The Commission's 2018 Proposal on Cross-Border Mobility – An Assessment

by

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Currently, the Council of the European Union is negotiating the European Commission's recent proposal on cross-border mobility. This paper provides an overall assessment based on the proposal's central pillars: freedom of establishment and protection of the interests of creditors, shareholders, and employees. The proposed directive meets a real necessity for regulation on a European level and pursues an ambitious agenda. While the general approach is excellent, there is room for improvement on some issues of importance.

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ECFR 2019, 196–221

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I. Preliminary Remarks

On 25 April 2018, the Commission brought forward its Proposal for a Directive on various issues of cross-border mobility,[1] which aims at introducing rules for cross-border conversions and divisions and at improving the legislative framework for cross-border mergers. The issue had been on the legislative agenda for a long time, starting with the unsuccessful Proposal for a Directive on Seat Transfers.[2] Since 2005, Directive 2005/56[3] (now art. 118–134 Directive 2017/1132[4]) has regulated cross-border mergers. However, market participants,[5] legislative bodies,[6] commissioned studies,[7]

1 Commission, Proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions COM(2018) 241 final (hereinafter 'the Proposal').

2 Commission, Proposal for a Fourteenth European Parliament and Council Directive on the Transfer of the Registered Office or the De Facto Head Office of a Company from One Member State to Another of 20 April 1997.

3 Directive 2005/56/EC on cross-border mergers of limited liability companies, Official Journal (hereinafter OJ) L310/1.

4 Directive (EU) 2017/1132 relating to certain aspects of company law, OJ L169/46 (hereinafter 'Dir. 2017/1132').

5 For an overview of consultations carried out by the Commission see Explanatory Memorandum to the Proposal (fn. 1), p. 14 *et seqq*.

6 See *e.g.* recently European Parliament Resolution of 13 June 2017 on cross-border mergers and divisions (2016/2065(INI)). See also the Commission, 2012 Action Plan on Company Law and Corporate Governance (COM/2012/0740 final), p. 12 *et seqq*.

7 See *e.g. Bech-Bruun/Lexidale*, Study on the application of the cross-border mergers directive (2013) (<https://publications.europa.eu/en/publication-detail/-/publication/0291c60a-df7a-11e5-8fea-01aa75ed71a1> last accessed: 20 December 2018); *Jessica Schmidt*, Cross-border mergers and divisions, transfers of seat: Is there a need to legislate? Study for the JURI Committee (2016) (<http://www.europarl.europa.eu/RegData/etudes/

and academics[8] contend that further legislative steps are required.

Concurrently, the ECJ has addressed the issue of cross-border mobility on the basis of the freedom of establishment under art. 49 TFEU in a series of seminal judgments over the last ten years. The principal issue in these cases was whether the home Member State can raise barriers to outgoing transfers. Already in its *Cartesio* decision,[9] the ECJ opened the way for a liberal approach as it stated in an obiter dictum that art. 49 TFEU prohibits barriers to "the actual conversion of such a company, without prior winding-up or liquidation, into a company governed by the law of the Member State to which it wishes to relocate [...], unless it serves overriding requirements in the public interest". While the ECJ's *Vale* decision[10] seemed to restrict the application of the freedom of establishment to situations involving the actual pursuit of an economic activity through a fixed establishment in the host Member State for an indefinite period, the recent *Polbud* decision[11] made clear that the ECJ[12] follows a wider approach: a conversion into a company governed by the law of another Member State is protected by art. 49 TFEU even if the location of the real head office does not change. In other words, no real economic link to the host Member State is necessary. Of course, this means that there is a free choice of law not just upon foundation of the company – as had been settled by the ECJ's decisions starting with *Centros*[13] –, but also at a later stage via reincorporation.

Irrespectively of whether this is the correct reading of primary law and without going into further details, these decisions highlight the importance of the issue. Without any doubt, the ECJ's judgments by themselves cannot solve all

STUD/2016/556960/IPOL_STU(2016)556960_EN.pdf> last accessed: 20 December 2018).

8 See *e.g. Jesper Lau Hansen*, "The Vale Decision and the Court's Case Law on the Nationality of Companies", ECFR 2013, 1, 15 *et seqq.*; *Marek Szydlo*, "The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment", ECFR 2010, 414, 441 *et seqq.*; *Eddy Wymeersch*, "Is a Directive on Corporate Mobility Needed?", European Business Organization Law Review 2007, 161, 169.

9 ECJ, 16 December 2008, *Cartesio,* C-210/06, ECLI:EU:C:2008:723, para. 113.

10 ECJ, 12 July 2012, *Vale,* C-378/10, ECLI:EU:C:2012:440, para. 34.

11 ECJ, 25 October 2017, *Polbud,* C-106/16, ECLI:EU:C:2017:804.

12 However, this is in stark contrast to Advocate General Kokott's opinion in this case; cf. *Kokott*, 4 May 2017, *Polbud,* C-106/16, ECLI:EU:C:2017:351.

13 ECJ, 09 March 1999, *Centros,* C-212/97, ECLI:EU:C:1999:126.

the practical problems connected to issues of cross-border mobility.[14] As this group has already pointed out,[15] legislation in this area is in line with the principle of subsidiarity and should be one of the top priorities for EU company law: the Court's decisions on freedom of establishment of companies identify the role for Community secondary legislation rather than remove the need for it. Therefore, we strongly endorse the Commission's Proposal in principle.

The following paper looks at some central issues after introducing the purposes of the Proposal and after providing a brief overview of its contents (II.). It will start by examining the method by which the Proposal intends to harmonise the Member State's interests with the ECJ's reading of the freedom of establishment (III.). The paper will then examine the three core interests that can be affected by a cross-border transaction: creditors (IV.), shareholders (V.), and employees (VI.). We do not purport to provide an exhaustive analysis of the Proposal, especially not on a technical level. Our more moderate aim is an overall assessment, based on the Proposal's central pillars.

II. The Proposal's Objectives and its General Approach

The Proposal's basic objective is to enable companies to make use of the freedom of establishment; however, at the same time it purports to protect stakeholders, *i.e.* creditors, minority members, and employees.[16] Additionally, the proposal takes account of the public interest, especially by trying to avoid undue tax advantages by "artificial arrangements". As always, there is a certain trade-off between enabling provisions for the company on the one hand and protection of stakeholders on the other as overly protective provisions can diminish the attractiveness of measures designed to promote mobility. Whether this is the case must be determined on the basis of a careful analysis of each provision. However, it is safe to make two general remarks in this respect:

First, protective provisions must be applied to all comparable transaction modes. If, for instance, the shareholders were given a right to exit in a cross-border conversion but not in a cross-border merger, the resulting loophole would certainly be made use of by those who decide upon the structure of the

14 See Explanatory Memorandum to the Proposal (fn. 1), p. 3. For the limits to this so-called negative harmonisation in the area of reincorporations see *Carsten Gerner-Beuerle/Federico Muciarelli/Edmund Schuster/Matthias Siems*, "Cross-border reincorporations in the European Union: the case for comprehensive harmonisation", Journal of Corporate Law Studies 18 (2018), 1, 34 *et seqq*.

15 *ECLE*, The Future of European Company Law (2012) (<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2075034> last accessed: 20 December 2018).

16 Explanatory Memorandum to the Proposal (fn. 1), *e.g.* p. 2 and 4.

transaction. Thus, consistency is one important issue in order to prevent unjustified biases and consequent distortions of choices.[17] Additionally, the legislator also has to consider that combinations of a purely national transaction (*e.g.* a domestic division) with another cross-border transaction (*e.g.* a subsequent cross-border conversion) can have the same effect as a one-step cross-border transaction (*e.g.* a cross-border division). We show in this paper that some issues remain open in this respect.

Second, in order to promote cross-border mobility it is useful to achieve a common framework in all Member States. The *Bech-Bruun/Lexidale*-study on the implementation of the Cross-Border Merger Directive shows that the approach pursued by that Directive, namely a light-touch approach giving considerable leeway to Member States in core issues, did not achieve all the desired results.[18] According to that Directive, in the field of creditor protection in cross-border mergers Member States can apply their regulations for domestic mergers,[19] which are based on art. 99 Dir 2017/1132 calling for "an adequate system of protection of the interests of creditors". The tremendous differences between Member States, *e.g.* on the commencement of the protection period before or after the merger takes effect (*ex ante*- or *ex post*-approach) and on the nature of the protection offered to creditors, make the merger process very complex and constitute a strong deterrent to cross-border mergers.[20] What seems to be needed is full harmonisation at least for the most critical issues. The Proposal takes a first step in that direction by introducing detailed mechanisms for the protection of creditors and minority members. However, it does not take the second step of introducing these measures as fully harmonised.[21] Rather, Member States are left with the possibility to introduce further protection devices (at least as long as they comply with primary law). Even if this may be a politically prudent move in order to achieve the necessary support from the Member States, on a conceptual level it is unfortunate that the Proposal is thus deprived of the benefits of full harmonisation.

17 See also the *Association of German Notaries*, Reaction to the Company Law Package (<http://www.dnotv.de/wp-content/uploads/StN-Master-Company-Law-Package-2018-07-04_final.pdf> last accessed: 20 December 2018).

18 *Bech-Bruun/Lexidale* (fn. 7), p. 31–38. See also *Geert Raaijmakers/Thijs Olthoff*, "Creditor Protection in Cross-Border Mergers: Unfinished Business", Utrecht Law Review 4 (2008), 34.

19 Art. 121 (1) (b) and (2) Directive (EU) 2017/1132. See also *Jessica Schmidt*, "EU Company Law Package 2018 – Mehr Digitalisierung und Mobilität von Gesellschaften (Teil 1)", Der Konzern 2018, 229, 238 *et seqq.*

20 See also *Martin Winner*, Creditor Protection in Mergers in Europe, in: Erika Kovacs/Martin Winner (ed.), Stakeholder Protection in Restructurings, in print.

21 Very clearly: Explanatory Memorandum to the Proposal (fn. 1), p. 19.

In its scope of application, the Proposal goes far by regulating cross-border mergers, divisions and conversions. However, some important transaction types are missing:

As far as mergers are concerned, the Proposal covers neither triangular mergers, whether forward or reverse, in which the shareholders of the target company receive shares not in the acquiring company but in its parent company, nor compulsory share exchanges; the latter can either take place in the form of a scheme of arrangement – which is binding on all affected members, creditors, and the company if sanctioned by a court – or through a merger of the different shareholder groups by majority decision without a merger at the asset level. Especially the share exchange would help to avoid difficulties in some Member States with the concept of universal succession,[22] although it is understandable that the Proposal does not cover all transactions with similar effects to a merger.[23]

Additionally, only divisions (both full and partial) in which newly formed companies are created are covered by the Proposal.[24] Therefore, for a cross-border division by acquisition a two-step approach of, for instance, a domestic division followed by a cross-border merger will remain the method of choice;[25] the Commission's explanation, namely that cross-border mergers by acquisition entail a high risk of abuse and necessitate the involvement of many authorities,[26] is not convincing as with the two-step approach the same issues exist but cannot even be assessed in one proceeding. Interestingly, not just full divisions and partial divisions (or spin-offs) are covered but also non-proportionate divisions, in which not all members receive the same proportion of shares in all new companies.

As a result, we think that the (already ambitious) scope of the Directive should encompass some additional transaction types; this would have huge practical importance without the necessity to address many additional issues. In any case, we support the Commission's approach of introducing rules on cross-border divisions as they provide added value by helping companies to avoid

22 See *Luca Enriques*, "A New EU Business Combination Form to Facilitate Cross-Border M&A: The Compulsory Share Exchange", European Company Law 11(2014), 214.

23 *E.g.* stock-for-assets exchanges when followed by the dissolution of the target.

24 Art. 160b (3) Proposal. See also *Association of German Notaries* (fn. 17), p. 44; *Association of German Attorneys*, "Reaction to the Company Law Package" Neue Zeitschrift für Gesellschaftsrecht 2018, 857, 866; *Jessica Schmidt*, "EU Company Law Package 2018 – Mehr Digitalisierung und Mobilität von Gesellschaften (Teil 2)", Der Konzern 2018, 273, 275.

25 Similarly, a cross-border division into a newly formed company can be combined with a subsequent domestic merger.

26 Explanatory Memorandum to the Proposal (fn. 1), p. 8.

cumbersome two-step transactions (national division plus cross-border merger or conversion).[27]

III. Limited Endorsement of Artificial Arrangements

The ECJ's Polbud decision of October 2017[28] clearly states that the freedom of establishment covers the change of the applicable company law even if it is not accompanied by a transfer of the real head office. That is remarkable as the Advocate General's opinion in the case was more conservative; even though she did not prescribe a change of the head office, she held that the freedom of establishment is applicable to a conversion "in so far as that company actually establishes itself in the other Member State, or intends to do so, for the purpose of pursuing genuine economic activity there".[29] However, the ECJ held, in line with earlier judgments, that "a Member State may adopt measures in order to prevent attempts by certain of its nationals to evade domestic legislation, given that, in accordance with settled case law, it is open to a Member State to adopt such measures".

The Polbud judgment presented the Commission with a hard choice. In order to make a regulation of conversions palatable to Member States on a political level – a prerequisite for the necessary majority in the Council – it was deemed necessary to introduce some kind of filter on such transactions. At least some Member States are worried by the fact that without such barriers regulatory competition in company law will not only be relevant to the initial choice of company law[30] but also at any later stage as the company can easily reconsider its initial choice via re-incorporation in another Member State without any concomitant change in the running of its business. However, even assuming that the Commission sympathised with this stance, the Polbud decision most likely has closed down any approach requiring some type of economic link to the receiving Member State although the Draft Report of the European Parlia-

27 Cf., however, the diverging approach in *Committee on Legal Affairs of the European Parliament*, Draft Report on the proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions 2018/0114(COD) 90 (<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+COMPARL+PE-625.524+02+DOC+PDF+V0//EN&language=EN> last accessed: 20 December 2018).

28 ECJ, 25 October 2017, *Polbud,* C-106/16, ECLI:EU:C:2017:804.

29 *Kokott* (fn. 12), para. 43.

30 Which is generally accepted since the ECJ decisions in ECJ, 9 March 1999, *Centros,* C-212/97, ECLI:EU:C:1999:126; ECJ, 5 November 2002, *Überseering,* C-208/00, ECLI:EU:C:2002:632 and ECJ, 30 September 2003, *Inspire Art,* C-167/01, ECLI:EU:C:2003:512.

ment's Committee on Legal Affairs on the Proposal[31] advocates reintroducing such a requirement.

Thus, the Commission has introduced another instrument for conversions and divisions in art. 86c (3) and art. 160d (3) of the Proposal: the departure Member State[32] "shall not authorise the cross-border conversion (or division) where it determines, after an examination of the specific case and having regard to all relevant facts and circumstances, that it constitutes an artificial arrangement aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors, or minority members." art. 86n and art. 160p empower the competent authority to carry out an in-depth assessment looking at all the relevant facts of the case. This assessment is to be made within the framework of a report by an independent expert, which *inter alia* has to describe in detail the factual elements necessary to evaluate whether the transaction constitutes such an artificial arrangement;[33] however, for micro and small enterprises[34] no independent expert report will need to be prepared.

Generally, at first glance the proposed exception for artificial arrangements is a shrewd move. The Member States when legislating or, at the very latest, when applying the national law based on the Directive will determine what constitutes an artificial arrangement, which is prejudicing the relevant interests. Additionally, the provision is (probably deliberately) vague, which has the advantage that each Member State is able to project its perceptions into the wording, although the Proposal ultimately does not substantially curb the possibility to reincorporate but only clamps down on somehow fraudulent transactions. However, this also means that Member States have to accept that their reading of the provision will be subject to review by the ECJ. Whether this is sufficient for a political compromise, remains to be seen. Member States may take the easy option of blocking the entire Proposal and curbing cross-border mobility by not providing a legislative framework.

On a more technical level, a cross-border conversion leading to the application of a legal system without any real link to the company may already be seen as constituting *per se* an "artificial arrangement". That, however, will not be suffi-

31 Committee on Legal Affairs of the EP (fn. 27), p. 46 *et seqq*.

32 As far as the destination Member States is concerned, the conversion in substance is a foundation with a contribution in kind, which will be subject to its company law (art. 86c (4) of the Proposal). Thus, there is little need for additional rules protecting its interests.

33 Art. 86g (3) (b) and Art. 160i (3) (f) of the Proposal.

34 As defined in Recommendation 2003/361/EC of 6 May 2013 concerning the definition of micro, small and medium-sized enterprises, OJ L124/36.

cient as the artificial arrangement must, indeed, be aimed at[35] obtaining undue tax advantages or at prejudicing stakeholder interests.

We understand the gist of the first instance, already developed extensively in EU tax case law,[36] which deems abusive „wholly artificial arrangements", *i.e.* arrangements that lack any economic substance and whose sole purpose is to circumvent the application of the concerned Member State's legislation.[37] We would like to point out that EU tax law follows a different approach: art. 6 Directive 2016/1164[38] stipulates that for the purpose of calculating tax liability Member States shall ignore artificial arrangements that are put in place for the main purpose of obtaining undue tax advantages. This *ex post* mechanism does not affect the validity of the transaction as such but combats artificial arrangements by ignoring them for tax law purposes only; this targeted approach is probably superior.

Additionally, we have some doubts as to the second instance: The Proposal contains numerous rules designed to protect the interests of the creditors, the minority members, or the employees, which will be dealt with below. Minority members get an exit right, creditors are entitled to receive collateral if their claims are endangered, and employees are protected against a loss of representation on the board. Obviously, an artificial arrangement cannot prejudice these rights as long as the instruments for their protection are adequate. In our reading, this leaves few cases in which Member States can block a transaction; additionally, if a Member State considers these rights to be inadequate, it can introduce additional rules protecting members or creditors. As a result, the power granted to Member States seems to be very limited;[39] if this is the understanding in the Council as well, negotiations may very well become protracted.

35 We believe that this does not require subjective intent but that objective effect is sufficient.

36 See *e.g.* ECJ, 16 July 1998, *ICI,* C-264/96 ECLI:EU:C:1998:370, para. 26; ECJ, 12 September 2006, *Cadbury Schweppes,* C-196/04, ECLI:EU:C:2006:544, para. 49, 50, 51, 55.

37 However, it is difficult to determine *ex ante* if an arrangement is artificial in this sense; see *Jaime Sanchez*, "Cross-border conversions and ex-ante control of artificial arrangements: is this an adequate reaction to Polbud?", Oxford Business Law Blog (2018) (<https://www.law.ox.ac.uk/business-law-blog/blog/2018/09/cross-border-conversions-and-ex-ante-control-artificial-arrangements> last accessed: 20 December 2018); *Segismundo Alvarez*, "The Commission's company law package: overview and critical view of the Proposal for Cross-Border Transactions", European Law Blog (2018), (<http://europeanlawblog.eu/2018/06/07/the-commissions-company-law-package-overview-and-critical-view-of-the-proposal-for-cross-border-transactions/> last accessed:20 December 2018).

38 Directive (EU) 2016/1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L193/1.

39 In a similar vein *Association of German Attorneys* (fn. 24), 858.

However, we think that the rule can serve as an emergency break in egregious cases of violation of stakeholder interests and as such has value.

As far as the practical application of such a rule is concerned, we doubt whether administrative or judicial bodies in all Member States would be able to arrive at a well-founded judgment; certainly, the registrars in most countries would be overwhelmed by such a task.[40] The Proposals solution, namely employing an expert, depends on whether such experts can be truly independent and have a strong backbone; practical experience in other areas of company life is not always encouraging. Therefore, in our opinion the negotiations should focus on designing rules to safeguard the expert's independence as far as possible. Certainly, it is not a good solution to drop the requirement of an expert report entirely and put the responsibility squarely on national authorities.[41] It is even less convincing that according to the Proposal no expert has to be appointed for micro and small enterprises.[42]

Finally, we find it very disturbing that, in line with the current situation according to Directive2017/1132, there is no corresponding regulation for cross-border mergers[43] or the transfer of the registered office of an SE[44]. This, of course, is an invitation to circumvent application of the rule in critical cases, which can be done easily by setting up a company in the destination Member State with the minimum capital and then merging the existing entity into it. As the Proposal is drafted, Member States do not have the authority to block such a transaction even if it constitutes an artificial arrangement within the meaning explained above. We think that this inconsistency must be remedied urgently if the prohibition of such artificial arrangements is to be maintained.

Summing up, the issue of barriers to the freedom of establishment for the purpose of combating evasion of domestic legislation is a central issue of the Proposal, especially as it goes to the core of Member States' interests. We think that the Commission has made a good first move by introducing a provision in line with the ECJ's Polbud decision. However, given the inherent limitations of the Proposal's approach, we very much doubt whether this will be the end of the matter.

40 Although in some countries judicial registrars are commonly checking the transaction in substance, at least summarily.

41 This, however, seems to be the solution favoured by parts of the EP; see *Committee on Legal Affairs of the EP* (fn. 27), p. 55 *et seqq*.

42 See also *Schmidt* (fn. 24), 278 *et seqq*.

43 See also *Association of German Notaries* (fn. 17), p. 29; *Association of German Attorneys* (fn. 24), 857 *et seqq*; *Schmidt* (fn. 24), 276.

44 See *Sanchez* (fn. 37).

IV. Creditors

As already mentioned, the system for the protection of creditors in cross-border mergers leaves a lot of discretion to the Member States. This has been criticised as an obstacle to cross-border mobility. The Proposal reacts by introducing a harmonised approach to creditor protection, which follows similar lines for conversions, mergers, and divisions as far as possible. However, the Proposal only follows a minimum harmonisation approach.[45]

Starting with cross-border mergers, Member States may require that the board of each merging company declare that they are unaware of any reason due to which after the merger the new company will be unable to meet due liabilities; if the Member State chooses to do so, liability for false statements may be the result.[46] It is unclear why the Proposal explicitly empowers Member States to do so as it follows a minimum harmonisation approach anyway.

More importantly, the Proposal opts for an *ex ante*-approach. First, the draft merger terms have to include "details on the safeguards offered to creditors".[47] This is probably not supposed to mean that the company has to offer such safeguards[48] but only that they have to be included in the terms if so offered; however, this is far from clear and should be stated explicitly. In any case, if the creditors are not satisfied with the terms offered, they can petition for adequate safeguards within one month of the disclosure of the draft terms;[49] that means that the petition has to be made at the day of the general meeting deciding on the merger at the latest. Although the provision does not state clearly what the petitioners have to bring forward, we infer from art. 126 b (3) that they have to demonstrate that there exists a reasonable likelihood their rights will be unduly prejudiced; this should be stated more distinctly as well.[50]

Of course, the uncertainty whether such claims will be made provides a major obstacle to cross-border mergers. It is very fortunate that art. 126 b (3) (a) provides a mechanism for reducing this uncertainty: the company may disclose a report by an independent expert, which has to state that there is no reasonable likelihood that the creditors' rights are unduly prejudiced.[51] Although the Pro-

45 Explanatory Memorandum to the Proposal (fn. 1), p. 19.
46 Art. 126 b (1) of the Proposal.
47 Art. 122 (n) of the Proposal.
48 See also Art. 126 b (3) (b) of the Proposal, which makes it clear that such safeguards are optional.
49 Art 126 b (2) of the Proposal.
50 See also *Association of German Notaries* (fn. 17), p. 38; *Association of German Attorneys* (fn. 24), 860 *et seqq*.
51 Supportive also *Schmidt* (fn. 19), 239.

posal does not stipulate it clearly, we understand this to mean that in this case the creditors have no right as to additional safeguards; this is a major incentive for the companies to try to obtain such a report. Thus, the Proposal follows a gatekeeper approach;[52] however, apart from the fact that the expert has to be "appointed or approved"[53] by the competent authority, issues of the rules for the appointment and the qualification of the gatekeeper are left to the Member States. Given that Member State's experiences with the quality of experts diverge due to varying local circumstances, the approach may have different practical effects among Member States.

It is more difficult to understand the second exception in art. 126b (3) (b), according to which the creditors are deemed not to be prejudiced if they have a claim against a third party or the company resulting from the merger of at least the same value as the original claim "and which is of a credit quality at least commensurate with the creditor's original claim immediately after completion of the merger"; additionally, the creditor has to be able to bring the claim in the same jurisdiction as the original claim. The purpose is clear: if the claim's quality is not affected by the merger, or if a claim of equal credit quality is granted against a third party in the draft merger terms, there is no justification to order additional safeguards. However, it is unclear who decides upon the credit quality; the independent expert is not mentioned in art. 126b (3) (b). Is it supposed to be a decision by a credit rating agency? Or is this just a clarification for circumstances to be taken into account by the independent expert when he makes his judgment on whether the rights of creditors are unduly prejudiced? We prefer the last approach, but we suggest that this should be clarified in the text.

In general, we consider the approach to be feasible even if details should be improved. It is probably not advisable to specify the types of safeguards the competent authority can choose from in order not to curtail judicial discretion. Finally, we do not see a grave problem in the fact that the regimes for domestic and cross-border mergers drift apart; in a purely domestic scenario, it is appropriate to leave the protection of creditors to Member States.[54]

52 See e.g. *Reinier Kraakman*, "Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy", The Journal of Law, Economics, & Organization 2 (1986), 53; *William A. Klein/John C. Coffee*, Business Organization and Finance, 10th ed., 2007, p. 218 *et seqq*.

53 Which probably means that the authority must follow a proposal for the expert made by the company, unless there are reasonable grounds for withholding that approval. Obviously, there is a danger that experts appointed by the company will be more pliant, unless this danger is countered by strong reputational incentives for the experts.

54 See *Raaijmakers/Olthoff* (fn. 18), 38.

The same rules apply for cross-border conversions. We would like to raise the question whether this is really adequate. In a cross-border merger, creditors are endangered primarily by the fact that both the composition of assets and the circle of creditors change; this may be to the advantage of some creditors but to the disadvantage of others. This complex situation is the main justification for a strict system of creditor protection. Additionally, creditors will be subject to a different company law,[55] which may be less creditor friendly, *e.g.* by having more permissive rules on distributions; they may also have to bring their claim in another jurisdiction. In a cross-border conversion, neither the asset base nor the circle of creditors change; the only changes are in the applicable company law and, at least sometimes,[56] in a different venue for claims. Thus, a system of creditor protection, which probably has been designed for mergers, is applied to conversions as well even though these pose fewer dangers to creditors. Without having a definite answer, we tend to think that a system addressing these two specific issues directly might be a better solution.

With divisions, the issue is a bit different as the main danger to creditors is not the mingling of assets, which have been separated, but the division of formerly unified assets and their allocation to different groups of creditors. The Proposal first contains rules designed to ascertain that each asset and liability is allocated to one company;[57] as a default rule the assets and liabilities are allocated to all companies in proportion to the net assets they have received. More importantly and in deviation from art. 146 (3) Directive 2017/1132 for domestic divisions,[58] all companies shall be jointly and severally liable if the creditor does not obtain satisfaction from the recipient company his claim has been allocated to; however, this liability of the other recipient companies is limited to the value of the net assets allocated to each company. The further rules on the protection of creditors, especially as to the right to petition for adequate safeguards, correspond to the situation in mergers. As, due to the division of assets and liabilities, the dangers to creditors are different but at least as grave as in mergers, the instruments are generally adequate; apart from that the same remarks as to mergers apply.

55 Of course, this does not refer to the law governing the company's obligation itself, which does not change as a result of the merger; cf. ECJ, 7 April 2016, *KA Finanz AG,* C-483/14, ECLI:EU:C:2016:205.

56 This, of course, depends on the applicable provisions of the Brussels Ia-Regulation (Council Regulation (EU) 1215/2012 of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L351/1) and any contractual provisions.

57 Art. 160 e (1) (m), (2) and (3) of the Proposal.

58 Which leaves options to Member States as to the type of liability.

V. Minority Members

The second group of stakeholders to be protected are the companies' shareholders who disapprove of the transaction; they need protection as the merger, *etc.*, affects them even if they vote against. From a theoretical perspective, this is crucial; in practice, it is not an issue if cross-border mobility measures concern only group restructurings without any minority shareholders (which seems to be common) or are supported by all shareholders. Of course, an overly elaborate system of shareholder protection may act as a barrier to cross-border transactions if minority shareholders are involved; it is important to get the balance right. While the Proposal goes much further than the current legislation for cross-border mergers, this is due to the fact that currently the issue is left to the Member States;[59] for the reasons described above, we think that it would be preferable to introduce adequate minority protection measures in European legislation but would favour fully harmonized rules.

First and foremost, minority protection is achieved by the majority necessary for approval of the transaction in the general meeting. The Proposal leaves leeway to the Member States: under existing law, they can stipulate the necessary supermajority for a cross-border merger, which may not be less than two thirds of the votes attached either to the shares or to the subscribed capital represented;[60] this remains unchanged. For cross-border conversions and divisions, Member States may provide for a majority of at least two thirds and up to 90% of these votes; however, the threshold may not be higher than for cross-border mergers.[61] We do not have any arguments for further harmonisation on this matter.

Second, art. 124 of the Proposal significantly increases the information contained in the management report to be made available to the members before they approve the transaction. Apart from valuation issues, the provision makes special reference to the implications of the cross-border merger on members and to the remedies available to them. Unanimously, the members of the merging companies can waive this requirement.[62] However, here EU law ends up being more flexible for cross-border mergers than for domestic ones; if this is a sound exemption, it should probably be available for all types of mergers, whether cross-border or domestic, and not be left to the discretion of the Member States.[63]

59 See art. 121 (2) Directive (EU) 2017/1132.

60 Art. 93 (1) and art. 122 (1) Directive (EU) 2017/1132. Under certain conditions a simple majority may suffice; see art. 93 (1) subpara. 2 Directive (EU) 2017/1132.

61 Art. 86i (3) and art. 160k (3) of the Proposal. This seems to be impossible if a Member States avails itself of the opportunity presented by art. 93 (1) subpara. 2 Directive (EU) 2017/1132 mentioned in the preceding footnote.

62 However, members cannot dispense with the report to employees.

63 See art. 95 (3) Directive (EU) 2017/1132.

For minority protection in the narrower sense of the word, the Proposal provides two different instruments: on the one hand, an exit right in cross-border conversions, divisions, and mergers; on the other, the right to challenge the exchange ratio in cross-border divisions and mergers. Even though the Proposal does not state this, clearly members can only make use of one of these rights.

As far as the exit right is concerned, the Commission is proposing the introduction of an appraisal right system in Europe for dissatisfied shareholders. There is almost no reflection on advantages or disadvantages, such as the burdens in terms of costs, time delays, etc. European experience with such rules is lacking; experiences with similar issues in the squeeze out regimes are, at least in some Member States, not very positive. We would be surprised if these parts of the proposal were not subject to further discussion.

The Proposal takes a clear position on who can disinvest: only those shareholders without voting rights and those with voting rights who did not vote for the approval.[64] We do not argue with this decision, but we want to note that it would also be possible to restrict the exit right to those shareholders who actually voted against the transaction;[65] this, however, would incentivise shareholders to vote against and might actually block the transaction while shares not represented in the vote will not usually be counted as a vote against. The major argument against an exit right for a large number of shareholders is, of course, the outflow of liquid funds resulting from it. However, in our experience, companies can usually find ways to make a transaction conditional upon sufficient shareholders not making use of or even waiving their exit right in order to avoid an excessive outflow of cash; probably, it would be helpful if the Directive clarified this.

However, we do take issue with another decision in the Proposal: in mergers, members of both companies have an exit right, not just those of the transferring company, who are merged across the border (see art. 126 a (1) of the Proposal: "members of the merging companies"); similarly, with divisions all shareholders have the exit right and not just those who find themselves in a company subject to another jurisdiction after the transaction (art. 160 l (1) of the Proposal). This is excessive. For members of the acquiring company, it does not matter whether the assets that company acquires are those of a domestic entity or of a foreign one; either they should have an exit right in both domestic and cross-border mergers or in neither. The exit right for the (former) members of the transferring company is justified not by the merger as such but because after the merger they will become members of a company governed

64 See art. 86 j (1), art. 126 a (1) and art. 160 l (1) of the Proposal.

65 This is suggested by the *Association of German Attorneys* (fn. 24), 860.

by foreign law. That is the reason why, *e.g.*, Austrian and German legislation provide an exit right only to shareholders of the transferring company.[66] Were that otherwise, domestic merger legislation would also have to provide for an exit right, which it typically does not.[67] Along these lines, art. 126a (1) of the Proposal is inconsistent with the rules of Directive 2017/1132 on domestic mergers, which do not foresee such an exit right. *Mutatis mutandis,* the same argument holds for cross-border divisions: an exit right can only be justified for members who, after the division, find themselves in a company governed by another company law. We strongly recommend the appropriate changes in the text.[68]

The proposal is agnostic as to who shall offer the compensation: it may be the company itself, the remaining members, or a third party.[69] If it is the company, it must observe the rules governing the acquisition of its own shares.[70] One can argue that the company should always be the debtor; importantly, this would clearly determine the type of default risk exiting shareholders have to accept.

The cash compensation must be adequate. Art. 86j on cross-border conversions does not contain any further specifications. However, the rules on cross-border mergers stipulate that the independent expert shall review the adequacy of the cash compensation having regard to the market price of the shares prior to the announcement of the planned transaction and to the value of the company before the merger.[71] By contrast, art. 160l on cross-border division does not contain any such rules.[72] We have two comments on that. First, we think that it is the correct decision not to try regulating the adequacy in detail but to make clear that the book value is not relevant – as the Proposal does for mergers.[73] Second, we fail to understand why the independent expert

66 See for details art. 10 Austrian EU-VerschG and art. 122i German UmwG.

67 There are exceptions where the legislator tries to further other aims, as for example in many Nordic countries where a squeeze out regime was introduced to stimulate simplified mergers between a parent company and a fully owned subsidiary: if the parent reaches 90%, the minority can be squeezed out, and the minority shareholders have a corresponding right to exit.

68 Cf., however, *Schmidt* (fn. 19), 237 with certain sympathies for the proposal.

69 See art. 86j (2), art. 126a (2), and art. 160l (2) of the Proposal. The English version seems to (wrongly) imply that the compensation is „paid to" the company, etc., although it should be read to mean that the shares „are disposed to", *i.e.* "sold to" the company.

70 Art. 86j (3), art. 126a (3), and art. 160l (3) of the Proposal.

71 See art. 126a (5) of the Proposal.

72 However and contrary to the text, the Explanatory Memorandum to the Proposal (fn. 1), p. 29, holds that the independent expert shall review the adequacy also in divisions. See *Schmidt* (fn. 24), 281.

73 In this crucial respect the Proposal addresses the issue of valuation; cf., however, *Schmidt* (fn. 19), 241.

does not have a similar role in conversions and divisions; in both cases – with the exception of transactions concerning micro and small enterprises – an expert has to be appointed in any case (in order to provide the authority with information on the factual basis for its assessment on "artificial arrangements"). We recommend rolling out the provision of art. 126a (5) to conversions and divisions.

Crucially, the Proposal holds that members cannot challenge the transaction on the ground that the compensation offered is not adequate.[74] Instead, it provides a special procedure in which those members who have actually chosen to exit the company can "demand the recalculation of the cash compensation" before a court.[75] Although this rule clearly impacts negatively on transaction security, as it can lead to additional payments, the impact is limited in various ways. First, the offer will not open again for acceptances if the compensation is raised;[76] therefore, members who think that the compensation is inadequate have to accept the compensation before instigating proceedings and thus run the risk to be left with the initial amount in case of an unfavourable judgment. Second, the Proposal does not stipulate that an award has effect *erga omnes*, *i.e.* as against all members who have accepted; rather it is in the discretion of Member States to limit the effects of an award to the initial parties to the proceedings and to those who have joined them.[77] Of course, that may lead to the surprising result that some shareholders who have accepted the offer get a top-up, while others do not – a solution which is foreign to many legal systems; in favour of the rule one can argue that only shareholders active in pursuing their rights and willing to take the risks of taking legal action should benefit from an award. Third and connected to this last point, cost rules for these proceedings are left to the Member States, which will be an important factor for the practical importance of these rules as shareholders will be incentivised to bring claims if the costs are to be borne by the acquiring company while a rule exposing shareholders to the full cost risk will have a strong deterrent effect. As a result, it is clear that Member States are left with large discretion in order to strike a proper balance between the interests of the company together with the majority of the members as opposed to the dissenting minority. With some justification, one could critically comment that the Proposal shies away from some hard but crucial policy decisions in favour of national legislators.

74 Art. 86i (5), art. 126 (4) (b), and art. 160k (5) of the Proposal.

75 Art. 86j (5), art. 126a (6), and art. 160l (5) of the Proposal.

76 However, this is a recommendation of the *Association of German Attorneys* (fn. 24), 860.

77 Joint proceedings must be possible; art. 86j (6), art. 120a (7), and art. 160l (6) of the Proposal.

As a final remark we would like to comment briefly on the issue of the law applicable to the cash consideration and issues of jurisdiction. The Proposal rightly holds that the law of the departure Member State governs the exit right and that the courts of that Member State have jurisdiction.[78] That is justified by the fact that the members probably use their exit right precisely because they want to avoid being affected by the application of foreign law.

We now turn to the second remedy, the right to challenge the share exchange ratio. Again, the Proposal tries to improve transaction security by stipulating that the merger or division cannot be challenged solely because the share exchange ratio has been set inadequately.[79] We would like to point out that, in the case of an inadequate share exchange ratio, very often the information given to the shareholders on that ratio, especially in the management report according to art. 124, will be incorrect as well. The Proposal does not address the issue whether such misinformation gives shareholders a right to have the resolution set aside; if the aim is to exclude a challenge in cases of incorrect valuation, it probably is preferable to cover cases of misinformation on these issues as well – an approach chosen by some legislators.[80] Second, challenging the resolution is not possible on the ground that the total value of the shareholdings allocated to a member is not equivalent to the value of the shares held by that member in the company being merged or divided.[81] It is reasonably clear what this means in the case of a division, where the value of all shares received in a non-proportionate division (*i.e.* where members do not receive shares in all the new companies proportionately) may be lower than the original value of the shares in the company being divided. In the case of mergers, however, this will usually coincide with an inadequate share exchange ratio.

Instead of challenging the entire resolution, members have the right to challenge only the share exchange ratio if it is set inadequately.[82] Thus, the current awkward coexistence of two different national systems of remedies in cross-border mergers (challenging the resolution in its entirety or only adjusting the exchange ratio) will be a thing of the past; as a consequence, art. 127 (3) Directive 2017/1132 is to be abolished.

According to the Proposal, the court can then order the company to pay compensation as cash payment; alternatively, upon the request of either party the

78 Art. 86l (6), art. 126a (7), and art. 160l (6) of the Proposal. See *Schmidt* (fn. 19) 237 *et seqq*.

79 Art. 126 (4) (a) and art. 160k (5) (a) of the Proposal.

80 See *e.g.* art. 243 (4) German AktG and art. 225b Austrian AktG.

81 Art. 126 (4) (c) and art. 160k (5) (c) of the Proposal.

82 Art. 126a (8) and art. 160l (7) of the Proposal.

court can order the company to provide additional shares.[83] In many instances, this latter option will be preferable as it serves to minimise cash outflow and leads to the outcome which would have been achieved, had the ratio been set adequately in the first place. However, as far as the other company's shareholders are concerned, providing additional shares or – although probably to a lesser extent – an additional cash compensation results in a different deal than the one they approved; from their point of view, setting aside the resolution may be the preferable option. In practice, the issue will be moot once the merger is entered into the register; as it usually cannot be nullified after that moment,[84] some type of cash settlement will have to happen in any case. Therefore, we think that the Proposal's general approach is appropriate,[85] but we want to raise some issues as to details:

First, only members "who did not oppose the cross-border merger" or division may challenge the share exchange ratio. Obviously, this has to be understood against the background of the exit right: opposing shareholders should leave the company altogether. However, we do not think this is adequate. Members who oppose the transaction may have varying reasons to do so: they may think that the transaction is a bad idea, irrespective of the share exchange ratio, or they may oppose only the share exchange ratio but not the transaction as such. In the second circumstance, the proposal forces members to vote in favour of the transaction and then rely upon the courts to determine the correct ratio; if they vote against and happen to be part of the minority, they will have no remedy. We think that the correct solution would be either to open the remedy to all members irrespective of their vote[86] or to restrict it to those members who have voted against the proposal. In any case, the Proposal rightly provides the shareholders of both merging companies with this remedy.[87]

Second, the text leaves open who benefits from an award: only those shareholders who have joined the proceedings or all shareholders? If only the claimants receive cash or additional shares, there is some tension with the principle that all members have to be treated equally, which will be especially salient if only some members receive additional shares.[88] However, a case can be made that shareholders should be forced to actively pursue their rights, which may also help to avoid free-riding behaviour. Alternatively, one could restrict any

83 Art. 126 a (9) and art. 160 l (8) of the Proposal.

84 See art. 108 Directive (EU) 2017/1132.

85 See also EP Resolution (fn. 6), para. 11; *Schmidt* (fn. 19), 237.

86 That is the solution in Germany and Austria; cf. art. 15 (1) German UmwG (for the transferring company) and art. 225 c (1) Austrian AktG (for both companies).

87 Positive also *Schmidt* (fn. 19), 238.

88 Cf. the criticism by *Schmidt* (fn. 19), 238.

effect *erga omnes* to those shareholders who voted against the proposal. If the current approach is followed, it probably would be expedient to explicitly mention that members can join proceedings instigated by others, similar to the wording for proceedings on the adequacy of the cash compensation in the case of the exit right.[89]

Third, the proposal clarifies that the law applicable to the company resulting from the cross-border merger shall govern the obligation.[90] There is no specific provision on jurisdiction, but the claim will have to be brought against the company resulting from the merger, as proceedings can only be initiated within one month after the merger takes effect; this leads to jurisdiction in the Member State of that company.[91] This is adequate as the members did not exit the company, thus signalling their acceptance of the change of applicable law. However, this may be a motivator for making use of the exit right, which is governed by the law of the transferring company and adjudicated by the courts of that Member State; thereby, dissenting shareholders can avoid the application of a (foreign) legal regime perceived to be less protective of shareholders.

Finally, these rules are also supposed to apply to cross-border divisions.[92] However, the issue is different in that context as cross-border divisions by acquisitions are not covered by the Proposal.[93] Therefore, a "share exchange ratio" as in mergers simply does not exist. However, there is a similar issue in non-proportionate divisions, as members receive shares in some newly formed companies but not in others, or at least not in the same proportion as in the company being divided.[94] In that situation, some members may be worse off overall after the transaction to the benefit of others, which is why the former need protection. However, it is probably difficult to achieve this protection by the same means as in mergers as there are a number of unresolved issues: Which of the newly formed companies shall make any additional cash payments? In which company should the member receive additional shares? The Proposal only states that the "court has the power to order the recipient company", without stating which recipient company. Should this be left to the claimant, *i.e.* to each claimant individually? Will they then not choose according to the remedies provided by the law applicable to that company?[95] We think that

89 See art. 126 a (7) of the Proposal.
90 Art. 126 a (10) and art. 160 l (9) of the Proposal.
91 Cf., however, *Schmidt* (fn. 19), 238: jurisdiction in the Member States of all merging companies.
92 Art. 160 l (7) and (8) of the Proposal.
93 Art. 160 b (3) of the Proposal.
94 See also *Association of German Attorneys* (fn. 24), 866 *et seqq*.
95 See art. 160 l (9) of the Proposal.

the rules on minority protection for divisions need to be refined further.[96] We would also like to point out that non-proportionate divisions are especially dangerous to shareholders and are therefore subject to additional restrictions in some Member States.[97]

VI. Employees

The third core issue are the rights of employees, especially as far as representation of the employees on either the management or the supervisory board is concerned. This is likely to be another politically decisive issue as some national trade unions are dissatisfied with the current situation for cross-border mergers and are likely to oppose further extension of these principles.[98]

There are two principal legal devices used in the Proposal for the protection of the interests of employees. The first is disclosure, which is applied across all three transactions, so that there will be an additional, non-waivable disclosure requirement for cross-border mergers as compared with the current provisions.[99] At the same time as the board of the initiating company provides its report to the members,[100] it must also produce a report explaining the implications of the proposed transaction for employees and communicate it to the employees' representatives (left to be defined in national law). In identical terms across the three types of transaction the employees' report must deal with the implications of the proposed transaction for the future business of the company and the management's strategy, the implications for employment relationships, and any "material changes" in conditions of employment and the location of the company's business. The employee representatives also receive copies of the members' report and vice versa. The representatives may make representations to the company and, probably more usefully from their point of view, to the independent expert and the competent authority (in the case of

96 Similar *Association of German Attorneys* (fn. 24), 866 *et seqq*.

97 See *e.g.* art. 128 German UmwG (unanimous decision necessary); art. 8 (3) Austrian SpaltG (90% majority required coupled with an exit right for dissenting members).

98 See *e.g.* for Germany *Deutscher Gewerkschaftsbund*, Stellungnahme des DGB zum Company Law Package der EU-Kommission, 18 June 2018 (<https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&ved=2ahUKEwifroCC9tjcAhUrxaYKHbsfCHQQFjAAegQIAhAC&url=http%3A%2F%2Fwww.dgb.de%2Fthemen%2F%2B%2Bco%2B%2B40dc8e12-7dd5-11e8-9ad7-52540088cada&usg=AOvVaw0I1rdaqC2r2dqTmI1JY5xW> last accessed: 20 December 2018).

99 Art. 86f, 124a, and 160h of the Proposal.

100 Which must be made available to the employee representatives of the concerned companies or, in absence of such representatives, their employees themselves (art. 86e (3) for conversions; art. 124 (3) for mergers; art. 160g (3) for divisions).

conversions and divisions[101]). Given the potential of the transactions to impact adversely upon employees, we think this additional disclosure is valuable, even if the impact of the report on the shareholders is speculative. Some national systems give employee representatives greater possibilities to influence companies' strategic decisions. The minimum harmonisation approach of the Proposal here plays the useful role of not putting these national provisions in jeopardy.

Where the cross-border conversion is undertaken wholly for choice of company law reasons, it is possible that there will be no impact on the employees, because labour laws tend to be territorial and so unaffected if the company's operations remain in the same place. However, there is one major exception to this statement, *i.e.* where the company laws of a particular jurisdiction are used to protect the interests of the employees, by giving them the right to influence (in some way) the choice of persons to fill a proportion of the board seats. Here a mere change of company law to one which has no such provisions raises an issue of major concern to the employees. This issue bedevilled all proposals for EU instruments relating to cross-border transactions, until a way forward was found in the Statute for the European Company (SE). The principle adopted was "no escape but no extension". This is the second employee protection technique to be found in the Proposal.

Following this principle, for all three transactions considered in the Proposal, the starting point is that the applicable board influence rules are those of the jurisdiction in which the company resulting from the transaction is incorporated (*i.e.* the transferee jurisdiction for conversions or the place where the resulting company is incorporated for mergers and divisions). This implements the "no extension" part of the principle where the ultimate jurisdiction has no or only weak board influence rules for employees. However, the starting point undermines the "no escape" principle where one or more of the prior jurisdictions contains board influence rules which are stronger (in the sense of influencing a higher proportion of board seats) than those of the resulting jurisdiction. In this case, the starting point is displaced by an application in the resulting jurisdiction of "standard rules" laid down in Directive 2001/86/EC (the SE Directive), which are essentially the rules of the prior jurisdiction which were the strongest in relation to board influence, amended so as to permit all employees to take part in the board representation system, no matter where in the EU they are employed. The standard rules are in turn subject to the capacity of the employee representatives and the relevant companies to agree a different outcome through a negotiating process structured by the relevant EU instrument. This approach was implemented for cross-border mergers in what is

101 Art. 86g (4) and art. 160i (4) of the Proposal.

now art. 133 (2) (a) and (b) of Directive 2017/1132, and is applied to conversions and divisions in art. 86l (2) (a) and (b), and 160n (2) (a) and (b) of the Proposal.

However, in a curious additional requirement, art. 133(2) of Directive 2017/1132 also requires negotiation and possible application of the standard rules where one of the merging companies employs at least 500 employees and is operating under an employee participation system. Here the provisions of the jurisdiction of the resulting company are displaced without the need to carry out a comparison of the participation rules in the 'before' and 'after' jurisdictions. Given that the strength of a jurisdiction's participation rules is measured by the number of board seats over which the employees can exercise influence (whilst ignoring differences in the type of influence, for example, appointment rights or only consultation rights), it is not clear that the comparison avoided is burdensome. In any event, this rule is reformulated in the Proposal, in relation to conversions and divisions, so as to address a more obvious problem.[102] For conversions and divisions, the "negotiation with standard rules procedure"[103] is triggered even where the relevant company is not subject to an employee participation system in its prior jurisdiction. However, the trigger operates only where, over a period of six months prior to the publication of the draft terms of the transaction, the company has employed on average a number of employees equivalent to 80 per cent of the threshold which would trigger the participation system in the prior jurisdiction. This provision reduces the incentive for a company to carry out a conversion or division when it is in the vicinity of the application of participation rules in its existing jurisdiction in order to be able to pass beyond that threshold without becoming subject to the participation obligation (or an enhanced participation obligation). Thus, the "no escape" element of the principle is strengthened. This seems an acceptable objective, even though it is likely to reduce at the margin the number of transactions taking place which are not driven by avoidance objectives. However, if it is a good rule for conversions and divisions, it is far from clear why it is not applied to mergers.

On a more general level, the current solutions for the issue of board level employee representation are very complex and hard to apply in practice. Already, the original approach in the Statute for the European Company was complicated; this has been rolled out with modifications for cross-border mergers and

102 See art. 86l (2) and 160n (2).

103 Curiously, art. 86l as currently worded clarifies beyond doubt that negotiations have to be started but does not make completely clear that the rules of the Member State of departure on board level employee representation will start to apply once the company resulting from the transaction triggers the threshold at a later stage. This should be introduced in the text.

now for other cross-border transactions, which has even increased the complexity.[104] Politically, trade unions and the European Parliament are not satisfied, which threatens any proposal on cross-border mobility. Probably, a more general change of the approach could help to tackle the issue at its roots. Thus, bearing in mind the effects of the European Company on the corporate governance of European firms[105] according to the national jurisdictions,[106] the parties to the ongoing negotiations in the Council might also consider alternative regimes for the protection of employee rights, ideally based on a more European-minded mechanism for employee participation.

With Denmark and France, two EU Member States departed from the traditional approach of representing only employees who are employed in the company's country of incorporation.[107] In other countries, there is a lively discussion whether such an extension should be incorporated into national law and even whether European law requires such an approach.[108] However, the ECJ held in its Erzberger judgment that employee representation can be restricted to employees employed in the country in which the company is incorporated.[109] In its Polbud judgment, the ECJ postulated that employee representation is a rationale which can justify restrictions of the freedom of establishment – of course only if these restrictions are appropriate for securing the attainment of their objective, namely protecting the interests of employees.[110]

On that basis, an alternative regime to be considered might include a general option for the transferor state to continue applying its national regime on employee representation to companies having changed the applicable law, be it as a result of a merger, a conversion, a division or the formation of a European Company. Of course, any such regime would have to be in line with European

104 On a technical level, it is very unfortunate that the Proposal contains numerous referrals to other instruments and thus cannot be understood by itself.

105 For whom with the introduction of the European Company the choice between different board models became a European standard for national company laws; see *OECD*, OECD Corporate Governance Factbook 2017, 93 (<http://www.oecd.org/daf/ca/Corporate-Governance-Factbook.pdf> last accessed: 20 December 2018).

106 Generally, see *Horst Eidenmüller/Andreas Engert/Lars Hornuf*, "Incorporating under European Law: The Societas Europaea as a Vehicle for Legal Arbitrage", European Business Organization Law Review 2009, 1; *Markus Roth*, "Employee Participation, Corporate Governance and the Firm: A transatlantic view focused on Occupational Pensions and Co-determination", European Business Organization Law Review 2010, 51.

107 Sec. 141 Danish Companies Act, art. L225-27-1 French Code de Commerce.

108 For Germany see the contributions in Matthias Habersack/Caspar Behme/Horst Eidenmüller/Lars Klöhn (ed.), Deutsche Mitbestimmung unter Reformzwang, 2016.

109 ECJ, 18 July 2017, *Erzberger,* C-566/15, ECLI:EU:C:2017:562.

110 ECJ, 25 October 2017, *Polbud,* C-106/16, ECLI:EU:C:2017:804.

standards[111] and could not restrict employee participation to employees in the country in which the company was incorporated before the cross-border transaction. Rather, such board level employee representation would have to cover at least all employees working in the European Union[112] as far as both the right to appoint members and the right to become a member of the board are concerned.

Minimum requirements for employee representation based on national regimes would have to be incorporated into the Directive and to be equivalent to the standard regime. The Directive should then ensure that all such employee representation regimes are compatible with the national systems for corporate governance. The nomination and election of employee representatives might be delegated to national works councils or the European works council.

Of course, many details would have to be fleshed out, *e.g.* on the open question of what should happen when transferors from various Member States participate in the cross-border transaction. This also refers to the question whether the application of this regime should be mandatory. On the one hand, referring to national regimes allows the implementation of cost efficient procedures and can avoid delays in cross-border transactions due to a prior negotiating procedure. On the other hand, negotiations between management and employee representatives lead to alternative and tailor-made solutions, which ideally will be better suited to the needs of the company.[113] We think that this can tip the balance; then, the transferor state system need not be the only solution available to the company.

Certainly, this very rough draft is not the only solution. But perhaps a change of perspective could help in bringing forward a new approach with majority appeal.

111 *Martin Henssler*, "Die Zukunft der deutschen Unternehmensmitbestimmung im europäischen Rechtsrahmen“ Zeitschrift für Arbeitsrecht 2018, 174, 195, calls for European standards to allow employees to vote for employee representatives in all Member States.

112 For this view in the German national discussion see *Hans-Jürgen Hellwig/Caspar Behme* "Die deutsche Unternehmensmitbestimmung im Visier von Brüssel? ", Die Aktiengesellschaft 2011, 740.

113 For the importance of negotiated solutions see *Horst Eidenmüller/Lars Hornuf/Markus Reps*, "Contracting Employee Involvement: An Analysis of Bargaining over Employee Involvement Rules for Societas Europaea", Journal of Corporate Law Studies 12 (2012), 201.

VII. Final Remarks

Summing up, we think that the proposal's general approach is excellent. We also think that there is a real necessity for a Directive on the issue of cross-border mobility. Therefore, we strongly endorse the Commission's ambitious proposal in principle.

However, in many details we see room for improvement. First, this regards the technical level where many details are not fully thought out (*e.g.* the instances in which creditors are deemed not to be unduly prejudiced). Second, we think that some political choices are doubtful (*e.g.* the exit right in mergers for members of both companies). Third, not in all instances the rules on cross-border conversions, mergers, and divisions are internally harmonised, the clearest example being the check for "artificial arrangements", which is not in place for cross-border mergers.