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Simplification of European Company Law

Position of the CCBE

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association internationale sans but lucratif
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Position of the CCBE

The Council of Bars and Law Societies of Europe (CCBE) represents more than 700,000 European lawyers through its member bars and law societies of the European Union and the European Economic Area. The CCBE responds regularly on behalf of its members to policy consultations which affect European citizens and lawyers.

1. Why simplify European Company Law?

The CCBE welcomes with great satisfaction the intention expressed by the Commission to undertake a simplification and improvement of European company law. Over the past years, our client and ourselves have often expressed our concern facing the increasingly complex set of rules applicable to companies all over Europe. Until today, changes by the Commission to adapt the existing legislation often resulted in creating additional rules rather than in the simplification of existing rules. Therefore the CCBE is today really hopeful that the Commission will pursue the contemplated simplification project in order to allow European companies to compete more effectively and successfully on worldwide competitive markets.

However, while unanimously supporting the Commission's initiative to provide a simplified environment for companies in the area of company law, accounting and auditing, the CCBE believes that this process is of greater magnitude than as set forth in the Commission's communication.

The CCBE does not see a reason for simplification or even repeal of existing European company law in the mere fact that since the adoption of the respective directive or regulation time has lapsed and there have not been any legislative changes. The scandals in the financial markets after approximately 1998 have lead to the adoption of new legislative measures also in the area of company law, including modification of existing directives. This fact alone shows that a detailed analysis of every single piece of EU legislation in company law would be required.

The CCBE has always supported the principle of better regulation for new legislation. However, we do not think that, given the limited resources, this principle would be sufficient justification for introducing changes to existing legislation. We realize of course, that the quality of some pieces of legislation, when adopted, could have been better, however these pieces of legislation in most cases represent the result of a difficult political compromise. We think that new enabling legislation such as the EPC regulation and the Transfer of Seat Directive would be more important than changing existing legislation only for better regulation based quality improvement.

Proportionality is to the CCBE part of the better regulation principle. Only such regulation is good regulation that does not go further than necessary to achieve the intended purpose. It would be a solid argument for simplification if detailed analysis shows that a given piece of European company law legislation in a specific respect is not proportionate.

The principle of subsidiary deals with the question of regulatory competency and not with what content European legislation should have. The strengthening of the subsidiarity principle apart from that is applicable only to future legislation, since it has not been given retroactive effect. It is therefor not sufficient justification to modify or repeal existing legislation.

2. The Way Forward

The experts members of the Company law Committee have long debated the proposals of the Commission regarding the way forward to achieve the contemplated simplification of existing company law. Few members of the Committee have expressed their views in favour of a radical simplification involving a possible repeal of existing directives. However in its majority, the CCBE is against the first option (the EU acquis in the area of company law should be reduced to legislation specifically dealing with cross-border problems) and for the second option (the focus should be only on concrete, individual simplification measures), for the following reasons.

The Tenth and Eleventh Directives are focussing on specific cross-border problems. The focus of the other Directives is on domestic problems, however that does not mean that they have no cross-border relevance. The opposite is true, after all these directives are applicable also to companies that are owned by shareholders from another Member State. The existence of these directives has considerably helped cross-border trade, investment and establishment. Take the example of a French company that has subsidiary companies in Germany and that has acquired, by share purchase and capital increase (Second Directive), most or all of the shares of another German company, with the expectation that it will be possible one day to optimize the structure of all German subsidiaries under the Third and Sixth Directives. Why should the trust of the French parent company be frustrated only based on the argument that the Third and Sixth Directives are focussed on domestic mergers and divisions? Another example would be a subsidiary company that has been set-up by a parent company in another member state under the Twelfth Directive. The repeal of that directive would mean that the single member private limited liability subsidiary company may have to be liquidated. Here, too, the focus of EU legislation on specific cross-border problems only would mean to frustrate the trust of cross-border investors.

The Commission conducts the Consultation regarding the two options only with respect to company law. In the areas of accounting and auditing the Commission proposes to follow the second option. However, the Commission does not give a reason for that preference. Accounting and auditing are not areas of particular cross-border problems, they are relevant both domestically and – cif. foreign trade, investment and establishment – cross-border. This is also true for the entire area of company law.

The acquis of European company law is of significant importance for the Internal Market. If by repealing legislation that acquis were to be reduced to specific cross-border legislation, the Internal Market would suffer a serious blow and the trust of market participants that have already gone cross-border, in the continuing existence of the acquis (not withstanding justified modifications) would be severely disappointed.

This would also be relevant for the New Member States of the EU that have only recently adopted the acquis. Reliability in the continuing existence (not withstanding justified modifications) of the acquis is an important factor also from that aspect that should not be overlooked.

The Commission Consultation seems to be missing also another aspect which is of particular relevance, namely the distinction between enabling and restricting legislation. The purpose of simplification is to simplify the business environment for companies. The repeal of enabling legislation would be absolutely counterproductive for that purpose. The Consultation in our view makes sense only for restricting legislation.

Often an existing piece of EU company law legislation is enabling, but it enables only under certain restrictions. In fact, the restrictions historically in most cases have been the political price for the adoption of the piece of legislation in the first place. Examples are the Second, Third, Sixth and Twelfth Directive. It may from the view point of today be desirable to alleviate (or lift altogether) some or all of the restrictions but that would raise the question whether the Member States will still consent to the enabling parts of the legislation. Freedom of companies which seems to be the primary objective of the Commission, often clashes with the interests of creditors, and freedom for management often clashes with the competences of shareholders.

In summary, it seems to us that matters are much more complex than they seem to be suggested in Chapters 1 and 2 of the Consultation, and need a much greater degree of differenciation.

3. How much Regulation does Europe need in the Field of Company law?

3.1 The General Approach to EU Company Law

The Commission discusses the administrative costs for companies following from EU company law and says it should be asked whether the benefits of EU company law rules in all cases outweigh the administrative costs to companies. The CCBE wishes to point out that not only the costs to the companies but also other costs must be considered, e.g. costs to creditors and consumers.

3.1.1 Option 1: Placing the Focus on Cross-border Problems

As regards the Third and Sixth Directives, we refer to our remarks above. They are relevant not only for companies owned by domestic shareholders but also relevant for companies owned by shareholders from another Member State. It is of course true that the directives do not provide for full harmonisation and consequently do not create a level playing field. However, before the Third Directive some Member States did not have merger laws at all, and the repeal of the Third Directive would make it possible for that situation to return. To repeal the Third Directive because it does not create a level playing field thus would become completely counterproductive. If the absence of a level playing field does in fact present a merger problem, why does the initiative of the Commission then not go into the opposite direction, namely more harmonisation?

It is of course also correct when the Consultation states that the existence of minimum requirements in EU law prevents Member States from adapting the national laws to changing needs. However, is the need for a level playing field which increases European competitiveness, no longer part of the needs of companies?

As regards the Second Directive, the CCBE thinks that first of all the outcome of the forthcoming study on an alternative to the capital maintenance system under that directive should be waited for. It is, of course, correct when the Consultation says that new national legal forms have been created outside the scope of the Second Directive which offer more flexibility than the Directive. These new company law forms under national law have however been designed primarily not for cross-border but for purely domestic purposes, and most of them are variations of the private limited liability company which in most national laws is clearly distinguished from the corporation as regulated in the Second Directive. The legal form of corporation as regulated in the Second Directive is the typical form of listed companies. Therefore, the Second Directive plays an important role for cross-border investment in listed companies.

As regards the Twelfth Directive, we again refer to the remarks above. This directive allows not only individuals but also companies as sole shareholder to create private limited companies in other Member States where before the directive more than one shareholder was required to form a company of that type and – a possibility not mentioned by the Consultation – for the continuing existence of such company. Many parent companies have made use of this directive by setting up in other countries single shareholder limited liability subsidiary companies. The repeal of that directive would open the way for Member States to adopt national legislation which would force the parent companies to change the shareholding structure of these subsidiary companies failing which these companies would by law go into liquidation and/or the parent companies would become jointly and severally liable for its liabilities. All of this would lead to additional costs for parent and subsidiary companies.

For the reasons outlined the CCBE rejects Option 1, namely to repeal entirely the aforesaid directives.

The Consultation also asks whether they should be repealed in parts. The Commission does not indicate which parts should be repealed. The CCBE thinks that that question in essence is identical with Option 2.

3.1.2 Option 2: More Principle Based, Less Detailed Regulation

As regards Item 1 of Annex 2, the CCBE is in favour of reducing the number of written reports, in particular where also the reporting obligations under the Second Directive are applicable which can be the case not only with a division (as mentioned by the Commission) but also with a merger. However, a detailed comment will have to wait until the presentation of the study on the Second Directive presently under way. The principle is clear, double reporting should be avoided to the extent possible.

The need for a new accounting statement in case the latest annual accounts are more than six months old, is more complex an issue. The company law practice of our members has shown that losses in the running business year can in fact present a problem from the view point of creditor protection. This is a typical example where the costs to the companies must be compared to the costs to creditors. Creditors cannot protect themselves against these risks, companies can avoid the extra costs by postponing the merger to a later date which does not require a new accounting statement.

As regards Item 2 of Annex 2, the CCBE supports the suggestion to align the provisions of creditor protection under the Second, Third and Sixth Directives.

As regards the need for a shareholder resolution on the part of the acquiring company in the case of a merger or division, we would support the suggestion that no shareholders meeting is needed if a subsidiary is merged into its at least 90% parent company or transfers all of its assets to its 100% parent company.

3.2 Additional Simplification Measures in Company Law

3.2.1 Publication Obligations under the First and Eleventh Directives

The CCBE supports the idea that publications under these directives should be made only through the electronic registers which in fact are better accessible to third parties than national paper gazettes. If Member States wish to continue the requirement of national gazette publication that publication should be limited to a reference to the electronic register.

As regards the need for translations in connection with the disclosure requirements under the Eleventh Directive the CCBE supports the concept of country of origin translation provided the translation certificate is accepted by the judicial or administrative authorities of the Member State of origin.

Further modifications following from the so-called BRITE Project can be considered once this project has progressed.

3.2.2 Registered Office of the European Company

The CCBE would favour the proposal to modify article 7 of the SE Statute so that SE can have head office and registered office in different Member States. This in our opinion follows not only from the Überseering case of the ECJ but it would also meet an important practical need. It is a well known fact that psychological problems play a very important role in merger negotiations, including mergers in a SE. One relevant aspect in this context is the question of registered office and head office. Article 7 of the SE Statute forces the merging parties to agree on one Member State for both offices. After the modification it would be possible for the head office to be in the Member State of one merging party

and the registered office to be in the Member State of the other merging party. That would help merger notifications.

While in favour of such proposal, the CCBE raises the fact that the existence of several head offices might trigger other issues relating to applicable law in matters such as bankruptcy or social issues.

4. Accounting and auditing

The CCBE basically welcomes the objectives of the Commission to reduce administrative burdens, especially the simplification in accounting, particularly in respect of publication requirements.

In the course of the above mentioned simplification, the legitimate interests of all business partners of the entrepreneurs, the general public and the objective of unification of the law should not be disregarded.

This being said, the proposals of the EU-Commission regarding simplification measures for SMEs in the areas of accounting and auditing are being assessed by the CCBE as follows:

4.1 Introduction of "micro entities"

Broadly it can be said that the introduction of the concept of "micro entities" and the creation of a new category of smallest limited liability companies in respect of accounting and auditing, respectively, is seen favorably. Not welcome, however, would be the introduction of that concept in all areas of company law and in broad areas of all ANNEX matters: An unequal treatment of different sized companies in the areas of the protection of creditors, disclosure, and insolvency law is certainly not adequate and leads to unsatisfactory results for the consumer and any business partner as persons worthy of protection.

The accounting regulations are connected with disproportionate expenditures for smallest limited liability companies.

The aspect of law harmonization is less significant for smallest limited liability companies (such as trade and repair businesses or small manufacturers), as "micro entities" do usually offer services on a local market and do only exceptionally conduct cross-border activities.

However, the CCBE considers that under these circumstances the proposed thresholds (balance sheet total € 500.000,00, turnover € 1 million, 10 employees) might still be too high for certain member State: an entire exclusion from the accounting directives should be foreseen only for genuine smallest limited liability companies. As a result, the CCBE suggests that the European thresholds should be considered as maximum thresholds, and that flexibility should be granted to each members to choose lower thresholds if they believe this to be relevant.

For these smallest limited liability companies, the CCBE considers that the obligation to disclose the balance sheet could be abolished: the business partner of such a company (for instance the customer in a bakery or the client of an installer), does not verify the disclosed balance sheet; the credit institutions and the suppliers have, on the other hand, due to their market and bargaining power, the possibility to require financial information directly from the company. This is the case for instance when the submission of the balance sheet is being considered as a premise for the business transaction (granting of credit, delivery, as mentioned above), or when appropriate measures securing the payment are being chosen in order to guarantee the protection of the business partner. In such case the obligation to disclose the balance sheet could therefore be abolished.

4.2 Trespassing thresholds for SMEs

a) More flexibility whereby a five-year period for companies exceeding the thresholds is not viewed favorably by the CCBE. The actual two-year period should be maintained.

Experience shows that the economical developments of companies are unpredictable: especially the extension of the threshold from two to five years is not appropriate for expanding companies, as on one hand it would create unjustified advantages for the expanding companies compared to same-sized rival businesses, that do show a stable growth, and on the other hand it would not take into consideration the legitimate information needs of the external addressees.

The CCBE is favorable, however, to a simplification of the procedure for adapting thresholds: the current adoption by the Council of the adaptations of thresholds is too burdensome and time-consuming; the adaptation of the thresholds should in the future take place on a regular basis, proportionate to the general economical growth.

4.3 Relieve from publication requirements for small entities

From the point of view of the CCBE a distinction has to be made: the relief from publication requirements is viewed favorably for small entities. Also no namable disadvantages can be found in this respect for external addressees *(see point 1).*

A relief from publication requirements on behalf of the external addressees is, however, not desirable.

In this connection it has to be pointed out that it should be searched for possibilities to simplify and reduce prices for the publication of the balance sheet: according to the CCBE, it would suffice if the publication was carried out electronically; in any case the obligation to publish the balance sheet in print media, as for instance in official gazettes of European newspapers, should be abolished for small entities as well as for large companies. A mere electronic publication would diminish the administrative burden as well as the costs; due to an easy access to the internet for everyone, publicity is guaranteed (in contrast to publication in print media).

4.4 Extension of exemptions for companies without particular external user

The proposal of the Commission to provide exemptions regarding the obligation to conduct a statutory audit or the publication of the balance sheet to companies, whose balance sheets do not spark public interest, is a concept favored by the CCBE. However, due to the indeterminacy of the proposal of the European Commission, a definite assessment is not possible yet; especially the criteria regarding the *"risk-based approach"* are lacking.

According to the CCBE, the examples given by the Commission in its Communication are not sufficiently elaborated. If the Commission means that exemptions for accounting regulations should count for companies where the managers are also the owners and where no other member has more than 5%, it has to be pointed out that obligations regarding accounting and publication are necessarily in the interest of the co-partners:

There exists a special protection requirement (and thus an interest in strict accounting regulations and publication requirements) for publicly owned firms, when the minority shareholder faces a controlling majority shareholder: in such a case, an exemption from the obligation of financial accounting and publication would be on no account justified.

b) However, the CCBE shares the view of the EU-Commission that unlimited liability companies (as for instance the general partnership) might be subjected to an extension of exemptions.

4.5 Simplification for all companies

The proposition to exempt medium-sized subsidiaries from statutory audit is problematical: the consolidation of the annual accounts of the dependent company in the group's annual accounts does not represent a security for the creditors of a medium-sized subsidiary: an external addressee has therefore a considerable interest in duly compiled annual accounts, which were verified by the group auditor.

An exception would only be possible in the case in which the parent company takes over the guarantee for the liability of the subsidiary: in this case, the creditors of the subsidiaries would be protected.

4.6 Subsidiaries of no material significance

a) The proposition, according to which the relationship between the IAS Regulation 1606/2002 and the Seventh Directive has to be clarified and whether parent companies that have subsidiaries of no material significance would fall under the IAS Regulation and would therefore be required to prepare IFRS financial statements, respectively, is viewed positively by the CCBE. This clarification should, however, take place for all companies (including small and medium-sized companies).

Furthermore, the elimination of consolidation requirements or requirements to provide IFRS financial statements in case where there are only subsidiaries of no material significance is seen as a substantial simplification and therefore favored by the CCBE.

b) Not comprehensible, however, is the proposition to abolish requirements to provide consolidated accounts for personal holdings (where the main holder is a natural person).

From the point of view of the CCBE there exists no connection between the owner of a company and the accounting directives: in the case of a group of companies, which are owned by one or several natural persons, the addressees may as well have a legitimate interest in consolidated accounts; the mere fact of the owner being a natural or a legal entity does not have any influence on the need of legal protection of the external addressees, neither does it have on the solvency of the company.

4.7 Accounting for deferred taxes

The proposed abolition of the obligation to account for deferred taxes for small and medium-sized companies is viewed positively by the CCBE.

4.8 Disclosures

The CCBE views favorably the intent of the EU-Commission to explore further possibilities of abolishing disclosure requirements which present only little meaningfulness.

Under these circumstances, a disclosure of an explanation of formation expenses (Article 34, paragraph 2 of the Fourth Directive) is welcomed.

The CCBE, however, does not favor a disclosure of the breakdown of net turnover into categories of activity and geographical markets (Article 43, paragraph 1, number 8). This disclosure is of considerable importance for the external addressees enabling a reliable risk assessment: the benefits for the addressees should thus overcome the encumbrance faced by the companies in respect of disclosure requirements.