SUPPLEMENT TO BULLETIN No. 9/10-1966

SEC (66) 1250
Brussels, 22 April 1966

Memorandum by the Commission of the European Economic Community on the Establishment of European Companies

(submitted by the Commission to the Council on 22 April 1966)

EXECUTIVE SECRETARIAT OF THE COMMISSION
OF THE EUROPEAN ECONOMIC COMMUNITY

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Memorandum
by the Commission of the European Economic Community on the Establishment of European Companies

I. Introduction

The creation of a common market presenting more and more the characteristics of a domestic market, faces companies with a number of problems which must be resolved by legal means. First, any company incorporated in a Member State should be able to carry on business in any Community country, and if it is not to be handicapped this implies equal treatment with national companies. Secondly, companies need to adapt themselves to the emerging large-scale market as well as to the frequently changing conditions on world markets. These readjustments should strengthen the companies' competitiveness and, hence, their staying power on the domestic, European and world markets.

Many firms in Europe will thus have to tackle a number of tasks: they will have to expand to optimum size, reorganize their supply or sales services, specialize or diversify their products, range of goods or services, and intensify research. All these tasks may require a broadening of the companies' capital base, combination of firms by means of the acquisition of controlling shareholdings or mergers at domestic or Community level, or possibly a transfer of the registered office from one Member State to another. To take these steps, companies will need an appropriate legal framework.

For instance, companies will not be able to increase their capital on the most favourable terms — by issuing shares or by offering debenture stock to the public or certain credit institutes, or by obtaining bank advances — until all the restrictions have been removed which now prevent foreign firms from raising capital and buying stocks and shares on the same terms as on the domestic market. There are, for example, restrictions on the introduction of shares on the market or on the issue of new shares. Other restrictions concern the placing of shares already issued — discriminatory provisions regarding the purchase of foreign securities by finance companies, even if these securities are in no way less safe, given the nature and quality of the issuing company and the protection offered. It would, in practice, be easier to get the equivalence of securities recognized if company law were as strict in its relevant requirements as it is on the preparation of the annual balance sheet and its assessment.

Mergers of companies subject to the same legal system do not in general encounter insurmountable difficulties. In all cases such mergers can take place under the terms of municipal company law and fiscal, social and financial law. It is true that the legal system is not the same everywhere, so that industrial combination finds more favourable conditions in some countries than in others — a situation which will have to be redressed in the first place by an approximation of national laws. Certain tax reliefs will no doubt also prove necessary. By contrast, companies subject to different legal systems can amalgamate only by satisfying the requirement that the company which is taken over, or all the companies which go out of existence when a new company is formed, must first be wound up. Participation is often ruled out by fiscal disadvantages, such as double taxation of distributed profits.

Finally, as regards the transfer of a company's registered office from one Member State to another, there are again no legal facilities at present for doing this without winding up the company first, that is, without a break in the continuity of legal personality.

The above-mentioned difficulties cannot be satisfactorily resolved without new international agreements.

What possibilities does the Treaty of Rome afford for avoiding differences in the treatment of companies, eliminating undesirable disparities of the law, filling in the gaps in various legal systems and settling international legal relations, that is, relations between different national legal systems? Briefly, the answer is as follows. The Treaty provides for the elimination in each Member State of all differences of treatment between home and foreign companies so far as carrying on business is concerned; it makes room by special clauses, such as Article 54(3, g), for an approximation of all laws, regulations and administrative instructions wherever differences in these provisions are prejudicial to the establishment or functioning of the Common Market.

But the Treaty leaves intact the autonomy of national legal systems. It assigns no specific powers to the Community as regards interconnecting the different national legal systems and mitigating the difficulties which derive from their autonomy. Yet the Treaty is not silent on the problems involved and, in Article 220, it suggests that they be solved by

intergovernmental negotiations with a view to international conventions. Nevertheless, the fact remains that in this field the Treaty does not provide for any unification of the law by means of Council regulations.

Companies of the Community countries thus encounter certain difficulties which stem from the fact that the single market which is open to them is not matched by any single legal system. These difficulties could be overcome by the adoption of a system governing company law as well as fiscal, financial and social law in the Community, a system no longer divided by national frontiers.

As regards social law, the manner of safeguarding the rights of the companies' workers would have to be examined.

These are problems of cardinal importance, and the Commission of the European Economic Community has long been studying how they may be solved. The idea of setting up companies adapted to the requirements of the Common Market met with a somewhat lukewarm reception at first, but is now gaining more and more favour in business circles. A number of leading personalities in European industry and trade have recently put forward proposals in this sense.

The Union of Industries in the European Community, having first declared itself "open to any suggestions by the Commission in this matter," has recently formulated more precise recommendations as to the legal aspects. It considers that admission to the status of European company should not be subject to administrative authorization, and that a uniform law should do away with problems of geographical scope and reduce as far as possible the incidence of subsidiary law; finally it expresses the hope that measures will be adopted to forestall any possible divergences of interpretation by national courts. In its turn, the European Secretariat of the International Confederation of Free Trade Unions has shown particular interest in any move to promote industrial concentration which will help to speed up social progress.

In a Note dated 15 March 1965 the French Government, finally, suggested the creation of companies of "European type." The argument is that this innovation would help accomplish the general purposes of the Treaty of Rome, given that the movement of goods, services and capital within the Community would be facilitated by the existence of uniform legal provisions. Furthermore, the existence of "European" companies would create favourable conditions for international industrial combination. Implicitly, this proposal aims also at strengthening the competitive position of European firms in relation to third countries and at making them less dependent upon capital markets outside the Community. It is suggested that the proposed "European" company be introduced into the Member States by a uniform law.

The Commission welcomes the French proposal as an important step toward the solution of the economic and legal problems set out above.

In its view, a special form of incorporation would in fact enable Common Market firms to operate and develop more freely within this market. The Commission regards the creation of European companies as part of the creation of the Common Market.

The institution of European — incorporated companies will, first and foremost, provide the essential legal basis for attaining the following two aims:

a) Enabling companies to operate in any Community country

i) This presupposes legal arrangements by which companies incorporated in any one Member State are recognized by law in other Member States.

ii) It requires, furthermore, some procedure by which companies can transfer their registered office from one Member State to another without change of legal personality.

iii) Finally, companies having their registered office in one Member State should be able, without difficulties deriving from company law, financial law or fiscal law, to set up in another Member State either subsidiary companies or permanent establishments in the form of branches or agencies without legal personality.

b) Creation of large concerns on a Community scale

i) Arrangements need to be made first of all for the merger of companies incorporated in different countries, that is, for international mergers.

ii) In addition, companies incorporated in any one Member State should be able to acquire an interest in companies of another Member State. This means eliminating the obstacles and difficulties which obstruct such interlocking arrangements.

iii) It may well be advantageous for companies of different Member States to set up joint subsidiaries. Obstacles to this form of combination should also be eliminated.

All these problems have one feature in common: they concern business transactions out-

side the frontiers of a Member State and hence subject to two different legal systems.

The new legal arrangements must help in the solution of these economic problems, which are of crucial importance for the Common Market.

To throw light on the choice of possible arrangements, Section II below discusses the various legal solutions afforded by the Treaty of Rome, and Section III those afforded by the creation of a new type of company, to be styled European company.

II. LEGAL SOLUTIONS UNDER THE TREATY OF ROME

A. Enabling companies to operate in any Community country

In general terms, the Member States are required to abolish all discrimination with respect to freedom of establishment and freedom to supply services, as well as to facilitate the geographical expansion of the activities of all companies incorporated in any one Member State especially by the establishment of agencies, branches or subsidiaries in other Member States (Articles 52 to 58).

Four legal questions need to be examined in this context, all of them directly relevant to the extension of company activities to the whole of the Common Market.

1. Recognition of companies — Article 220 of the Treaty of Rome

Article 220 of the Treaty requires Member States to enter into negotiations with a view, among other things, to "the mutual recognition of firms or companies as defined in Article 58, second paragraph". These negotiations are to lead to the adoption of a convention by which Member Governments undertake to recognize any companies as defined by Article 58 which are incorporated in another Member State.

A draft intergovernmental convention on the mutual recognition of companies has accordingly been prepared by a working party of government experts in collaboration with the Commission.

2. Co-ordination of guarantees under company law — Article 54(3,g) of the Treaty of Rome

Work on the co-ordination of guarantees required under company law to protect the interests of members of a company and third parties, as required by Article 54(3, g), is at present going forward on the following lines.

a) Co-ordination will first reach a certain degree of uniformity of the law, so as to facilitate the actual exercise of freedom of establishment as well as access to credit and other sources of finance; it must, secondly, ensure that abolition of restrictions on establishment does not cause serious economic disturbances; it must, finally, prevent any shifts of business activities and capital in response to varying degrees of rigour of the different countries' laws rather than according to real economic factors.

b) The preparatory work for directives on co-ordination is done by the Commission in collaboration with a group of experts from the six member countries.

By the end of 1963, this group had got as far as preparing a draft directive on the co-ordination of provisions relating to public announcement, the validity of commitments, and nullity of association of companies limited by shares *(sociétés par actions)*, partnerships limited by shares *(sociétés en commandite par actions)* and private limited companies *(sociétés à responsabilité limitée)*. This draft formed the basis of a formal proposal submitted by the Commission to the Council on 21 February 1964.

The experts are now preparing a second directive, on co-ordination of the law governing joint stock companies *(sociétés anonymes)*. This draft proposes co-ordination in the following fields: rules governing incorporation, proper use of capital, subsidiairies and reciprocal equity holdings, increase of capital, reduction of capital.

Studies are now in hand on the following subjects:

1. Organization, structure and control of joint stock companies;

2. Securities (classes of shares, characteristics of shares, rights attaching thereto, debentures, etc.);

3. The balance sheet and profit and loss account of joint stock companies, and related problems.

Other aspects of the law governing joint stock companies as well as problems relating to other types of company will be examined later; in the meantime, experts or specialized institutes have been asked to undertake preliminary studies.

c) The most important prospects opened up by co-ordination include the following.

a. As regards legal security in Community dealings of this kind and, hence, an increase in their volume: Any shareholder in a company in another Member State, or any creditor of such a company, must be sure that his interests are safeguarded as well as with a company of corresponding type in his own country.

b. As regards economic security: Equivalence of the law, and especially the legal obligations, with which companies in the six countries of the EEC must comply is necessary, as was pointed out above, in order to avoid activities and capital being shifted not in accordance with real factors governing the choice of location, but instead in response to the greater or lesser rigour with which company law enforces safeguards in different countries. Thus co-ordination is an indispensable prerequisite of balanced development in conditions of effective competition.

c. As regards financial facilities: After the elimination or, at least, a considerable narrowing of the major divergences between the legal rules governing the memorandum and articles of association of different types of companies in the six EEC countries, any Member State will more readily allow companies incorporated in another Member State access to credit and the raising of capital by security issues.

To this end, co-ordination of the rules governing the preparation of balance sheets and profit and loss accounts is of particular importance.

d. As regards the establishment and management of subsidiary companies: It has happened in the past that a company set up a subsidiary in another Member State, or that several companies set up a joint subsidiary in different Member States.

However, legal differences obstruct relations between the parent company and its subsidiaries, and more generally the management of the whole group of which they form part. An attempt is being made to diminish the relevant legal differences by co-ordination. In this field, the experts have already identified the factors which must enter into the legal definition of the concepts of a subsidiary and a combine.

e. As regards participation: The working group has examined the possibilities of harmonizing the restrictions which the law places on reciprocal equity holdings in the six Member States.

f. As regards international mergers: Co-ordination of the provisions governing mergers in the domestic law of the six Member States should make it easier to arrive at a convention on international mergers.

3. Transfer of registered office

The maintenance of legal personality where a company's registered office is transferred from one Member State to another raises problems under company law and under fiscal law.

a) Problems under company law

Article 220 of the Treaty requires Member States to enter into negotiations with a view to "the maintenance of ... legal personality, if [the] registered office is transferred from one country to another."

In this case, too, the negotiations are to lead to the adoption of a convention which should solve the problem of how a company can transfer its head office from one Member State to another while maintaining its legal personality.

When a company is formed, the location of its registered office determines the law to which the company will be subject; a transfer of its registered office therefore involves for the company a change of the law to which it is subject. It is not possible in case of such transfer to remain subject to the law applying to the original registered office. A situation in which a company having its registered office in one country is subject to foreign law would, in fact, constitute a serious menace to legal security in the countries concerned. But if a transfer of registered office involves a change in the applicable law, the question is whether a company can pass under another law and yet maintain its legal personality, since the latter derives from the law under which the company was incorporated. If the answer is in the affirmative, there arises the further question whether adaptation to the new law requires new incorporation. This problem is especially important in cases where a company which transfers its registered office to another country is of a type which does not exist under the latter country's law.

The main thing which a convention ought to do is to prevent the legislators of the various countries concerned — the country of original incorporation, the new host country and, as far as possible, all third countries — from arriving at divergent conclusions in the legal interpretation of a transfer of registered office, for this would create legal insecurity within the Community.

The laws of Member States do in fact deal in different manner with the problem of the transfer of a company's registered office out of or into their country.

b) Problems under fiscal law

If companies are to be enabled to carry on business anywhere in the Community, harmonization of company law will have to be accompanied by harmonization of fiscal law. The main taxes to be harmonized are turnover tax and the tax on company profits. Without such harmonization, competition may be distorted or companies might be tempted to transfer their registered office into whatever country offers the most advantage from the taxation point of view.

A legal basis for the approximation of fiscal law exists in Articles 99, 100 and 101 of the Treaty.

As regards the harmonization of turnover taxes, two draft directives have so far been submitted to the Council; both propose the introduction of a common system of taxation on value added (TVA) in all Member States.

The problem of harmonizing on company profits cannot be solved without prior clarification of a number of important questions, including the definition of taxable profits, tax structure, tax rates, withholding taxes on incomes from securities, and double taxation (companies and shareholders). Some work on this subject has already been done.

Furthermore, the transfer of a company's registered office raises a number of special problems under fiscal law. The first question is whether, and how, to tax profits already earned but not yet taxed in the country out of which the company transfers. Reassessment in the new host country may bring to light hidden profits arising from higher depreciation allowances, as well as other undisclosed reserves. These problems link up with those of international mergers which are now under study, and seem to be susceptible of a number of different solutions.

As regards current profits, the company would, in the absence of special arrangements, become subject to the fiscal law of the country to which it transfers its registered office, except for any establishment which remains in the original country and will continue to be subject to the latter's fiscal law.

4. Foreign subsidiaries

The establishment of subsidiary companies in another country, a case already mentioned above in connection with co-ordination on the basis of Article 54 (3, g) of the Treaty, raises problems which have to do less with company law than with financial and fiscal law.

a) Problems under company law

The establishment of a subsidiary company by a foreign company does not, in principle, occasion any difficulties under company law in any Member State, given that foreign individuals and corporations may acquire an interest in domestic companies. If there exist discriminations to the detriment of foreign nationals, whether individuals or companies, these discriminations will have to be removed in compliance with Article 52, second paragraph, on the right of establishment.

It is obvious that a subsidiary can be set up in any Member State only in accordance with the latter's law . This implies that the parent company and the subsidiary company will be subject to different laws. If a subsidiary company is set up abroad for the purpose of making the advantages of freedom of establishment available to the whole concern, this difference may have a harmful effect on that concern's organization and management. In the case of small and medium-size firms, ignorance of the legal requirements in the country where the subsidiary is to be set up may constitute a major obstacle. Furthermore, at present no subsidiary companies whose equity is wholly owned by the parent company may be set up in France, Belgium and Luxembourg, nor may an existing subsidiary in these countries continue in existence after withdrawal of all shareholders except one — the reason being that these countries do not recognize one-man companies.

b) Problems under financial law

Though the establishment of foreign subsidiaries raises no problems deriving primarily from company law, it does raise problems under financial law.

First of all, arrangements will need to be made to facilitate the transfer of capital as well as free access to the capital markets of Member States. Free capital movement is indispensable for the establishment of foreign

subsidiaries. Generally some of the parent company's capital, that is, domestic capital, will have to be transferred abroad. Free movement of capital is also necessary so that the foreign subsidiary's profits may be remitted to the parent company. Indirectly, the relations between a parent company and its subsidiary are generally affected also by difficulties connected with the circulation of foreign securities, their admission to quotation on domestic stock exchanges and their eligibility for inclusion in the portfolios of institutional investors. These problems have already been touched upon in the Introduction.

Two directives in pursuance of Article 67 of the Treaty have so far been issued, to provide for the abolition of exchange control on numerous classes of financial transaction. A proposal for a third directive is now before the Council; this is concerned with the elimination of Member States' discriminatory provisions in respect of the issue of foreign securities, their introduction on stock markets and their eligibility for inclusion in the portfolios of institutional investors.

Other problems to which attention is drawn are connected with the floating of loans, the placing of securities with certain institutions and access to bank credit in a Member State other than that in which the company concerned has its registered office. In this field the rules imposed by financial law and company law, as well as those governing public announcement, are so closely interwoven that any scheme for the co-ordination of financial law presupposes one for the co-ordination of company law.

c) Problems under fiscal law

The problems which arise under fiscal law include those of double taxation as between different countries and of double taxation of distributed profits in one and the same country.

There exists a network of bilateral agreements between Member States with a view to avoiding international double taxation. However, there are still some gaps in this network; there is as yet no double taxation agreement between Belgium and Germany [1], Luxembourg and the Netherlands, and Luxembourg and Italy. Several of these agreements were concluded a long time ago and have become obsolete. The desirability of replacing these bilateral agreements by a multilateral convention is now under study.

The establishment of subsidiary companies raises the problem of how distributed profits are to be treated for tax purposes. Double taxation in the same country is avoided if the profits distributed by the parent company or the subsidiary company are taxed only once, in the hands of the parent company or in those of the subsidiary.

Member States apply different methods in order to avoid taxing both the parent company and its domestic subsidiaries. There are further differences between countries in the degree to which double taxation is in fact eliminated, with the frequent result of discouraging a domestic company from acquiring an interest in a foreign one.

In addition, there are differences in taxes on company profits, especially as regards taxation at the source. These differences, too, may impair the liberalization of capital movements and many call forth capital movements solely for fiscal reasons. This is another matter which has a bearing on the establishment of subsidiaries.

Finally, there is the important question of duties on capital movements. If the shares and other securities issued by a company incorporated in one Member State are to circulate freely throughout the Community, this presupposes the absence of any charge upon crossing frontiers. It follows that the same treatment must be accorded to securities regardless of their country of origin. Otherwise, capital available in any given Member State would be at a disadvantage in relation to capital originating in other Member States if this is subject to less heavy taxation.

The Commission has accordingly submitted to the Council a proposal for a directive which would abolish stamp duties on securities and which provides at the same time for harmonization of charges on capital subscriptions.

(1) Such an agreement was recently signed, but still awaits ratification.

B. Creation of large concerns

5. International mergers

There exists no international law governing company mergers in the sense of a body of rules subsuming national legal provisions and making it possible for two or more firms subject to different legislation to amalgamate into a single legal entity. In some countries the law recognizes international mergers in the form of a foreign company being taken

over by a domestic one. Italy is the only country where the law also provides for the takeover of a domestic by a foreign company.

In regard to this matter Article 220 of the Treaty requires Member States to enter into negotiations with a view to "the possibility of mergers between firms and companies which are subject to different domestic laws."

The purpose of these negotiations would be the adoption of a convention creating the necessary legal facilities.

The government experts who prepared the draft convention on the mutual recognition of firms and companies on the conclusion of their work expressed the hope that priority would be given to problems connected with international mergers, which were among the most urgent.

It must be stressed that the pertinent arrangements need to cover all existing types of companies and that, given the number of possible cases to examine, it is unlikely that such a draft convention can be prepared in the near future.

In its turn, the question of international mergers raises problems under company law and under fiscal law.

a) Problems under company law

So far as company law is concerned, the particular difficulties involved in international mergers of companies incorporated in different Member States stem from differences in the relevant municipal laws and from the territorial limitation of their applicability.

For companies to merge, their representatives have to take certain steps together. Their legal acts must have effect outside the country in which they are executed.

A solution might be found in first establishing rules under which companies can transfer their registered office from one country to another while maintaining their legal personality. A merger could take place under municipal law, at the same time or later, in the form either of a takeover or of the establishment of a new company involving the disappearance of the individual companies which amalgamate therein. This procedure implies the successive application of treaty law and municipal law and is too slow and cumbersome.

Another solution that comes to mind is amalgamation in a single step. To this end, a uniform definition of the prior conditions and formalities for amalgamation would be needed. This solution, which looks so simple at first sight, would, however, raise a major difficulty in so far as it rests on a generalization of the principle of universal succession, that is, the transfer, without prior liquidation, of assets and liabilities to the acquiring company or the newly formed company. Since this principle is alien to the law of several Member States, there will no doubt be international difficulties in defining it for purposes of company law. This system would, furthermore, require rules governing conflict of laws. Finally, it would be necessary to ensure that decisions of the general shareholders' meetings of the amalgamating companies and such legal acts as may be required, e.g., entry in the Commercial Register, have identical effects in all member countries.

Such a solution could be achieved by coordination of the relevant domestic laws and by a multilateral convention between Member States on the basis of Article 220 of the Treaty of Rome. It would amount to partial equivalence of the law, but it would not do away with the psychological disadvantage of a company's having to change its nationality when it is taken over by a foreign company; the same disadvantage arises in the case of a transfer of registered office.

b) Problems under fiscal law

An international merger raises virtually the same problems under fiscal law as does the transfer of a registered office. It presupposes harmonization of company taxation (turnover tax and profits tax) in all Member States, for otherwise international mergers would be carried out not on business grounds but simply in order to take advantage of differences in fiscal treatment. In individual cases, there will again be fiscal problems in connection with the taxation of profits not yet taxed in the country of origin and with the taxation of current profits.

Given that, from the point of view of fiscal law, only such capital appreciation should be regarded as taxable as is actually realized and not merely shown in the books, and that furthermore the merger of two companies, whether on the national or the international plane, generally involves no realization of capital gains but merely a new legal ranking of assets, taxation at the moment of merger should be abolished. If capital gains are subsequently realized by the new company, they should be subject to the general tax system in the country of location. Various possible fiscal methods are at present under study.

6. International interlocking arrangements

a) Problems under company law

Economically speaking, it would be possible to create larger concerns adapted to the scale of the Common Market and yet maintain the legal independence of domestic companies as well as their subjection to the law of their country, simply by allowing a company to acquire a large part of another, foreign company's share capital. Legally, such arrangements most often take the form of one company becoming associated with another; economically, they assume a certain importance when the company concerned can, by exercising its rights as an associate, control the management of the company in which it has a stake. When the controlling company owns a majority holding, its influence is preponderant; it is dominant when other shareholdings do not amount to the minimum percentage (25 or 10 per cent) required by the law of different countries to block certain decisions by the shareholders' meeting, which are valid only when taken by a vote representing 75 or 90 per cent of the capital.

In some Member States (the Netherlands, Germany), this form of setting up large units (groups of companies) is more usual than the merger of two companies into a single legal entity.

Such participation entails no great difficulties under company law. As in the case of the establishment of subsidiary companies, provisions concerned with the freedom of establishment will have to eliminate such discrimination as may exist against nationals or companies of Member States, even if it applies only to control through preponderant or dominant equity holdings.

However, it should be noted that participation in foreign companies is subject to foreign law, that is, to the law governing the company in which a stake is held. This means that in this case, too, there are differences in the law applicable to the controlling company and the company controlled, and hence differences within one and the same concern. This may have a considerable bearing on the grouping of companies belonging to different Member States, which is a desirable economic process.

In addition to this form of control and often in conjunction with it, companies may interlock through a profit-sharing *(Organschaft)* agreement. These agreements vary in scope and content, but their economic purpose is likewise the control of dependent companies. Interlocking arrangements between companies on the international plane by the conclusion of profit-sharing agreements with foreign companies are similarly rendered difficult, if not impossible, by differences in the law. In addition to these differences, it is not clear what law is applicable to these agreements. Under private international law in the various Member States the criterion of domicile in questions falling under company law (in this case, the question of what law is applicable to interests held in foreign companies) is the head office or registered office of the company in which rights are exercised; but profit-sharing agreements leave open the question of what real factor is to be taken as a criterion of domicile. Possible criteria to be considered are the place where the agreement was concluded, the intention of the parties, the registered office or head office of the controlling company or the company controlled.

b) Problems under financial law

Apart from the problems which arise under company law and private international law, interlocking arrangements between companies of different nationality again raise problems under financial law. Even if, by virtue of the Treaty of Rome or of the Council directives on participation in companies by way of direct investment, exchange controls are eliminated for transactions connected with the contribution of subsidiaries to the overhead costs of the parent company and vice versa, as well as with the repatriation of profits, there are still difficulties in raising capital for a combine as a whole where it is a question of drawing on the capital markets of all the Member States in which the concern has establishments.

c) Problems under fiscal law

Under fiscal law, the same problems arise as in the case of the establishment of subsidiaries, namely, the problems of international double taxation and of double taxation in the same country of the profits earned by the controlled company.

These fiscal problems need to be solved simultaneously with the problem of company law. It is in this field alone that any solutions from the point of view of company law and of financial law can take economic effect.

7. Joint subsidiaries

The establishment of joint subsidiaries by companies of different Member States is a suitable means of creating larger concerns better adapted to the Common Market. From the point of view of company law, financial law and fiscal law the problems here are the same as in the case of ordinary subsidiaries

or part interests. Under the company law of all Member States companies can acquire an interest in foreign companies; as regards financial law, the questions to be settled are those of free capital movement; and as regards fiscal law, double taxation whether international or national must be avoided.

Once more, the chief economic obstacle stems from differences in the law applicable to one of the parent companies, on the one hand, and to the foreign joint subsidiary, on the other. Joint subsidiaries, too, are subject to the law of the country in which they have their registered office, that is, generally, to the law under which they have been set up. It should be added that where the joint subsidiary is subject to the same law as one of the parent companies, this latter will, at equal financial stakes, have a stronger *de facto* influence than the other foreign parent companies, because of the identity of legal conditions. If the joint subsidiary is established in a third country, the problems are the same as in the case of the establishment of a subsidiary by one company alone.

8. Conclusion

In examining the possible solutions offered by the Treaty of Rome to meet the requirements discussed above — namely, to help business companies spread their activities beyond national frontiers and to promote industrial combination within the Common Market — it will be seen that, while the Treaty's possibilities are real enough, they fall short of economic needs and make no room for the unification of company law. Articles 52 to 58 give companies the benefit of freedom of establishment and thereby the opportunity to expand beyond the frontiers of the country where they have their registered office by setting up either subsidiary companies or branches. Even if the relations between a company's registered office and its branches or agencies abroad are governed by the same law throughout the Community, the relations between a parent company and its subsidiaries still remain affected by differences in the law applicable within and outside the frontiers, which differences cannot be eliminated complety by co-ordination. Article 54(3, g) aims at narrowing the differences of law in the six Member States and should thus greatly facilitate legal relations between one country and another in so far as they concern companies, and enhance the security of these relations. But it points no way to any solution in situations simultaneously involving the law in several countries, situations which will of necessity be a prominent feature of the Community economy.

Article 220 proceeds from the existence of six legal orders; it seeks to reconcile them while leaving them intact. This method is to be applied to all types of companies, and because of this very intent is bound to be lengthy and laborious; nor, of course, does it make room for any unification of the law. If a company wants to transfer its registered office from one country to another, for example, the change from one legal system to another will always require a change in the company's articles so long as no uniform type of company exists.

In the financial and fiscal fields, Articles 67 et seqq. and Articles 99 and 100 open the way for a number of measures necessary in order to eliminate the obstacles which firms of European scale encounter in this respect.

III. LEGAL SOLUTIONS BY THE CREATION OF A "EUROPEAN" COMPANY

Section 1

ENACTMENT OF A UNIFORM LAW

Another way to solve the economic problems discussed above would be to create a new and uniform type of company, a company of European type, alongside the existing types of company in various countries. This legal form might be introduced into the law of all Member States by the enactment of a uniform law. This would constitute progress in comparison with what can be done under the Treaty of Rome. It is the method proposed by the French Government in its Note of 15 March 1965.

The solutions thus offered for important economic problems are discussed below.

The creation of European companies would lead to a certain unification of law. Their

European character would be expressed in the formal identity of the legal rules under which they would be incorporated in the different Member States and to which they would be subject. Material identity would be afforded only by the uniform application of this uniform law in practice and in the courts, more especially by the institution of a single judicial authority for the interpretation of this law. Material identity, in its turn, may in the longer term lead towards unification of the law, an objective which is also mentioned in the French Note. There is no doubt that legal identity so understood can do much to promote economic relations within the Common Market.

But the introduction of a standard type of company in all Member States cannot as such vouchsafe complete legal unification. A European company under the uniform law would still remain subject to domestic law in all Member States. This applies to law applicable in a subsidiary manner. Since this subsidiary law differs from one Member State to another, there would still be no complete legal identity with respect to European companies belonging to distinct legal systems. At least, however, the law applicable to one and the same company would be homogeneous, pending more far-reaching harmonization, for instance, of commercial law.

There is the further question whether the uniform law could finally govern situations involving the simultaneous application of the law of several countries, or whether, in addition to the uniform law, international agreements are needed to establish supplementary rules, in such situations as regards legal relations between countries, on the transition from one legal system to another or the combination of several different legal systems. The terms of this problem will now be examined.

A. Enabling companies to operate in any Community country

9. Recognition of companies

The creation of a standard type of company in the six Member States does not necessarily imply automatic legal recognition of foreign companies of this type in other Member States. However, the convention on the mutual recognition of companies, which already exists in draft, would become applicable to these companies and the problem of their recognition would thus be solved.

10. Transfer of registered office

Given that the uniform law would still be domestic legislation, the transfer of a company's registered office would, in this case too, imply a change of the law applicable. But the uniform law would have this advantage over solutions under the Treaty of Rome, that the European company would not need to undergo any formal transformation, nor any adaptation to the law of the country to which it transfers its headquarters, since the same legal form would exist in both countries concerned in the transfer. By contrast, the other problems connected with a transfer of registered office, as set out above on p. 8, would not be solved by the uniform law as such, but by the convention envisaged in Article 220 with a view to enabling such transfers of registered office to take place.

From the point of view of fiscal law, the same problems arise as were discussed in connection with the implications of Article 220.

11. Foreign subsidiaries

One of the arguments which have been put forward in support of the creation of a European company is that it would facilitate the establishment of subsidiaries. This would apply, on the one hand, to medium-sized firms with an imperfect knowledge of the law of the country where they wish to set up a subsidiary. A familiar legal form would remove this handicap. It would also give large concerns a chance of more effective control over several subsidiaries. These are unquestionable advantages. It should be recalled, however, that (as was seen above on pp. 8 and 9) the establishment of subsidiaries raises no insoluble problems under company law, and that the main problems arise rather under financial and fiscal law.

B. Creation of large concerns

12. International mergers

As the French Note rightly points out, the introduction of a standard type of company would, just as in the case of a transfer of registered office, simplify the formalities for the merger of companies subject to different domestic laws. Given that the amalgamating companies would be of the same type, it would be unnecessary to proceed to reincorporation or to any adaptation to the legal form of the take-over company or the company to be newly established. To this extent there would be simplification. The psychological difficulty of companies having to change their nationality would remain.

The proposed uniform law cannot by itself solve the legal difficulties involved in international mergers. To promote international mergers, it would have to be supplemented by rules governing the transition from one jurisdiction to another or the combination of several different jurisdictions; these rules would have to form part of the convention to be adopted in pursuance of Article 220.

13. International interlocking arrangements through acquisition of part interest

Identity of company type would offer attractions for capital investment, since companies of the same type throughout the Community would provide equal security. This would certainly be progress in comparison with possible solutions under the Treaty of Rome which, in the matter international participation, assumes the existence of different legal systems. However, whether capital is invested in loan stock or equities, security does not depend solely upon the type of company in which the investment is made. It depends also on a whole set of other factors which have nothing to do with the type of company (publication of particulars, stock exchange legislation). It follows that there would be no great difference compared with the present legal situation. The main problems are of a financial or fiscal nature. Without common jurisdiction, the only uniformity achieved would be one of legal company structure. This limitation would be most felt in relations between two companies located in different Member States when one of these companies has a controlling shareholding in the other.

As regards the dominant situation of any company by virtue of a profit-sharing agreement, the same considerations apply as were set out above.

14. Joint subsidiaries

The establishment of joint subsidiaries by firms belonging to different Member States would no doubt be facilitated by the creation of a standard type for the companies concerned. The participating firms could progressively transfer business to these subsidiary companies and merge their interests in them.

15. Conclusion

The introduction of a uniform law would help companies to carry on business troughout the Common Market and would facilitate the establishment of rules for international participation and international mergers. It would thereby represent progress in comparison with the solutions afforded by the Treaty of Rome. A uniform law would not, however, completely solve the two main problems involving the concomitant application of different legal systems, namely, the transfer of a company's registered office and international mergers. Supplementary provisions would need to be adopted. A standard type of company would constitute a first step along the road to general harmonization of the law and would without doubt help to facilitate economic relations among Member States. It would of course, be necessary to arrange for the application of the uniform law to be subject to a single judicial authority, as indeed the French Note proposes.

Section 2

EUROPEAN LAW

A standard legal type could be introduced also by the incorporation of companies under "European law". A solution on the basis of "European law" would have three characteristics: the convention creating a European company would supplement the Treaty

of Rome in so far as, being concluded by the same countries, it would serve the achievement of the Treaty's purposes, and it should have general and direct effects in the Member States; this legal form would, however, differ from the European company under national law in that it would not be introduced by a domestic statute into the law of Member States, but would constitute "European law" alongside the Member States' domestic law.

The key question is again the extent to which the introduction of this type of company would help in solving the problems involving the simultaneous application of the law of several countries.

A. Enabling companies to operate in any Community country

16. Recognition of companies

It goes without saying that companies set up by virtue of a convention between Member States on the incorporation of companies under European law would be recognized in all Member States. The concept of recognition presupposes a company subject to foreign law. Since European law is not foreign law in any Member State, there is no problem of recognition in the case of this type of company.

17. Transfer of registered office

A transfer of registered office implies, as was shown above, a change in the law to which the company concerned is subject. Hence a company which so transfers its headquarters must be reincorporated or must adapt to the law of the country to which the registered office is transferred. A European-incorporated company would be subject to European law, which is equally valid in all Member States. If such a company were to transfer its registered office from one Member State to another, this would, barring only the determination of subsidiary law, signify no change whatever as regards the content and quality of the applicable law and would entail neither transformation nor adaptation for the company. In practice, such a company could transfer its registered office abroad just as it could transfer it within a Member State.

18. Foreign subsidiaries

While incorporation under European law affords the most satisfactory solution, from the point of view of company law, for the two crucial problems of transfer of registered office abroad and international mergers, it would offer the same advantages for the establishment of subsidiaries as would incorporation under a uniform law enacted nationally. Medium-sized companies would be similarly induced to set up subsidiary companies in another Member State if there were a type of company they know, and similarly again this type of company would give large concerns better control over the activities of several subsidiaries of this type in different Member States, because of the legal identity of company form. More generally speaking, the business risks of a company's being subject to foreign law would be eliminated.

As in the case of European companies under national law, there is, in this case too, a problem of the extent of legal unification (see pp. 14 and 18).

The establishment of subsidiaries in the legal form of European company under European law also raises problems under fiscal and financial law, problems the solution of which will have to be sought by means of the same convention.

B. Creation of large concerns

19. International mergers

Companies incorporated under the law of different Member States and wishing to amalgamate should, to this end, be able to take advantage of the legal form of incorporation under European law. Companies from different countries might merge by setting up a European company to which each of the national companies involved would hand over the whole of its assets against shares in the new company (merger by reincorporation).

Provision should also be made for European companies under European law to merge with each other. This might be done either by the establishment of a new company under European law, or by the transfer of the whole of one European company's assets to another against the latter's shares (merger by takeover). Since the amalgamating companies are of the same legal type and are subject to the same European law, there should be no difficulty whatever in providing for such cases in the convention establishing the legal form of companies under European law. The problem of subsidiary law will be more conveniently discussed on later pages.

Provision will, finally, need to be made for the case of companies incorporated under European law wishing to amalgamate with companies incorporated under national law. As above, mergers could take place by re-incorporation, a new company being set up under European law, or by takeover.

The convention should, furthermore, require safeguards for the minority shareholders and creditors of domestic companies absorbed by a European company, such as transfer to the European company of all the assets and liabilities of the domestic companies concerned without prior liquidation, decisions by the shareholders' meeting on the merger agreement, financial particulars of the merger, publication, etc.

Compared with the arrangements that might be made on the basis of Article 220, paragraph 3, of the Treaty, the scheme here proposed would have the advantage that the sureties to be provided by the European company as a takeover company could be determined in a uniform and very firm manner. However, to permit merger in one single step in the case of European companies taking over conventional companies it would still be necessary to harmonize the various domestic legal provisions which govern domestic mergers; this would be required, on the one hand, to permit the transfer of all the assets and liabilities of conventional companies, and on the other hand in order to avoid the rights of the creditors and shareholders of the different national companies involved in the merger receiving different treatment. However, mergers through the intermediary of a company incorporated under European law would involve no longer a change of nationality, but "Europeanization".

20. International interlocking arrangements through acquisition of part interest

The legal form of a company incorporated under European law would afford the same security for international interlocking arrangements, that is, essentially, for investments, as does the European company incorporated under national law. This security would derive from the identical organizational form of the companies concerned.

There would be no fundamental problems under company law, as was shown above, given that a European company could acquire shares in national companies or, conversely, make over to them some of its own share capital. The essential aspects of the solution would fall under financial law and fiscal law.

The different variants of interlocking arrangements between companies raise certain problems in connection, especially, with the law applicable to these relations. But these problems are the same as those which arise generally in cases where a company acquires an interest in a foreign company.

21. Joint subsidiaries

Because a company incorporated under European law has greater mobility, its institution would foster the establishment of joint subsidiaries by companies preserving their national character, so that the firms concerned could gradually merge their interests in these subsidiaries and eventually be absorbed by them.

Incorporation under European law offers the advantage that none of the participating companies need incur the risks involved in setting up and managing an establishment subject to foreign law. For such problems as may arise from the application of subsidiary law, see pp. 14 and 18.

The establishment of joint subsidiaries in the form of companies incorporated under European law might well prove a method of interlocking for Common Market firms of which widespread use may be made for economic, legal and psychological reasons, provided free competition is not impaired thereby.

For the rest, the problems arising under company law, fiscal law and financial law are the same as in the case of a single company setting up subsidiaries. Again, the degree of legal unification achieved will depend on how comprehensive the chosen solution is and on the need to apply subsidiary law.

C. Other questions connected with European-incorporated companies

22. Principles of eligibility

A company incorporated under European law should be a joint stock company endowed with legal capacity, that is, the capacity to assume rights and obligations in its own name. Legal capacity may be obtained in two ways. First, it may be granted by a public authority, which does so on having satisfied itself that certain legal conditions are fulfilled by the company. In principle, this investigation covers also the question whether the company's proposed activities are necessary. Thus the public authority has discretionary power. Legal capacity may also derive from the company's incorporation in conformity with the conditions laid down by law and from its fulfilment of the requisite formalities, e.g., entry in the Commercial Register.

There is in this case no examination for desirability. Subject to compliance with the conditions laid down by law, the authorities responsible, say, for registration have no discretionary power.

The problem consists in determining the scope of the material conditions for a European company, that is, in setting standards for the creation of a category of companies subject to European law. It would be desirable to preserve the system of legal conditions now current in nearly all Member States, the Netherlands being the only partial exception.

It remains to consider the implications of general and immediate access for all companies to the new legal form.

23. Subsidiary law

Subsidiary law is generally understood to mean law applicable only in the event that the principal source of law contains no provision for given case. Subsidiary law then fills in the gaps. It follows that subsidiary law will be of greater or lesser importance according to the precision and differentiation of the rules governing any case by virtue of a statute or a convention. Subsidiary law may derive either from the body of law whose deficiencies are so to be made good, or from another. In the case of a convention for the creation of European companies under European law this means that subsidiary law may equally well derive from European law or from national law. What solution is preferable, and to what extent is it possible to make sure that the preferred solution will take effect?

A first alternative would be to use national law to fill in the gaps left by the convention. This might be done by laying down in the convention itself that the subsidiary law should be that of the country in which the European company has its registered office. This solution was adopted, for example, in the case of the *Société Internationale de la Moselle*, which has its headquaters at Trier and is subject to German subsidiary law. Apart from the fact that a uniform application of this principle would require that the convention lay down a definition of headquarters, this system would cause a European company to be subject to two different legal systems, one national and the other European. Furthermore, subsidiary law applied to a European company would then differ according to the location of its headquarters in one or the other Member State. It would indeed be possible with this system to fill in completely any gaps in European law, but there would be difficulties in determining the scope of applicability of the one or the other system of law. What is more serious, the European rules would cease to be uniform the very moment they entered into force. Examples to quote in this context are the Geneva conventions of 7 June 1930 and 19 March 1931 on the unification of the law applying to bills of exchange and cheques; in the absence of a single supreme jurisdiction and by virtue of the subsidiary application of national law, the application and interpretation of these conventions went their several ways. In practice, the implementation of certain provisions essential for the operation and administration of the companies concerned would lead to divergences, because the concepts contained in these provisions would be interpreted differently according to such national law as might be applied subsidiarily where needed. Examples which come to mind in this connection are provisions relating to powers of directors, the concept and limits of wrongful acts in business (slight or serious negligence, fraud), the concepts of abuse of majority, damages, and just grounds for the dismissal of directors. This disadvantage could not even be avoided by giving a single supreme court, for instance the Court of Justice of the European Communities in Luxembourg, competence for the interpretation and application of the convention on the creation of a European-incorporated company; common jurisdiction cannot achieve legal unity if it has to apply different national laws whenever gaps have to be filled in by subsidiary law.

Alternatively, a solution may be sought under which gaps in the convention on the creation of the new legal form of company would

be filled in by European law. The pertinent European law might be created by the Court on its own authority, judiciously expanding the principles contained in the convention. One might draw on the example of the French-German company *Union Charbonnière Sarro-Lorraine*, where provision is made for subsidiary law to be the law resulting from the common principles in the legislation of the two countries, applied in a spirit of co-operation. Another conceivable solution is to follow the terms of Article 17 of the draft uniform law on the international sale of goods, prepared by the Diplomatic Conference at the Hague, which lays down that questions arising in fields governed by that law but not explicitly settled by it shall be settled according to the general principles on which it rests. If the convention itself were to rule on essential points not falling under company law, the number of such questions could be kept down. Points so to be covered might include those mentioned in the preceding paragraph. The widening of European law by the adoption of other conventions tending to unify the law would, at the same time, contribute to the development of a body of law deriving from common principles.

24. Interpretation of the law

The creation of a form of company incorporated under European law raises the question of what court should interpret and, if need be, expand the underlying legal provisions.

There exists no court of a federal character in the European Economic Community. It follows that the application and interpretation of European law would have to be entrusted to national courts. This is not, in itself, open to objections from the legal point of view, since it is perfectly possible for domestic courts to apply international or foreign law. The problem is rather one of uniform legal interpretation, which is the only safeguard for the lasting material equivalence of a law formally unified by the introduction of identical legal forms.

Unity of case law can be ensured only by placing the interpretation of the proposed law in the hands of a single court which will harmonize the divergent views of national courts. Such uniform interpretation is of decisive importance, as it is in all questions of equivalent or identical law.

The supreme court for the application, interpretation and development of the law governing European companies might be the Court of Justice of the European Communities.

25. Problems of social law

The creation of new legal forms designed to facilitate the transfer of registered office, the establishment of joint subsidiaries, and international mergers must make due allowance for the question of workers' representation within the firm. This representation takes various forms in the countries of the European Economic Community; mere information, consultation and even sharing in management. In some cases, workers also have a share in trading profits or in the company's productive investments. A careful study will have to be made, therefore, of the bearing which the creation of European companies may have on these questions.

IV. CONCLUSIONS

Three possible solutions have been examined in this memorandum: first, one deriving from the Treaty of Rome (Articles 54(3, g); 100 and 220, third sub-paragraph); secondly, the creation of a European company incorporated under a uniform law to be introduced in all Member States; and thirdly, the creation of a European company incorporated under European law by virtue of a convention complementary to the Treaty of Rome in that it would serve the aims of the Treaty, be concluded by the same countries and have general and immediate effects.

1. These solutions have been examined in the light of the Community's objectives — to facilitate the activities of companies beyond national frontiers and to encourage desirable combinations which will enable firms to adapt themselves to a large European market, to technological progress, to the requirements of modern research and, above all, to international competition. It has been shown that the possibilities afforded by the Treaty of Rome do not fully meet economic needs and, from the economic and the legal point of view alike, can provide only

fragmentary solutions for the various problems arising.

2. Only two solutions merit consideration:

a) The creation of a European company by a uniform law. This solution is certainly a step forward, in so far as it leads, at least for one type of company, to unification of the essentials of applicable law. This unity of legal form would improve the opportunities to establish and control subsidiaries; by offering equal safeguards for shareholders and creditors, it would tend to give companies easier access to the capital markets of all member countries; it would facilitate participation between firms of different Member States and would enhance the legal security of business relations in so far as this new form of company is adopted in the business world. As regards the problems of transfer of registered office and of international mergers, the uniform law would, however, need to be supplemented either under Article 220 of the Treaty, which would necessarily involve a lengthy and complicated procedure, or by equivalent provisions in the convention on the uniform law itself.

b) The other possible solution is the creation of a company under European law. This solution has the advantage of making available to firms an instrument no longer involving any problems as regards transfer of registered office and mergers of companies of this type. Nevertheless, like the solution by a uniform law, it still requires a certain amount of harmonization or unification of domestic law, for instance on the point of the validity of the merger agreement, as mentioned earlier. Unlike the solution envisaged in Article 220, however, such harmonization or unification of the law might perhaps, in this case, be limited to matters arising on the occasion of the establishment of European companies.

The legal form of a European company incorporated under European law differs in essence from that of a European company incorporated under national law. Rather like the draft convention on European patent law, it would eliminate the dfificulties which firms encounter because the single market in which they can transact business is not matched by a single system of incorporation. The new law would take its place alongside the legal system of the member countries, which is conterminous with the area over which they have sovereignty. The field of its general and direct application would coincide with the market within which firms can operate as freely as within a domestic market. Freedom of movement for factors of production, as provided by the Treaty of Rome, would be supplemented by a legal system whose existence would be guaranteed by its belonging to a distinct "European legal order". Such a solution has the additional merit that under the proposed arrangements the European company under European law, as an institution founded in Community law, would give its shareholders real equality of status, both economically and psychologically. Mergers under European law would no longer entail a change of nationality, but "Europeanization" instead. Under certain conditions, a common high court could, finally, ensure identical interpretation in the six Member States.

At the present stage of its work, the Commission feels that the legal form of a company incorporated under European law, which would add to the great advantages already held out by the French government's proposal, is fully in line with the growing interest currently shown in the creation of European firms having equal access to factors of production in all Member States and well placed to compete with the world's leading concerns. However, in practice this innovation remains subject to coherent solutions being found for the great number of problems which arise not only under company law, but also under fiscal, financial and social law.

For this reason, the Commission does not consider that the final choice can be made until careful studies have made it quite clear which of the alternative legal forms proposed is better suited for the solution of the practical problems discussed in this memorandum.

The Commission therefore proposes that the decision be deferred pending the results of the studies now being made by independent experts on the implications of the different possible solutions. The experts' conclusions could then be examined by the working party which it is proposed to set up. For the same reason, the Commission also feels that it would be premature at this stage to take any decision regarding the conditions on which a firm may acquire the status of European company.