The Adopted Proposal for an EU Directive on Cross-Border Operations: A Realistic Compromise

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1. INTRODUCTION

This journal's year-opening issue has been completely devoted to the so-called 'Company Law Package' of the European Commission dated 25 April 2018.[1] This proposal consists of two draft directives intended to be incorporated in the Directive Relating to Certain Aspects of Company Law, also known as the EU Company Law Directive (hereafter abbreviated as 'CLD').[2] The first draft directive aims to modernize European Company law by introducing digital tools and processes for inter alia setting up a company or opening a branch of that company and the fulfilment of filing and disclosure requirements.[3]

The second part of the 'package' deals with cross-border conversions, mergers, and divisions.[4] It is suspected that the recent Polbud judgment[5] of the Court of Justice of the EU ('CJEU'), allowing an EU cross-border transfer of statutory seat (conversion) without transferring the company's real seat, triggered the European Commission to come up speedily with a proposal for cross-borders conversions, mergers and divisions, in an attempt to finally get some level of harmonization in place as regards all said forms of company restructuring within the EU. After all, the desire in practice for the adoption of a set of minimum rules on cross-border transactions has been recognized many times.[6] Moreover, the EU legislator's continued incapacity to deal with urgent matters and its inclination to leave these for the CJEU to solve on a case-by-case basis threatens to undermine both the credibility and the effectiveness of the process of European integration. Although an EU directive on cross-border mergers has been in effect since 2007 – now to be found in Chapter II CLD – attempts to adopt a directive on cross-border conversions have failed dramatically so far. An attempt to regulate cross-border divisions was never even made. Hence, the second part of the Company Law Package was a very welcome initiative indeed.

2. CRITICS

As for its contents, reactions in literature were rather positive on the whole. The provisions of the draft directive certainly promote legal certainty and transparency by introducing reporting requirements and instruments aimed to protect the interests of shareholders, creditors and employees. At last minority shareholders who opposed the cross-border transaction, cross-border mergers included, are given an exit right against cash compensation.[7] No wonder that Professor Jessica Schmidt enthusiastically concluded: *'In summary, the Company Law Package undoubtedly constitutes a significant achievement which has the potential to substantially advance cross-border mobility of companies by way of a real quantum leap.'*[8]

This being said, the Commission's directive proposal of 28 April 2018 (hereafter 'Original Proposal') was also met with some severe

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1 ECL 2019, Volume 16, Issue 1.

2 Directive (EU) 2017/1132.

3 COM(2018) 239 final. *See* for a critical analysis Florian Möslein, *Back to the Digital Future? On the EU Company Law Package's Approach to Digitalization*, 16(1) ECL 4 (2019), and Sebastian Omlor, *Digitalization and EU Company Law: Innovation and Tradition in Tandem*, 16(1) ECL 6–12 (2019).

4 COM(2018) 241 final.

5 CJEU, C-106/16 (Polbud).

6 *See* e.g. the final report of the EU Study on the Law Applicable to Companies, published by the European Commission on June 2016 and https://publications.europa.eu/en/publication-detail/-/publication/259a1dae-1a8c-11e7-808e-01aa75ed71a1.

7 *See* on this my editorial titled *10 Years Cross-Border Mergers Directive: Some Observations About EU Border Protection and Minority Exit Rights*, 14(6) ECL 214–16 (2017).

8 Jessica Schmidt, o.c. at 17.

Bartman, Steef M. 'The Adopted Proposal for an EU Directive on Cross-Border Operations: A Realistic Compromise'. *European Company Law Journal* 16, no. 5 (2019): 140–142.

criticism from both academics and practitioners.[9] The main focus of critic was on the specific anti-abuse provision that obligated the national authority of the state of departure, authorized to issue a pre-conversion or pre-division certificate as a prerequisite for the whole transaction, to check whether or not the transaction *'constitutes an artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members.'*[10] To fulfil this task the authority had to carry out an in-depth assessment *'of all relevant facts and circumstances and […] take into account at a minimum the following: the characteristics of the establishment in the destination Member State, including the intent, the sector, the investment, the net turnover and profit or loss, number of employees, the composition of the balance sheet, the tax residence, the assets and their location, the habitual place of work of the employees and of specific groups of employees, the place where social contributions are due and the commercial risks assumed by the converted company in the destination Member State and the departure Member State.'*

Those who criticized this mandatory artificial arrangement provision inter alia argued that:

(1) a similar provision for the cross-border merger is lacking;
(2) it might easily be used by national authorities to frustrate an undesired cross-border transaction for (hidden) political reasons;
(3) it is likely to cause an unforeseeable amount of delay to the transaction and thus of legal uncertainty, which would make the whole instrument far less attractive;
(4) likewise, it would make any cross-border transaction much costlier and would therefore certainly scare off minimally capitalized start-up companies in their foreign expansion intentions;
(5) performing such an in-depth scrutiny assessment would go well beyond the usual task of the public notary – in many Member States the national authority designated to issue the pre-completion certificate – and, foremost;
(6) it is simply not right to use company law for such anti-abuse goals, while specific (sectoral) tax, financial and competition law instruments are probably far better suited for such purposes.

3. THE ADOPTED PROPOSAL OF 18 APRIL 2019

After all, the basic idea behind company law still entails that it is mainly designed to facilitate entrepreneurs when shaping and expanding their businesses in their home state and abroad. From the sequence of events after 25 April 2018 one may conclude that this fundamental idea indeed still prevails in Europe. The various EU legislative gremials advising the European Parliament, including the Commission itself, have obviously taken the criticism set forth above seriously and on 18 April 2019 Parliament adopted a heavily amended text (hereafter the 'Adopted Proposal').[11] As far as I can see the general call for simplification by Professor Jessica Smith has been heard well and many provisions from the Original Proposal seem to have at least been trimmed down to a workable size in the Adopted Proposal. Also, the overall term *'cross-border operation'* is introduced, covering conversions, mergers and divisions alike.[12]

However, by far the most important substantive amendment to the Original Proposal is the deletion of the check on artificial arrangements by the national authority issuing the pre-completion certificate by performing a mandatory in-depth assessment. Understandably, a cross-border operation will not be allowed if the competent national authority has *'serious doubts'* that the transaction is *'set up for abusive or fraudulent purposes'*, but it need not exercise an a priori investigation in all situations to that end. It is now at the discretion of the competent authority to decide if and to what extent an additional investigation into the facts and purposes is needed to issue the pre-completion certificate. The maximum period to issue the said certificate may then be extended for an additional maximum period of three months.[13]

Moreover, the indicative factors that may cause *serious doubts* in the eyes of the national competent authority as regards the malicious intentions behind the cross-border operation can now be found in paragraph (33) of the Adopted Proposal's recitals. In this paragraph the European legislator is also reaching out somewhat to those who still have trouble leaving hold of the real seat theory by giving the following option: *'The competent authority may consider it as an indication of absence of circumstances leading to abuse or fraud if the cross-border operation results in having the place of the effective management and/or the economic activity of the company in the Member State where the company or companies are to be registered after the cross-border operation.'*

Compared to the indicative factors mentioned in the Original Proposal these have been also extended in the Adopted Proposal, laying more emphasis on the protection of employee participation rights. Paragraph (33) of the recitals to the Adopted Proposal now presents the following enumeration:

9 *See* inter alia Jessica Schmidt, *The Mobility Aspects of the EU Commission's Company Law Package: Or – 'The Good, the Bad and the Ugly'*, 16(1) ECL 13–17 (2019), Isabelle Corbisier & Francois Bernard, *Cross-Border Mobility Within the EU and Specifically in Luxembourg and Belgium: Same Destination, Different Roads*, 16(1) ECL 17–29 (2019) and Sébastien Binard & Laurent Schummer, *The Case for Further Flexibility in Matters of Cross-Border Corporate Mobility*, 16(1) ECL 31–37 (2019).

10 Cf. Arts 86c(3) and 160d(3) of the Original Proposal.

11 To be found at http://www.europarl.europa.eu/doceo/document/TA-8-2019-0429_EN.html. The text is still provisional in that it has not yet undergone legal-linguistic finalization.

12 Recitals Paragraph nr. (10).

13 Cf. Art. 86m(8–10) of the Adopted Proposal regarding a cross-border conversion. The same provisions can be found in the Arts 127 and 160o regarding respectively the cross-border merger and the cross-border division.

'(…) the intent of the operation, the sector, the investment, the net turnover and profit or loss, number of employees, the composition of the balance sheet, the tax residence, the assets and their location, equipment, beneficial owners of the company, the habitual place of work of the employees and of specific groups of employees, the place where social contributions are due, the number of employees posted in the year prior to the conversion within the meanings of Regulation (EC) No 883/2004 of the European Parliament and of the Council 10 and Directive 96/71/EC of the European Parliament and of the Council 11, and the number of employees working simultaneously in more than one Member State within the meaning of Regulation (EC) No 883/2004 and the commercial risks assumed by the company or companies before and after the cross-border operation. The assessment should also take into account the relevant facts and circumstances related to employee participation rights, in particular as regards negotiations on such rights where those were triggered by the four fifths of the applicable national threshold.'

4. FINAL REMARKS

In my opinion, this is a sensible and realistic compromise. To appreciate this one must realize that, despite the CJEU's caselaw about freedom of establishment of companies in recent years[14], there is one remainder of the battle between real seat and incorporation theory left. The state of origin may still apply real seat to its own national companies and thereby create additional obstacles and restrictions for an *outbound movement* of such companies. As the choice of the connecting factors for determining a company's existence and internal structure is still a matter of national law (vide art. 54 EUT), the freedom of establishment (art. 49 EUT) does not affect this fundamental right of the Member States. In fact, all the CJEU's case law in this context can be seen as one major attempt to 'steer' clear between freedom of establishment and freedom of connecting factor-choice.

However, under the CBM Directive – laid down in Articles 135-143 CLD – these additional outbound obstacles are not allowed if the cross-border movement takes the shape of a legal merger. If I understand the adopted Mobility Directive correctly such obstacles will neither be allowed in future in the event of a cross-border conversion or a cross-border division. In other words, by adopting the Mobility Directive Member States waive their right to implement such additional outbound restrictions. I consider this as a major step forward and as the final blow for the real seat approach in the EU, which is good for business integration.

Now let's hope that, as stated by my Maastricht colleagues Thomas Biermeyer and Marcus Meyer in their introduction to the third Report on Cross-Border Corporate Mobility in the EU, '*cross-border corporate mobility in Europe will enter into a new area*', as a consequence of the adoption and transposition of this so long awaited EU directive.[15] Whatever the concrete effect, in any event it sure is a positive sign that, even after Brexit, the EU intends to become an ever closer Union on company law after all.

14 For a fine overview of this caselaw I refer to Morshed Mannan and Iris Wuisman, Freedom of Establishment for Companies in Europe (EU/EEA), Ars Aequi Libri, Nijmegen, 2019.

15 Report to be downloaded from http://www.europarl.europa.eu/doceo/document/TA-8-2019-0429_EN.html.