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CHRISTEN BOYE JACOBSEN

An introduction to modern EU company law

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This series of papers aims at contributing to that program by documenting studies undertaken by academic staff, students and guest speakers.

About the author:

Christen Boye Jacobsen (1942-2005) was a Deputy State Secretary (Danish Ministry of Business and Industry) and an honorary professor at RGSL. For a number of years he worked as Chief Adviser under the Pre-Accession program for Central and Eastern Europe under the Danish Royal Ministry of Foreign Affairs.

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CHRISTEN BOYE JACOBSEN: In Memorium

Professor h.c. Christen Boye Jacobsen died unexpectedly in September 2005 shortly after submitting this paper for publication. It is my privilege to pay tribute to this scholar and gentleman.

I had the honor to work with Christen for approximately two years. During that period, he worked tirelessly to improve legal education in Latvia and other Accession countries. He headed the Danish project to assist in the reform of legal studies at the University of Latvia and to support the Ph.D. program for University students enabling them to become qualified teachers of community level and domestic law. At the Riga Graduate School of Law, Christen read in the areas of the internal market, commercial and company law. His efforts to improve the quality of legal education were tireless and successful. Christen had a lengthy and distinguished career in Denmark holding a variety of posts related to the development of the European Union. He last held the position of deputy permanent secretary in the Danish Ministry of Business and Economy.

In this Working Paper, Professor Jacobsen has written a compelling introduction to European Union Company Law. He provides an accessible overview of the sources of EU Company Law, its structures, methods of interpretation and main current problems. He skillfully demystifies the subject by avoiding getting bogged down in analyses of the massive detail of Regulations and Directives. The paper explains the importance of company law for the market economy, identifies its place within the legal system and its sources of law, discusses the relationship between national and EU company law, provides guidelines for how to read and interpret EU company law, and talks about future developments and contemporary issues.

While the approach is conceptual, Professor Jacobsen does not neglect discussion of distinct EC Treaty provisions and landmark cases of the European Court of Justice, for example, *Centros, Inspire Art, Ûberseering* and the *Golden Shares* cases. Professor Jacobsen also examines the new SE and SCE Regulations, the impact of securities and tax law upon company law development, and the emerging attention to corporate governance rules. Two annexes list respectively the “Existing and Proposed European Company Law Instruments” and the “EU Normative Acts in the Securities Area”.

The paper serves the salutary purpose of introducing students and observers of company law into the legal structure of Community level law in this important area. It also serves as a platform for further study of discrete issues and problems of EU company law. Professor Jacobsen’s paper brings needed clarity and simplicity to a complex field. Professor Jacobsen, our friend and colleague, will be greatly missed.

John J. A. Burke
Rector of the RGSL
Riga, September 2005

PREFACE

I have worked with company law for nearly 4 decades, both at national and EU level, and in the legislative, regulatory, judicial, and scientific spheres. Such experience means that many things come to be taken for granted. However, during my years of advising Central and Eastern European countries in their pre-accession period, I realised how difficult it was to transmit a proper knowledge and understanding of European company law. The subject is difficult and polycentric. Moreover, many treatises on EU company law deal with the topic in a way that makes it difficult to obtain an overview of its sources, structures, method, and main current problems. This is because the reader is expected to be *ex ante* familiar with both company law and EU law. Explaining EU company law to freshmen especially has to avoid the triple dangers of:

- getting bogged down in the details of the various directives, regulations, and recommendations,
- centering on a litany of ECJ decision recitals, and
- dealing with EU law as mere modifications or amendments to national law.

My chance and challenge came when I was invited to lecture at the RGSL summer school 2004 for an audience of practitioners from law firms, public administration, and enterprises. The task also had the challenge of being demand driven. This provided the inspiration to write a short and hopefully comprehensive overview covering the major aspects from an EU perspective: the sources of law, the nature and function of company law, the major problems and challenges in company law today, and cross-border problems.

In writing this, I realised that the sources of EU company law remain unacceptably inaccessible, even if you know their existence in advance. In a computerised world, you might expect that the lists contained in annex 1 and 2 are easily found by activating www-copy-paste. But it proved to be cumbersome to establish a complete list of normative acts on company and securities law.

I underline that this paper is not a textbook or a *Lehrbuch* on company law. To-day's company law *de lege lata* can only be taught on the basis of a national company law system. Nor does it attempt to be a full analysis of European company law directives and regulations. The purpose is to give an overview of the state and tendencies of company law in Europe.

By this appetiser, it is my hope that readers should be better equipped and motivated to embark on the real textbooks on company law, and to study the normative acts and the scientific literature.

I thank those at the Riga Graduate Law School who inspired me to write this: our rector *John Burke*, and my collaborator of many years *Ulla Zumente-Steele*, and finally *Chris Goddard* who meticulously sees to it that our thoughts are wrought into proper English.

Copenhagen and Riga, June 2005
Christen Boye Jacobsen

P.S. As this is not a textbook claiming to cover all things in detail, there are very few footnotes. It is left to the reader or the teacher to add such information. Also, I tried to avoid abbreviations, except that I often write ECJ instead of the Court of Justice.

CONTENTS

1. Introduction: What and why is EU company law?

1.1. Why is company law important, and why does it merit more attention than 150 years ago when it was just one of the various forms of contracts?

The answer is that the company is the organisational vehicle of the market economy. The days are gone when a personally-owned firm was the appropriate form for managing all kinds of enterprises. Through regulation of "legal persons", legislators perform a double task and service in relation to economic life: they provide a solid tool, and they set limits. They protect conflicting interests and offer a conflict-saving or -solving framework. Thereby the law creates *clarity* and *reliability,* and induces market participants to create the *trust* without which no economic life can exist. When a company trades outside its home state, transparency and inspiring trust becomes even more central.

Thus, company law is also a detailing of the fundamental principle of *pacta sunt servanda.*

1.2. European company law today stands in the midstream. There was a pause in legislative activities in the EU during the 1990's. When the company law wagon arrived at the other side of the river, it found a landscape that had changed profoundly from what we have known for the last 120 years in Europe.

Ancillary to this is that company law has evolved. That is, from something of interest only to government department specialists, a few law firms, professors, and industrial lobbyists, it has come to be a discipline surrounded by much public interest. This is underlined by the victory of the market economy during the 1990's, by the public focus on corporate scandals, and in Europe the Lisbon process.

Annexes 1 and 2 list the accomplishments of the EU in company and securities law. If we look at the developments during the last 40 years, some tendencies can be noted.

The first is the increased tendency to use instruments other than directives: directly applicable regulations instead of directives, and non-binding recommendations (codes of conduct).

The second is that the regulations and directives do not create a self-supporting regulatory system like the normative acts that we know from national law. Albeit the directives tend to be increasingly detailed, the subsidiarity principle (Article 5(2) of the EC Treaty) and political forces place limits upon the EU's competencies and (thus) the quest for regulation or detail at EU level.

A further limitation follows from Article 44(2)g of the Treaty, which indicates that harmonisation need not mean uniform rules, but mutually recognisable "equivalent" rules. But the market has a preference for clarity and efficiency, and thus for the use of regulations.

This is forcefully supplemented by Articles 47 and 48, and the ECJ's jurisprudence, on *mutual recognition*, cf. 3.4 and 4.9.

1.3. The decisive factors driving future EU company law are

- the split between companies formed under EU law *versus* national, harmonised law,
- the arrival of securities law in massive force,
- the rise of good governance questions, and

- the deregulation-reregulation trend for private companies.

To this should be added that some company law areas are covered by *leges speciales*, e.g. in financial services, energy, and transport. This is mirrored in EU law. Especially on financial enterprises the body of detailed directives is on the increase.

The EU's efforts primarily target public and private limited companies. "Other" entities, legal persons and bodies corporate such as associations, co-operatives, associations, and partnerships are – rightly or wrongly – deemed less central to ever-closer integration in the EU. And certainly harmonisation would be more difficult due to larger differences in legal traditions than is the case for public and private companies.

2. System for the following

The following is split into four parts.

First, under 3, we briefly discuss what company law deals with, and its place in the legal hierarchy and system.

Next under 4, we describe formally the sources of EU company law. The "old" directives (before the mid 1990's), can be classified and put into a scheme due to their subject matter. But more recent developments have to be described in another way, as these developments are much more sprawling. This leads quasi-automatically to a new thinking and method in company law, and to a new system of sources of law, which in Nordic legal theory is called "polycentric".

To this is added the 5th part on how to read the EU company law normative acts.

The 6th part aims to distil and discern some major tendencies in company law today. This is at the same time both the most prospective and the most guesswork-infected part.

In the 7th and final part I take up some of the subjects suggested by Baltic lawyers. I do *not* discuss matters closely linked to national law.[1] I take up three subject groups, which are cross-border by nature, responsibility, group law, and cross-border enterprises.

[1] A number of such matters are found in a report by Prof. Paul Krüger Andersen and myself at the web side of the Latvian Enterprise Register: http://www.ur.gov.lv/drukat.php?t=8&id=865&v=lv.

3. What does company law deal with?

3.1. The 1980 Rome Convention on the law applicable to contracts describes company law in Article 1(1)e as follows:

> ”Questions governed by the law of companies and other bodies corporate or unincorporate such as the creation, by registration or otherwise, legal capacity, internal organization or winding up of companies and other bodies corporate or unincorporate and the personal liability of officers and members as such for the obligations of the company or body”, OJ 1980 L 266/1.

From Article 44(2)g of the Treaty we learn that the rules should aim to protect creditors and third parties. The ECJ, on the publicity rules, has stated that these terms comprise all interested parties (*Daihatsu*, case C-96/97, 4.12.1997, and Commission *versus* Germany, case C-191/95, 29.9.1998)

3.2. Historically, company law protected shareholders and creditors, and clarified the competences of company organs. During the period 1930-90, minority shareholders (investors) came more into focus as the target of protective measures.

But the law also considers the “general interest”, i.e. the public’s interests, especially through publicity rules. Employees, too, benefit from modern company law, either by receiving special information, or by participating in the company’s decision-making process.

Company law serves economic or industrial policy. The rules on reconstruction (merger, splitting, reorganisation, liquidation) should be read in that light. The same applies to group law (*Konzernrecht*) which treats a group of linked legal persons as being economically one unit, cf. 7 below.

Many of the rules also benefit the public policy interest at large, including the taxman and the financial press.

In the case of quoted companies, the publicity rules of company and securities law consider the interests of market participants. As markets integrate, e.g. by international Stock Exchange mergers and by increasingly applying international standards on accounting, financial reporting, and clearing and settlement, the protected public and market is no longer just the national market, but the global market place. Major corporate scandals in the USA and EU at the beginning of our millennium demonstrate that breaches of company law can cause shockwaves in the global market economy.

In the present world of capital mobility, the law has become what can be called a competition parameter and a service to industry. A good and practical company law can attract companies. Sadly there are also countries that attract by bad laws – but in the EU area there is a qualitative common minimum standard at a rather high level thanks to harmonisation.

During the last decade, company law has become central in the debates on business ethics. This may become more emphatic and impact both contents and form of company regulation, cf. 4.6 and 6.2.

3.3. Company law belongs to the branch of law often called economic or commercial. This branch comprises part of contract, bankruptcy, and land law, and the three fundamental laws for commercial activity: company law, fair marketing law, and competition law:

CIRCLE	SUBJECTS
1st (inner)	- Contract, tort, and property law, incl. mortgage law - Bankruptcy law and parts of enforcement procedures - Criminal Code - Intellectual and industrial property law
2nd (middle)	- Company law - Competition Law - Marketing and Consumer protection law - Part of tax law
3rd (outer)	* *Special Legislation e.g.* - Financial sector & supervision law - Special contracts (e.g. insurance, securities, labour, transport, rent and con-dominium - Special protection rules (e.g. advertising, product liability and safety) - Standardisation, conformity assessment & accreditation * *Institution Building, e.g.* - Bankruptcy courts - Competition Enforcement Agency - Consumer protection agency - Financial Supervision - Land Book service - Standardisation, accreditation and certification bodies - General rules on recognition of professional qualifications

You could compare this to the three layers of a tree trunk. These depend on each other, and especially on the inner core which provide the definitions and the legal apparatus that create a coherent legal system.

3.4. Companies or legal persons are classified in various ways. The starting point in EU law is Article 48 of the EC Treaty:

> “Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.
> ‘Companies or firms’ means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.”

This is a very broad definition. We need to define which companies and bodies can benefit from the Treaty’s rules on establishment and services.

Article 48 is described in all books on establishment and services law, to which we refer. Only two features are mentioned here.

The first is that profit-making means the same as “normally provided for remuneration” in Article 50 of the Treaty.

The second is that all member states have kinds of companies unknown elsewhere. They may not mean much in economic life, but they make it impossible to create a unified EU picture. Thus it is not decisive whether an entity is a “legal person” or not. In continental law the distinction between entities without or with legal personality traditionally played a big role, see also EC Treaty Article 281, under which “The Community shall have legal personality”. The German partnership (OHG) does not have legal personality. Inversely, in Nordic and Common law this is regarded as a practical matter best dealt with *ad hoc* by the courts.

Outside recognition under Article 48 falls a mere economic entity. Thus, a group of companies *(koncern)* or a public department running an important public service cannot benefit from Article 48.

3.5. In practice, a variety of companies, bodies, and entities, corporate or incorporate participate in economic life. Most basic structures are common to all Member States.

The most practical distinction is companies with and without limited liability. In limited liability companies, all shareholders have their responsibility limited to the amount subscribed, but the regulatory approach varies between public and private limited companies.

It is difficult to define a private company otherwise than as a non-public limited liability company. The clearest difference from the public company is that the private company cannot solicit investments from the public or an undefined, wide circle of persons. Typically, the private company will have only few shareholders, who otherwise know each other. Thus there is little use for investor protection, but there may be a case for more elaborate creditor protection than for the public company.

There may be other entities with limited liability. This is the case for some economic associations and co-operatives. There are also commandite partnerships where one class of associates has limited responsibility, while the other class has full responsibility (but may itself be a limited liability company).

Full personal liability is found in partnerships, be they civil or commercial, and in a number of associations and co-operatives.

On this basis, companies could also be classified into personal and capital companies. This distinction is used in the directive of 1969 concerning indirect taxes on the raising of capital, cf. 4.10.

In future we may need to split the descriptions of limited liability companies into segments such as:

- National public companies.
- European (public) companies.
- European and national companies quoted on a regulated market.
- One-man private companies.
- Closed private companies.
- Other limited liability companies.
- Mother companies of group of companies.

- Companies under specific regulation by e.g. energy, financial services, or transport law.

As private and public limited liability companies are most important to the economy, and from the outset had basic “equivalence” from one member state to another, EU directives and the regulation on the European public company (SE, Regulation 2001/2157) concentrated on these. Outside limited liability companies, the EU has adopted two regulations on the European partnership (EEIG, 2137/85), and on the European co-operative company (SCE, 1435/2003).

3.6. There are basically two ways to structure statutory national company law.

The method mostly used, even in countries with a code tradition, is a statutory act for each form of company. Outside this may be acts on specialised or horizontal matters such as registration, groups (*konzern)*, reconstruction, and merger.

Another tradition is that of a commercial code, as known in the Baltic States. Here, you may begin with generalities on definitions, registration procedures, and common rules for all commercial companies. Then follow common rules for personal companies, and specialised ones for partnerships and commandite partnerships, common rules for capital companies and specific rules for public and private companies. The code finishes by horizontal rules on merger and other reconstruction, and on groups. Theoretically this can give a very coherent law. But it may be difficult to master and apply a comprehensive, intellectual rigour and to ensure coherence in every detail, and such slips in drafting may lead to contradictory provisions. This may also lead to regarding the various economic associations and co-operatives that lie outside the code, as something more marginal than their economic importance would justify.

Under the $4^{th,}$ $7^{th,}$ and 8^{th} directives, Member States have taken annual accounting and auditing out of the company law framework. This tendency will be more obvious in the coming years, as more of this area will be regulated on the basis of international standards, especially from the International Accounting Standards Board (IASB)[2] and the International Federation of Accountants (IFAC).

It is important to stress that the distinctions of 3.3 to 3.5 do not in themselves tell us much about the actual regulation of companies. They are primarily relevant for legislators and authors of textbooks who have to delimit their subject matter in a practical way. In future, a further difficulty for classification will be how to include companies created under EU regulations (SE, SCE, EEIG).

3.7. Many tend to forget that a company is basically a contract, and that the core of company law is private law. This is probably due to the large volume of to-day’s normative acts on company law, and the active role of the Register in many Member States, including the Baltic and Nordic states. The first document is the constituting contract, and until the registration the company is just a contract.

Therefore the method for interpreting company law is that of contract law and not of public law. This applies also to company law rules in financial legislation. Banking and insurance acts are laws, which supplement the normal company law in areas where more is needed: constitution, capital adequacy, public control, and dissolution procedures.

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[2] These would also include IFRS (International Financial Reporting Standards).

Therefore it is healthy and correct when Article 3 of the Latvian Commercial Law reminds us that company law is intrinsically linked to the civil law area.

The EU has added a further dimension. The general principles of EU law, and eventually of unwritten EU company law, will in future be added to the tools of European company lawyers.

3.8. Interstate company law must deal with a further subject: *Which foreign companies it will or must recognize*, i.e. permit before its courts and public authorities, and licence to exercise economic activities. In practice, there are three areas of recognition problems:

- Recognition of the existence of the legal entity and its right to take part in litigation,
- Recognition of its chosen legal form under home state law by the host state as equivalent to corresponding national forms, and
- Licence to engage in economic activities.

The *first part, recognition of existence* was to be provided in part from Article 48, in part from a convention to be concluded under Article 293.

Under classic private international law this was a complicated topic. It constituted a major interest for legal scholars, and also a practical problem or barrier. For many years legal theory did not sufficiently take into account that Article 48 could be declared directly applicable, as we shall see with the *Ûberseering* case, cf. 4.9. A convention under Article 293 is no longer needed. In practice, this means that the "incorporation theory" of the UK and Netherlands, and the corresponding "registration theory" of the Nordic countries prevail. A company exists if it has been registered in a public register, or otherwise incorporated under the laws of a Member State.

The *second part, recognition of the home country company form as equivalent,* arises because many laws limit access to certain trades to some defined forms of companies (typically, public and private companies, and co-operatives).

For public companies, the problem is minor. In the EU they are, due to tradition and harmonisation, essentially equivalent. For private companies, the variations are bigger, even on core questions. This formed the background for the *Centros – Inspire Art* decisions, cf. 4.9. The *Centros* case was about the huge difference in capital requirements in the UK and Denmark. The ECJs results can be summed up as follows:

- It cannot be presumed that Member States with "lenient" rules have sub-standard rules that could justify host countries in applying supplementary rules or refusing recognition of the form of company chosen under home office law.
- It is presumed that Member States have decent and equivalent laws.

For other forms of companies, equivalence may be a bigger problem. However, in applying the SCE Regulation Member States must recognise co-operatives of other Member States.

The *third part concerns foreign companies' access to and exercise of commercial activities in a host country*.

There is a widespread desire to try to apply host country law. The reasons given are to ensure a level playing field for competition, and to protect creditors, consumers, and the taxman. It is striking that the liberal countries Denmark and

Netherlands used the same language in *Centros* and *Inspire Art*, as did the more restrictive Germany in the *Ûberseering* case.

EU establishment law permits this when the host country can justify it, and demonstrate that it is proportional and not realised by home country law. But it becomes a company law problem when the host country tries to realise this not by commercial regulation, but by applying in part its company law to a company governed by another company law. To run a company under 2-25 company laws evidently does not make sense. Thus the justification must be very convincing.

Trying to generalise, the Court seems to say that

- harmonization, be it by EU normative acts or in any other way, and the possibilities of Member State cooperation must be taken into consideration, and
- a Member State wanting to impose its own law on the top of home company law has the burden of proof.

In retrospect a philosophical question arises: Why did it take so many years to arrive at this point, considering that this concerns fundamental rights under Articles 43 and 48 of the Treaty and Article 15(2) of the Charter on Fundamental Rights, and considering the right of due process of law under Article 6(1) of the European Human Rights Convention?

4. The sources of European company law

4.1. The advantage of a converging starting point

At the outset we must bear in mind that even without harmonisation, Member States' company laws have much in common, beginning with the heritage of the medieval trading systems. The problems of a company, especially of limited liability companies, are by their very nature alike in Member States, and there are not many solutions possible. The fact that the vantage point of this paper is EU law, should not make us forget the historical importance of the statutory company acts of some Member States such as France and Germany whose laws inspired most of continental Europe.

The legal history of Europe shows parallel developments in national company law, at the beginning of the 20^{th} century, in the 1930's, the reform wave in the 1960's, which gave many states a modern starting point for their negotiations in Brussels, and the deregulation wave for private companies in the 1990's. The reforms in Eastern Europe during the last ten years constitute a further wave.

Thus from the outset there was much common ground. The biggest differences stem from links to the core civil law and the general legal system of the Member States. Only now is EU harmonisation beginning to penetrate into the general body of civil law.

The Treaty of Rome adds to this a double message of harmonisation and mutual recognition.

Historically, the mutual recognition track was first explored. But it ran out of steam around 1970, and is now overtaken by solutions from the ECJ, see 3.8 and 3.4.

The second track is harmonisation under Article 44(2)g by directives in order to protect creditors and third parties, by making protection “equivalent” – not identical – under national laws. The first directive was adopted in 1968, but harmonization had a “political” pause in the 1990’s.

Originally the use of regulations or EU law-based companies was not foreseen. But discussion on the use of regulations had begun already in the mid 1960’s, based on the use of Article 306. By the 1960’s it was realised that the transposition of directives into national law caused considerable varieties in text and interpretation, and that regulation-based EU partnerships, EU public companies, and eventually an EU co-operative seemed more workable in cross-border relations. The saying of those days was that instead of repairing old houses by harmonisation we should build new ones by regulation.

4.2. A reminder and warning on EU company law versus national company law

Even though we speak in this paper about EU company law, it is important never to forget that the EU company law system is not – at any rate not yet – a self-supporting system in the way of national company law systems.

You may compare the two systems to a semi-detached house – independent but intrinsically linked.

EU law has a double function. *First* through *harmonisation* it “equalises” the essentials of national laws in order to facilitate creation of the Single Market with an equivalent protection of shareholders, creditors, and third parties, including society at large. *Second* EU law works not only by harmonisation rules, but also through the ECJ’s doctrines on *loyal implementation and interpretation*, and on the rank of EU law as *lex superior* and *direct applicability*. This means that to the company law directives and regulations must be added the role of the directly applicable provisions of the Treaty.

It is due to these functions – which create a kind of container or framework for national laws - that EU company law can qualify *presently* as a system. Remaining with the semi-detached house picture, EU law elements are found both as part of the structures, as well as throughout in the national house.

EU law has a third role, in the scientific study of company law in Europe. It tends to help us Europe-wide to use language, definitions, and systems that are more alike than generations ago.

The picture may change, as regulations on European public companies and co-operatives become operational. This means that the double house is extended into a triple house. Thus EU law will increase visibly. But the national house still stands, and as EU law is found around in the national house, so is national law in the new EU house because the regulations contain on many matters a *renvoi* to (harmonised) national law. The difference between the older parts and the new house is that through the SE and SCE, EU company law becomes a system in its own right.

With this in mind, we can turn to the various sources of law by which the European Union strives to impact company law in Europe.

By far the most important source of EU company law are the directives and regulations.

4.3. The first wave of harmonisation

The achievements of the EU in harmonisation are listed in Annex 1. The 1st directive was adopted in 1968, the 10th and the 13th directives in 2005. Eight date from the period 1976 to 1989.

The chronological approach should be supplemented by an analysis of which matters have been covered by directives for public and private companies:

Subject	*Public companies*	*Private companies*
Constitution	2.dir.	-
Registration	1.dir.	1.dir.
Capital	2.dir.	-
Distribution	2.dir.	-
Capital increase	2.dir.	-
Capital reduction	2.dir.	-
Own shares	2.dir.	-
Directors & Board of supervision	-	-
Shareholders rights	- (2.,3.,6.,13.dir.)	-
Shareholders' responsibility	-	12.dir.
Auditing	8.dir.	8.dir.
Accounting	4. & 7.dir.	4. & 7.dir.
Dissolution	-	-
Merger	3. & 10.dir.	-
Splitting	6.dir.	-
Branches	11.dir.	11.dir.
General principles of law	1. & 2.dir.	1.dir.

NOTE: A list of directives in Annex 1.

In a political and historical perspective, this is a remarkable accomplishment. Some of their good consequences merit highlighting.

First of all, legally-technically the directives are of good quality. In those days, as company law was lawyers' law of little political interest, the directives were well-prepared by, and reflected the *opinio communis* of the greatest names of Europe's universities, and the wording was lovingly cared for in the working groups.

Second, the directives meant a convergence not only in substantive law, but also in general legal thinking and terminology.

Third, they caused Europeanization of research and publishing. In government offices, in law firms, and universities all over Europe, the basic text was the same. Increasingly, textbooks and *Lehrbuecher* and other research refer to the supranational legal framework. And with the Wise men's Report (4.5), the problems, the language, and the solutions tend to become Europe-wide.

Fourth, the directives also meant progress and improved protection. Several countries might claim to possess the world's best law. But when the 4th directive on annual accounting was adopted in 1978, it undoubtedly modernised all laws and brought EU legislation to the forefront of modernity world-wide.

Over the years, the degree of detail in directives became visibly greater- and the preambles have grown manifold. There are many reasons for that: We know each other better, we dare to go further. But when directives permit more than one method, it requires details to ensure that the methods are really equivalent. The eight articles in the 2nd directive on own shares may serve as an example. (The short alternative was to forbid own shares, but that is not politically feasible. Today a more liberal alternative may enter the own share rules, cf. 6.7). But the increasing degree of detail also underlines that the Treaty and the ECJ allow the Council a wide discretion in judging what "equivalence" might require.

To this may be added that the ECJ in its first company law case insisted that directives must be implemented even if the changes were not foreseen when adopting the directive, and even if it might cause major practical consequences (*in casu* amending and re-registration of statutes), Case 32/74, *Haaga,* 12.11.1974.

From this period came only one small regulation from 1985 on European partnership – of modest practical implications.

4.4. Proposals that failed

In order to understand the harmonisation process, it is also important to ponder the proposals that failed and are (still) not adopted:

- Convention 1968 on mutual recognition of companies, cf. 3.8.
- the proposed 5th directive on the structure of public companies.
- a draft 9th directive on material group law – *konzernrecht*.
- the first proposal for a 13th directive on take-over bids.

The three directives failed, principally because European industry did not like them.

The most visible failure was the 13th directive that fell in Parliament in 2002 on a draw 273-273. It fell on a mixture of hostility from industry and the German government, because it wanted to do away with all the protective national mechanisms against so-called hostile takeover bids (such as "poison pills"). A slimmed-down directive was adopted in 2004.

However, in a company law context the failure of the 5th and 9th directives is more conspicuous, because their subject-matter was an ambitious regulation of subjects that are considered politically important and belong to company law's core, notably shareholders' rights.

Normally the shelving of the 5th directive is attributed to a failure to resolve conflicts around the one-tier or two-tier management systems or employees' co-*gestion* where all wanted their own system or no system. But in the SE regulation they could be resolved. The fight against, e.g., multiple-vote shares and poison pills, and fairness to even small shareholders was equally important in the political evaluation.

The 9th directive was never formally proposed. The idea was to treat a group of companies as if they were they one enterprise, thus according protection to the whole group's creditors and minority shareholders. This is law in Germany and in Latvia, but there is a solid criticism of such formalistic solutions.

4.5. The mid 90's: Quo vadimus?

The directives of the 1970's were written for a stable world, where frequent politicised changes, and penetration of US ideas, appeared unlikely.

In the 90's it became increasingly discussed whether the method hitherto used for harmonising needed rethinking.

The Lisbon process, adopted by the European Council in 2000, affirmed that commercial law was important in the modernisation process. Company law had become a growth tool and a competition parameter. There was, however, also the question whether we did the right things and in the right way, because in the USA problems are solved differently.

All this was highlighted when the 13th directive on takeovers fell a year later in Parliament, whereas declared political will pushed the European Company – the SE – to the statute book.

The Commission reacted by creating a group of independent experts, mostly professors, the so-called "Wise Men's Group" or "de Winter Group". Upon its report of November 2002, the Commission in May 2003 presented an action plan for "modernising company law and enhancing corporate governance". The discussion on modernisation is taken up in 6.3 and 6.7.

4.6. Corporate governance and the harmonisation measures of recent years

Note that the headline does not refer to *directives* of recent years, because regulations and non-binding soft law (incl. codes of conduct) play equal roles. The recent harvest of adopted rules consists of:

- a renewed 8th directive on accountants 2005.
- the 10th directive (international mergers), 2005.
- the 13th directive (takeovers), 2004.
- the European public company regulation (SE), 2001.
- the European co-operative regulation (SCE), 2003.
- the regulation on accounting in quoted companies, 2002.
- the two Commission recommendations on auditing, 2000 and 2002.
- the two Commission recommendations on directors, 2004.

Pending drafts are mentioned in 4.8.

The first observation is that directly applicable regulations are gaining ground. The SE and SCE regulations are spectacular achievements. Business finds it increasingly difficult to live with the implementation delays of directives or varying national methods of interpretation and implementation.

Comparing the 350 articles of the SE drafts from the 1970's with the final regulation of about 100 articles, the difference is striking. In the 1970-drafts little was left to national laws and the company statutes. Outside constitution questions, the regulation has fewer rules than any known public company law. Instead the regulation refers *either* to the public company law of the country of registration, *or* to the statutes of the company.

Many see this as surrender to national law. However, this is only partly the case, because

- national law has been harmonised through directives and ECJ jurisprudence, and
- the law for quoted companies is further harmonised by the securities directives and international accounting and reporting standards.

But the regulation also heralds a resurrection of the autonomy of the parties and to flexibility, because

- the parties can choose any of the 25 Member States as the registered seat, thereby also choosing their company law,
- the reference refers to the national public companies act as it stands for national companies. This implies a prohibition on issue of special rules for the SE, unless the regulation so authorises,
- the parties can choose between the two permissible management systems: the one-tier (UK) system or the two-tier (German) system, and
- the regulation accords formally and in reality a role to the statutes of the company.

Regulation 1606/2002 on accounting standards for quoted companies transfers the substance of legislative power on accounting of quoted companies to an international body, the International Accounting Standards Board (IASB), an association of national auditing associations of a number of countries – and under considerable pressure from the US standards (GAP) and the US administration. The EU legislative role is reduced to the Commission's right to veto a standard, as was the case on IASB 39 where banks persuaded the Commission to not make that standard mandatory in the EU. But we also saw that this creates problems for the EU in the global market.

To future historians, the most important development of recent years will be the *corporate governance* discussion. In the UK, the market is familiar with non-binding codes on best practice, and has a consultative body to oversee it, whereas it was an unfamiliar regulatory tool to continental thinking. The code idea therefore has changed the way in which Europeans think on company law regulation.

The first "formal" text in Europe was an OECD recommendation from 1999. Most member states have adopted a local code or codes. In Denmark the code was made by a private working group, but with the assistance of the Companies Registry and the Copenhagen Stock Exchange. And so will it be in Latvia where the code is a project of the Riga Stock Exchange, not the financial supervisors, nor even involving the Enterprise Registry.

The codes on corporate governance supplement the law on what should be the practise in decent and efficient companies on:

- Composition of the board - internal versus external members, and expertise versus "names".
- The role and work of the board, including the need for committees on remuneration, appointments, and auditing.
- The role of major and institutional shareholders - should they have and publish a policy on the way in which they intend to manage their investments?
- Remuneration of board members and directors.
- Transparency and conflicts of interest.
- Policy on risks, acquisitions, and own share programs.

Behind this lurks a core policy choice: In whose interest do we run the company, or how much can we accommodate other interests than shareholder interests? It seems that today more focus is accorded to the role and interests of the owners, i.e. the shareholders. But interests other than short-term interests fed by the daily stock exchange index should also be taken into account.

The codes cannot be sanctioned in the same manner as normative acts. But they have the important principle of "explain or comply", and the financial press will be instrumental to sanctions from the market. In the long term, the codes will also impact the standard of *bonus paterfamilias* behaviour in contractual and tort liability.

Till recently, no EU initiatives were planned. However, in 2004 the Commission became active in the corporate governance discussion. This led to the issue of the two recommendations on directors' remuneration and independence. But the Commission went further by proposing to amend the accounting directives (4^{th} and 7^{th} dir) to enhance confidence in financial reporting. Board members should be collectively responsible for financial statements and key non-financial information. All companies must provide full information about off-balance sheet arrangements, including "Special Purpose Vehicles" which may be located offshore. Unlisted companies' transactions with related parties should be more transparent. And listed companies should issue an annual corporate governance statement, i.e. "comply or explain".

With this, and with the IASB and the OECD – and in future eventually the WTO - as central participants, the sources of company law and their interpretation now reside with authorities under varying jurisdictions, procedures, and interpretation principles. Thus the law has become *polycentric*.

4.7. Securities law

The accomplishments of recent years cannot be evaluated without including the securities area directives. The full list thereof is in Annex 2. Securities issues are also discussed in 6.5.

Some of these rules, e.g. on major shareholders, could also be classified as company law, and are issued under Article 44(2)g of the Treaty. Others are more related to the regulation of the market. As explained in 6.5, there is no general principle which in case of conflict with company law gives priority to securities law (or *vice versa*).

But it merits highlighting that securities law has impacted the extent to which the law protects shareholders. Earlier on, company law protected two types of shareholders rights:

- Administrative rights, meaning the right to attend the general meeting, to take the floor and to ask questions there, to submit proposals, and to vote, and
- Economic rights, such as the right to dividends, new issues of free shares, preferential subscription rights.

The focus of securities law is upon the protection of the shareholder in the regulated market, including the prospective shareholder. But this also changes the way in which company law looks upon these questions. Securities law extends the notion of shareholders' equality to their dealings in the regulated market. The 13^{th} directive on takeover bids makes a single share of equal value with shares forming part of a majority holding.

4.8. What is in the pipeline now?

Legislation of the present falls into two distinct groups.

The first is reforming and completing the existing normative EU acts.

The politically most important recent initiative is the new 8^{th} directive, expected during 2005. The accounting scandals in the USA and EU (Enron, Tyco, Ahold, Parmelat etc.) revealed a number of problems in the regulation of the accounting profession, and also demonstrated that fallible accountants form a threat to the world economy. Public supervision, and the requirement of life-long learning and regular post-graduate upgrading may become a legal obligation.

The Council in 2005 should adopt the 10th directive on international mergers, completing the 3rd, 6th and 13th directives.

After this, there is not much in the pipeline on formal rules. The draft regulation on economic associations is still pending before the Council. The Commission is working on a 14th directive on "change of legal form" (German: *Umwandlung*). This would be a natural initiative after the adoption of the 10th directive on cross-border mergers. These measures are related to the Lisbon process.

The second group concerns initiatives that can, in the medium term, totally restructure the means and ways of company law. The two great reforming tasks before us now concern corporate governance, described under 4.5, and capital requirements, described under 6.7.

4.9. The role of the ECJ[3]

For decades, company law cases were extremely rare. But during the last 10 years, the Court of Justice became an important player in company law regulation. Some lacunas left by legislation have been filled in by the Court. The four judgments described in the following can illustrate this. They all fell like a bomb into national law.

The most innovative of these cases is ***Centros*** (C-212/97, 3.3, 1999). In the early 1990's, the capital requirements of the Danish private companies act were drastically increased. A private company would require about 27.000 Euro fully paid-up, before the company could be registered. Some Danes, in order to avoid this, constituted the UK private company Centros, which under UK law only required about 20 Euros, and whose declared objective was to do business in Denmark. They then asked the Danish companies register to register a branch of the UK company. The Register refused, citing the reason that the company avowedly wanted to avoid Danish law. The Court found that the company Centros was legal under UK law and thus entitled under Article 43 of the Treaty to have a branch in any other Member State. That the UK capital requirements differed from the Danish ones, did not qualify as a public policy exemption.

The Danish government further submitted that, as there was an uncontested intent to avoid Danish law, to require that the UK company *also* followed the Danish private companies act should be construed as a "purely internal Danish matter", and that Danish law was required to protect creditors and the taxman. (The latter argument was not recognized by company experts in Denmark.) The ECJ rejected them as disproportionate, as there are many other and better ways to protect creditors.

The ***Inspire Art*** (C-167/01, 30.9.2003) followed up *Centros* in a case on Dutch law:

[3] Further judgments are mentioned in: 3.1&3.5: Daihatsu 1997 & Com v Germany 1998, 4.3: Haaga, 1974, 4.10: Fantask 1997, 4.12: Tomberger 1996, & Marleasing 1990, 5.4: Kefalas 1998, 5.5: Paul 2004 & Berlusconi 2005, 5.6: Karallas 1998, Bauunternehmen, Daihatsu, Berlusconi, 6.5: Pafitis 1996 & Karella 1998, 7.1.3: Diamantis 2000. – The enigmatic Daily Mail case 81/87, 27.9.1988 is intentionally not discussed.

> "The reasons for which a company chooses to be formed in a particular Member State are, save in the case of fraud, irrelevant with regard to application of the rules on freedom of establishment. The Court has also held that the fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of more favourable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in that second State. … the fact that a company does not conduct any business in the Member State in which it has its registered office and pursues its activities only or principally in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct…." (points 95, 96, and 139).
>
> The SCE Regulation illustrates that the way of thinking of the ECJ is applied also by the Council. Whereas the SE regulation refers to a well-developed body of national law with a basis in written normative acts - the rules for national public companies - the reference in the SCE regulation Article 9 to "as if it were a cooperative, formed in accordance with the law of the Member State in which it has its registered office" is theoretically clear, but practically ambiguous. Some countries have statutory law, but not so well developed as public companies laws. Some countries, e.g. Denmark, have only unwritten law, which must be recognised in all Member States.

Überseering (C-208/00, 5.11.2002) concerned an old way of denial of justice disguised as a question of private international law. According to continental case-law and long-standing legal theory, a company's legal capacity was determined by reference to the law applicable in the place where its actual centre of administration is established (*siège réel*), as opposed to the incorporation principle, by virtue of which legal capacity is determined in accordance with the law of the State in which the company is incorporated. The *siège réel* rule also applied where a company had been validly incorporated in another Member State and had subsequently transferred its actual centre of administration to Germany.

The company Überseering acquired a piece of land in Germany, which it used for business purposes. By contract Überseering engaged a company to refurbish some buildings. Überseering subsequently claimed that the work was defective. However, the German courts held that as a company incorporated under Netherlands law, Überseering did not have legal capacity in Germany and, consequently, under German law it did not enjoy rights nor could it be the subject of obligations or be a party to legal proceedings unless it had been reincorporated in Germany.

Until the ECJ declared Treaty Articles 43, 49 and 50 directly applicable in the 1970's, it was thought that this could only be changed by a convention under Article 293. Such a convention was agreed in 1968, but failed to be ratified. However, the General Program on Establishment adopted by the Council in 1961 specified the right to be a party before the courts as part of that freedom. The Court stated (points 59-60):

> "A necessary precondition for the exercise of the freedom of establishment is the recognition of those companies by any Member State in which they wish to establish themselves. Accordingly, it is not necessary for the Member States to adopt a convention on the mutual recognition of companies in order for companies meeting the conditions set out in Article 48 EC to exercise the freedom of establishment conferred on them by Articles 43 EC and 48 EC, which have been

> directly applicable since the transitional period came to an end. It follows that no argument that might justify limiting the full effect of those articles can be derived from the fact that no convention on the mutual recognition of companies has as yet been adopted on the basis of Article 293 EC."

The ***Golden shares cases***, C 367/99 (Comm. *versus* Portugal), C-483/99 (Comm. *versus* France) and C-503/99 (Comm. *versus* Belgium), all dated June 4, 2002 set limits upon shares with special rights. Such shares make it possible to retain control of certain aspects of an ex-state enterprise that has been formally privatised.

In the Belgian case, Belgian law entitled the government, in the case of two energy enterprises, to use its "golden shares" to oppose:

- any transfer, use as security or change in the intended destination of lines and conduits or of certain other strategic assets, and
- second, certain management decisions regarded as contrary to the guidelines for the country's energy policy.

The Commission considered this a restriction on the movement of capital between Member States. The Court set out the limits for Member States as follows (points 48-55):

> "It is necessary … to ascertain whether the legislation in issue enables the Member State concerned to ensure a minimum level of energy supplies in the event of a genuine and serious threat, and whether or not it goes beyond what is necessary for that purpose.
>
> First of all, it should be noted that the regime in issue is one of opposition. It is predicated on the principle of respect for the decision-making autonomy of the undertaking concerned, inasmuch as, in each individual case, the exercise of control by the minister responsible requires an initiative on the part of the Government authorities. No prior approval is required. Moreover, in order for that power of opposition to be exercised, the public authorities are obliged to adhere to strict time-limits.
>
> Next, the regime is limited to certain decisions concerning the strategic assets of the companies in question, including in particular the energy supply networks, and to such specific management decisions relating to those assets as may be called in question in any given case.
>
> Lastly, the Minister may intervene … only where there is a threat that the objectives of the energy policy may be compromised. Furthermore, … any such intervention must be supported by a formal statement of reasons and may be the subject of an effective review by the courts.
>
> The scheme therefore makes it possible to guarantee, on the basis of objective criteria which are subject to judicial review, the effective availability of the lines and conduits providing the main infrastructures for the domestic conveyance of energy products, as well as other infrastructures for the domestic conveyance and storage of gas, including unloading and cross-border facilities. …
>
> The Commission has not shown that less restrictive measures could have been taken to attain the objective pursued. …
>
> The legislation in issue is therefore justified by the objective of guaranteeing energy supplies in the event of a crisis."

Although France pursued the same objective (namely, to guarantee supplies of petroleum products in the event of a crisis), the Court considered that the French rules clearly went beyond what is necessary in order to attain the objective indicated. It found that the French provisions did not indicate the specific, objective circumstances in which prior authorisation or a right of opposition *ex post facto* would be granted or refused, and thus were contrary to the principle of legal certainty. Such lack of precision and such a wide discretionary power constituted a serious impairment of the fundamental principle of the free movement of capital.

The Portuguese rule provided for manifestly discriminatory treatment of investors from other Member States: its effect made it unlawful under the Treaty rules on free movement of capital.

The ***Lankhorst-Hohorst*** case (C-324/00, 12.12.2002) set aside German tax law rules on "thin capitalisation", because they distinguished between groups where the mother company was also established in Germany, and other groups where the daughter was established abroad. This was different treatment contravening Article 43 on establishment. This meant that Member States must either treat foreign mother companies as well as their own, or their own as harshly as foreign mother companies. Both solutions bring further practical complications into corporate tax law.

These judgements – like the regulations on the SE and the SCE – are all based upon the presumption that Member States are civilised and *equally* civilised states. The background and reasoning can be found in general principles of EU law. The decisions rely on the non-discrimination rules of the chapters on establishment, services, capital, and taxation. But general principles of EU law, as established by the Court, may be equally relevant. The principles of loyalty, proportionality, efficiency, transparency and equal treatment explain why national law could not be upheld. To this is added the requirement of access to legal redress. These principles must also be read into the directives and regulations.

The ECJ's principles of mutual recognition and *ad hoc* interpretation raise the problem known in the US as "delawarisation". A country with an attractive law has the chance of becoming the country of registration of many companies that have otherwise little relation to that country. This leads directly to tax law.

4.10. Tax law

Tax law often is a major component of business strategy. Thus no description of business law is perfect without including tax law.

There are many directives that affect business in the EU concerning indirect taxes, notably the VAT system.

But right from the beginning company taxes attracted attention and led to Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital, (OJ 1969 L 249/25). This directive has the important effect that it hinders – together with the 1st company law directive – Member States from turning registration fees into indirect taxation, see case C-198/95, 2.12.1997, *Fantask*.

On transnational groups there are the following three directives:

- Council Directive 90/435 of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, (OJ L 1990 225/6)
- Council Directive 90/434 of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and

exchanges of shares concerning companies of different Member States, (OJ 1990 L 225/1).

- Council Directive 2003/49 of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, (OJ 2003 L 157/49).

These directives may contain definitions of interest for company law.

This must be supplemented by three reminders.

The first is that within the framework of the requirements of establishment and services law, the ECJ has taken a substantial number of decisions on discriminatory tax law during the last 10 years. One of these decisions (Lankhorst-Hohorst 2002) is discussed under 4.9.

The other is that low taxes can also be a problem, as they can distort competition. This is why there is a code of conduct on corporate tax law (OJ 1998 C 2/2). Estonia is considered the biggest sinner here.

Tax authorities cooperate against tax avoiders. The most important rules are:

- Council Directive 77/799 of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336/15) ,
- Council Directive 91/308 of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, (OJ 1991 L 166/77),
- Council Directive 2003/48 of 3 June 2003 on taxation of savings income in the form of interest payments (OJ 2003 L 157/38).

4.11. The literature

For the practitioner, a natural question is whether there be legal literature to assist.

In national law we are accustomed to having a large number of books and commentaries. Thus, albeit the German Companies Act is the most detailed, German law commentaries are the most voluminous.

For EU law the answer is “not yet”. There are many articles describing one directive or part thereof, and a few books giving factual description of each EU directive.[4]

But the literature has not really managed the transition from an aggregate to a system of mutually dependent elements. There are no books analysing EU law *as a system* in the way we expect for national company law systems. Such books should include reflections on the question whether there be an unwritten EU company law.

Furthermore, books by academics often suffer from a certain distance to Brussels. This is a bigger problem than for national law, as we do not have a public track record of preparatory works in the way we would have for national law.

[4] See e.g. Edwards: EC Company Law (2001). Werlauff: EU Company Law (2003) describes secondary acts and proposals as a system, but a good part of his work relies on anticipation of legislation and jurisprudence. Both authors includes securities directives in their work.

4.12. Is there also unwritten EU company law?

The answer to this *must* to some extent be in the affirmative.

The reasons for this are found in the general principle of interpretation. Words and notions can basically only have one meaning, to be ascertained by the methods of interpretation of EU law. And as EU company law grows into a system of mutually dependent elements, the need for creating coherence through unwritten law increases.

The first step in this process was the *Marleasing* doctrine, under which there is a general duty to interpret national law in the way that is most in conformity with EU law. The *Marleasing* case (case C-109/89, 13.11.1990) directly concerned company law, as it was about the nullity rules in the 1st company law directive which are closely linked to national contract law.

A good illustration of the problem of one or several permissible meanings of words could be Article 6 of the 2nd directive. Under this article the shareholders must pay up their subscription. But does *paid-up* in common law mean the same as the French notion, requiring the capital to be "*liberé*". Thus Article 6 can either mean that each Member State can refer back to its normal commercial or civil law understanding, or that there should be only one understanding, to be found by normal EU interpretation methods.

But the question becomes more pertinent in cases where the directive introduces something that is new in relation to national law before implementation of the directive. Thus the accounting directives (4th and 7th) introduced both principles and methods so far unknown in most national laws. Here, the case for one common interpretation is strong. When asked a highly technical question on group accounting, (case C-234/94, *Tomberger*, 27.6.1996), the Court prefaced its answer as follows:

> "With regard to Article 31 of the Fourth Directive, it should be borne in mind that the Fourth Directive seeks to coordinate national provisions concerning the presentation and content of annual accounts of certain types of companies (see the first recital of the preamble). In order to coordinate the content of annual accounts, the directive lays down the principle of the "true and fair view", compliance with which is the primary objective of the directive. According to that principle, the annual accounts of the companies to which the Fourth Directive applies must give a true and fair view of their assets and liabilities, financial position and profit or loss (see the fourth recital in the preamble to the Fourth Directive and Article 2(3) and (5) thereof)." (Point 17).

The real area for an autonomous EU company law may be the area of regulations, see 5.3 below. But the results of the application and interpretation of regulations may affect the whole system by a "rub off" effect.

5. How should we read EU normative acts

Directives and regulations on company law differ from other directives and regulations by dealing with private law matters. Interpretation methods are basically those of contract law, and not from public law, cf. 3.7.

But the EU company law rules must be further divided into several groups - at least three.[5] Their subject-matter requires a somewhat different approach to interpretation.

5.1. The *first group* are directives which harmonise areas of "classical" company law, e.g. the 2nd directive on capital and the 3rd directive on mergers. They deal with areas that to a large extent were "common ground" for law and theory in Member States. One of the important interpretation issues will then be, whether the notions which the directives use should have one and the same meaning applicable in all Member States, or may be understood as a *renvoi* to the corresponding national notions.[6] An illustration of one or more permissible meanings of notions is Article 6 of the 2nd directive, cf. 4.12.

Interpretation is complicated by the fact that these directives cannot be classified wholly as minimum or total harmonization directives. This must be decided by interpretation of each article.

5.2. The *second group* covers directives that introduce a new, common system. This is the case for the accounting and auditing directives. They benefit a wider group, cf. 3.1, and introduce new principles and methods. The most important example is the "true and fair view" as the overriding accounting principle. Here arguments for a common interpretation and application throughout the EU are strong. I refer to the reflection on general principles of the *Tomberger* case, quoted in 4.12.

5.3. The *third group* concerns basically the regulations. The SE and SCE regulations put the need for uniform application of notions with renewed force. By their very nature the SE and SCE are transnational companies, and may well be quoted on several regulated markets. A higher degree of unitary understanding and interpretation must be read into the SE and SCE regulations. Otherwise third parties may encounter considerable insecurity in understanding and dealing with an SE or SCE, their functionality and *effet utile* could be undermined, and the incentives for forum shopping and delawarisation would increase. A further argument for unitary interpretation comes from companies that are quoted in more than one country.

It may also be that over the years the ways of interpreting a SE's statutes, constituting or shareholders' agreement, and other documents adopted by or in such EU companies will begin to differ from the interpretation applied to

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[5] There may be a fourth group, the 10th and 13th directives on international merger and takeover. The notions would lead them to the first group, but their purpose would rather lead them towards the second group.

[6] A corresponding issue arises in the Banking Directive 2000/12. This enumerates classes of assets that may serve for own capital or for various risk classes. But here it is evident – due to lack of property and contract law harmonisation – that the reference is to the national law notions.

corresponding documents from national public companies. In those cases, we have elements of an autonomous EU company law.

But often we find the same notion in directives and in regulations. This may reinforce the arguments for one, common interpretation, especially on cross-frontier company law problems. However, there are also arguments for a more nuanced approach, notably in areas where there is a need for integrating the notions into the general body of property and contract law. An example may be Article 9 of the 1st Directive on the powers of the organs to bind the company. To this is linked an unwritten exception in the form of a *renvoi* to national contract law on *contra bonos mores*. Such rules vary in scope and effects. The ECJ has accepted that unwritten (company) law on disloyal behaviour by shareholders be compatible with the 2nd Directive, i.e. applied as an exception, see the *Diamantis* case, referred to under 7.1.3.

The practical disadvantages of this are reduced by the duty of EU-conforming interpretation under the *Marleasing*-doctrine, see below.

5.4. There are relatively few ECJ judgments on company law proper, and many of these decisions concern matters that are not regarded as essential questions of company law. The few books on EU company law also spend a good part of their pages on adjacent areas, such as primary and secondary establishment and security law, and tax law cases.

The starting point is the wording …

If we look at cases like *Haaga* or the Greek reconstruction cases, it is evident that it would have been much easier if the ECJ had permitted ”flexible” constructions in stead of giving priority to the wording. Both cases created considerable practical problems. In *Haaga*, German (and UK) implementation of the 1st Directive was defective. The effect could be that all companies had to amend their statutes at a general meeting and reregister the amendments. This implied costs in billions for companies and public authorities. But the ECJ stuck to its normal stance that the practical consequences cannot dilute the wording.

… but should be read in a way that creates a coherent company law.

This is not astonishing in cases where the EU directives aim at being a coherent system, as was the case in *Tomberger*.

At the present stage of harmonisation, most directives on substantive company law presuppose a national framework, in which they can be implemented, and which – within the limits of the *Marleasing* doctrine - has its own life.

An example of permissible integration can be found in the Greek *Diamantis* case, mentioned in 7.1.3. Inversely, the *Centros* case illustrates national means that go beyond the permissible, cf. 4.9.

Another of the Greek cases illustrates that company law cannot be set aside by “reclassifying” a problem, or making a *lex specialis*:

> “It would mean that, in the event that the company found itself in a financial crisis, a shareholder could never rely on Article 25(1) of the Second Directive. Consequently, the scope of that provision would be altered, whereas, according to the case-law cited above, the provision must remain applicable in such a situation.” (*Kefalas*, C-367/96, 12.5.1998, point 25).

And the directives should be read in an EU-loyal way.

This follows from the general duty to implement Articles 10 and 249 of the Treaty. This is mentioned here, because a leading judgment on the duty of EU compatible interpretation of national law (*Marleasing,* C-1O6/89, 13.11.1990) concerned the nullity rules of the 1st directive.

There is in this an old conflict-of-law problem: Should we enforce the law of another Member State, if that law is not compatible with EU law? General principles and *Marleasing* would indicate that the answer is negative, but this now also follows from SE Regulation Article 9(2).

5.5. Sanctions

The general EU law requires an efficient and loyal implementation and enforcement of EU law. Since much company law suffers from lack of efficient remedies, especially for minorities, the question is poignant. But when the ECJ had to decide whether Germany had implemented the publicity rules correctly, it restricted itself to finding that the German rules were inefficient and thus not "*sanctions appropriées*". The practical consequences were left to the Member State.

In an adjacent area, the ECJ recently affirmed this restraint. German financial supervision is – since it lost a compensation case – exercised "in the public interest" only which means that private individuals have no rights of compensation for faulty supervision. On this the ECJ stated:

> "… it does not necessarily follow either from the existence of such [supervisory] obligations or from the fact that the objectives pursued by those directives also include the protection of depositors that those directives seek to confer rights on depositors in the event that their deposits are unavailable as a result of defective supervision on the part of the competent national authorities. … [T]he harmonisation … is restricted to that which is essential, necessary and sufficient to secure the mutual recognition of authorisations and of prudential supervision systems, making possible the granting of a single licence recognised throughout the Community and the application of the principle of home Member State prudential supervision. … [T]he coordination of the national rules on the liability of national authorities in respect of depositors in the event of defective supervision does not appear to be necessary to secure the results described …
>
> Moreover … it is not possible in a number of Member States for the national authorities responsible for supervising credit institutions to be liable in respect of individuals in the event of defective supervision. It has been submitted in particular that those rules are based on considerations related to the complexity of banking supervision, in the context of which the authorities are under an obligation to protect a plurality of interests, including more specifically the stability of the financial system," Case C-222/02, *Paul et al*, 12.10.2004, points 40-2 & 44.

In the directives on structural adjustment (the 3rd, 6th, 10th, and 13th directives), we avoided any specification of the basis for civil liability. If we substitute the reference in *Paul* to systemic stability with the protection of investors *versus* the business freedom of management, then there appears a reasoning that does not lend much support to shareholders and investors. Thus, this must wait until general tort and contract law has been harmonised.

Inversely, the directives may more readily be invoked in cases on invalidity, nullity, and the like, due to the principle on EU- compatible interpretation.

The lack of harmonisation on private law remedies can be a problem in relation to the SE and SCE Regulations. This may encourage forum shopping, which is permissible under the *Centros*-doctrine.

To complete the picture, a case on criminal responsibility should be added:

> "According to that case-law, while the choice of penalties remains within their discretion, Member States must ensure in particular that infringements of Community law are penalized under conditions, both procedural and substantive, which are analogous to those applicable to infringements of national law of a similar nature and importance and which, in any event, make the penalty effective, proportionate and dissuasive". But the directive could not justify retroactive increase of sanctions, (case C-387/02, *Berlusconi.*,3.5.2005, point 65).

5.6. Direct applicability

A generation ago, the legal situation appeared simple. Regulations were directly applicable, and thus "implementing" them was forbidden. Directives were not directly applicable, and required implementation

Today the only certainty is that regulations are directly applicable, and that member States must implement directives. Due to the slimming of the SE- and SCE-Regulations, they require supplementing, be it by *renvoi* to national public company law, by contractual autonomy, or by the duty of Member States to add supplementary legislation.

For directives, the *Marleasing* case created uncertainty. Some authors argue that the requirement of EU-conforming interpretation of national law equals direct applicability. And the only example of a directly applicable company law rule, Article 25(1) of the 2nd Directive, does not clarify the overall picture:

> "It must be held in that connection that that provision is clearly and precisely worded and lays down, unconditionally, a rule enshrining the general principle that the general meeting has the power to decide upon increases in capital.
>
> The unconditional nature of that provision is not affected by the derogation provided for in Article 25(2) … That individual, clearly defined derogation does not leave Member States any possibility of making the principle of the power of the general meeting subject to any exceptions other than that for which express provision is made. … The same applies to Article 41(1) … Moreover, the fact that the Community legislature provided for precise, concrete derogations confirms the unconditional character of the principle set forth in Article 25(1) ...
>
> It is appropriate therefore to answer the national court by stating that Article 25(1) of the Second Directive may be relied upon by individuals against the public authorities before national courts. " (*Karella*, case C-19&20/90, 30.5.1990)

It could also be postulated that the increasing detailing of directives make them directly applicable. This argument concerns especially the publicity and accounting directives. Most rules of the 4th and 7th directives are drafted in a way that could make them directly applicable. The practical counter-argument would rely upon the many rules with alternatives or exceptions that give Member States a choice, even though it may be a limited freedom:

> "However, the powers of the national authorities in this regard are restricted by the Directive. First, it is clear from the primary aim of the Directive that the

> annual accounts must give a true and fair view … Second, it is clear from Article 42(1) of the Directive that provisions for liabilities and charges may not exceed in amount the sums which are necessary. It follows that the valuation criteria laid down by the national authorities must comply with those two conditions.” (DE+ES Baunternehmen, C-275/97, 14.9.1999,Point 36).

Karella was a case against a state before an administrative tribunal. The general line over decades is that the directives are not directly applicable:

> “Since a directive cannot of itself impose obligations on an individual, and cannot therefore be relied upon as such against such a person, there is no need to examine whether Article 6 of the First Directive … has direct effect.” (Daihatsu (3.1), conclusion point 2.)
>
> “In the specific context of a situation in which a directive is relied on against an individual by the authorities of a Member State within the context of criminal proceedings, the Court has ruled that a directive cannot, of itself and independently of a national law adopted by a Member State for its implementation, have the effect of determining or aggravating the liability in criminal law of persons who act in contravention of the provisions of that directive.”(Berlusconi (5.5), point 74.)

The developments of recent years have made accounting and reporting standards from international organisations (IFAC and IASB) a primary source on accounting and auditing. For international groups it is a must or a legal duty under Regulation 1606/2002, and for other companies it is becoming good accounting and auditing practice.

IFAC and IASB have their own interpretation principles and organs. Thus central parts of company law are under a double system, i.e. polycentric law and interpretation systems. This creates an international obligation for the EU when applying the law of this area.

The ECJ added a Frankovitsch-reminder to this:

> “This finding is without prejudice to the possible applicability of the principle that Community law requires Member States to make good loss and damage caused to individuals by reason of their failure to transpose a directive or their failure to do so correctly.” (*Daihatsu,* point 25.)

6. Tendencies in modern company law

6.1. The role of legislation

I begin this section by presenting two modern thinkers.

The first is *Francis Fukuyama* of the USA. The second is *Hernando de Soto* of Peru. They both (in *The End of History and the Last Man*, 1992; *Trust*, 1995; *The Mystery of Capital*, 2002) stress the role of commercial law. Even in poor countries, there is much more capital than we envisage. There may be more dollar notes in Russia than in the US. But that does not constitute a functioning market economy. That requires trust. Experience teaches that without a coherent and functioning legal system there can be no such thing as trust.

From this we may deduce that there cannot be a well-functioning market unless our society has modern, high quality commercial law, and competent, efficient, and honest civil services and courts, i.e., a functioning legal *system*.

This may indicate that, contrary to what is taught in constitutional law, the legislator is not only the voice of the public will. It is also a service provider that should see to it that good laws, courts, and civil services exist – and are constantly revised and upgraded. For there are no possibilities of a calm, static situation. It has been said that, due to structural changes, company law is moving from entity to enterprise law.

Thus, modern company law is not just about ordering, forbidding, and sanctioning. It is primarily about ways to make “economic man” behave in an honest, transparent, and efficient way. Modern commercial law works through persuasion, consensus, and inducements, rather than relying upon the criminal code.

These tendencies are accentuated when the national legislature becomes an implementing agency of the EU, OECD, WTO, IFAC, or IASB. It becomes an essential part of the competitive advantages or disadvantages of a state in fierce competition with others. Latvia cannot legislate that a Danish enterprise should prefer Latvia instead of Estonia. And today’s markets are transparent and analysed and controlled at a higher level than Member States, by the experts of big business and the investigative financial press.

Some think that bad laws are an attraction in emerging economies. It may be true that the dishonest are attracted by it. But whom do they benefit? For the rest of us, both the nice and the brutal ones, bad legislation will somehow somewhere be a costly millstone. That is why a proper analysis in any business planning includes an assessment of the legal environment of a prospective country.

6.2. Soft law - Self-regulation – Transparency - Control

From this redefined role of legislation there is but a short step to discussion about soft law and self-regulation.

From a theoretical point of view, we might believe that increased use of soft law went hand in hand with a wider application of self-regulation. But in the case of the auditing profession, scores of accounting norms are IASB or IFAC standards, completed on professional independence and quality by two Commission recommendations. However, enforcement requires the state to become implicated in the process by mandatory supervision.

There are several ways to look at this. Provided the law be good, it does not matter who issues it. But it does matter that it is properly enforced. In Europe, only the states can ensure full enforcement. Furthermore, enforcement enhances the transparency without which efficient competition, the crux of the well-functioning market, cannot occur.

Inversely, it seems to matter less whether soft law codes are national or international, private or public. What matters is the quality, the enforcement, and the capacity to update it at regular intervals. Experience shows that the chances of high quality are about the same. National fora may have an advantage in speed, but may be outweighed by the disadvantages of parallel national standards, and thus constitute an added cost.

The next decade may present us with problems when it comes to interpretation methods and interpretation mechanisms, because the forum for, and methods of, interpretation vary between a state, the EU, OECD, IFAC, and IASB. In future company law there are elements from all, working in parallel. This creates a kind of legal jigsaw called *polycentric law*.

There is yet insufficient experience of how this may work. The job of creating an intellectual order and a legal system out of this becomes the duty of the legal profession and the universities of the next decades.

6.3. Autonomy of the parties versus legal economy

In the introduction and in 3.7, I recalled that a company is basically a contract. When we look at the mass of mandatory law, we may say “yes, but”. But there are tendencies towards more contractual autonomy in modern company law. This answers two practical questions:

First, how many imperative rules should we issue?

Second, should we try to assist the parties by giving rules from which the statutes may deviate, i.e. helping the draftsmen if they forgot something, and freeing them from inventing statutes of hundreds of articles. This is a core argument of the advocates of legal economy.

Until the 1990’s the tendency was that the number of mandatory rules was on the increase. But this levelled off due to a change in the attitude to the needs of business.

The change is illustrated by the SE regulation, cf. 4.6. It leaves much to national law, but there is also room for deciding issues by the shareholders in the statutes. This is especially important for a company that is by nature multinational.

However, in practical terms, contractual autonomy becomes especially important in legislation on private companies. The legislator must ask itself whether it be likely that the legislature is able to foresee the presumptive needs of such business in greater detail, as there are several types of private companies:

- The one-man.
- The two-man.
- A small active group.
- Both active and passive participants.

- A big private company.

How can a statutory, normative act provide a solution to all these? And how can the written law cope with the need for rapid changes?

Furthermore, contrary to public companies there is less need to protect (passive) investors. That is why there has been a tendency to reduce the number of mandatory rules in private companies' acts and concentrate on protection of creditors and society, especially stricter rules on capital insufficiency. The rest, the internal conflict solution rules, must be provided for by the statutes or shareholders' agreements.

This imposes a delicate burden of care upon lawyers. Old standards or paradigms must be reworked, and the problems relating to shareholder agreements need to be rethought. When persons from several cultures and various legal systems join up, a clearer solution on many issues should be spelled out, and when it comes to shareholder agreements it is important also to ponder that as a contract it should or can follow another law than the law of the country of registration.

6.4. Auditing and accounting regulations

Traditionally, rules on auditing and accounting of companies would be found in the companies act.

But under influence of the voluminous 4th, 7th, and 8th directives, combined with a new perception of the nature of the subjects, they have been taken out for special legislation.

Two recent developments have underpinned this development. One is the major scandals in the EU and USA. This has changed enforcement from purely private to public control of the annual accounts of quoted and major companies, and of the professionals (chartered accountants and similar professionals).

The other is the arrival of international standards from IASB and IFAC, cf. 3.6, 4.6, and 6.1.

At the same time there has been an internationalisation of the major accounting companies.

6.5. The invasion of securities law

The first EU security law directives date from the late 1970's. Since then the EU and national securities regulations have seen a massive growth. One of the consequences of this is a shift of emphasis, as described in 4.7. Securities law protects prospective buyers of shares, the intermediaries, and the market as such. As the takeover directive demonstrates, we now also protect shareholders' rights in the market place, i.e. acting outside and independently of the company framework.

Part of security law deals with publicity and transparency. This adds to the normal company law rules, including accounting and auditing. But some rules, such as the takeover requirement of the same price for a dominant block of shares and a single minority share, affect central company law concepts.

Therefore the interface between company and securities law is a legal no-mans' land with two competing regulators. In a recent Danish case, a buy-back obligation under the own shares policy conflicted with insider rules. And the question became a grave one: Was it a criminal abuse of insider knowledge that would send the bank's directors to jail for some years, or was it a loyal fulfilment of duties under contract and company law.

Financial supervisors normally possess sharper legal enforcement instruments. But it cannot be stated in general terms what will be the result of the *lex generalis versus lex specialis* principles between company and securities law. That must be decided on an *ad hoc* basis. The ECJ has held on several occasions that the procedural requirements of the 2nd directive must be observed in the case of restructuring of financial enterprises, see cases C-441/93 *Pafitis,* 12.3.1996 and C-367/96, *Kefalis,* 12.5.1998, cf. 5.4. These cases and the golden share cases (cf, 4.9) may indicate that other areas of law (energy, financial, or transport) cannot totally denaturize companies in such a way that they cannot function as private corporations.

6.6. Group law

Group law consists of material group law and accounting rules. It deals with a linked group of companies, dominated by a mother enterprise, as one economic entity.

The most important economic and legal consequence of a group is that the consolidated accounts become of more interest to readers than the individual companies' accounts, because they present the true and fair economic situation after elimination of internal transactions. Group accounting under the 7th directive of 1982 is a complicated operation. It is further supplemented or superseded by the IASB standards. Under the revised 8th directive, group accounting will get formal primacy over individual companies' accounts.

Group construction could also have consequences for the legal situation of creditors and minority shareholders of dependant companies. However, the extent of such "material group law" protection varies notably under Member States' laws. The most "complete" is the German, which is contested by business as being too cumbersome. Thus the idea of a directive on material group law appears presently to be a dead duck, cf. 4.7. But group law may seep in through corporate governance, securities law, tax law, and accounting rules.

6.7. The notion, use, and utility of traditional capital requirements

The last point to take up under tendencies is the new thinking on capital requirements for limited liability companies.

The traditional capital system for a public company, entrenched in the 2nd directive, works as follows: The statutes should indicate the formal "social capital" of the company. This capital should be wholly subscribed, and wholly or partly paid up before the company can be registered. The eventual rest is callable if the company decides. This is supplemented by the minimum requirement that the capital must at least be 25.000 Euros.

To protect this capital the law must contain a number of other rules on increase, reduction of capital, on own shares, dividends and loans to shareholders, and on liquidation, plus requirements of expert evaluation of considerations other than cash.

There are two ways of explaining traditional capital requirements. These can be seen as a guarantee for creditors. Alternatively, they are seen as the token of the participants' intent to run a proper business, and loss of (part of) capital rings the alarm bell for reconsideration or reconstruction.

In the financial sector this is supplemented by the capital adequacy rules. The company must have an "own capital" or "solvency margin" that stands in a defined, percentual relation to the risks which the transactions (assets and/or debts) create. Under some national laws, the principle of adequate capital may follow from general principles of contract or tort law, or from express company law requirements. But they are not detailed as financial law requirement, and are thus left for the courts' future completing.

The critique of this system is inspired from the US experience, since most US states abolished the traditional capital requirements without experiencing problems. Among experts in (Northern) Europe there is a visible change in attitudes, and some reworking of the basic concepts of the 2nd directive in the direction of the US development is likely to take place within a decade.

The core of the critique is that the capital requirements known for a century are insufficient. *First,* the minimum capital does not meet the argued needs for working capital in companies, nor does it afford a meaningful guarantee to creditors. *Second,* concentration on the formal capital requirements may drive other, and perhaps more efficient, means from the general parts of law, into obliteration (bankruptcy, contract, criminal, and tort). *Third,* it causes a creditor-centered thinking under which shareholder protection is pushed into a secondary position.

From the EU angle there is the question whether the 2nd directive created a real harmonization. Member States' rules still contain important differences, and under the *Centros* doctrine (4.9) Member States must recognize these. It can also be observed that nobody today would advocate a 2nd directive such as a directive for private companies where the effects of the *Centros* doctrine may be more felt.

The Commission's reaction so far has been to study further. The recent proposal for amendments to the 2nd directive only contains some softening of the strict rules on distribution and valuation, combined with some improvements in minority protection.

A radical change would underline flexibility and contractual freedom in company law. The real legislative challenge would lie with establishing an efficient alternative protection or sanction, be it from bankruptcy, contract, or criminal law. In the USA, both criminal and civil liability may be considerable. European courts have been rather deferential to management outside cases of fraud. Therefore an upheaval of the present system would have to be accompanied by new approaches on investor protection, not only in law, but also in procedural remedies (e.g. reversal of the burden of proof, or class action), in the public authorities' role, and even more in attitude (industry, lawyers, accountants, and mostly the judiciary).

7. Some major problems raised

The two subjects on material law raised by Baltic lawyers concern cross-border company activities, and responsibility.

7.1. Responsibility

A company is, of course responsible to third parties in contract and tort like anyone else. But out of the limited liability construction arise some responsibility questions which would not arise for a physical person or for a partnership with personal responsibility. They concern

- the company's responsibility to minority shareholders, and to creditors and shareholders of daughter companies,
- the responsibility of the management towards the company itself, and towards creditors, third parties, and shareholders of the company and of other companies of the group,
- the responsibility of major shareholders towards creditors, third parties, and shareholders of the company and of other companies of the group, and towards the company itself, and
- the duty of loyalty of shareholders towards the company.

Space considerations force the following to concentrate on aspects that are so general that they can postulate a cross-frontier nature, common to most EU laws, namely what can be the basis for responsibility claims. This is supplemented by group law responsibility, and shareholders' duty of loyalty.

7.1.1. The basis of responsibility

By basis of responsibility is meant the negligence (*culpa-* or *bonus pater*) standard against which we should measure whether the company or the members of its organs have acted legally or in fault/in negligence. This standard may be deduced from various areas of the law, and this may differ from country to country.

The basis may be general contract law, e.g., in relation to creditors. Often the principles will be a mixture of contractual responsibility and company law. It becomes further complicated if the case includes a need to "find" the law applicable under Private International Law. The 1980 Rome Convention on the law applicable to contract applies to shareholder agreements. It is thus possible that Danish law may be applied to the shareholder agreement for a Latvian company.

The basis for responsibility may also be tort or extra-contractual liability. The text of the acts often does not provide real guidance, as they often refer to "general rules of responsibility law". In that case, conflicts of law become more difficult. The law applicable may be the *lex fori*, or *lex loci contractus*¸ or the *lex loci delictus*.

Companies' acts may contain special clauses, e.g., giving an abused minority the right to sell their shares to the company or the abusing shareholders. It may also do the opposite, and restrict the responsibility between shareholders and management to intentional damage or gross negligence. It may have special rules on the valuation of shares (market value, inner value, or fair value), and it may have rules inverting the burden of proof, giving the management a kind of collective responsibility for management.

There can be a further basis for responsibility of a stricter nature in bankruptcy or criminal law. French law invented the "*complement du passif*", under which, in bankruptcy, the directors must "fill in" the negative balance. They answer jointly unless a member can prove that he or she was not in fault.

The laws, however, are mostly conservative, resulting in a lenient/deferential treatment of management. Industry reacts strongly against proposals for sharpened reactions, arguing that it is against long-term interests to sustain risk-adversity. This implies that the small shareholder who cannot prove, has the formal *onus probandi*, and those who know can keep the truth and documents for themselves – and defend themselves with the small shareholders' money.

Finally it is recalled that not all breaches of standards lead to payment of compensation. In some cases, the sanction may be prohibition or invalidity and de-registration, removal of persons not fit and proper, publication, or administrative or criminal sanctions. That is decided on the basis of interpretation of each statute, including statutory instruments on criminal or administrative sanctions.

Most legal theory concentrates on the situation where the law and the courts of the country of registration decide the conflict. The problems that arise with the use of foreign courts or foreign laws may concern the burden of proof, which in some countries is material law, but in others is considered procedural law. As a court always applies its own procedural law, there may result surprises from the application of the application of burden of proof. Another area where it is difficult to expect courts to use foreign norms, is on assessing the damage and compensation due as national laws have different rules concerning which expenses or losses may constitute a reimbursable "economic loss". Nordic law, both the civil responsibility act and the public companies act, gives the judge a discretionary power to reduce damages due, if this appears reasonable. But could we expect a foreign judge, whose own law does not permit this, to apply the rule?

Contrary to continental law, the common law judge is not supposed to know all applicable law (*Jura novit Curia),* The importance of this is linked to the wide use of London as the chosen forum for conflict settlement in many contracts.

7.1.2. Lifting the corporate veil/ Haftungsdurchgriff

Enron and Parmelat and the likes reminded us that group accounts are more important than those of individual companies. Only at group level can accounts show a true and fair view as required by the law and the market.

When creditors see that their debtor company forms part of group of companies with limited liability, and see the owners treating them as one economic entity, naturally a question arises: Should we accept that the other companies be untouchable, just because the owners for various practical reasons split the economic entity into several legal persons with limited liability?

The answer in law is: of course, yes. There is nothing suspicious or immoral in invoking limited liability, as long as no laws are broken. That the shareholders can stay rich while the limited liability company's creditors suffer losses, is the core of the limited responsibility's purpose.

Therefore the corporate veil must be overwhelmingly respected. To allow, in a general way, the shareholders' other assets to cover a limited liability company's debts (be it in contract, in tort, or in taxation), would cause investors to think twice before subscribing. We would then end up in the lack of trust, anti-market situation described in 6.1.

The courts respect this. It can even be argued that in some cases of graver abuses, where the courts *seem* to lift or break the corporate veil (*Haftungsdurchgriff)*, the result could as well be explained on other grounds such as contractual liability or normal tortuous responsibility on a strict construction. In some cases, responsibility may result from rules on responsibility in contract, which often imply stricter standards and a reversed burden of proof. It may also be the case that company law itself contains rules. An example is the "Nordic general clause" found in all Nordic acts:

> "The company in general meeting shall not pass resolutions which are clearly likely to confer upon certain shareholders or other parties undue advantages over other shareholders or over the company".

It could also be special rules. The Nordic countries once speculated about a rule on "starving out of minorities", and most countries have rules on the right to leave the company or dissolution in case of grave abuses. But they are not much used, and most have given only limited or problematic protection of minorities.

Finally there may be (construed) an agreement to guarantee creditors of daughter companies and minorities. This is the preferred solution in German and Latvian group law. Critics consider, however, that these laws have found an inefficient solution, and point out that the company can be dominated without a contract.

Banks very often require that the mother company or the major shareholders guarantee the debts of a daughter company. This creates rights and duties under contract law. In practice, there is also a use of "Letter of intent" from the mother company or major shareholder. This states that they will duly consider the interests of the creditor of a (daughter) company. But the starting point is that letters of intent are not legally binding, as they declare intentions and thus do not contain a formal promise. And general contract law of most Member States does not accept enforceable, legitimate expectations.

7.1.3. Is there a duty of loyalty?

When asked whether shareholders have a duty of loyalty towards the company, natural human instincts would say "yes".

But the correct answer is "of course not". A Laima shareholder who openly prefers Kalev chocolates commits no illegal acts.

Basically there are only two exceptions. The first comes from a breach of a shareholder agreement, but then you do not breach company law, but a contract (to which the company cannot be a party). The other one is the case of major shareholders, who have special duties to register, and in take-overs.

There may be a case for including a third situation. This concerns situations where a shareholder *grossly* abuses his influence in the company to hinder the normal life of the company, e.g., voting against a decision in the general meeting, and the vote's *only* motive can be malicious wrecking of the company. Many national courts have had to deal with such cases, probably taking inspiration from the rules in contract law on mutual loyalty. The ECJ has accepted this in cases on the 2nd directive, summed up in *Diamantis* (C-373/97, 23.3.2000, points 32 & 40):

> "Community law cannot be relied on for abusive or fraudulent ends … That would be the case if a shareholder, in reliance on Article 25(1) of the Second Directive, brought an action for the purpose of deriving, to the detriment of the company, an improper advantage, manifestly contrary to the objective of that provision.
>
> … Community law does not preclude national courts from applying a provision of national law which enables them to determine whether a right deriving from a Community law provision is being abused. However, in making that determination, it is not permissible to deem a shareholder relying on Article 25(1) … to be abusing his rights under that provision merely because he is a minority shareholder of a company subject to reorganization measures, or has benefited from reorganization of the company, or has not exercised his right of pre-emption, or was among the shareholders who asked for the company to be placed under the scheme applicable to companies in serious difficulties, or has allowed a certain period of time to elapse before bringing his action. In contrast, Community law does not preclude national courts from applying the provision of national law concerned if, of the remedies available for a situation that has arisen in breach of that provision, a shareholder has chosen a remedy that will cause such serious damage to the legitimate interests of others that it appears manifestly disproportionate."

But what are the remedies for this situation? Not necessarily compensation in money. It could be invalidation of the voting, or that the company or the other shareholders by special law rules are entitled to acquire his or her shares.

7.2. Cross-border companies

The perfect form of cross-border enterprises is of course the SE and the SCE. They are conceived just for this purpose. This will be supplemented by the 10th directive on cross-border mergers. This is a scientifically well-studied subject as far as company law is concerned. But the law on workers co-*gestion* and taxation may become a practical deterrent.

But industry through contract law has invented other forms as a kind of *ersatz* for real cross-border companies:

- Branches.
- Daughter companies by foundation or takeover.
- Cooperation agreements.

The EU's recognition of such constructions follows from Articles 43, 48 and 81 of the Treaty.

Those who acquire a daughter company are confronted with international group law. This *konzernrecht* is summarized as follows in the preamble (nos 15-16) of the SE Regulation:

> "Under the rules and general principles of private international law, where one undertaking controls another governed by a different legal system, its ensuing rights and obligations as regards the protection of minority shareholders and third parties are governed by the law governing the controlled undertaking, without prejudice to the obligations imposed on the controlling undertaking by its own law, for example the requirement to prepare consolidated accounts. …. The rules and general principles of private international law should therefore be applied both where an SE exercises control and where it is the controlled company."

They may also meet barriers from securities laws. Takeover rules make takeovers costly. Next, their arrangements must comply with competition law (Treaty Articles 81&82, and the merger regulation 139/2004). Under Regulation 1/2003, cross-frontier companies will mostly be dealt with under EU law. And in tax law it seems as if tax bureaucracy is growing, and that tax authorities take more and more of the time of such enterprises, cf. 4.10.

Finally there are the classical international conflicts of contract law problems to which several references have been made. These are to be solved under the EU's Rome Convention of 1980, which has universal application. Due to the massive *renvoi* to national law in the SE and SCE regulations, conflict of law becomes an important subject for company law experts.

In this, we should not forget the practical, daily duty of managing an enterprise that covers several legal systems and the implicit clash of traditions, and the task of seeing to it that the enterprise remains profitable. Therefore companies need good advisers, for it is easier to lose money abroad than at home. In combination, this makes cross-frontier business a difficult thing, even under the best conceivable regulatory environment.

ANNEX 1

List of existing and proposed European company law instruments

EXISTING EUROPEAN COMPANY LAW INSTRUMENTS

Regulations

- Council Regulation 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG), (OJ 1985 L 199/1)
- Council Regulation 2001/2157 of 8 October 2001 on the Statute for a European Company SE *supplemented by* Council Directive (2001/86/EC) of 8 October 2001 supplementing the Statute for a European Company with regard to the involvement of employees, (OJ 2001 L 294/1 and L 294/22)
- Regulation 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting Standards, (OJ 2002 L 243/1)
- Council Regulation 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE) *supplemented by* Council Directive 2003/72/EC of 22 July 2003 with regard to the involvement of employees, *(OJ 2003 L 207/1 and 25)*
- Commission Regulation 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council (Text with EEA relevance), *(OJ L 261 13.10.2003 p. 1)*

Directives

- **First Council Directive** 68/151 of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community,(OJ 1968 L 65/8). Amended by Directive 2003/58/EC of the European Parliament and of the Council of 15 July 2003, (OJ 2003 L 221/13).
- **Second Council Directive** 77/91 of 13 December 1976 on coordination of safeguards, which for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent throughout the Community, (OJ 1977 L 26/1). Amended by directive 92/101 of 23 November 1992 (*OJ 1992 L 34/66)*.
- **Third Council Directive** 78/855 of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies, (OJ L 295/36)

- **Fourth Council Directive** 78/660 of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies, (OJ 1978 L 222/11). Amended several times.
- **Sixth Council Directive** 82/891 of 17 December 1982 based on Article 54(3)(g) of the Treaty concerning the division of public limited liability companies, (OJ 1982 L 378/47)
- **Seventh Council Directive** 83/349 of 13 June 1983 based on Article 54(3)(g) of the Treaty on consolidated accounts, (OJ 1983 L 193/1). Amended several times.
- **Eighth Council Directive** 84/253 of 10 April 1984 based on Article 54(3)(g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents, (OJ 1984 L 126/20). *To be replaced by a new directive in 2005*
- **Tenth Directive** of the European Parliament and of the Council 2005/000 of 00 yyyy 2005,on cross border mergers of companies with share capital, (OJ 2005 L 000/000)
- **Eleventh Council Directive** 89/666 of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State, (OJ 1989 L 395/96)
- **Twelfth Council Directive** 89/667 of 21 December 1989 on single-member private limited liability companies. (OJ 1989 L 395/40)
- Directive 2004/25 of the European Parliament and of the Council of 21 April 2004 on takeover bids (Text with EEA relevance), (OJ 2004 L 142/12) – often called **Thirteenth directive**

Recommendations
- Commission Recommendation 2001/256 of 15 November 2000 on quality assurance for the statutory audit in the European Union: minimum requirements, (OJ 2001 L 91/9)
- Commission Recommendation 2001/453 of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual reports of companies, (OJ 2001 L 156/33)
- Commission Recommendation 2002/590 of 16 May 2002 on “Statutory Auditors’ Independence in the EU: A Set of Fundamental Principles”, (OJ 2002 L 191/22)
- Commission recommendation 2004/913 of 14 December 2004 on fostering an appropriate regime for the remuneration of directors of listed companies, OJ 2004 L 385/55.
- Commission recommendation 2005/162 of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, OJ 2005 L 52/51.

PROPOSED EUROPEAN COMPANY LAW INSTRUMENTS

- Amended Proposal for a Council Regulation (EEC) on a statute for a European Association [1993] OJ C 236/1
- Amended Proposal for a Council Regulation (EEC) on a statute for a European Mutual Society [1993] OJ C 236/40

- Proposal for a Directive of the European Parliament and of the Council on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC, COM/2004/0177 final (a new "8th directive"), agreed by the Council in December 2005, formally to be adopted during 2005
- Proposal for a directive of the European Parliament and of the Council amending Council Directive 77/91/EEC, as regards the formation of public limited liability companies and the maintenance and alteration of their capital, October 2004, OJ 2005 C 24/8.
- Proposal for a directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC concerning the annual accounts of certain types of companies and consolidated accounts, October 2004

ANNEX 2

EU normative acts in the securities area

- Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, [OJ 2004 L 390/38],
- Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, (OJ 2004 L 162/70) (Text with EEA relevance),
- Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, (OJ 2994 L 149/1) (Text with EEA relevance),
- Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council, (OJ 2004 L 145/1)
- Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments, (OJ 2003 L 336/33) (Text with EEA relevance),
- Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest, (OJ 2003 L 339/73) (Text with EEA relevance),
- Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards

the definition and public disclosure of inside information and the definition of market manipulation, (OJ 2003 L 339/70) (Text with EEA relevance),

- Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, (OJ 2003 L 345/64) (Text with EEA relevance),
- Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), (OJ 2003 L 096/16)
- Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council, (OJ 2003L 035/1)
- 2001/528/EC: Commission Decision of 6 June 2001 establishing the European Securities Committee, (OJ 2001L 191/45)
- 2001/527/EC: Commission Decision of 6 June 2001 establishing the Committee of European Securities Regulators, (OJ 2001 L 191/43)
- Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, (OJ 2001 L 184/1)
- Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes, (OJ 1997 L 084/22)
- Agreement on the European Economic Area - Annex IX - Financial services -List provided for in Article 36 (2), (OJ 1994 L 001/403)
- Council Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public, (OJ 1989 L 124/8)
- 85/612/EEC: Council Recommendation of 20 December 1985 concerning the second subparagraph of Article 25 (1) of Directive 85/611/EEC, (OJ 1985 L 375/19)
- Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), (OJ 1985 L 375/3)
- 77/534/EEC: Commission Recommendation of 25 July 1977 concerning a European code of conduct relating to transactions in transferable securities, (OJ 1977 L 212/37)