to Community citizens: the elimination of internal frontiers, not only for the movement of goods, services and capital, but also for the movement of persons, whether they be wage-earners or self-employed. This implies for the self-employed the right to free establishment. Any national of a Member State should be able to undertake and carry out a professional activity in another Member State under the same conditions as nationals from the host country and should be treated in exactly the same way as the citizens of that country.[1]

These fundamental freedoms apply not only to individuals. Article 58 of the Treaty of Rome also extends them to all companies which pursue an economic objective. This is particularly important given that most of the Community's economic activity is carried out by undertakings with company status.

With the publication in 1985 of its White Paper on the completion of the European internal market by 1992, the European Commission gave a new impetus to the Community and defined a programme which was approved by the Member States on the adoption of the Single European Act. To reinforce in particular the Community's international competitiveness — the capacity of its companies to face the challenge from undertakings in third countries — it appears indispensable to realize the large market and establish an environment more favourable to firms, to competition and to trade. How can this be achieved?

Company law and the European dimension

Companies are organizations which are created and administered according to legal requirements. They involve different categories of persons — shareholders, employees, creditors or third parties — who are all concerned in some way in the activity of the undertaking. Equal protection of these diverse interests helps to create a suitable environment for companies. Unfortunately, the laws providing such protection differ considerably from one country to another. With the constant development of the European internal market, the growth in cross-border dealings between companies and the different groups just mentioned, these differences are becoming increasingly inconvenient. The harmonization or coordination of company law at European level is essential to establish an equivalent degree of protection throughout the Community which will ensure that

[1] This file replaces our No 4/85.

the interests of shareholders, employees, creditors and third parties are safeguarded. This is why, since the 1960s, the European Commission has proposed a series of measures (based on Article 54 (3) (g) of the Treaty of Rome) as a basis for coordinating the legislation of Member States.

Harmonization: how far have we got?

Despite the very wide scope of Article 58 of the Treaty of Rome in relation to companies, the Community has essentially confined itself until now to public limited companies. In terms of economic importance and numbers employed, these are the predominant form of company in the Community. To date, seven directives on company law have been adopted by the Council of Ministers while seven other proposals are still under consideration.

- The first directive, adopted in 1968, defines a system of public disclosure applicable to all companies. Member States must maintain an official register of companies, accessible to the public, and ensure the publication of certain information in an official gazette. This system ensures that the same type of information is available to the public in respect of all companies in the Community: the memorandum and articles of the undertaking; the identity of those empowered to represent it, whether jointly or singly; procedures for the winding-up of a company; etc. Subsequent directives have extended the application of this disclosure system to new categories of documents or information.

  The first directive also deals with the validity of obligations entered into by a company. For example, a company cannot invoke against a third party the fact that, in a legal transaction, the object of the enterprise has been exceeded. Member States may only award this right in cases where the third party in question could not reasonably have been unaware of the breach. To protect third parties, the directive has severely restricted the permitted grounds for winding-up companies.

- The second directive, adopted in 1976, deals with the raising, maintenance and alteration of the capital of public limited companies. Because this capital is an essential guarantee for shareholders and creditors, the minimum is an essential guarantee for shareholders and creditors, the minimum subscribed capital of a public limited company must be at least ECU 25 000.[1] Subscribed capital may be in cash or in kind; however, when it is in kind, it must be evaluated by an independent expert. Distribution profits are defined so as to prevent the distribution to shareholders of 'profits' which would effectively erode capital or reserves. Whenever capital is to be increased, the new shares

[1] ECU 1 (European currency unit) = approximately £ 0.68, Ir£ 0.78 or US$ 1.07 (at exchange rates current on 29 August 1989).

must be offered first to existing shareholders, in proportion to their existing holdings. The directive also expressly sanctions the principle of equal treatment for shareholders who find themselves in identical situations.

- The third and sixth directives define the legal principles governing the main types of company reconstruction.

  - The third directive, adopted in 1978, introduces into the legislation of all Member States a common procedure for company mergers, whereby the assets and liabilities of the acquired company are transferred to the acquiring company. This is to ensure that mergers are not preceded too often by complicated winding-up procedures. Shareholders in the acquired company receive shares in the acquiring company, in line with an exchange ratio defined by an independent expert. Creditors are also protected: they have the right to appropriate guarantees when the financial state of the merging companies justifies it.

  - The sixth directive, adopted in 1982, concerns the scission of a public limited company into several undertakings. Member States are not obliged to introduce such a procedure into their national legislation but, if they do so, they must conform to the sixth directive. The allocation of assets and liabilities among the various beneficiary companies requires specific measures to protect creditors. This protection is ensured by joint and several liability for debts.

The third and sixth directives apply only to transactions involving companies in the same Member State (though they could have repercussions at the common market level if some of the affected shareholders, employees or creditors live in another member country). The increasing internationalization of capital holdings in companies and the development of European and world trade has made it necessary to provide for the merger of companies registered in different Member States. This is why in 1985 the European Commission submitted to the Council of Ministers a proposal for a tenth directive on cross-border mergers between public limited companies. The European Parliament has not yet commented on the proposal.

Although of major importance for the Community, legal provisions for company reconstruction cannot be considered in isolation. They remain subject to Community regulations intended to maintain free competition and prohibit the abuse of a dominant position. It is necessary to ensure that company mergers have no lasting effect on competition. The Commission therefore intends that mergers of large companies should be subject to authorization.

The Community is also concerned to protect, with a specific directive, rights acquired by workers so that any reconstruction of their undertaking will not result in a deterioration of their situation.[1]

Harmonization of accounting regulations

☐ The fourth, seventh and eighth directives have created a high-level code of European accounting law, albeit one which is not yet complete.

- The fourth directive, adopted in 1978, puts into effect the commitment made by the Community in the first directive to harmonize the annual accounts of public limited companies. Subject to limited concessions for small and medium-sized companies, this directive determines the lay-out of the balance sheet and profit and loss accounts and prescribes the minimum information to be published in the notes to the accounts and the annual report. The annual balance sheet should give an accurate picture of the company's situation with regard to its assets, financial position, and profits and losses in accordance with general principles such as consistency, prudence and attribution to the financial year in question. Valuation rules are also defined. In general, valuations are based on historical cost, but Member States may allow current cost valuation provided two fundamental conditions are respected. First, any resulting additional value cannot be treated as profit but must be entered into a reserve not to be released for the distribution of dividends. Second, a table can be provided to enable comparisons to be made between valuations based on current cost and those based on historical cost.

- While the fourth directive had to limit itself of necessity to the accounts of individual companies, the seventh directive, adopted in 1983, concerns the consolidated accounts of 'groups' of undertakings — parent companies and subsidiaries. It begins by defining the undertakings whose accounts must be consolidated in order to give an overall view of the group's financial position. The basis adopted for consolidation is the legal power of control exercised by a parent company over one or more of its subsidiaries. This control can be established either by holding a majority of the voting rights, or by the right to appoint a majority of the members of the company's management board, or by a specific contract. In accordance with the directive, the consolidated accounts must give an accurate picture of the assets and liabilities and the financial position and performance of the different enterprises in a group as if they were one and the same entity. Thus, in the accounts, the value of the shares of a consolidated undertaking held by another undertaking of the same group is offset against the

[1] See *European File* No 9/84: 'Workers' rights in industry'.

proportion of capital and reserves that these shares represent. Transactions between member companies of the same group are not entered into the accounts.

- The eighth directive, adopted in 1984, defines the qualifications to be held by those responsible for the statutory audit of accounts required under Community legislation. Both the fourth and seventh directives provide for an annual audit of company accounts, to be carried out by an independent expert. Under the eighth directive, this auditor must have undergone defined theoretical and practical training and have passed a professional examination. The auditor must then be appointed by the competent authority of the Member State in which he works.

It was not possible to apply the provisions of the fourth and seventh directives as they were to the banking and insurance sectors and specific rules were therefore provided. A directive on banks was adopted in 1986. Given the particular nature of these financial institutions, the legislation provides for extra provisions and derogations as regards the layout of annual accounts, special procedures for the building-up of reserves, and a particularly conservative valuation of claims and certain securities.

Future prospects

Much of the coordination of company law in the European Community is now in place. Several decisions, however, remain to be taken.

□ Following the detailed opinion of the European Parliament, the Council of Ministers is examining the amended proposal for a fifth directive on the structure of public limited companies. This proposal deals with the organization of these companies, including the question of worker participation. Depending on the country, public limited companies could be managed either by a unitary board or by a two-tier structure with separate management and supervisory boards. The Commission, however, hopes to approximate the operation of the two systems, in order that the management and supervisory functions are always clearly distinct.

On the question of worker participation, the diverse traditions governing industrial relations in the different member countries led the Commission, in keeping with the wishes of the Parliament, to offer a choice between four equivalent options. This leaves it up to the Member States to decide whether participation should be established according to one of the following: the election of worker representatives to supervisory and management boards; the co-option of members of the supervisory board; the creation of a body which represents the workers but is separate from the board; the negotiation of a collective agreement which provides for one of the three abovementioned options. All worker representatives must be elected democratically and by secret ballot.

Another part of the proposal deals with the rights of the general meeting of shareholders. This contains detailed rules concerning the convening of the meeting, the representation of shareholders, the use of the right to vote, and the grounds to make null and void or dispute any faulty decision. The proposal also includes a body of guarantees intended to safeguard the independence of the auditor.

- ☐ The creation of branches (legally subordinate) is one of the ways in which a company can exercise its right to free establishment in all Community countries. However, different legislative systems in the Member States, particularly as concerns information on the management of companies, effectively limit the exercise of this right. This is why in 1986 the Commission submitted to the Council of Ministers a proposal for an eleventh directive on the disclosure requirements for branches which are created by a company in another member country and which then become subject to that country's legislation. According to this proposal, branches would not be obliged to publish annual accounts of their own activity provided they submitted a consolidated and duly audited report for their parent company. This proposal should soon be adopted.

  Another directive of this type, concerning branches of banks, has already been approved by the Council in 1989.

- ☐ To give individual business operators access to a legal system which limits their personal liability in respect of commitments made by their undertaking, the Commission has submitted a proposal for a twelfth directive on the creation and operation of limited liability companies by a single person. This proposal also should soon be adopted.

- ☐ As already mentioned, decisions still have to be taken on cross-border company mergers. The question of take-over bids can be looked at in conjunction with these measures. In general, the maker of such a bid directly approaches the stockholders of the company involved and proposes either the outright purchase of their stock or its exchange against other stock. The objective is to increase influence within the undertaking, even to dominate it completely. At the beginning of 1989, the Commission submitted to the Council of Ministers a proposal for a thirteenth directive which would make these transactions more transparent. To ensure equal treatment for all shareholders, a threshold would be determined (currently a third of shares) which when exceeded would require the announcement of a take-over bid. In order to protect minority shareholders and to discourage partial bids which are often speculative in nature, the bid would have to cover all the stock of the company in question. One important detail here is that those to whom the bid is addressed would benefit from full information because the maker of the bid would have to provide them with a comprehensive dossier, including information on all the proposed terms. In addition, the management of the company affected woud be invited to give its opinion. Both dossiers would have to be communicated to employee representatives, who would have to be kept

clearly informed by the maker of the bid about his intentions for the workforce. Once published, the bid could be withdrawn only under very precise conditions. Some independent authorities, to be organized in large measure by the Member States, would ensure respect for the provisions of the directive.

☐ In 1986 and 1988, the Commission proposed amendments to the fourth and fifth directives in relation to:

- Extending the scope of the directives to include partnerships, in as far as the partners with unlimited liability are themselves incorporated as companies with share capital.

- Concessions for small enterprises in respect of the statement of accounts. In particular, small family-type enterprises would be excluded from the scope of the fourth directive.

  The Commission has also proposed that Community undertakings could denominate and publish their annual accounts in ecus. This should help progress on monetary integration.

☐ As for the reports and consolidated accounts of insurance companies, the Commission submitted a proposal in 1987 for a directive which would take account of the particular requirements of these companies. The European Parliament has delivered an opinion in favour of the proposal.

Beyond company law coordination

The coordination measures just discussed cannot change the fact that the companies concerned have been established according to national law and remain subject to it. However, by creating specifically European legal structures, the Community is opening up new possibilities for cooperation for its undertakings.

☐ With the Regulation of 25 July 1985 on the European Economic Interest Grouping, the Community has created an original instrument, directly connected to the Community legal system, for cooperation between companies in different Member States. By availing themselves of it, companies in several Member States can jointly pursue certain activities while continuing to retain their national legal incorporation and economic independence. This Regulation became effective on 1 July 1989.[1]

☐ The European Company Statute would constitute a new form of company. Based on specifically European legislation independent of the different

[1] See *European File* No 6/89: 'The European Economic Interest Grouping (EEIG)'.

national legislations, it would facilitate cross-border cooperation between companies in different Member States. At the same time, it would remain optional because no one would be forced to use it.

The European Commission first proposed such a measure in 1970. This proposal was amended in 1975 but the Council of Ministers suspended its discussions in 1982. As part of the completion of the internal market, the Commission judged it necessary to revive the proposal and submitted a memorandum in 1988 setting out the main problems and the means to resolve them. This document has recently been followed by a new proposal for a European Company Statute.

Simpler than the 1975 version, the new proposal provides that a European company could be constituted either through a merger, or through the creation of a holding company or through the establishment of a joint subsidiary. To make the statute attractive to small and medium-sized enterprises, the minimum capital required would be reduced from ECU 250 000 to ECU 100 000.

The proposal also provides that there would be no 'European company' without worker participation. The intention is to recognize the place and role of workers in such a company and to ensure that they feel involved in its affairs. To this end, workers must be able to participate in supervision and to take advice of 'European company' strategy. Participation can be according to one of three possibilities: the election by workers of a section of the supervisory council, this section to be not less than one-third nor greater than one-half of council members; participation through a body which represents employees but is distinct from industrial relations bodies; participation established through collective agreement. Each Member State could limit the choice offered to 'European companies' registered in their territory. For the rest, it would be up to the management or administrative bodies of the founding companies and their worker representatives to agree on a choice between the different possibilities. In the absence of such an agreement, management would choose the mode of participation.

From the taxation point of view, the 'European company' would be subject to the legislation of the country in which it has its headquarters. However, the proposed statute provides that it can offset against profits any losses sustained by its permanent establishments abroad. This provision is essential to eliminate obstacles which a 'European company' might confront when carrying out its cross-border activities.

The Community's aim in company law is to create a homogeneous legal area, which would operate to the benefit of all interested parties. This would help to realize the objectives of the Treaty of Rome: the harmonious development of economic activities within the Community and closer relations between its peoples ■

The contents of this publication do not necessarily reflect the official views of the institutions of the Community. Reproduction authorized.

Commission of the European Communities

Directorate-General for Information, Communication and Culture
Rue de la Loi 200 — B-1049 Brussels

Office in Ireland	39 Molesworth Street, Dublin 2 — Tel. 71 22 44
Office in England	8 Storey's Gate, London SW1P 3AT — Tel. 222 81 22
Office in Wales	4 Cathedral Road, Cardiff CF1 9SG — Tel. 37 16 31
Office in Scotland	7 Alva Street, Edinburgh EH2 4PH — Tel. 225 20 58
Office in Northern Ireland	Windsor House, 9/15 Bedford Street, Belfast BT2 7EG — Tel. 24 07 08
Information services in the USA	2100 M Street, NW, Suite 707, Washington DC 20037 - USA — Tel. (202) 862-9500 305 East 47th Street, 1 Dag Hammarskjöld Plaza, New York, NY 10017 - USA — Tel. (212) 371-3804

* Countries fully or partly English speaking. Offices also exist in other countries including all Member States.

Office for Official Publications of the European Communities
L - 2985 Luxembourg

ISSN 0379-3133

Catalogue number: CC-AD-89-014-EN-C

EN