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"Critically assess the main issues raised by the EU Regulation and Directive on the Creation of a European Company (SE)".

Introduction

Finally, on 8th October, 2001 the Council of Europe adopted the regulation on the statute for a European Company (SE)[1] and its companion directive[2] that deals with the involvement of employees. After thirty years in the making or forty years from the day that the idea was put forward by Pieter Sanders in his inaugural address as Professor of Rotterdam University,[3] we have the creation of the SE.

The reasons that it took 30 years in making the regulation is because firstly, the working groups of experts who were drafting the regulation had to consider the many differences that existed in the legal systems of every Member State in order that their proposal could be accepted from every country in the European council and secondly, they wanted to create the SE in such a way that it would not be subject to domestic law.

The dream of creating such a company without being subject to domestic law turned out to be the quest for a utopia and their achievement fails to regulate legal areas like taxation, competition law, intellectual property and insolvency. Even specific provisions like board structure (corporate governance) and employee participation are subject to the choice of the member state in which registration is taking place.

This essay will commence with a chronology presentation of the history of the European company, will continue with the company law directives and show their impact on the SEs regulation. Then it will try to critically assess the

[1] Council Regulation (EC) No. 2157 /2001, O.J. 2001, L 294/1.

[2] Council Directive 2001 /86 /EC, O.J. 2001, L 294 / 22.

[3] Thompson, D, *The proposal for a European Company***,** London: Chatham House/PEP, 1969, at 7.

main issues that are raised by the EU Regulation and directive on the creation of a European Company.

Historical background – a chronology presentation.[4]

The European company is conceived to be a method of facilitating cross-border mergers and cooperation. Moreover, it is a vehicle for economic integration.[5] The idea of the creation of the European company is almost as old as the European Economic Community.[6] In 1951, the European council had discussed the creation of a company that would perform public services and public works. The first legal basis for such a company (despite the fact that it in terms does not mention anything for the creation of a European Company) was the old Article 220 that would call all member states to have a convention for the mutual recognition of companies …the retention of the legal personality in case of transfer of their seat from one country to another, and the possibility of mergers. Those needs could be facilitated by the European company as it was proposed in 1965 from Professor Sanders. A year later, after a request from the commission, a working group of experts was set up and the first draft was prepared. The two main targets were first, that the new Company should not be subject to national law and the second was that it could enable large European enterprises to form units capable of competing with US and Japanese multinationals.[7] In 1970 the commission presented its own proposal based on Sanders draft but with changes like working participation. In 1972 the parliament suggested amendments, and in 1975 the commission re-submitted an amended proposal particularly on employee involvement. That proposal was very complex and made the council appoint an ad hoc working party. The working party could not reach a consensus and finally in 1982 discussions were suspended.

In 1989, the Commission relaunched the proposal and issued the first memorandum of "Societas Europaea" and shortly thereafter proposed a council

[4] The following historical background is based on the articles of Burnside and Edwards. Full details in footnotes 5 and 7.
[5] Burnside, A, *The European Company Re- proposed*, Comp. Law.1991, 12(11), at 216.
[6] A chronology for the past and future of the European company is given from the above writer.
[7] Edwards, V**,** *the European Company – Essential or Eviscerated Dream*? Common market Law Review 40, (2003), at 443.

regulation on the Statute for a European Company. At the same time, the commission proposed a directive dealing with employee participation and provided either a two - tier or a one- tier board system. After an exchange of opinions between the European parliament and the Economic social Committee, the commission issued an amended proposal in May 1991.

In 1996, the commission established a high level group chaired by Viscount Davignon and after many negotiations in 2000 under the French presidency at the Nice summit on 8 December 2000 an agreement was reached.

The regulation and directive were finally adopted in October 2001 and both have entered into force on 8 October 2004, the date by which the directive requires implementation (Art.14).

The company law Directives

Member States realized that they had to harmonize their company laws, and at the same time make sure that there companies would not move from the European Stock markets to the American Stock market. The dream for the United States of Europe could be achieved with the harmonization of EC company law, free market and free trade. We should not forget that the European Union started as European Economic Union.

The European Economic Union, in order to achieve its goal started the development of Directives that would gradually harmonize the EC Company Law. The directives in many aspects achieved this goal. The directives regulating company law can be categorised into four generations. The first one includes the first directive (1966) that deals with aspects *inter alia* on information disclosure, validity of commitments (capacity/agency) and nullity of the companies. The second directive (1976) deals with the formation of public limited companies, gives a definition of Public Limited Companies and regulates aspects of maintenance and alteration of capital.

The second generation includes the Third Directive in 1978 and the Sixth Directive in 1982 regulating aspects like mergers, protection of share holders, and the national law on PLC divisions. Further, the fourth directive in 1978 deals with company accounts, the seventh directive (1983) about the national law on

consolidated group accounts and the Eighth Directive on 1984 for the approval of statutory auditors of company accounts.

The third generation consists of the eleventh Directive in 1983 on disclosure requirements in the host state for a branch of the company from another member state, and the twelfth directive permits the creation and operation of a single member private company, giving the evolution on the classical theory of company law.

The fourth generation is the thirteenth Directive in 2004 on national law on takeovers that can be done by share purchase.

The main problem on the creation of law is that the legislators have to take notice, and equalise interests that contradict, in order that the regulation of society would be fair. The problem on a European level is even bigger. Economic and political interests are the main obstacles in that law development. That is one of the reasons that it took so many years for the EU Council to adopt the SE statute regulation and its complementing directive. A good example is the issue of employee participation that caused delay. Germany's main fear was that German companies would choose the SE in order to avoid the national regulation that is based on the two-tier system. Finally, an agreement was reached at the Nice summit on December 8th, 2000, but the regulation adopted was far from the first proposal. Also the goal for a European company that would not be subject to national law was partly achieved. Issues like winding up, insolvency etc., are subject to national law, and one could say that we do not have a SE regulated as a whole from the Regulation but we have 25 SEs which is the number of member states being subject to their national law.

The legislators, in order to produce a Regulation, "closed" the subject by dealing with issues that could be characterized as the "easy ones", and the "hard ones" were left for the national law.

The proposed statute for the SE was arranged in fourteen titles[8] and it included,

[8] Schmitthoff, C , *European Company Law Texts*, Stevens and Sons, 1974 at 54.

1. General provisions
2. Formation
3. Capital; shares and the rights of shareholders and debentures
4. Administrative organs
5. Representation of employees in the SE
6. Preparation of the annual accounts
7. Groups of companies
8. Alteration of statues
9. Winding up, insolvency, and similar procedures
10. Conversions
11. Merger
12. Taxation
13. Offences
14. Final provisions

The crucial question is if the (SE) European Company would work. On the other hand, the great importance of the harmonisation directives should be recognised; more specifically the impact that they have on the operation of the European Company. The regulation expressly refers to certain provisions from company law directives[9]; like the protection of the interests of the members of the company and others and public in general. Also the third directive[10]applies to the merger procedure. Article 3 (2) provides that the Twelfth Council Company Law Directive on single member private limited liability should apply instead of national law.

Ways of Formation.

A. Cross border –merger.

[9] First Council Directive (EEC) 68/151 of March 1968, O.J. Spec Ed. (I) 41.

[10] Council Third Directive 78/885/EEC of 9 0ctober 1978 based on Article 54 (3) (g) of the treaty concerning mergers of public limited liability companies, O.J 1978, L 295/36.

There are four ways relating to the formation of a European company. The first way is by merger under the procedure of the third company law directive on mergers. Under that directive there are two procedures, either merger by acquisition to an excisting company or merger by the formation of a new company.

Where there is a merger by acquisition Article 29(1d) describes the *ipso jure* consequences; it has to be noted that the acquiring company automatically adopts the form of an SE.[11] This means the Shareholders of the merging companies will become shareholders of the SE. An issue raised is that the company which will be acquired will no longer exist. If in case it would wish to convert back to a public limited company that company must wait for two years as is provided under Article 66; but what would be the legal status of that company in the two years until it converts to its initial form? The Regulation does not give any answer to that. Article 66 should be amended in order to provide for the status of the company that would wish to convert back to its old form. Also it would be better if article 66 provided for the instant conversion from a SE to PLC.

This new possibility of the formation of an SE through a merger by acquisition potentially broadens the number of interested companies who would wish to become an SE or in other words would join capital and power with other European Companies.[12] At the same time, Article (19) gives the authority to member states and in particular to the member state of registration, to oppose the formation of an SE by merger. This problematic Article provides the possibility of an authority of that member state to oppose a merger without giving a reasonable explanation and without setting the limits of the power of such authorities. On what grounds of public interest, as is "explained" from the article could that authority oppose the formation of the SE? Which is that public authority? This article could cause many problems because it is not clear and predictable. It gives the chance to every country that would want to oppose the establishment of an SE in its territory to prohibit that establishment, (many countries would oppose such establishment for reasons like the protection of national interests). In the case of an amendment that article should either be removed or be given a definition.

[11] Cerioni, L, *The approved version of the European Company Statute in comparison with the 1991 draft: some critical issues on the formation and the working of the SE and the key Challenge: Part II, Comp.Law.2004, 25*(9), at 259.
[12] Ibid.

We must also note that under Article 2(1) the right of forming a SE is only given to public limited companies.

B) Formation of a holding SE

The second way of forming an SE is by the formation of an SE holding.[13] The article dealing with the formation of a holding SE states that a company promoting this operation shall continue to exist and Article 2(2) gives the right not only to public limited companies but *mutatis mutantis* to private companies limited by shares or by guarantee having a shared capital to form a holding SE. The issue that is raised on which Article 32 is silent is whether Article 19 applies; we don't now and we cannot predict if a member state can prevent a company governed by the law of that state, to take part in the formation of a Holding SE. As was noted above, a member state can oppose on the formation of an SE "on grounds of public interest."

The main problem which could be raised is by article 32(6). The Sixth paragraph of that article could generate problems; it provides that "the general meetings of each company promoting the operation may reserve the right to make registration of the SE conditional upon its express ratification of the arrangements so decided." That paragraph enables the general meetings to make the registration conditional because first, it is them who would approve the plan for the formation of the SE and second they have the legal right to reserve the right of registration of the SE.[14] The question that is not answered yet is what would happen in case that the general meeting refuses the registration?

Article 34 provides the right to member states to adopt provisions in order to ensure protection for dissenting minority shareholders, creditors and employers. That aspect could be defined by the Regulation and at least give a minimum percentage of protection without leaving this aspect to be regulated by national law. The protection of dissenting minority, creditors and employees are aspects

[13] Article 32.
[14] Cerioni, L, n 11 above, at 266.

that are characterized as "very sensitive areas" and these are problems that every country would want to solve. In these kind of problems there are not any contradictory interests but there are common problems. The European Union should show its concern for these problems and at least give the minimum standards of protection.

C) Formation of Subsidiary SE

The formation of a subsidiary SE is a matter that is totally left to be governed by national law[15] but under Article 2(3) there are two conditions that have to be met. Firstly, the parent companies must be governed by different legal systems from different member states. Secondly, they must have already had a subsidiary in a different member state for at least two years. The second condition is very strict especially for companies that are now expanding to other countries and this would cause them a two year delay in order to get a subsidiary SE.

D) Formation by conversion of Public Limited Company to a SE.

The fourth way of forming an SE is by converting a public limited company to an SE.[16] Again, article 2(4) demands that a public limited company could only be converted to an SE if for at least two years it had a subsidiary governed by the law of a different member state. The same *mutatis mutantis* are as the formation an SE holding but the difference between those two is that for the SE holding you can either have a subsidiary or a branch governed by a different legal system from a member state or any other state. Consequently, on the conversion of a public limited company to an SE it has to have a subsidiary that will be regulated in a different member state for at least two years.

[15] Article 36.
[16] Article 37.

One other important issue is that the company is not allowed to transfer its constitutional seat from one member state to another, because of the cross border movement. This is a substantial restriction and raises questions if article 37(3) is compatible with the free movement of natural and legal entities, as it has been established by the European Court of Justice (*Centros*).[17] Also that article is in conflict with article 8 in that it expressly gives the right of free movement. In any case, article 69(a) requires review in 2009 of the real seat provisions as is stated in the European Company Statute.

Registration and Cross – border movement of the seat.

An SE's registered office and head office must be located in the same member state. Moreover, a member state may require the SEs to be registered in their territory to have their central administration in the same place where the incorporation took place (article 7). This provision varies from the classic theory of English company law; where a company could have its head office in another member state but its registered office had to be in England because for if its registered office would move, then the applicable law would also change.[18]

Member states supporting the real seat theory cannot transfer their registered offices abroad without winding-up. Their only option is to establish branches in the foreign countries in which they wish to expand. The new provision that the European Company offers is that it can be moved across borders within the community under the retention of its legal personality and identity without resulting in either winding–up or the creation of a new legal person. This was a very good provision that could facilitate cross-border mergers, but someone could say that after the European Court's decision in the *Centros*[19] case this made the SE redundant.

In the *Centros* case the court *held* that Denmark had infringed a company's freedom of establishment, when that company was incorporated in Great Britain, but carried on all its business in Denmark and the Danish

[17] Case C-212/97 *Centros Ltd v. Erhvers* [1999] ECR I -1459.
[18] Gower and Davies', *Principles of Modern Company Law,* Sweet & Maxwell, 7th Ed., 2003 at 120.

[19] *Centros*, n 17, above.

authorities refused to register its Danish operations as a branch.[20] Moreover, another very important case from the ECJ was in *Uberseering.*[21] *Uberseering* was a company that transferred its administration from an incorporation theory country (Netherlands) to Germany, where the latter is a supporter of the real seat theory. When Uberseering wanted to sue the NCC Company for a dispute they had, the German courts refused to recognise the company's legal personality, according to the German civil Code and its Private International Rules. The German high court sent the ECJ two questions for interpretation on articles 43 and 48. Finally, the findings of the court were *inter alia* that, as whether the treaty's provisions on freedom of establishment would apply and also that Germanys refusal was a restriction on the freedom of Establishment. Consequently, after those two very important cases there is no more need for companies to establish a SE company since it has been recognised that companies should enjoy the right of free movement as natural persons do.

An SE could transfer back its registered office under article 8 and its special procedure but it is clear from the Regulation that the transfer will not mean winding up or loss of its legal personality .This is a very successful provision that needed to be clarified in light of disputes under different national law and legal systems.

Management structure

The management structure is regulated by Article 38. According to the statute, with regard to corporate governance either a two tier system could be adopted that would be comprised of a supervisory organ and a management organ or an one tier system with an administrative organ.[22] Both corporate governance systems must be eligible in each member state so that when there are no provisions for a two tier system, a member state may adopt the appropriate measures in relation to SE's. This should be compulsory in order that the two tier systems will be available for all twenty-five member states.

Annual accounts and consolidated accounts

[20]Gower and Davies , n 18 above at 122.

[21] Case C-208/00, *Uberseering BV v.Nodic Construction Company Baumanagament GmbH(NCC).*

[22] Sabine, E, *the European Company on the level playing field of the community* 2003 Company lawyer 24 (9), 262.

Subject to the special rules contained in Article 62 concerning SE's, an SE will be governed by the rules applicable to public limited liability companies under the law of the member state of their registered office(Article 61).This is because of the harmonization directives that member states have been required to implement with their provisions. Those directives are the fourth, seventh and eighth company law directives but there are substantial differences between accounts prepared in accordance with legislation implementing the fourth and the seventh directives in the different member states.[23] However, the framework from directives given to member states will lead to the same result. In any case, this will not be a big problem because from 2005 the European electronic commercial registers (eleventh directive) will be initiated which shall be a big step forward for transparency in the company's book keeping.[24]

Winding up and liquidation

The European Company Statute does not deal with the aspect of winding up and authorizes the national law to substitute. This is an issue that has to be regulated by a European Regulation from the European Union. This issue has to be faced, in order to harmonize the national law of member states and it would be a benefit for the creditors from every European country that they would wish to do business with SE's.

Employee involvement

The issue of employee participation poisoned the negotiations over the SE and was the main reason for its delayed adoption.[25] The problem was that countries such as Germany and France who were accustomed to have labour laws dealing with worker participation required that similar laws should apply to any SE. At the same time, countries such as the United Kingdom and others that do not have such laws persisted on excluding such provisions. They suggested that in

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[23] Wooldridge, F, *the European Company*, *the successful conclusion of protracted negotiations.* Company Lawyer [2004] 25 (4) 121-128.

[24] Sabine, E , n 14 above, at 261.

[25] Burbidge, P, *creating high performance boardrooms and workplaces –European Corporate Governance in the twenty century*. E.L .Rev .2003, 28(5) ,2003, at 659

case there are such provisions they should not apply to SEs registered in their member states.[26] Finally, the solution adopted was to separate the issue of employee participation from the Regulation; as a result we have on the one hand the council regulation providing for the European Statute and on the other, a council directive that supplements the Regulation and regulates the involvement of employees.[27]

Article 12(2) of the regulation provides that an SE could be registered only if there is an agreement for employee involvement .Consequently, an SE may not be registered if the requirements of the same article have not been fulfilled.[28] However, each member state will decide the method in which the working participation models must be applied for SEs having their registered office in its country.[29]

The directive provides that if the management or administrative organ of a company decides to draw a plan for the formation of an SE, they must initiate negotiations with the representatives of the companies' employees for their involvement in the SE (Art.3. (1)). A special negotiating body should be formed ("SNB") to represent the interests of the different workforces and then both of them should reach within six months (or one year by joint agreement), a written agreement for employee involvement. If the SNB does not reach an agreement then there are two options; first the management will introduce certain standard rules on employee involvement or abandon its registration as a SE. In case the SE is created by merger or the establishment of a subsidiary in another country there are rights for employee participation on company boards. The existing employee participation cannot be reduced without a 2/3 vote on the SNB. Where an SE is formed by the conversion of a public company, any participation must be continued in the SE, but if there were no participation rights, they will not be created in the future.

The key idea about employee involvement in the SE is that the directive does not aim to impose employee participation where none exists; but it aims to

[26] Hannigan, B, *Company Law,* Lexis Nexis UK , 2003, at 57.
[27] Ibid.
[28] Edwards, V, n 7above, at 459.
[29] Bruycker, J, *E C Company Law – the European company V. the European economic interest grouping and the harmonization of the national company laws,* at 207.

preserve existing rights unless the parties decide otherwise.[30] That was the best solution that could be achieved without changing the legal status of the countries that under their national law they use the two-tier system (Germany for instance)and at the same time those companies that under their national law have to have employee participation will not misuse the directive and get away from their obligations from their domestic law.

The provisions contained in the accompanying directive on worker participation are complex[31] because they are a product of negotiations that lasted for decades. The arrangements for employee involvement (information, consultation, participation) will be time consuming and expensive[32], and when an SE is formed, this may discourage companies and other legal persons from making use of it.[33]

General assessment

Issues like taxation, minority protection, director's liability, audit and accounts, capital chances and insolvency, intellectual property, competition are left untouched. Also forming an SE by merger is restricted to private companies and generally all the above are left for the national law. This situation justifies someone to wonder if we have one SE or 25 different ones which is the number of member states.

[30] Edwards, V, n 7 above at 457.
[31] Hannigan, B, n 14 above, at 59.
[32] Oliphant, R, *Opinion on the European Company*, The lawyer (8), 2004, at 16.
[33] Wooldridge, F, the *European company, the successful conclusion of protracted negotiations,* Comp. Law.2004, 25 (4), at 127.

Conclusion

After many years of making the regulation dealing with the European Company Statute, the final result was substantially different from the initial proposals. The idea for creating a company that would not be subject to national law systems turned out to be very ambitious.

The establishment of the SE is a step forward for European integration because entities of different European countries will be able to cooperate more easily with each other.[34] Also, the experience of jurisdictions such as Canada and Australia, shows that truly supranational company law vehicles, having such features and enabling business to carry out their activities throughout the territory of the federation, prove to be quite competitive and are usually chosen by foreign investors too as well. On the other side, the basic decisions of the European Court of Justice recognising the free movement of legal entities justify wondering if we really need the European Company.

Many crucial aspects are left untouched by the European legislators to be regulated by national law. The harmonization directives have a great role to play. The success of the SE will mean success for the European company law harmonization program.

The European commission believes that the European company represents a symbolic step on the way to the single internal market. To others this appears as a Trojan horse, designed to introduce into their national laws concepts which they have consistently opposed.[35] Time will tell whether the European company was necessary and if it was worth the long wait.

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[34] Brucker, J., n29 above at 191.
[35] Burnside, A, n 5 above, at 220.