

OUTLINE OF A COMMUNICATION ON THE SIMPLIFICATION OF EU RULES IN THE AREAS OF COMPANY LAW, ACCOUNTING AND AUDITING

1. "High level review" of the Company law Acquis

The acquis has been the subject of a number of revisions in the recent past, and some of these still need to show their effects.

In the context of the fourth phase of the Simplification of the Legislation on the Internal Market Process (SLIM) and more generally of the 2003 Company law Action Plan, the First and Second Company law Directives were modernised, the Tenth Company law Directive on cross border mergers adopted and the directive on shareholders' rights proposed.

The Third and the Sixth Directive, since their first adoption, have not undergone any general review. These directives, together with the Second Directive, have now been identified as priority areas for simplification. With a view to these directives as well as for the – already slightly revised – Second directive, and possibly also the Twelfth Directive a more far reaching review seems appropriate.

1.1. Third and Sixth Company law Directives

The two directives regulate mergers and divisions of public limited companies within the same Member State. Some decades ago these rules had a major role in opening new possibilities for companies and promoting the internal market. But today it seems questionable whether it is necessary and appropriate to have such rules at EU level; it could be sufficient if the EU regulates operations of cross-border restructuring (which has been done by adopting the Tenth Directive). If the Third and the Sixth Directive were to be repealed those provisions that are referred to in the Tenth Directive obviously would have to be integrated into that latter directive.

Repealing the directives would of course not mean that the rules that companies have to observe would change automatically. It would, instead, be left to Member States to decide to what extent they maintain their current regime that is based on the two directives.

Question 1: Should, in your view,

- the rules on domestic mergers and divisions contained in the Third and Sixth Directive be repealed, or, alternatively,
- the scope of these directives be limited to listed companies?

If not, what are in your views the benefits of having these rules at EU level and why do you think that these benefits outweigh the costs related to them?

1.2. Second Company law Directive

The directive deals with the capital of public limited companies and therefore with operations that are internal to one company within the same Member State.

Also in this case a general repeal could be considered, leaving it therefore to the Member States to determine the capital system that should apply to the companies governed by their law. The forthcoming study will provide additional information that should facilitate the assessment in this case. Nevertheless, first views on the question are welcome.

Question 2: Should, in your view,

- the rules of the Second Directive entirely or partially be repealed, or, alternatively,
- the scope of this directive be limited to listed companies in order to ensure a minimum protection level for non-resident shareholders?

If not, what are in your views the benefits of having these rules at EU level and why do you think that these benefits outweigh the costs related to them?

1.3. Twelfth Company law Directive

The Twelfth Directive in principle is an enabling one as it opened the possibility to single persons to found private limited companies in Member States where before the transposition of the directive a minimum number of members were required to form a company of that type.

However, at the same time the directive sets a number of minimum requirements that aim at ensuring a certain transparency of the company's decision, and a clear distinction between the member's private property and the company. The question is whether such restrictions need to be determined at EU level or whether each Member State should provide for the appropriate measures under its own law, in particular as there are indications that some of the rules provided for by the directive (such as the need to lay down decisions of the general meeting in minutes or in writing, Article 4, and to conclude certain contracts between the member and the company in writing, Article 5) create problems in practice.

Question 3: Should, in your view,

- the rules of the Twelfth Directive entirely or partially be repealed, or, alternatively,
- be limited to stating the principle that one member private limited companies should be allowed in the Member States?

If you think the Twelfth Directive should be maintained in its current form, what are in your views the benefits of having these rules at EU level and why do you think that these benefits outweigh the costs related to them?

2. SINGLE SIMPLIFICATION MEASURES IN COMPANY LAW

Even if the repeal of entire directives should seem to be a too far reaching measure to some, at least parts of these directives should be abolished or simplified. A number of the reporting requirements contained in the Third and the Sixth Directive seem excessive from today's perspective and for other directives, such as the Eleventh, it seems appropriate to adapt them to improvements that have been achieved through prior revisions of the *acquis*.¹

A first proposal for a simplification of the Third and the Sixth Directive has already been tabled in the context of the Commission's Action programme for reducing administrative burdens of 24 January 2007² that should be endorsed by the European Council in spring. The Action programme aims at launching the measurement of administrative costs that are caused by the EU legislation and by the transposition rules of the Member States, with a view to identifying administrative burdens (i.e. unnecessary information obligations) until mid 2008. During this process the Commission will already carry out a fast track procedure for removing administrative burdens by measures that are considered "low-hanging fruits" (i.e. relatively minor changes that have the potential to reduce administrative burdens for companies to a considerable extent).

In this context, it has been proposed to bring the Third and the Sixth Directives in line with the rules of the Tenth Directive to the extent that in the latter directive no expert report on the draft terms of merger is required where all shareholders renounce to it. Whereas the Sixth Directive already contains a similar rule in its Article 10 that however is formulated as a Member State option, the Third Directive knows no such possibility of exemption. However, to require an expert report where the shareholders of all companies involved do not consider such a report necessary seems indeed to be an unnecessary formality. The proposal to extend this exemption to all mergers and divisions therefore seems well-suited for a fast-track procedure.

However, apart from this minor modification there are more substantial ones that should be approached.

2.1. Draft terms of merger/division and the report of the management – Third and Sixth Company law Directives

The management or administrative bodies of the companies that are involved in the merger or the division must draw up the draft terms of the operation (Article 5 of the Third Directive, Article 3 of the Sixth Directive). The draft terms specify the most important elements of the proposed agreement (share exchange ratio, allotment of the shares, etc.) and have to be published. Furthermore, the directives provide for a detailed written report of the management explaining the draft terms of the operation and setting out the legal and economic grounds for them (Article 9 of the Third Directive, Article 7 of the Sixth Directive).

¹ There would of certainly also be scope for simplification as far as the Takeover bids Directive (Directive 2004/25/EC of 21 April 2004, OJ L 142, 30.4.2004, p. 12 is concerned. However, in accordance with Article 21 of the Directive the Commission will present a report on its implementation in the year 2011. Taking action before this report has been established seems inappropriate.

² COM(2007) 23

The preparation of the merger and the division and ensuring its legal and economic justification form part of the **directors' responsibility** - hence it is an issue of liability. In this case, a number of regulatory approaches can be considered adequate, and indeed Member States' rules in that area differ outside the scope of the directives. Instead of requiring in any circumstances the setting up of a detailed written report it can be argued that it should be left to the management's appreciation whether the written explanations, in the light of the concrete content of the draft terms, are needed. Another reasonable approach is to leave it to the shareholders to judge whether there is need for explanation.

It cannot be questioned that the explanatory report is an important mean to ensure the appropriate information of the shareholders and to protect, in particular, the interests of minority shareholders. However, there does not seem to be a need for requiring, at EU level, such a report in all cases. Member States seem to be much better placed to deal with this question by fitting it into their national legal systems and in particular their rules on directors' liabilities. In order to ensure more flexibility, an amendment to the Third and Sixth Directives should **give Member States the right to lay down the rules for the written explanatory report** of the management or administrative organ.

2.2. Expert report on the draft terms of merger/division – Third and Sixth Company law Directive

Both directives require an independent expert report on the draft terms of the merger or the division (Article 13 of the Third Directive, Article 8 of the Sixth Directive). The main issue that the expert report is to deal with is whether the share exchange ratio is fair and reasonable. This examination requires the evaluation of the consideration in kind in cases of mergers and divisions.

The basic rules of the valuation of the consideration in kind are set out in Article 10 of the Second Directive. These provisions were modified and rendered more flexible by the recent Directive 2006/68/EC which granted several options to Member States. Based on the new Article 10a they may exempt various assets from the independent expert report under certain conditions.

These facilitations should be available also in the context of the expert report on the draft terms of merger/division which often involves the valuation of contribution in kind. **Member States should therefore be allowed to use the exemptions of Article 10a of the Second Directive also in the cases of a merger or a division.**

2.3. Expert report in the case of a division – Sixth Company law Directive

The company law directives require the report of an independent expert in the case of a merger or a division. In order to avoid double reporting in the case of a merger Article 27(3) of the Second Directive allows Member States not to apply the rules on the expert report on consideration in kind if the capital increase is carried out in order to enable a merger.

The Sixth Directive follows a different regulatory path in order to achieve the same objective. Member States here may only provide that the report on consideration in kind and the report on the draft terms of the division are drawn up by the same expert (Article 8(3) of the Sixth Directive).

In order to increase their coherence, the directives should apply the same regulatory method. Article 8(3) of the Sixth Directive should be deleted and the case of division should be added to the exemptions of Article 27(3) of the Second Directive.

However, Article 27(3) of the Second Directive in its current form only provides for a Member State option to prevent double reporting. This option should be transformed into a general exemption from the reporting requirement as there does not seem to be any justification for requiring the setting up of two reports. Therefore **the Second Directive should clearly state that the expert report on consideration in kind is not necessary if the capital increase is related to a merger or a division.**

2.4. Accounting statements in the case of a merger or a division – Third and Sixth Company law Directive

The directives require companies to draw up an accounting statement as at a date that must not be earlier than the first day of the third month preceding the date of the draft terms of merger/division if the latest annual accounts relate to a financial year that ended more than 6 months before the date (Article 11(1)(c) of the Third Directive, Article 9(1)(c) of the Sixth Directive).

This provision, firstly, does not take account of the introduction, for listed companies, of half-yearly financial statements by Article 5 of the Transparency Directive³. Also these half-yearly statements should qualify for making new accounting statements redundant. Secondly, however, it should be noted that also the assessment of the real value of the company in the case of a merger or a division is an issue covered by the directors' responsibility so that they can be held liable for any mistakes they commit. It should therefore be sufficient to rely on a written statement by the directors that sets out the financial conditions of the companies involved. The directors always have the possibility, if they wish so, to rely on expert reports for their statement.

Member States should therefore have **the possibility to allow companies to rely on a statement by the directors instead of requiring new accounting statements** in the case of a merger or a division. They will also have the possibility to leave this decision to the **general meeting**. In any case companies should, have the possibility to use the annual accounts or the half-yearly financial statement instead of the annual accounts in the context of Article 11 of the Third Directive and Article 9 of the Sixth Directive.

2.5. Protection of the shareholders and creditors of the acquiring company – Third and Sixth Company law Directive

The Report of the High Level Group of Company Law experts (the so-called "Winter report")⁴ already addressed the burden that the Third Directive may put on

³ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issues whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC

⁴ Report adopted in November 2002,
http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf

the acquiring company. As a rule, the acquiring company has to go through the same procedure as the company being acquired. Article 8 of the Third Directive lays down the conditions under which Member States do not have to require the approval of the general meeting (publication, shareholders' right to inspect the documents and minority shareholders' right to require the general meeting to be called).

The Winter report pointed out that there are cases however where **the effect of a merger on the shareholders and creditors of the acquiring company does not differ from normal trading transactions**. Therefore, in many cases it is unnecessary to require the convocation of a special general meeting to authorise the transaction or to apply costly creditor and minority shareholder protection measures. The same applies to the position of the acquiring company participating in a division by acquisition.

In this context it should be noted that the rules of the Second Directive, too, protect the interests of the shareholders. Mergers often involve capital increase and in that case Article 29(1) of the Second directive ensures pre-emption rights of pre-existing shareholders. In order to waive this right, a formal decision of the general meeting is required. Mergers by using own shares that can be carried out without capital increase can only relate to companies of a relatively minor size, as also the new version of Article 19 of the Second Directive limits the acquisition of own shares by referring to the net assets of the company.

Creditors are protected by other rules; in particular Article 13 of the Third Directive ensures adequate safeguards to secure their claims.

In this situation, the determination whether and in which cases the approval of the general meeting or additional protection measures are needed should be left to the Member States. This will enable them to fit these rules into their general system of powers that, at national level, are attributed to the general meeting. At EU level only **the right of the shareholders and creditors to inspect the documents** at least one month before the general meeting of the acquired companies should be maintained in order to ensure the necessary transparency of the process in particular with a view to the minority shareholders.

Similar considerations apply in the cases of **acquisition (transfer of the assets) of a wholly owned subsidiary and of a subsidiary whose parent company holds 90% of the shares** that are dealt with in Articles 24 and 25 of the Third Directive. These rules should therefore be adapted accordingly.

2.6. Uniform creditor protection rules – Third and Sixth Company law Directive

Directive 2006/68/EC modifying the Second Directive modernised the creditor protection rule applicable in case of a reduction in capital (Article 32). The procedure for protecting creditors whose claim antedate the publication of the decision on the reduction was specified more in detail, and it was clarified that these creditors have to show credibly that their claims are being jeopardised by the capital reduction if they want to obtain security.

Article 13 of the Third Directive and Article 12 of the Sixth Directive that deal with creditor protection in the case of mergers and divisions **should be aligned with this new wording of Article 32(1) of the Second Directive.**

2.7. Publication in the national gazettes – First Company law Directive

The EU directives require companies in different contexts to publish certain information in the national gazettes. On the substance, it has to be noted that these publication obligations can be divided into two subgroups. The first includes the disclosure of the particulars and documents that have to be entered into the Member States' commercial register. This obligation is principally based on the First Directive but there are other elements in the Second, the Third, the Sixth and other directives and regulations. The second group consists of publication obligations that have to be complied with before the actual change takes place, e.g. the publication of the draft terms of the merger or the division. Only the first group of publication obligations is addressed in the following.

From January 2007 the Member States have to allow companies to file their documents and particulars by electronic means. This information is through the electronic registers accessible to third parties in all Member States, and the European Business Register facilitates the access to national registers further.

The objective behind obliging companies to publish information in the national gazette has always been to ensure the publicity of the companies' authentic data. Today however the same particulars and documents can easily be reached by contacting the register (as the source of the published information) online. **The obligation to publish registered data in the national gazette has therefore become superfluous**, all the more so as the gazettes often do not reproduce the full information but only contain a reference to the register. This function of the gazettes can therefore easily be replaced by a simple service of the register that provides information on the latest changes.

At the same time, publication in the national gazette generates costs for the companies that are not in any way proportionate to the added value that the publication may bring. Under the current rules, Member States are allowed to replace publication in the national gazette with equally effective electronic means; however, also this solution leads to a duplication of the publication obligation.

In order to allow companies to save costs **Article 4 of the First Directive could be replaced by a rule stating that Member States may not require, in addition to the publication pursuant to Article 3, a publication in the national gazette. However, as a minimum, the reference to the publication in the national gazette should be deleted from the First Directive.** The reference point for the legal consequences defined in Article 3(5) of the First Directive would then in future be the publication in the electronic register.

2.8. Disclosure obligations for branches – Eleventh Company law Directive

The Eleventh Company law Directive lays down the disclosure requirements in relation to branches. This obligation also covers the filing of the documents and particulars of the company and the branch (Article 2). Member States may provide for the disclosure of further documents, e.g. the articles of association of the

company. Pursuant to Article 4 they may furthermore, require that certain documents relating to the company are provided with a certified translation when registering the branch.

These rules imply a two-fold cost for companies: they have to ensure the translation of certain documents relating to the company into the local language of the Member State where the branch is situated and they have to register these documents and their particulars, together with the particulars referring to the branch, at the register of the branch. The national rules of the Member States that determine the details around the certified translation, furthermore, often entail excessive requirements (notarisation etc.) that raise the costs further.

In order to reduce these costs to an acceptable level, **it is essential that the Member State of the branch accept the certified translation prepared in another Member State.** This obligation should at least apply where the certificate that has been issued is accepted by the judicial or administrative authorities of that other Member State.

However, there is further scope for simplification with a view to the establishment of branches. In 2000 the SLIM working group addressed the issue whether to abolish the disclosure requirement for branches in the respective Member State. It was suggested that the register of the company should contain the relevant data; however, at the same time it was recognized that the lack of a European electronic system would lead to negative consequences for the stakeholders. Therefore the proposal was, finally, not put forward.

Today the existence of electronic registers all over Europe makes it possible for registers to communicate with each other by electronic means. This possibility is reinforced by the BRITE project that provides for **a common multi-language interface to access the registers in form of the European Business Register (EBR).** This progress calls for searching for more flexible solutions that would reduce administrative burden for companies.

At the moment where a full coverage of all European registers by the EBR will be reached, the data on companies covered by the First Directive and their branches will be accessible electronically through a single interface. The question where these data are entered into the database, in this situation will not play a role any more for the accessibility of the information – i.e. on the user's side - but will only be of interest on the side of the provider of the information, given the considerable differences in the fees that Member States charge to the companies for registering their details. **Companies should therefore in the future have the choice whether they want to file the particulars of the branch in their own Member State or in the country of the branch.** The particulars of the branch would then either be entered into the register of the company and accessed via the European Business Register from every Member State, or be entered into the register of the Member State where the branch is situated.

The same principle should apply to the registration of a **grouping establishment of a European Economic Interest Group (EEIG)** situated in a Member State other

than that in which the official address of the EEIG is situated (Article 10 of the Council Regulation on the EEIG⁵).

2.9. Registered office of the European Company

In 2009 at the latest the Commission will submit a report on the European Company Statute, in accordance with Article 69 of the Statute⁶. A general overhaul of the Statute and in particular of the issues listed in Article 69 does only seem realistic on the basis of that report.

However, Article 7 of the SE statute provides inter alia for that the registered office of an SE shall be located in the same Member State as its head office and allows Member State to provide in addition that SEs registered in their territory have the obligation of locating their head office and their registered office in the same place.

These rules seem outdated in the light, in particular, of the latest judgment of the European Court of Justice on corporate mobility, i.e. the judgments in the cases C-208/00 ("Überseering", judgment of 5 November 2002) and C-411/03 ("Sevic", judgment of 13 December 2005). The second half sentence of the first sentence of Art. 7 as well as the second sentence should therefore be deleted from the SE Statute.

⁵ Council Regulation (EEC)2137/85 No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG)

⁶ Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)